

Auditing and Assurance Services

Arab World Edition

Alvin A. Arens, Randal J. Elder, Mark S. Beasley
and Mohamed A. Hegazy

Chapter 2: The Public Accounting Profession

Review Questions

2-1 CPAs provide four major services:

1. *Audit and assurance services.* Assurance services are independent professional services that improve the quality of information for decision makers. Assurance services include attestation services, which are any services in which the audit firm issues a report that expresses a conclusion about the reliability of an assertion that is the responsibility of another party. The four categories of attestation services are audits of historical financial statements, attestation on the effectiveness of internal control over financial reporting, reviews of historical financial statements, and other attestation services.
2. *Accounting and bookkeeping services.* Accounting services involve preparing the client's financial statements from the client's records. Bookkeeping services include the preparation of the client's journals and ledgers as well as financial statements.
3. *Tax services.* Tax services include preparation of corporate, individual, and estate returns as well as tax planning assistance.
4. *Management consulting services.* These services range from suggestions to improve the client's accounting system to computer installations.

2-2 These are the major characteristics of audit firms that permit them to fulfill their social function competently and independently:

1. *Organizational form.* An audit firm exists as a separate entity to avoid an employer-employee relationship with its clients. The CPA firm employs a professional staff of sufficient size to prevent one client from constituting a significant portion of total income and thereby endangering the firm's independence.
2. *Conduct.* An audit firm employs a professional workforce of sufficient size to provide a broad range of expertise, continuing education, and promotion of a professional independent attitude and competence.
3. *Peer review.* This practice evaluates the performance of audit firms in an attempt to keep competence high.

2-3 The Public Company Accounting Oversight Board provides oversight for auditors of public companies in the U.S., including establishing auditing and quality control standards for public company audits, and performing inspections of the quality controls at audit firms performing those audits.

2-4 The purpose of the Securities and Exchange Commission (SEC) in the U.S and the capital market authorities in Arab countries is to assist in providing investors in publicly quoted companies with reliable information upon which to make investment decisions. Since most reasonably large CPA firms have clients that are listed on a stock exchange and, therefore, must file audited financial statements and other reports, typically at least once a year, the profession is highly involved in ensuring that their clients met the reporting requirements set by the appropriate capital market authority.

Capital market authorities play a role in setting local accounting standards. In the U.S, the SEC has considerable influence in setting the general accepted accounting principles and disclosure requirements for financial statements because of its authority for specifying reporting requirements considered necessary for fair disclosure to investors. In addition, the SEC has the power to establish rules for any CPA associated with audited financial statements submitted to the commission. In addition to the role of the main capital market authorities, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) sets standards for accounting and auditing for the Islamic financial industry.

2-5 The AICPA is the organization that sets professional requirements for CPAs in the U.S. The AICPA also conducts research and publishes materials on many different subjects related to accounting, auditing, management advisory services, and taxes. The organization also prepares and grades the CPA examinations, provides continuing education to its members, and develops specialty designations to help market and assure the quality of services in specialized practice areas.

Similar to the AICPA, professional associations in Arab countries prepare exams for students to become certified public accountants and organize professional development activities. Most Arab professional accountant associations do not have a similar responsibility to set standards and codes of professional conduct for auditors to follow. Formal publication of accounting and auditing standards tend to be a government responsibility.

2-6 The AICPA *Statements on Standards for Attestation Engagements* provide a framework for attest engagements, including detailed standards for specific types of attestation engagements.

- 2-7** a. The PCAOB has responsibility for establishing auditing standards for public companies, while the Auditing Standards Board (ASB) of the AICPA establishes auditing standards for private companies. The ASB previously had responsibility for establishing auditing standards for both public and private companies. Existing auditing standards were adopted by the PCAOB as interim auditing standards for public company audits.

Responsibilities vary in Arab countries. For example, in Lebanon, Egypt and UAE the International Standards on Auditing (ISA) are required by all companies, but additional compliance requirements by the stock market supervisory boards (Arab countries SEC) are more strict for public companies than for private companies.

- b. ISAs do not override a country's regulations governing the audit of financial or other information, and each country generally has its own regulations governing audit practices. Generally speaking the local Auditing Standards are established based on a translation of the International Standards of Auditing (ISA). However, the process of continuous updates of such standards differs among the various Arab countries. Such process is properly followed by professional bodies in many of the Gulf states compared with updates implemented by similar professional bodies in Egypt, Lebanon, Jordan.

