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Quality Control Through Coordination with Existing Auditing Standards

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QUALITY CONTROL THROUGH COORDINATION
WITH EXISTING AUDITING STANDARDS

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CHAPTER I

INTRODUCTION

Rule 202 of the Rules of Conduct of the Code of Professional Ethics states:

> A member shall not permit his name to be associated with financial statements in such a manner as to imply that he is acting as an independent public accountant unless he has complied with the applicable generally accepted auditing standards promulgated by the Institute. Statements on Auditing Procedure issued by the Institutes' committee on auditing procedure are, for purposes of this rule, considered to be interpretations of the generally accepted auditing standards, and departure from such statements must be justified by those who do not follow them.[1]

This requirement appears to relate to the conduct and auditing procedure of the individual auditor. It is certainly within reason to assume that it may be beneficial to the practice of an accounting firm if the firm could apply these auditing standards, or at least some of them, to the audit practice of the firm taken as a whole.

It is the objective of the generally accepted auditing standards as applied to the individual auditor to assure that his actions and work meet a certain quality which is acceptable to the profession and enhances the integrity and public view of the accounting profession.

It would also appear that the major objective of applying these standards to an accounting firm would be to enhance the quality of the work produced by the accounting practice. But in order to effectively apply standards to the accounting firm we must devise some means of evaluating whether or not these firms are effectively implementing controls to assure that the standards introduced are being effectively put to use.

In December of 1974, the Auditing Standards Executive Committee issued a statement entitled "Quality Control Considerations for a Firm of Independent Auditors."[2] This statement sets forth nine elements of quality control that were considered by the executive committee in deciding whether the procedures in the firms quality control plan would provide reasonable assurance that the audit practice is being conducted in accordance with generally accepted auditing standards.

The committee also presented in the statement policies and procedures that may serve as guidelines to aid accounting firms in implementing their quality control plans. Although the committee believes the nine elements of quality control apply in some way to all accounting firms, the recommended policies and procedures which may apply will depend on a variety of factors, such as the size and organizational structure of the firm and its philosophy as to the degree of operating autonomy appropriate for its people.

The elements of quality control and statements as to procedures are presented as stated in the statement of the Executive Committee.

> 1. Independence. Policies and procedures should be established to provide reasonable assurance that persons at all organizational levels maintain independence in fact and in appearance.
> 2. Assigning Personnel to Engagements. Policies and procedures for assigning personnel to engagements should be established to provide reasonable assurance that audit work will be performed by persons having the degree of technical training and proficiency required in the circumstances.
> 3. Consultation. Policies and procedures for consultation should be established to provide reasonable assurance that auditors will seek assistance on accounting and auditing questions, to the

extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority.

4. Supervision. Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide reasonable assurance that the work performed meets the firms standard of quality.

5. Hiring. Policies and procedures for hiring should be established to provide reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently.

6. Professional Development. Policies and procedures for professional development should be established to provide reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned.

7. Advancement. Policies and procedures for advancing professional personnel should be established to provide reasonable assurance that the people selected will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

8. Acceptance and continuance of clients. Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity.

9. Inspection. Policies and procedures for inspection should be established to provide reasonable assurance that the other procedures designed to maintain the quality of the firms auditing practice are being effectively applied.[3]

These nine elements currently are not standards, but represent potential areas for standardization. There has recently been some discussion within the accounting profession and the executive committee that there should be a new pronouncement sent out to employ standards in these nine areas or at least in similar areas. There is also strong sentiment that a pronouncement should not create a new set of standards but should treat the nine identified areas as substandards or guidelines under two of the general audit standards as contained in Statement on Auditing Standards, number one.

The nine elements are interrelated so a clear cut division as to which of the elements should be included under each of the general standards is difficult. But as some organization is necessary, the two elements contained under the first general standard which has to do with training and proficiency of the independent auditor are hiring and professional development. They relate to the preparation of the auditor in the areas necessary to enable him to responsibly fulfill his duty.

The remaining seven elements of client acceptance and retention, independence, assigning personnel to engagements, consultation, supervision, advancement, and inspection are included under the discussion of the third general standard relating to due professional care in the performance of the examination as these elements appear to relate more to the auditor's work or are a result of his work.

It was previously mentioned that the policies and procedures implemented to control the quality of work performed may vary with the size and organizational structure of the firm.

Acceptance and continuation of clients and independence with respect to those clients would be much simpler to implement in the smaller or local CPA firms. In the first place there are fewer employees and the office manager or owner will have a closer relationship with his employees and probably have more knowledge as to their investments. Since they are a small or local office, investments they might have with large corporations would not present any problem with regard to independence as the size of the firm prohibits these corporations from ever being prospective audit clients. In the second place the office manager or owner will have fewer clients and in a smaller community the reputation of these clients as to honesty and integrity and their operations will be more widely known.

Assigning personnel to engagements, supervision while on the engagement, and consultation provided would also lend itself to simple procedures in the local CPA firm because of the relatively small number of auditors required to complete the average engagement. A problem might arise in the area of consultation if a situation should call for the advice of an expert in a particular field. Larger firms would have greater access to these specialists as they are usually employed by the firm. The smaller firms are destined to go outside their own operation and seek the help they require.

Hiring and advancement would involve relatively the same procedure regardless of the size of the firm. All firms recognize the need for well educated and efficient personnel and would attempt to acquire these people or employees through recruiting programs at the various colleges and universities. Large firms, as a rule, are able to offer higher salaries for the beginning accountant but many times the informal, personal attitude inherent in the smaller firms is very attractive to prospective employees. Advancement procedures in a larger firm are more formal, usually the result of several evaluations of the individual's work. Although based on simpler evaluation methods, the smaller firm as with the larger firm advance their personnel on the basis of work performed and the opinion of the management or supervisors as to whether or not the individual is ready for and can handle additional responsibility.

