

THE CPA PROFESSION

CHAPTER 2





CHAPTER 2 LEARNING OBJECTIVES

- 2-1 Describe the nature of CPA firms and what they do.
- 2-2 Describe the structure of CPA firms.
- 2-3 Understand the role of the Public Company Accounting Oversight Board and the effects of the Sarbanes-Oxley Act on the CPA profession.
- 2-4 Summarize the role of the Securities Exchange Commission in accounting and auditing.
- 2-5 Describe the key functions performed by the AICPA.
- 2-6 Understand the role of international auditing standards and their relation to U.S. auditing standards.
- 2-7 Use U.S. auditing standards as a basis for further study.
- 2-8 Identify quality control standards and practices within the accounting profession.

OBJECTIVE 2-1
**Describe the nature of
CPA firms and what
they do.**

TABLE 2-1

Revenue and Other Data for the Largest CPA Firms in the United States

2014 Size by Revenue	Firm	Net Revenue— U.S. Only (In \$ millions)	Partners	Professionals	U.S. Offices	Percentage of Total Revenue from Accounting and Auditing/Taxes/ Management Consulting and Other
BIG FOUR						
1	Deloitte	\$ 14,908.0	3,030	50,562	107	29/18/53
2	PwC	\$ 11,724.0	2,691	33,024	72	41/28/31
3	Ernst & Young	\$ 9,900.0	2,700	26,100	80	36/29/35
4	KPMG ⁽¹⁾	\$ 6,870.0	1,813	20,113	101	34/28/38
NATIONAL/REGIONAL⁽²⁾						
5	McGladrey	\$ 1,470.7	644	5,075	75	41/36/23
6	Grant Thornton	\$ 1,382.5	529	4,692	57	41/28/31
7	BDO	\$ 833.0	346	2,967	52	58/32/10
8	Crowe Horwath	\$ 686.6	257	2,315	29	28/24/48
9	CBIZ/Mayer Hoffman McCann ⁽³⁾	\$ 600.0	429	1,832	103	30/35/35
10	CliftonLarsonAllen	\$ 598.4	225	3,245	29	40/33/27
LOCAL						
50	Frank, Rimerman + Co.	\$ 70.2	23	267	5	27/62/11
75	Freed Maxick CPAs	\$ 45.5	35	240	4	38/38/24

⁽¹⁾ KPMG's office figure comprises business offices, as opposed to every physical location.

⁽²⁾ Only the six largest national/regional firms are listed.

⁽³⁾ Office figures are for CBIZ; MHM has 34 offices.

Source: Data from *Accounting Today* (www.accountingtoday.com).



ACTIVITIES OF CPA FIRMS

- CPA firms provide audit services as well as other attestation and assurance services.
- CPA firms also provide accounting and bookkeeping services, tax services, and management consulting and risk advisory services.
- Although the Sarbanes-Oxley Act and the SEC restrict auditors from providing many consulting services to public company audit clients, audit firms are not restricted from providing consulting to private companies and public companies that are not audit clients.

OBJECTIVE 2-2
Describe the structure
of CPA firms.



ORGANIZATIONAL STRUCTURE

CPA firms vary in nature and range of services, which affects the structure of the firms. Three main factors that affect the structure of all firms are:

1. The need for independence from clients
2. The importance of a structure to encourage competence
3. The increased litigation risk faced by auditors

SIX ORGANIZATIONAL STRUCTURES ARE AVAILABLE TO CPA FIRMS

- Proprietorship
- General Partnership
- General Corporation
- Professional Corporation
- Limited Liability Companies
- Limited Liability Partnership

ORGANIZATIONAL HIERARCHY OF TYPICAL CPA FIRM

TABLE 2-2

Staff Levels and Responsibilities

Staff Level	Average Experience	Typical Responsibilities
Staff Assistant	0–2 years	Performs most of the detailed audit work.
Senior or in-charge auditor	2–5 years	Coordinates and is responsible for the performance of audit procedures, including supervising and reviewing staff work.
Manager and Senior Manager	5–10 years	Helps the in-charge plan and manage the audit, reviews the in-charge's work, and manages relations with the client. A manager may be responsible for more than one engagement at the same time.
Partner	10+ years	Reviews the overall audit work and is involved in significant audit decisions. A partner is an owner of the firm and therefore has the ultimate responsibility for conducting the audit and serving the client.

