

Chapter 2

The Public Accounting Profession and Audit Quality

Overview

It's best to start this lecture with a short review of Chapter 1. Remind students that the basic premise behind auditing is "checking". Keeping in mind that the vocabulary used in this course continues to be new for most students and that most have not actually done any audit work, we can say that this lecture is about organizations that set the rules for how audit work should be performed and about the qualities that must be possessed by individuals who conduct this work. Why is this important? Because the audit process gives users more confidence in the information presented on financial statements and it's this confidence that creates the value of the audit. This lecture is about how confidence in the audit process is created and protected.

Learning Objectives

1. Describe the public accounting industry.
2. Identify the organizations that affect the public accounting profession and their role.
3. Describe how the *CPA Canada Handbook—Assurance* is organized.
4. Use Canadian Auditing Standards to explain the purpose of and the principles underlying the financial audit.
5. Understand the drivers of audit quality and explain the competing pressures auditors face that threaten audit quality.
6. Identify quality control standards and practices within the auditing profession and apply those standards and practices to enhance audit quality.

Chapter Opening Vignette: "A Focus on Audit Quality"

This vignette highlights how the 2008-09 financial crisis reignited the debate over improving financial statement audit quality and how the IAASB has made audit quality central to its work plan. It then points out that the difficulty of assessing the quality of audits is that there is no agreed-upon definition or measurement of audit quality. The vignette concludes that, although in Canada the quality of public company audits is improving, one key area that remains a challenge is auditing in emerging markets. (A good question to ask the students is how they would define and measure audit quality, or how they would describe a "good quality" audit).

LO 1 An Overview of the Canadian Public Accounting Industry

Refer to Table 2-1 and Table 2-2 to present the difference in size between public accounting

firms and how a typical firm is organized.



Teaching Tip: A good question to ask the students is if they are pursuing the CPA designation and if they are aware of university career events put on by Public Accounting Firms. This question can lead to an engaging discussion about why students are interested in working in the public accounting sector.

Students are usually interested in CPAs' salaries. The instructor may wish to show the results of Robert Half 2016 Salary Guide for Accounting and Finance professionals, which lists the salary ranges for accounting and finance professionals. The guide can be found at:

https://www.roberthalf.ca/sites/roberthalf.ca/files/rh-pdfs/atfamr_0915_iapdf_sq2016_can_eng.pdf

Most students may not be familiar with the differences in the working environments of a large versus a small public accounting firm. Auditing in Action 2-1 as well as sharing your firm working experience can be useful to discuss this.



Teaching Tip: Most universities have accounting clubs/organizations. When preparing for this lecture, the instructor can prearrange a 5-10 minute presentation with the accounting club/organization. Topics for the presentation could include: upcoming career events, the role of the club/organization.

LO 2 Organizations Affecting the Canadian Public Accounting Profession

Review the key roles of organizations affecting the Canadian Public Accounting Profession. We should tell the students that:



Teaching Tip: Students would be interested in the educational and work experience requirements of a CPA. These can be found at www.gocpaontario.ca

CPA Canada: represents the CPA profession nationally and internationally; it plays a key role in audit quality. It supports the setting of accounting, auditing, and assurance standards for business, not-for-profit organizations, and government. Individual CPAs are not members of CPA Canada, but rather members of their provincial CPA organizations.

We can explain to students here that, in simple terms, standards are instructions about “how to do things.” For instance, accounting standards describe how to define, record, and disclose information about economic events and transactions. Similarly, just like a cake recipe contains step-by-step instructions and a list of baking ingredients, auditing and assurance standards contain step-by-step instructions on how to conduct an audit. We can ask the students what would happen to the quality or taste of a cake if the steps in the recipe are not followed, or incorrect ingredients are used (most likely the cake would not taste good and would be of poor

quality) and point out that audit quality can be impacted the same way (when the auditor fails to follow auditing and assurance standards).

Students may think of standards as rigid rules, with some thinking that these rules are seldom changed. We can point out here that, just like a new cake recipe can be created or updated to include new ingredients, standards are frequently developed and old ones are adapted to reflect changes in the “real-world.” For example, we discuss how standards need to be adapted to “real world” developments, such as digital currencies like BitCoins.

After you have completed this discussion, briefly talk about the importance of:

- *Canada’s Auditing and Assurance Standards Board (AASB)*: has the authority to set generally accepted auditing standards (GAAS) for financial statement audits.
- *International Auditing and Assurance Standards Board (IAASB)*: is an independent standard-setting body that sets international standards for auditing, assurance, and other related standards.



Teaching Tip: Auditing in Action 2-2 can be used to explaining to students the relationship between AASB and IAASB and how public interest plays a role in the standards setting process.

- *Canadian Public Accountability Board (CPAB)* and its practice inspection program is something that students may find interesting if we revolve the discussion around the following question. If the responsibility of the auditor is to audit, then who audits the auditor? The role of the CPAB mentioned in the opening vignette can be brought into this discussion.
- *Public Company Accounting Oversight Board (PCAOB)* is the US counterpart to CPAB. However, unlike CPAB, it also establishes auditing and quality control standards for public company audits.
- *Provincial Securities*. Mention that Securities regulation in Canada is a provincial matter. Many large Canadian companies, however, are listed on the American stock exchanges, and, therefore, must meet the requirements of the *Securities and Exchange Commission (SEC)*.

LO 3, LO4 An Overview of CPA Canada Assurance Standards

All of the standards start from fundamental principles on how an audit engagement should be planned and conducted and then how the results should be communicated. Use Table 2-3 to provide an overview of the Assurance standards and introduce students to the *CPA Canada Handbook*. Students are usually confused by the terminology in Table 2-3, so to simplify things we can remind students that standards found in each *Handbook* section are simply instructions that describe how and what work the CPA should conduct.