The element of inspection lends itself to the organizational structure of the larger accounting firms but it may be implemented by smaller firms in certain instances. In the larger accounting firms, the inspection is usually conducted by partners within an office or in multi-office firms by partners of another office. This inspection provides a check on the professional performance of the partner responsible for the audit examination by one of his peers.

This simple form of peer review has gradually developed into a formalized peer review system which has recently been expanded to include a review of quality control. The AICPA has adopted this formalized review from a previous plan entitled "Audit Supervision." It gained little momentum until about a year ago when requests were made of the profession to give the review a higher priority and at the same time the Securities and Exchange Commission asked the Institute to assist it with quality reviews of firms against which the Commission was taking or contemplating disciplinary action.[4]

The quality control project has as its overriding objective, quoted from an early draft prepared by the Audit Supervision Task Force of the Auditing Standards Executive Committee: "To provide reasonable assurance, but not absolute assurance, against issuing a report that lends credibility to misleading financial statements or is otherwise inappropriate."[5]

ENDNOTES

[1]American Institute of Certified Public Accountants, AICPA Code of Professional Ethics (New York: AICPA, 1975), p. 18.

[2]American Institute of Certified Public Accountants, Statement on Auditing Standards, no. 4 (New York: AICPA, 1974), p. 1.

[3]Ibid., pp. 2-6.

[4]Leroy Layton, "Quality Control in Auditing," Massachusetts CPA Review, March-April 1974, p. 12.

[5]Ibid.

CHAPTER II

QUALITY CONTROL AND THE FIRST GENERAL STANDARD

Hiring and Professional Development

The first general standard is, "The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor."[6] It would be an impossibility to attempt to control the quality of a firm's practice without first controlling the quality of the professional staff.

Education

Controlling the quality of the professional staff first begins with recruiting persons having an adequate educational background. It is recognized that however capable a person may be in other fields, including business and finance, he cannot meet the requirements of the auditing standards without proper education and experience in the field of auditing.

At the present time the majority of candidates for the CPA examination are being provided by the undergraduate colleges and universities of business and accounting. The accounting profession in the United States has given to colleges and universities full responsibility for basic education and much of the training of future members of the profession. This fact accounts for the wide range and diversity of the nature, scope, and quality of attitudes and competence of CPA's. They have no common professional background except passing the CPA examination.[7]

The preparatory requirements of the businessman, including the accountant, came under attack in the 1960's. Typical of the views expressed was the Gordan and Howell report, which took a dim view of undergraduate business education when it stated:

> Current dissatisfaction with the quality of undergraduate business education is widespread and acute. It is virtually inevitable that this should be so. We have already seen that it is practically impossible to do in the four undergraduate years what the undergraduate business schools try to do: to provide both a general and a professional education of satisfactory quality. In fact, the situation is much worse than this implies. The undergraduate schools are plagued with more than their share of poor students with inadequate backgrounds; curricula have not been planned to meet the kind of needs we have described; teaching is frequently at a superficial level, emphasizing description and procedural detail and failing to provide a true intellectual challenge to the student; both general education and business fundamentals are too often sacrificed for the sake of specialized knowledge and skills that may soon be obsolete and faculties are frequently inadequately trained and too immersed in their own specialties.
>
> The insistent demand by students and parents for some form of business training in the undergraduate years cannot be washed away. It is the inevitable result of the dominating role which business plays in American society, the continuing democratization of higher education, and the inability or unwillingness of most students to defer their professional training until after a sound general education has been obtained. Eventually, we anticipate, the pressure for business training at the undergraduate level will subside somewhat. Even so, it can be assumed that for the indefinite future most college students seeking a business education will receive it at the undergraduate level rather than the graduate level. But if we are to meet the future needs of American business and of the broader society it serves, widespread and fairly drastic reform is necessary. Change is called for in curriculum, in teaching methods and course content, and in academic standards. These in turn imply other improvements in quality and training of the faculty, in research, and so on. . . .[8]

The accountant, self made without the aid of any type of formal education, is rapidly phasing out of the picture. Accounting firms, especially the larger CPA firms, almost all require their new personnel to have completed requirements for a degree in business or accounting from an accredited college or university.

In most states, a college degree or a determined number of years of experience is a common precedent to writing the CPA examination. It is the hope of the profession, that through professional education, students may develop the ability to analyze and solve independent problems and situations of a diverse nature. Sound solutions require the use of knowledge, reasoning and judgment. Accounting educators, as well as educators in other professional areas, must do their best to develop this kind of ability insofar as it can be developed through education.[9]

The university should concentrate on general education, the preprofessional program and a professional program centered on the general principles and concepts of the technology. It should be directed to the development of critical and analytical thinking, with only those procedures included which are essential for understanding the concepts.[10]

Inclusion in the university curriculum of material on the social obligations of accountants and how the profession meets these responsibilities represents course material conducive to the development of a preprofessional character. This type of course may bring out an understanding of why formal rules of professional ethics exist and would provide a basic foundation for the study of professional conduct at the professional level.