OBJECTIVE 2-3

Understand the role of the Public Company Oversight Board and the effects of the Sarbanes-Oxley Act on the CPA profession.



SARBANES-OXLEY ACT AND PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

- **Sarbanes-Oxley Act**—Established the Public Company Accounting Oversight Board (PCAOB).
- **PCAOB**—Provides oversight for auditors of public companies including:
 - Establishing auditing, attestation, and quality control standards for public company audits.
 - Performing inspections of audit engagements and quality controls.

OBJECTIVE 2-4
**Summarize the role of the Securities
Exchange Commission in accounting
and auditing.**



SECURITIES AND EXCHANGE COMMISSION

- The Securities Exchange Commission (SEC)—A federal government agency that assists in providing investors with reliable information upon which to make investing decisions.
- The Securities Act of 1933—Requires most companies planning to issue new securities to the public to submit a registration statement to the SEC for approval.

SECURITIES EXCHANGE COMMISSION (CONT.)

- The Securities Exchange Act of 1934—Provides additional protection for investors by requiring public companies to file detailed annual reports with the commission.
- The Securities Acts of 1933 and 1934—Require financial statements and the opinion of an independent public accountant as part of the registration statement and subsequent reports.

SECURITIES EXCHANGE COMMISSION (CONT.)

Several reports required by the SEC are of interest to auditors:

- **Form S-1**—“S” forms must be completed prior to issuing new securities to the public
- **Form 8-K**—report significant events of interest to investors
- **Form 10-K**—annual report with detailed financial information, including audited financial statements
- **Form 10-Q**—quarterly report containing certain financial information and auditor reviews of financial statements

OBJECTIVE 2-5
**Describe the key functions
performed by the AICPA.**



AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

CPAs are licensed by the state in which they practice, but significant influence is exerted by their professional organization, the American Institute of Certified Public Accountants (AICPA).

Membership in the AICPA is restricted to CPAs. Membership is voluntary, so not all CPAs are members, but it is the largest professional association for CPAs in the United States.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

The AICPA sets standards and rules that all members and other practicing CPAs must follow in four major areas:

- Auditing standards
- Compilation and review standards
- Other attestation standards
- Code of Professional Conduct

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Establishing Standards and Rules

- The Auditing Standards Board (ASB) of the AICPA issues auditing standards, called **Statements on Auditing Standards (SASs)**, which apply to all audit engagements not covered by PCAOB standards
- The Accounting and Review Services Committee issues **Statements on Standards for Accounting and Review Services (SSARS)** that apply to preparation, compilation, and review services
- **Statements on Standards for Attestation Engagements** apply to assurance on nonfinancial information. **Attestation Standards** are studied in Chapter 25
- The AICPA Professional Ethics Executive Committee sets rules of conduct that CPAs are required to meet. The **Code of Professional Conduct** is the subject of Chapter 4

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Other AICPA Functions

- The AICPA writes and grades the CPA Exam.
- The AICPA supports its own research staff and provides grants to others for research.
- The AICPA publishes the *Journal of Accountancy*, industry audit guides, and periodic updates to the Codification of Statements on Auditing Standards and the Code of Professional Conduct.

OBJECTIVE 2-6

Understand the role of international auditing standards and their relation to U.S. auditing standards.



INTERNATIONAL AND U.S. AUDITING STANDARDS

- International Standards on Auditing (ISAs) are issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC).
- IFAC is a worldwide organization for the accountancy profession.
- IAASB works to improve uniformity of auditing practices throughout the world.

INTERNATIONAL AND U.S. AUDITING STANDARDS (CONT.)

- ISAs do not override a country's regulations governing audit practices.
- Most countries, including the United States, base their auditing standards on ISAs, modified as appropriate for each country's regulatory environment.
- The Auditing Standards Board in the United States has revised its audit standards to converge with international standards.