2-8 *Generally accepted auditing standards* are ten general guidelines to aid auditors in fulfilling their professional responsibilities. These guidelines include three general standards concerned with competence, independence, and due professional care; three standards of field work including planning and supervision, understanding the entity and its environment, including its internal control, and the gathering of sufficient appropriate evidence; and four standards of reporting, which require a statement as to presentation in accordance with generally accepted accounting principles, inconsistency observed in the current period in relation to the preceding period, adequate disclosure, and the expression of an opinion as to the fairness of the presentation of the financial statements.

Generally accepted accounting principles are specific rules for accounting for transactions occurring in a business enterprise. Examples may be any of the opinions of the FASB.

2-9 Auditors can obtain adequate technical training and proficiency through formal education in auditing and accounting, adequate practical experience, and continuing professional education. Auditors can demonstrate their proficiency by becoming licensed to practice as CPAs, which requires successful completion of the Uniform CPA Examination in the U.S. or equivalent examinations in the other parts of the world.

There is no formal relationship between generally accepted auditing standards (GAAS) and statements on auditing (U.S.) and International Standards on Auditing. However, as a results of efforts by the Auditing Standards Board in the U.S. to converge GAAS with international standards, the GAAS and International Standards on Auditing are similar in most respects.

2-10 Many practitioners along with critics of the profession believe that the auditing standards should provide more clearly defined guidelines as an aid in determining the extent of evidence to be accumulated. This would eliminate some of the difficult audit decisions and provide a source of defense if an auditor is charged with conducting an inadequate audit. However, highly specific requirements could turn auditing into mechanical evidence gathering, void of professional judgment. From the point of view of both the profession and the users of auditing services, there is probably a greater harm from defining authoritative guidelines too specifically than too broadly.

2-11 International Standards on Auditing (ISAs) are issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). ISAs are designed to improve the uniformity of auditing practices and related services throughout the world and cover a variety of audit and attest functions. An auditor who conducts an audit in accordance with GAAS will not necessarily comply with International Standards on Auditing as there are a few differences between each set of standards. In the future, the two sets of standards will eventually agree in all respects as a result of efforts by the Auditing Standards Board (ASB) to converge GAAS with the international standards.

2-12 Quality controls are the procedures used by an audit firm that help it meet its professional responsibilities to clients. Quality controls are therefore established for the entire audit firm as opposed to individual engagements.

2-13 The element of quality control is personnel management. The purpose of the requirement is to help assure the audit firm that all new personnel are qualified to perform their work competently. An audit firm must have competent employees conducting the audits if quality audits are to occur.

2-14 A peer review is a review, by CPAs, of an audit firm's compliance with its quality control system. A mandatory peer review means that such a review is required periodically. In the U.S., AICPA member firms are required to have a peer review every three years. Registered firms with the PCAOB are subject to quality inspections. These are different than peer reviews because they are performed by independent inspection teams rather than another CPA firm. In the Arab world, the review of the quality of the audit provided by auditing firms is undertaken by the international CPA networks. Each CPA network carries out an interim review of its members' quality of services using standard practices applied within the network.

Peer reviews can be beneficial to the profession and to individual firms. By helping firms meet quality control standards, the profession gains if reviews result in practitioners doing higher quality audits. A firm having a peer review can also gain if it improves the firm's practices and thereby enhances its reputation and effectiveness, and reduces the likelihood of lawsuits. Peer reviews are costly. There is always a trade-off between cost and benefits.

2-15 Audit firms in the U.S. may belong to the Center for Audit Quality and the Private Companies Practice Section (PCPS) Firm Practice Center. The mission of the Center for Audit Quality is to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. The PCPS Firm Practice Center provides practice management resources for firms of all sizes.

In addition to these resource centers, the AICPA also provides the Governmental Audit Quality Center and Employee Benefit Plan Audit Quality Center to provide resources for performing quality audits in these unique and complex audit areas.