Training

Formerly, most CPA firms have indicated that they wish the graduating senior in college to be able to fulfill the role of a junior accountant as rapidly as possible. Practitioners have been heard to complain about university graduates who cannot immediately perform such duties. But more and more educators and practitioners are coming to the conclusion that a university which concentrates on teaching students to perform the duties of a junior accountant is not supplying the profession with an accountant containing a broad background understanding of our physical and social world. Training, they say, is the profession's job; the mission of educators should accomplish a two-fold purpose. It must equip the graduate to perform the greater variety of complex services being demanded. In addition, since the precise course of future development cannot be predicted, the graduate must have the ability to adapt to rapidly changing requirements.[11]

Once a member of the accounting firm's professional staff, the accounting firm's teaching staff is responsible for training the new member in such a way as to enable him to be able to fulfill the various responsibilities to which he will be assigned.

The firm is vitally interested in the development of the staff. Their only product is service and the quality of the product is directly proportional to the quality of the staff. To help the staff in their development, accounting firms have developed training programs.

The program would include reviewing the firm's staff manual which covers, for all practical purposes, all the areas of audit and personnel requirements to which the new accountant will be exposed. Usually the accountant will receive this information in an in-house training session which may last anywhere from two to four weeks and will occur at the beginning of the employment period.

Additional in-house staff-training sessions are held at periodic intervals. Subjects of professional and technical interest are discussed at such meetings. In addition, matters pertaining to client relationships, personnel problems, and firm-staff procedures are reviewed.[12]

Members of the professional staff are expected to have at least a basic understanding of federal and state income taxes. This knowledge is usually acquired prior to joining the staff, but each staff member should add to his basic knowledge at the maximum amount of his capability by taking advantage of the firm's training programs in such areas.

Training is sometimes available in areas not directly related to accounting but certainly indirectly related when considering that a certified public accountant has not fulfilled his duty to a client unless he has conveyed the necessary information to the client in such a way that it can be easily understood.

Public speaking engagements are a medium through which the firm can benefit by advancing both the technical knowledge of the profession and the prestige of the firm. When a staff member receives inquiries regarding speaking engagements, the individual should indicate a willingness on the part of the firm to provide speakers. The individual is encouraged to take advantage of speaking opportunities as it promotes assurance, self-confidence, and the ability to communicate one's thoughts, all of which are highly desirable of a professional man.

Speeches and lecture notes should be reviewed with someone of proper authority to determine if any statements are contradictory to firm policy and would be embarrassing to both the individual and the firm.[13]

Once an individual has completed his university education requirements and completed any initial staff training sessions, probably the greatest training device and the most effective advancement of skills is the on-the-job training one receives, subsequent to assignment to an audit engagement.

Exposure to a wide area of work situations under the guidance of supervisors who are trained to develop others, makes every working day a learning experience. Assignments are planned to provide a diversity of experience in size and type of clients and to present the opportunity to work with different people in the firm. This experience provides the technical and administrative breadth needed to achieve professional stature early in a professional staff member's career.[14]

In on-the-job training, definite criteria should be introduced as to enable the staff accountant to develop a clear picture of the exact meaning of the rules of professional ethics. The AICPA would probably be responsible for development and clarification of such rules, as applicable to each individual firm, based on their code of professional ethics.

A final but essential element of a training opportunity provided by a public accounting firm is assistance in passing the CPA examination and receiving the certificate. This is accomplished in one of two ways. Some firms have classes conducted at the office of the firm, taught by its own people. Generally the time for such sessions is set up in such a way that the firm is willing to permit only a portion of the working day as class time. The remainder is to be taken from the free time of the candidate. The second method is to make available to the individual's professional CPA courses taught outside the firm.

In almost all firms there is a reimbursement to successful candidates of anywhere from the cost of the initial examination to full reimbursement of the cost of a professional course. The amount is determined by firm policy.

Continuing Education

Continuing education and training are interrelated, as the majority of both are provided after employment by the accounting firm. The common body of knowledge that underlies the accountant's capabilities to meet the responsibilities to his client and to his profession is continually changing as new government regulations are imposed and new accounting principles supercede or clarify old ones. It is also changing to meet new economic developments and new demands imposed on certified public accountants by the profession to master the new concepts and techniques as they are developed.

In other words, the accountant's future and success are dependent on continuing education. For some accountants, this continuing education will be the result of new legislation. For example, in a number of states in the United States, the state board of accountancy laws give the CPA the option of completing forty hours of formal education classes each year or 120 hours over a three-year period, divided as he sees fit.[15] These formal education classes may be in the form of state conventions where various current or problem topics are studied. In addition, the AICPA may provide a seminar, usually in a larger city, and invite members from various distant and surrounding CPA firms to come and participate in the programs. Most of the larger CPA firms have flexible education programs, running almost continually throughout the year, that staff members may participate in.

Other accountants will undertake the continuing education program because they recognize the need for a self-education process to bring the technical qualifications of the whole profession up to the level of the best performance within it. This aspect of education has received the attention of the Division of Professional Development of the American Institute of Certified Public Accountants.[16]

This division began by offering the profession a few general courses but new courses have been developed of broadened scope and the whole program appears to be gradually expanding and carrying the profession along with it. While it is too early to suggest an examination of the professional development program in terms of its educational objectives, it appears that any study directed to a broadening of the university professional program to encompass all phases of measurement and communication of economic data, may very well play an important part of the professional development program.