AICPA AUDITING STANDARDS

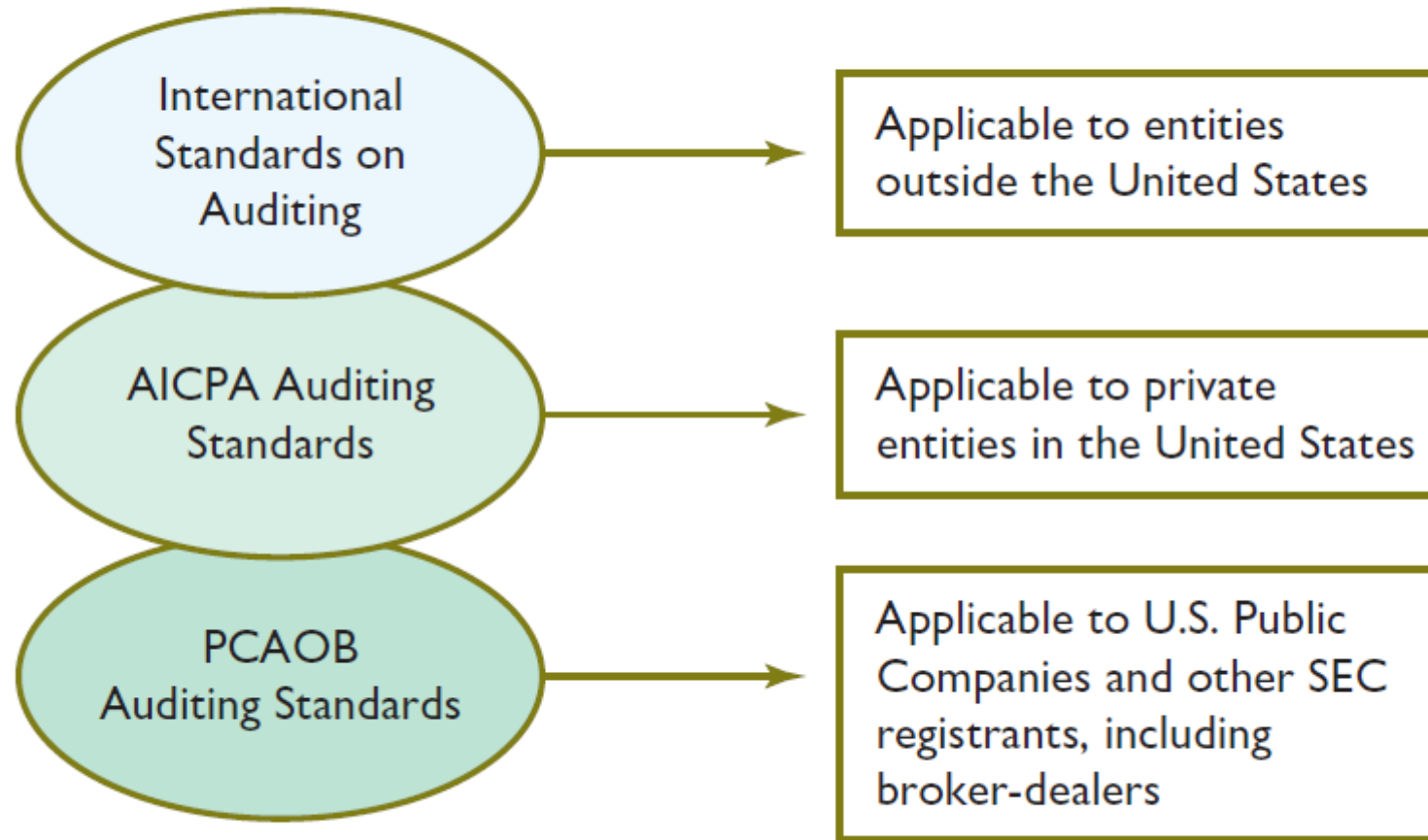
- Auditing standards for private companies and other entities in the United States are established by the Auditing Standards Board (ASB) of the AICPA.
- These standards are called Statements of Auditing Standards (SASs). The AICPA standards are also referred to as generally accepted auditing standards (GAAS).
- Prior to passage of the Sarbanes-Oxley Act, the ASB established auditing standards for private and public companies. Now the PCAOB has responsibility for auditing standards for public companies and brokers and dealers registered with the SEC.