In the Arab world, there are no directly comparable resource centers. Several organizations provide professional oversight and help audit firms comply with quality control procedures and policies. In Saudi Arabia, for example, firms are expected to follow standards for quality control issued by the Saudi Organization for Certified Public Accountants (SOCPA). In general, systems of quality control vary throughout the Arab world. However, the Big Four audit firms operate in many Arab countries. These multinational companies provide knowledge and information about the latest accounting and auditing standards and practices and, in so doing, help to develop the local accounting and auditing professions.

Multiple Choice Questions From CPA Examinations

2-16 a. (1) b. (2) c. (3) d. (3)

2-17 a. (2) b. (1) c. (2) d. (3)

Discussion Questions And Problems

2-18

Procedure	Element of quality control
a.	Engagement performance
b.	Engagement performance
c.	Engagement performance
d.	Engagement performance
e.	Relevant ethical requirements
f.	Monitoring
g.	Acceptance and continuation of clients and engagements
h.	Human resources
i.	Human resources
j.	Leadership responsibilities

2-19

Brief description of GAAS: General standards	Sara's actions resulting in failure to comply with GAAS
1. The auditor must have adequate technical training and proficiency to perform the audit.	1. It was inappropriate for Sara to hire the two students to conduct the audit. The audit must be conducted by persons with proper education and experience in the field of auditing. If junior assistants have not completed their formal education, they may help in the conduct of the audit as long as there is proper supervision and review.
2. The auditor must maintain independence in mental attitude in all matters relating to the audit.	2. To satisfy the second general standard, Sara must be without bias with respect to the client under audit. Sara has an obligation for fairness to the owners, management, and creditors who may rely on the report. Because of the financial interest in whether the bank loan is granted to Ibrahim, Sara is independent in neither fact nor appearance with respect to the assignment undertaken.
3. The auditor must exercise due professional care in the performance of the audit and the preparation of the report.	3. This standard requires Sara to perform the audit with due care, which imposes on Sara and everyone in Sara's organization a responsibility to observe the standards of field work and reporting. Exercise of due care requires critical review at every level of supervision of the work done and the judgments exercised by those assisting in the audit. Sara did not review the work or the judgments of the assistants and clearly failed to adhere to this standard.

2-19 (continued)

Brief description of GAAS: Standards of field work	Sara's actions resulting in failure to comply with GAAS
1. The auditor must adequately plan the work and must properly supervise any assistants.	1. This standard recognizes that early appointment of the auditor has advantages for the auditor and the client. Sara accepted the engagement without considering the availability of competent staff. In addition, Sara failed to supervise the assistants. The work performed was not adequately planned.
2. The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.	2. Sara did not obtain an understanding of the entity or its internal control, nor did the assistants obtain such an understanding. There appears to have been no audit at all. The work performed was more an accounting service than it was an auditing service.
3. The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.	3. Sara acquired no evidence that would support the financial statements. Sara merely checked the mathematical accuracy of the records and summarized the accounts. Standard audit procedures and techniques were not performed.

2-19 (continued)

Brief description of GAAS: Standards of reporting	Sara's actions resulting in failure to comply with GAAS
1. The auditor must state in the auditor's report whether the financial statements are presented in accordance with generally accepted accounting principles (GAAP).	1. Sara's report made no reference to generally accepted accounting principles. Because Sara did not conduct a proper audit, the report should state that no opinion can be expressed as to the fair presentation of the financial statements in accordance with generally accepted accounting principles.
2. The auditor must identify in the auditor's report those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.	2. Sara's improper audit would not enable her to determine whether generally accepted accounting principles were consistently applied. Sara's report should make no reference to the consistent application of accounting principles.
3. When the auditor determines that informative disclosures are not reasonably adequate, the auditor must so state in the auditor's report.	3. Management is primarily responsible for adequate disclosures in the financial statements, but when the statements do not contain adequate disclosures the auditor should make such disclosures in the auditor's report. In this case both the statements and the auditor's report lack adequate disclosures.
4. The auditor must either express an opinion regarding the financial statements, taken as a whole, or state that an opinion cannot be expressed, in the auditor's report. When the auditor cannot express an overall opinion, the auditor should state the reasons in the auditor's report. In all cases where an auditor's name is associated with financial statements, the auditor should clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking, in the auditor's report.	4. Although Sara's report contains an expression of opinion, such opinion is not based on the results of a proper audit. Sara should disclaim an opinion because she failed to conduct an audit in accordance with generally accepted auditing standards.