A program designed to encompass all phases of measurement and communication of economic data should include courses in addition to English, history, languages and general liberal subjects, which appear to be suitable preaccountancy education. Others that may be included are: mathematics, up through calculus; logic, with emphasis on use in the social sciences; philosophy, with particular emphasis on ethics; social sciences, particularly economics, political science, sociology and anthropology; and communications, both in the sense of writing and in the sense of conveying information to others by any means.[17]

It appears the AICPA has a most important role in developing an interest in the cultural aspects of education and encouraging assumption of community and public responsibility. The Institute will have to expand on past activities in attempting to create the conviction among members of the profession that they belong to a learned profession with a responsibility for contributing to the development of our society in technical, cultural, political and social areas.[18]

As the continuing education program continues to grow, the profession can anticipate that:

1. Universities and colleges will offer continuing education programs as part of their curriculums, either at the undergraduate or graduate level or both.
2. The undergraduate curriculum for the accountant will gradually be reduced from four years to three and the education of the accountant will shift to a system in which he acquires additional degrees throughout his work career.
3. Schools presumably will extend their graduate degree requirements beyond the one to two years mentioned above and tailor their programs accordingly. In the end, professional schools of accountancy will evolve from the program in order to provide a better means for entry into the profession and the needed environment and facilities for continued education and research.
4. Individual courses will be structured for a mix of practitioners and students and will become a better environment for the exchanging of ideas and experiences.
5. Faculty members will have the opportunity to gain work experience or benefit from the participation of the practitioners.
6. Effective self-study programs will be created for the use of the accountant who cannot attend formal classes at school.
7. The accounting profession will give financial support and will participate to a greater extent in the development of new teaching techniques and instructional material.[19]

The ideal position for promoting the individual members of the profession along both cultural and social lines rests with the accounting firms themselves. The assumption of responsibilities in developing community and public service programs should be considered a part of the activities of every member of the firm and systematic programs for assuring the cultural development of personnel should be established.

ENDNOTES

[6]American Institute of Certified Public Accountants, Statement on Auditing Standards, no. 1 (New York: AICPA, 1973), p. 7.

[7]John L. Carey, "The CPA Plans for the Future," AICPA (New York: AICPA, 1965), p. 262.

[8]Robert A. Gordon and James E. Howell, Higher Education for Business (New York: Columbia University Press, 1959), pp. 132-133.

[9]Carey, p. 262.

[10]Norton M. Bedford, "Education for Accounting as a Learned Profession," Journal of Accountancy, December 1961, p. 38.

[11]American Institute of Certified Public Accountants Position Working Papers, Problems of Education--Views of Accounting Educators (New York: 1975), p. 600.

[12]American Institute of Certified Public Accountants, Guide to Preparing a Staff Manual for a Public Accounting Firm (New York: 1969), p. 27.

[13]Ibid., p. 33.

[14]This is Haskins and Sells, National Director of Recruitment, (New York: Haskins and Sells, 1975), p. 12.

[15]Frederick E. Horn, "Academic Preparation of the Accountant of the Future," Journal of Accountancy, May 1975, p. 67.

[16]Bedford, p. 40.

[17]Ibid., p. 39. [18]Ibid. [19]Horn, p. 67.

CHAPTER III

QUALITY CONTROL AND THE THIRD GENERAL STANDARD

The third general standard is, "Due professional care is to be exercised in the performance of the examination and preparation of the report."[20] This standard requires the auditor to use due professional care in his work and also requires the auditor to comply with the standards of field work and reporting. In other words the due care standard refers to the examination itself and to control the quality of a firm's work. The first consideration is the quality of the client under examination.

Client Acceptance and Retention

As a man is known by the company he keeps, so a professional firm is known and measured by the standing and quality of its clientele. Quality control in an accounting practice begins with the acceptance of engagements. The principles desired by clients, the type of business activity we are associated with, the nature of the engagements and observance of requirements for financial independence are the principal objectives of the control procedures applied at this point.[21]

In most CPA firms, the clients are accepted by the office of the firm by the partners of that office, but only after a careful investigation is made by a partner of the client's reputation and integrity. The responsibility of making this investigation rests with the individual partner but he usually will discuss the matter with another partner or partners before making his decision as to accept or reject a new client or retain or reject an existing client. Maintenance of a high quality practice suggests that an auditor be selective in determining his professional relationships.

> In pursuing its quality control objectives with respect to the acceptance and continuance of clients, a firm may use policies and procedures such as reviewing financial statements of a proposed client; inquiring of third parties, such as the proposed client's previous auditors, its banks, legal council, and investment bankers, and others in the financial and business community as to the reputation of the proposed client; evaluating its ability to service the client properly, with particular reference to industry expertise, size of engagement, and manpower available to staff the engagement; and periodically reevaluating clients for continuance.[22]

Independence

Rule 201 of the Code of Professional Ethics states, "A member shall not undertake any engagement which he or his firm cannot reasonably expect to complete with professional competence."[23] Examples of companies that an accounting firm may not wish to be associated with may include those companies that contain illegal elements interrelated with the legitimate part of their organization. Gambling operations seem to be an unattractive source of accounting practice when the principal business of a company is the operation of a casino or similar establishments. Also, enterprises have often been organized to avoid government regulation or act as a go-between enterprise to aid in the liquidation of previously illiquid investments.

Maintenance of control over the quality of these engagements is simply not possible and extreme care should be used before the name of an accounting firm is associated with the financial statements of these companies.

Independence is required by the Code of Professional Ethics and also by generally accepted auditing standards. It may be discussed in the context of the firm's clients to point out that maintaining quality in such accounting firms requires that their accountants are and remain financially independent of their clients.

It is simple to say that a staff member should not be associated in the audit of any client in which he has an investment. But many times an auditor may be indirectly related as a result of investments held by relatives or family. This circumstance has led the accounting profession to codify at great length what constitutes an infringement of independence (Appendix A).

Since acceptance of a client is contingent upon initial and continuing independence, the names of new clients are regularly made public throughout the firm and notice is also given of any clients for which the audit firm is no longer performing any services. In many larger firms, the staff members are each required to sign an affidavit to the effect that his independence has been maintained and will continue to be maintained and his affairs will be conducted in accordance with that affidavit. The procedures for controlling the quality of clientele and independence with regard to these clients are simple yet very important for controlling the quality of the audit practice of the accounting firm.