We point out that Assurance standards make up a chapter of the *Handbook*, another one being “Accounting,” something students should already be familiar with.

Questions below and Figure 2-1 can help with the discussion about the general requirements of the Financial Statement Audit. The key concept for students to understand is that audit enhances the users’ confidence in the information presented in the financial statements.

Confidence comes from the fact that financial information was checked by a competent, independent individual. We can relate this point to the mid-term exam example from session 1, and ask the students if they would feel more confident about the accuracy of their posted final exam grade if they knew that the grade posted online was checked by an independent and competent individual.

Purpose of the Audit:

- What do the numbers on the financial statements represent?
- Why are numbers on the financial statements checked?

Personal responsibilities of the auditor:

- What qualities should the Auditor possess that will give confidence to those that rely on the audit opinion?
- Why is that important?

Auditor actions in performing the audit:

- Would financial statement users be confident in the audit process if it was up to each individual auditor to decide how audit work is planned and performed?

Reporting:

- Why is it important to express an opinion on financial statements in writing?
- What happens when the wrong opinion is issued?
- How would this impact users' confidence in the audit process?
- How would students feel if later on they find out that their final exam grade that was posted online and was checked by the "auditor" was still, in fact, incorrect? Would they lose trust in the process?



Teaching Tip: Figure 2-2 is a good figure to use to highlight and explain the different sections of the Independent Auditor's Report.

LO 5 The Drivers of Audit Quality

We can discuss the events surrounding The World Com and Enron bankruptcies, as well as the 2008–09 financial crisis. Ask the students if they think these events would impact users' confidence in the audit profession. We can then explain to students that around the globe, several initiatives are underway to enhance audit quality to ensure users' remain confident in the audit profession and information presented on financial statements.

It is important to point out that Public Accounting Firms are in a constant struggle trying to maintain the appropriate balance between commercialism (managing the economic business of the firm) and professionalism (sustainable high-quality audits). This could be explained by discussing the following:

Time Pressures

CPA firms often compete for clients through bids. The low bidder is likely to get the job. But, in order to make a sufficient return on the audit, there will be time pressures to get the audit done as quickly as possible to minimize labour costs.

Rationalizing Behaviour

When potential misstatements are detected, it takes time to investigate and determine if they could be material. To save money and time, the auditor may rationalize that the misstatement is not likely to be material, when in fact it could be.

Providing Nonaudit Services

CPAs may help non-public companies or other organizations improve their information system, suggest and help the client implement “best practices,” do the client’s bookkeeping, identify potential candidates for management positions, etc.

Independence is likely to be compromised if auditors are put into the position of auditing their own work, or if auditors identify too closely with the company as if it were an extension of their work.



Teaching Tip: Question 2-22 is a good question to use to highlight beliefs of some practitioners about quality control and practice inspections.

LO 6 Quality Control

Most students would not have actually performed any audit work and therefore they don’t understand the audit process. Most will therefore struggle to understand what is meant by “quality control” policies and procedures within a Public Accounting firm. The concept of quality control can be demonstrated using the exercise from the previous lecture where students were asked to audit if all students that are currently sitting in the classroom are actually registered in the course. Except this time, we would discuss the quality control procedures over the audit work that was previously conducted. For instance, the following questions can be discussed as part of this exercise:

- Was the individual who conducted the work independent?
- What if the work was conducted by a close friend of a student who was not registered in the course but was sitting in the classroom?
- Was the audit work reviewed by someone else to ensure it was conducted completely and accurately by an independent individual?



Teaching Tip: Auditing in Action 2-3 can be used to explain the purpose of practice inspections and point out key findings from the 2016-17 round of inspections.

Instructors may wish to show this video

<http://www.cpab-ccrc.ca/en/topics/AuditQualitySymposium/Pages/default.aspx>



In November 2014, CPAB held its third Audit Quality Symposium convening Canadian and international directors, business leaders, policy makers, audit firm leaders, regulators and academics to discuss the changing expectations in the world of audit. This video presents comments of some of the participants who took part in the symposium.

Lecture Review

This chapter discussed the nature of the public accounting profession and the activities of public accounting firms. Because public accounting firms play an important social role, several Canadian organizations provide oversight to increase the likelihood of appropriate audit quality and professional conduct.

How are public accounting firms organized? Small accounting firms are set up as sole proprietorships or partnerships. Most of these firms have fewer than 25 professionals in a single office. Many small local firms do not perform audits and primarily perform reviews and compilations along with accounting and tax services. Larger firms such as Deloitte Touche LLP, Pricewaterhouse Coopers LLP, KPMG LLP, and Ernst & Young LLP, are set up as limited liability partnerships. These international firms have offices throughout Canada and the world, and audit nearly all of the largest companies in Canada and worldwide and many smaller companies as well.

How do we ensure that the public remains confident in the audit profession? Completion of audits to high ethical standards helps maintain confidence in the audit profession.

What are quality control standards and how are they enforced? Quality controls are policies and procedures used by a public accounting firm to ensure that it fulfills its professional responsibilities. Practice inspections are conducted by the professional associations, the provincial institutes, and the CPAB.

Suggested Homework Problems

Learning Objectives	Review Questions	Multiple Choice Questions	Discussion Questions and Problems	Professional Judgment Problems and Cases
LO 1	2-1, 2-2, 2-3	2-17		
LO 2	2-4, 2-5, 2-6, 2-7, 2-8, 2-9	2-17		2-23
LO 3	2-5, 2-10,			
LO 4	2-10, 2-11, 2-12	2-18	2-20	2-23, 2-26
LO 5	2-13		2-22	2-24, 2-25, 2-27
LO 6	2-14, 2-15, 2-16	2-19	2-22	2-23, 2-24, 2-25, 2-27