PCAOB STANDARDS

- Initially, the PCAOB adopted existing auditing standards established by the ASB as interim standards.
- The PCAOB considers international standards when developing new standards.
- PCAOB standards apply only to the audits of U.S. public companies and brokers and dealers registered with the SEC.
- Figure 2-1 shows the relationships among international auditing standards, AICPA auditing standards, and PCAOB auditing standards.

FIGURE 2-1

Relation of U.S. and International Auditing Standards



OBJECTIVE 2-7
**Use U.S. standards as a basis for
further study.**



ORGANIZATION OF U.S. AUDITING STANDARDS

- The ASB issued a Preface to the Codification of Auditing Standards containing the “Principles Underlying an Audit in Accordance with Generally Accepted Auditing Standards” (the principles).
- The principles provide a framework for the two objectives of conducting an audit of financial statements:
 1. Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
 2. Report on the financial statements, and communicate as required by GAAS, in accordance with the auditor’s findings.

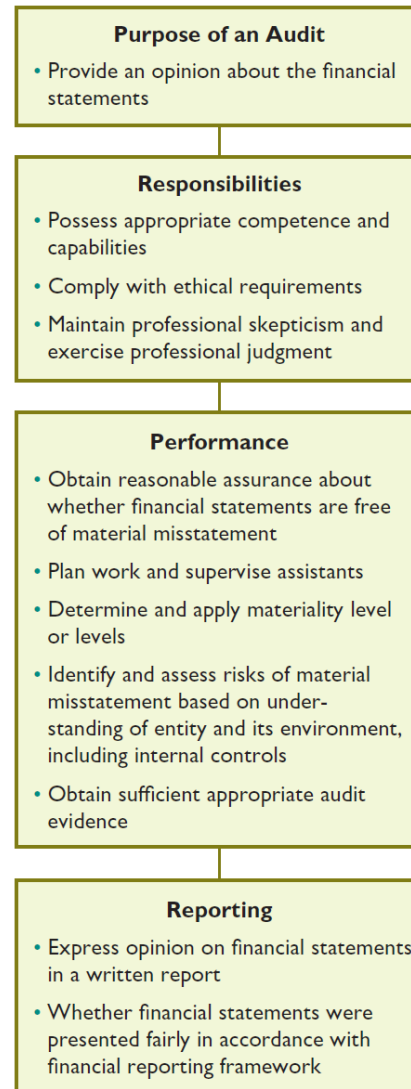
ORGANIZATION OF U.S. AUDITING STANDARDS (CONT.)

The **principles** are not requirements and do not carry authority, but they provide structure for the Codification. The structure is organized around the following principles:

- Purpose of an audit (**Purpose**)
- Personal responsibilities of the auditor (**Responsibilities**)
- Auditor actions in performing the audit (**Performance**)
- Reporting (**Reporting**)

These principles are summarized in Figure 2-2.

Principles in AICPA Auditing Standards



ORGANIZATION OF U.S. AUDITING STANDARDS (CONT.)

- **Purpose:** The purpose of an audit is to provide financial statement users with an opinion issued by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with applicable financial reporting framework.
- **Responsibilities:** The auditor's responsibilities stress the importance of the qualities that the auditor should possess:
 - Appropriate competence and capabilities
 - Comply with relevant ethical requirements
 - Maintain **professional skepticism** and exercise professional judgment
(questioning mind + being alert to conditions that indicate misstatements + critical assessment of evidence)

ORGANIZATION OF U.S. AUDITING STANDARDS (CONT.)

- **Performance:** To obtain reasonable assurance that the financial statements are presented fairly, the auditor fulfills several performance responsibilities:
 - Adequate planning and supervision
 - Determine and apply materiality levels
 - Assess risks of material misstatement
 - Sufficient appropriate evidence
- **Reporting:** The auditor is responsible for expressing an opinion in the form of a written report about whether the financial statements are expressed fairly, in all material respects, in accordance with the applicable financial reporting framework.
- The **audit report** is the final step in the auditing process.

ORGANIZATION OF U.S. AUDITING STANDARDS (CONT.)

Principles versus Auditing Standards

The principles underlying auditing standards are general.