Consultation and Supervision and Review

Supervision and review when related to the audit engagement consist of two basic phases. The first of these phases may be considered the on-the-job supervision and review. The auditor in charge of supervising the engagement is responsible for instruction of those working under him prior to the start of a specific work assignment, constant availability for consultation during performance of the work and a review of the audit working papers upon completion of each work assignment. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the assignment, extent of assistance and advice given to auditors who performed the work, and the qualifications of those personnel performing the work.[24] Inherent in the first phase of observing the quality of supervision and review is the first standard of field work which states, "The work is to be adequately planned and assistants, if any, are to be properly supervised."[25]

As designated by the AICPA in their Statement on Auditing Standards, number four:

> In pursuing its quality control objectives with respect to supervision, a firm may use policies and procedures such as providing direction as to the form and content of working papers and as to the nature and extent of instruction to be included in an audit program; developing and using standard audit forms, checklists, and questionnaires; requiring that working papers be reviewed by supervisory personnel; and requiring that auditor's reports and the accompanying financial statements be reviewed by qualified personnel for conformity with generally accepted auditing standards and generally accepted accounting principles.[26]

The supervision and review policies and procedures actually used on the engagement will not only depend on firm policy, but also will be the result of the auditor's judgement as indicated by the circumstances. As an example, firm policy might be to require that working papers bear some evidence of review by those auditors in charge of supervision and review. Such evidence would probably be in the form of signatures on the working papers themselves indicating that they have been reviewed and are in order. Ordinarily the auditor would have to perform some limited investigation into the substance of the working paper involved before he would be willing to concur with the conclusions reached by the staff members and affix his signature to such working papers.

If the staff accountant had spent considerable time consulting with his supervisor on the matters contained in the working paper being reviewed, when it came time for the supervisor to indicate by his signature that he reviewed the working paper, his supporting investigation would probably be substantially less. It should be readily apparent to him whether or not the staff accountant followed his advice on the matter at hand and if this proved to be true, no further action may be necessary.

It is very important to the quality of an accounting firm's work that auditors will seek assistance on accounting and auditing questions to the extent required. It is the responsibility of the supervisor to provide the necessary information to the staff accountant or refer him to persons having the appropriate levels of knowledge and authority to resolve the problem.

It is almost always firm policy to review the federal income tax provision and liability. Often it is to the staff accountant or supervisor accountant's benefit to consult with income tax specialists on these matters. Tax laws are complex and always changing and it is very difficult for an auditor to be current on tax legislation and tax laws.

Advancement and Assignment of Personnel

Another important aspect of the supervisors job is the completion of personnel appraisal forms on the work of staff accountants working under him on the audit engagements. These appraisals often cover current performance and technical ability, efficiency, communication skills, personal attitude and readiness to undertake added responsibility. In most firms these evaluation reports are openly discussed with the individual being evaluated. This gives the individual a chance to react to comments made by the supervisor and also to make him aware of areas needing improvement and ways of overcoming these deficiencies. It is often very beneficial to hear a staff accountant's reaction to a supervisor's evaluation. A low evaluation may be the result of personality conflicts and not necessarily from poor execution.

Periodically, evaluation reports are accumulated and reviewed by some sort of an advisory committee and this committee recommends advancement, based on the conclusion of the committee as to whether or not the accountant is ready for additional responsibility and whether or not he is ready to be assigned to new engagements.

In making new assignments, the nature and extent of supervision to be provided should be taken into account. An obvious but important statement would be that the more experience and ability a person possesses, the less he will have to be supervised.[27]

From the supervisor's participation in the initial adoption of the audit program, to reviewing working paper schedules as proposed by his staff, he assumes primary responsibility for the quality of the work in the specific engagement and consequently an important role in the quality of the firm's accounting practice. Quality controls are provided to assist the supervisor in fulfilling his responsibilities.

The second basic phase of controlling the quality of audit work through supervision and review is the review procedure as the files are passed up the firm structure. Staff members prepare the schedules, the senior in charge of field work reviews the schedules and accumulates a working paper file, the file is reviewed by the manager and correlated closely with the final result, and finally the financial statements and the files are reviewed by the partners as the examination nears a conclusion. It is noted that not all firms carry the titles as previously mentioned in their firm structure, but the succession of offices is similar.

This responsibility for decisions is made at the lowest level practical, but subsequent reviews by more qualified people assure that the integrity of the work and the quality of that work as desired by the firm is maintained.

A partner on an engagement assumes full responsibility to the firm to determine the scope of the work to be performed on a particular engagement, to evaluate the results, and to decide when the client's financial statements are acceptable and may be issued with the firm's opinion. From the personal involvement of the partner in the decision making process, the firm as a whole is assured that the responsibility for the quality of the engagement has been accepted personally by the partner of the engagement. It is this decentralized responsibility of which the firm relies for the quality of its practice.[28]

Inspection

As part of their review responsibilities, partners have for many years been engaged in a program referred to as inspection. Inspection programs were conducted as interoffice programs where a partner in an office would inspect the performance of partners in the same office. They were also conducted by multioffice firms where teams of partners or managers would inspect the performance of other offices within the same firm. These programs were implemented to determine whether the firm's quality control procedures are operating effectively, and to review the audit practice to determine whether engagements are being conducted in accordance with professional and firm standards.[29]

Somewhat related to inspection conducted by partners in the same office or multioffice firms, but more sophisticated, is the program known as peer review of professional work. Although peer review has received a large amount of publicity in recent years, it is not really a new concept.

Peer review has been around for many years in the medical profession evidenced by its "tissue committee" reviews of hospital staff doctors. More recent evidence in the medical profession is the Professional Standards Review Organization program enacted by Congress in 1972.

This involves physicians and other health professionals who receive federal funding for health care under federal programs. The program sets standards for treatment, with local physician boards reviewing their colleagues' work for deviation from such standards.[30] This program is a genuine example of peer review as professional performance is judged by members of the same profession, subject to the same regulation and rules, and who have appropriate experience to be able to judge performance and understand the professional decision making process.

The key to the success of the peer review process appears to relate to reviewer's understanding the professional decision making process. In professional practice, there are many times when the action taken depends on the judgment of the professional in accordance with the circumstances and in no field is such judgment more prevalent than in the field of accounting.

The first form of peer review conducted by the accounting profession was the AICPA's Practice Review Committee which administers a program to review reports submitted to the committee because of possible reporting deficiencies. This program has been in effect since about 1965 and its primary objective is to point out to a practitioner, on a confidential basis, what appears to a committee of his peers to be substandard professional practice.[31]

Since 1972 the institute has made available to local CPA firms a quality review program providing independent review of selected audit engagements and engagements for unaudited financial statements. This review is voluntary in nature and it covers a post audit review of engagement selected by those being reviewed. Reviewers sometimes come from out of state firms if there is any question of competition among the state accounting firms. The program has been well received by both reviewers and the firms being reviewed. There is a charge for time and expense of reviewers which can be negated by supplying reviewers for subsequent reviews of other accounting firms.[32] Such a quality review program as set up in accordance with the executive committee's Statement on Auditing Standards, number four, is presented in this discussion (Appendix B) to provide examples of quality control policies and procedures for local firms. Specific policies and procedures of a particular firm would be based on that firm's overall system of quality control and would not necessarily include all of the examples listed.

Several state CPA societies have recently begun peer review programs. These programs appear to be conducted along the same lines as the Institute program for quality review of local CPA firms.

The chartered accountants of Canada have also had a form of peer review available to their organization for the past three or four years. This review engages the staff of some provincial institutes to visit offices of practitioners and review engagements. Since these reviews are not performed by active practitioners, the benefits of such a program are believed not to be as useful as those programs that involve reviews by practicing peers.[33]

Early in 1974, the AICPA engaged a special committee to conduct a study of quality review procedures of multioffice firms. In April of 1974 this committee recommended to the Board of Directors of the AICPA that the institute should take another step forward and adopt a voluntary program for review of quality control procedures of multioffice firms and the committee also submitted a separate document entitled "Plan for Implementation of AICPA Voluntary Program for Reviews of Quality Control Procedures in Multi-Office Firms." This plan sets forth the recommendations of the committee and how the program could operate.[34]

The AICPA would appoint a committee in charge of supervision and coordinating the overall program. This supervisory committee is also charged with adjusting the program to fit the needs of the engagement based on experience with actual reviews. Several other features of the proposed program are summarized as follows:

1. Multi-office accounting firms are asked to nominate partners to serve on a quality control review panel. The reviews are conducted by reviewers drawn from the panel.
2. The supervising committee is to set standard fees for reviewers, such fees to be paid by the reviewed firm to the Institute for disbursement to members of the review team.
3. Each review team is to be headed by an individual designated as the review team captain. He is assisted in the administration and policy aspects of the review by two individuals, the three of them being designated as the review team executive committee.
4. The reviewed firm is required to have a description of its quality control procedures (quality control document) approved in advance by the review team executive committee. The review is directed toward determining whether the procedures described in the quality control document are appropriate in the circumstances and whether they are operating effectively at the national, regional and practice offices visited by the review team.
5. The review team executive committee decides which offices are visited, and the lead reviewer at each practice office decides which engagements are to be reviewed at that office.
6. Members of the review team inspect audit engagements at practice offices to the extent necessary to determine whether the described quality control procedures are operating effectively. The extent or depth of review of particular engagements is left to the judgement of the reviewers. But the review of each engagement is to be directed primarily to selected key areas of each audit, in order to make a judgement as to whether the auditing procedures were well planned, appropriately executed, and documented in accordance with the reviewed firm's policies, and whether the findings are consistent with the opinion expressed on the financial statements.

7. The review team captain prepares a written report, the only copy of which is given to the reviewed firm. That report is not filed with the Institute or the supervisory committee.[35]

The plan includes an illustrative timetable which shows the sequence of events which an average voluntary program for reviews of quality procedure may follow and the time span necessary to complete the review (Appendix C).[36]

This plan for voluntary review was intended as an important aspect of peer review and would serve to increase public confidence in the standards of the profession. In the initial stages of the program, it appeared that the greatest benefit to the profession was a result of this increased public confidence of the investing public because these quality controls helped the firms do a better job for the benefit of the public.

Other benefits to be derived from the program are varied depending on the accounting firm but are essentially similar to benefits derived by any organization subject to a peer review.

A fresh outside review of the firm's procedures conducted by a group of objective experts will undoubtedly result in suggestions for improvement.

Firm personnel are likely to perform their duties in a more effective manner if they are aware that each audit is subject to a review by outsiders. They are aware that substandard performance is not acceptable and will strive to achieve the standards of the firm in all work that bears their signature.

Reevaluation and upgrading of quality review procedures will result simply because the firm is required at each review to present in writing the review program. It will initiate an up-to-date and effective program and will make it easier for reviewers to submit recommendations to help the firm.

Improvement within the profession may be achieved as a result of the operations of accounting firms being brought out in the open. It could very well result in the development of new and better professional standards and may also initiate action on proposals by the Executive Committee on Auditing Standards to present some recommendations in the form of Statements on Auditing Standards.