The standards (SASs issued by the AICPA and ASs issued by the PCAOB) provide specific guidance.

Classification of Auditing Standards

SASs issued by the AICPA have two classification numbers: an SAS number identifying the order in which it was issued and an AU-C number indicating its location in the Codification of Auditing Standards.

Auditing Standards issued by the PCAOB are also numbered consecutively as issued. The PCAOB recently reorganized their standards by topic.

ORGANIZATION OF U.S. AUDITING STANDARDS (CONT.)

Standards of Performance

Although auditing standards provide authoritative guidance for members of the profession, the amount of guidance is limited.

The AICPA principles and auditing standards are **minimum standards** of performance. If standards seem impractical in a certain situation, the auditor may use an alternative course of action, though the burden of justifying a departure from the standards falls on the auditor.

When auditors want more specific guidelines, they must use less authoritative sources. Materials published by the AICPA, including industry audit guides, provide assistance on specific questions.

OBJECTIVE 2-8
**Identify quality control standards
and practices within the accounting
profession.**



QUALITY CONTROL

For a CPA firm, **quality control** includes the methods used to ensure that the firm meets its professional responsibilities to clients.

Elements of Quality Control: Each firm should document quality control policies and procedures. The quality control system should address the six elements detailed in Table 2-3.

TABLE 2-3

Elements of Quality Control

Element	Summary of Requirements	Example of a Procedure
Leadership responsibilities for quality within the firm ("tone at the top")	The firm should promote a culture that quality is essential in performing engagements and should establish policies and procedures that support that culture.	The firm's training programs emphasize the importance of quality work, and this is reinforced in performance evaluation and compensation decisions.
Relevant ethical requirements	All personnel on engagements should maintain independence in mind and in appearance, perform all professional responsibilities with integrity, and maintain objectivity in performing their professional responsibilities.	Each partner and employee must answer an "independence questionnaire" annually, dealing with such things as stock ownership and membership on boards of directors.
Acceptance and continuation of client relationships and specific engagements	Policies and procedures should be established for deciding whether to accept or continue a client relationship or specific engagement. These policies and procedures should minimize the risk of associating with a client whose management lacks integrity. The firm should also only undertake engagements that can be completed with professional competence.	A client evaluation form, dealing with such matters as predecessor auditor comments and evaluation of management, must be prepared for every new client before acceptance.
Human resources	<p>Policies and procedures should be established to provide the firm with reasonable assurance that</p> <ul style="list-style-type: none"> • All new personnel should be qualified to perform their work competently. • Work is assigned to personnel who have adequate technical training and proficiency. • All personnel should participate in continuing professional education and professional development activities that enable them to fulfill their assigned responsibilities. • Personnel selected for advancement have the qualifications necessary for the fulfillment of their assigned responsibilities. 	Each professional must be evaluated on every engagement using the firm's individual engagement evaluation report.
Engagement performance	Policies and procedures should exist to ensure that the work performed by engagement personnel meets applicable professional standards, legal and regulatory requirements, and the firm's standards of quality.	The firm's director of accounting and auditing is available for consultation and must approve all engagements before their completion.
Monitoring	Policies and procedures should exist to ensure that the other quality control elements are being effectively applied.	The quality control partner must test the quality control procedures at least annually to ensure the firm is in compliance.

QUALITY CONTROL (CONT.)

Peer Review

Public accounting firms must enroll in an AICPA-approved practice-monitoring program, also known as **peer review**, which is administered by the state CPA societies.

Firms required to be registered with the PCAOB must be reviewed by the **AICPA National Peer Review Committee** to review the non-SEC portion of the firms practice that is not inspected by the PCAOB.

QUALITY CONTROL (CONT.)

Audit Practice and Quality Centers

The AICPA has established audit practice and quality centers to improve audit practice quality.