The key to the success of the program still depends on the reaction of the public to the reviews of the accounting firm. The program should provide additional assurance to the investing public that the profession is genuinely concerned with the maintenance of high standards, and that accounting firms, by requesting voluntary reviews, acknowledge that maintenance of standards is an individual firm effort as well as a profession-wide effort.[37]

The greater majority of quality review programs, especially peer review, whether initiated before or subsequent to the Statement on Auditory Standards, number four, follow the nine elements of quality control as presented in that statement or at least areas similar to those presented in the statement. The reason is probably that the statement used as a precedent the existing quality control programs and subsequent programs were based on the statement's recommended areas of control.

In February of 1976, the committee on self-regulation of the securities and Exchange Commission urged the AICPA to issue a discussion draft entitled "Proposed Plan for Voluntary Quality Control Review

Program for CPA Firms with SEC Practice."[38] This plan also follows the nine elements of quality control as presented in SAS, number four and in most respects is similar to the quality review programs for multi-office firms.

The committee on self-regulation urged the profession to expand and promote their existing quality review programs but they felt the greatest sense of urgency in moving forward with quality review programs are with those firms that have clients with SEC practices or which have a desire to prepare for such a practice. It is in the area of SEC practice that the credibility of the accounting profession with the public at large is most crucial and this area of practice has borne the brunt of concern resulting from publicity concerning litigation against auditors. The committee recognizes that the program can't provide absolute assurance that all breaches of audit performance will be avoided in the future. However, it can be expected to reduce the number of such failures that might otherwise occur and it will provide additional assurance that the audit was conducted in accordance with auditing standards.

The committee concluded that the terms "participants in the program" or "participating firms" should be used instead of registered firms. The change was adopted to avoid the expressed fear that CPA firms would soon be referred to as registered or unregistered and there may be some confusion as to stock registered with the SEC and sold through the exchange.[39]

As presented in the discussion draft, the quality control review program would have the following features:

1. The program would be open to CPA firms with SEC practices or which have a desire to prepare for such practice.

2. A quality control review committee would be appointed to administer the program.

3. Participation in the program would be initiated by a firm's filing a letter of intent with the Institute. The firm would state in the letter that it will comply with the provisions of the program and that it will undergo a review of its documented quality control policies and procedures.

4. Reviews would be conducted in accordance with standards approved by the auditing standards executive committee. A review would be carried out by one of the following methods at the election of the firm to be reviewed:

   a. A review team appointed by the committee.

   b. A CPA firm engaged by the firm under review.

   c. Some other form of independent review satisfactory to the committee, such as an acceptable plan administered by a state society of CPA's.

5. A review would include examination of audit working papers to the extent necessary to determine whether the firm's quality control policies are in compliance with professional standards. The depth of review of working papers for particular engagements would be left to the judgement of the reviewers. The review would be directed primarily to the key areas of an audit to determine whether in those areas there were well-planned and appropriately executed auditing procedures that were documented in accordance with the firm's policies.

6. A firm electing to use a committee-appointed review team would agree to provide qualified personnel for the panel from which reviewers for the reviews of other firms would be drawn.

7. Upon completion of the review, the review team or reviewing firm would prepare a short report stating the results of the review. The report would be submitted to the reviewed firm which, at its option, would submit the report to the Institute. Such reviews would have to be conducted at least once every three years for the firm to continue as a participant.

8. For administrative purposes, the Institute will maintain a record of firms filing letters of intent and a record of firms submitting reports on the results of reviews. These records would be available to the public upon request.

9. At its option, a firm may advise its clients that it has filed a letter of intent and, subsequently, the results of the review and that the report of the review is on file at the Institute. Results of reviews would not be released until the end of an interim period which would provide time for the completion of reviews of firms participation in the program at its outset.

10. To place the program on a self-supporting basis, the committee would set the following fees to be charged firms:

   a. An annual participation fee based on the number of the firm's professional personnel. The fee, which is expected to be modest, would cover the administrative cost of the program.

b. Fees for reviews conducted by committee-appointed review teams. These fees would be based on the per diem rates for the reviewers and their out-of-pocket expenses. Participating firms electing to be reviewed by other firms would make their own fee arrangements.

The committee recognizes that there are differences in the size, structure, and clientele of CPA firms and that quality control procedures will vary according to those characteristics. This program should be administered in such a way, however, as to provide a degree of confidence that the participating firms are adhering to applicable professional standards even though they may have varying policies and procedures to achieve such adherence.

The program is not intended as a means for taking disciplinary action since it is directed toward reviewing the systems of quality control of firms for their compliance with professional standards rather than the performance of individual professional staff members. It relies on the firms to maintain a continuing surveillance of the performance of their professional staff members. However, in the event serious violations of technical standards are encountered as a by-product of the program and the reviewed firm has not taken appropriate corrective action, the reviewers would not be precluded from referring such information to the Institute's professional ethics division. Such reference would be discretionary and any decision in that regard would be made in light of the circumstances.

A firm may terminate its participation in the program at any time. Also, a firm's participation would be terminated if it failed to submit a report or the results of its field review within the time period specified under the program. After termination, the firm could no longer refer to itself as a participating firm although it may apply at any time to renew its participation.[40]

The discussion draft presents examples of policies and procedures of firms with SEC practices (Appendix D). These examples are included as they present a clear definition of the program of quality control.