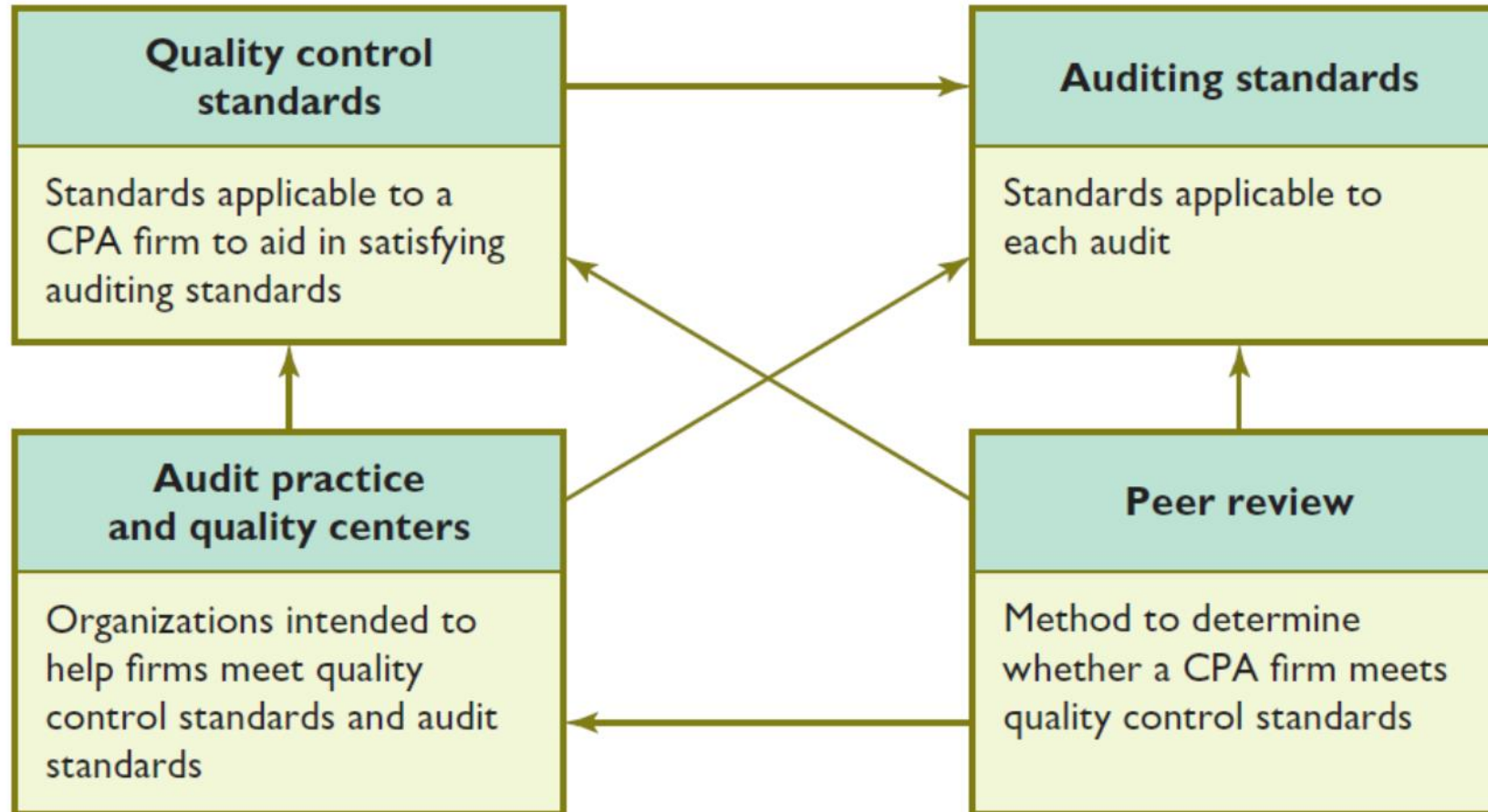
The **Center for Audit Quality (CAQ)** is a public policy organization affiliated with the AICPA serving investors, public company auditors, and the capital markets.

The **Private Companies Practice Section (PCPS)** provides practice management information to firms of all sizes.

Figure 2-3 summarizes the relationships among auditing standards, quality control, the audit practice and quality centers, and peer review in ensuring audit quality.

FIGURE 2-3

Relationships Among Auditing Standards, Quality Control, AICPA Practice Centers, and Peer Review



CHAPTER 2 SUMMARY

This chapter discussed the nature of the CPA profession and the need for CPAs to conduct themselves at a high level, which is detailed in Figure 2-4 below.