The term "local" in the discussion draft refers to all CPA firms not having SEC practices and the procedures for multi-office firms with SEC practices also include large single office firms with SEC practices.[41]

Another feature of the program allows a participating firm to have the field review of its procedures conducted by another CPA firm instead of by a committee appointed review team. The reviewing firm, which would be expected to have an SEC practice, would follow applicable standards for the conduct of field reviews. The CPA firm conducting the review would be required to be independent of the reviewed firm. For example reciprocal reviews by firms would not be permitted.

As is the case with the committee-appointed review team, the reviewing firm would be responsible for applying appropriate review procedures and policies as warranted by the circumstances.[42]

The first review of this kind was recently conducted by Arthur Young & Company on the practice of Peat, Marwick, Mitchell and Company, the nation's largest firm of certified public accountants.

Peat Marwick originally intended the review to be carried out under the direction of the AICPA by a panel of reviewers drawn in accordance with procedures outlined in the quality review program of multi-office firms. That intention drew complaints from competitive accounting firms with the announcement that the report was to be made public, as they stated that Peat, Marwick, Mitchell and Company was only after a "Good Housekeeping" seal of approval relating to their previous litigation involving antifraud enforcement actions initiated by the Securities and Exchange Commission. At that juncture, Peat Marwick, committed to a public report, retained Arthur Young and Company to complete a comprehensive audit.

The quality review, considered a pioneering effort in the accounting profession, consumed 12,000 hours' work by 150 Arthur Young

Auditors over six months. It involved on-the-spot inspections of eighteen of Peat Marwick's 100 United States offices and a detailed check of about one-sixth of those offices audit output last audit season. Arthur Young's fee exceeded $500,000.[43]

The review conducted by Arthur Young followed the AICPA's program for peer review and is considered by many the most comprehensive and objective job of its kind. It apparently resulted in one of the largest assemblages of audit experience on record. About 50 of the 150 reviewers were Arthur Young partners with the remainder coming from its most senior staff. By comparison, an audit requiring roughly 12,000 hours to complete, is required of a corporation with $1.5 billion in sales. However, such an audit would involve only a small number of partners with junior staff members completing most of the work.[44]

There were a few instances where Arthur Young's auditors disagreed with Peat Marwick's decisions but they recognized that different professionals have different opinions on how to handle certain situations. A peer review involves continually passing judgement on professional judgement and professional judgement is what the accounting profession is all about.[45]

ENDNOTES

[20]American Institute of Certified Public Accountants, Statement on Auditing Standards, no. 1 (New York: AICPA, 1973), p. 10.

[21]John C. Biegler, Quality Control in a Large Professional Practice (New York: Price Waterhouse, 1974), p. 3.

[22]American Institute of Certified Public Accountants, Statement on Auditing Standards, no. 4 (New York: AICPA, 1974), p. 6.

[23]American Institute of Certified Public Accountants, AICPA Code of Professional Ethics (New York: AICPA, 1975), pp. 17-18.

[24]American Institute of Certified Public Accountants, Statement on Auditing Standards, no. 4 (New York: AICPA), p. 4.

[25]Statement on Auditing Standards, no. 1, p. 11.

[26]Ibid., no. 4, p. 4.

[27]Ibid., p. 5.

[28]Biegler, p. 13.

[29]Joseph T. Boyle and Thomas L. Holton, "Peer Review in the Accounting Profession--Who Audits the Auditor?," CPA Journal, January 1975, p. 16.

[30]Ibid., p. 15. [31]Ibid., p. 16. [32]Layton, p. 22.

[33]Boyle and Holton, p. 16. [34]Ibid. [35]Ibid., pp. 16-17.

[36]Ibid., p. 17. [37]Ibid., p. 18.

[38]American Institute of Certified Public Accountants, Proposed Plan for Voluntary Quality Control Review Program for CPA Firms with SEC Practices (New York: AICPA, 1976), p. 1.

[39]Ibid., p. 6. [40]Ibid., p. 8. [41]Ibid., p. 11. [42]Ibid., p.10.

[43]Wall Street Journal, 24 November 1975.

[44]Ibid. [45]Ibid.

CHAPTER IV

CONCLUSION

In the near future, accounting and reporting will become more complicated because of inflation, tax laws, and the need to report on the results of the emerging social and environmental programs of industry. Auditing techniques will be expanded to include management audits, price level accounting, and extremely complicated computer applications. Industry specialization will continue to grow as businesses are affected more and more by economic and social conditions and come under closer scrutiny by public and regulatory agencies. Accountants will specialize in sophisticated mathematical and quantitative techniques and apply them to forecasting, operations research, and other areas of business.[46]

These examples are only a small indication of the additional skills and techniques necessary for the accountant to maintain his professional competence. The useful life-span of accounting knowledge is growing shorter and shorter. Now, more than ever before, education, training, and continuing education will play a more and more important role in the lives of accountants.

Controlling the quality of the education, training and continuing education within the accounting firm as a whole will be an important accounting profession goal as they strive to achieve excellence in accounting standardization. No firm, regardless of size, will prosper and grow with mediocre staff. It is essential to employ and maintain personnel with competence and enthusiasm for the work they will be doing.

Implementing the quality controls as implied in the Statement on Auditing Standards, number four, or controls in similar areas will be an effective way of assuring that the accounting firm will comply with generally accepted auditing standards, a basic objective of every firm conducting an audit practice.

Quality control standards should probably be the same for all firms but procedures implemented to achieve these standards may vary from firm to firm, depending on the size and practices of the firm.

It seems practicable to include the nine elements of quality control under existing audit standards, most beneficially as subsections. As pointed out in the previous discussion, the two standards are the first general standards relating to personal qualifications of the auditor and the third general standard relating to due professional care in conducting the engagement. The first step to quality is to control the quality of the professional staff and the second step is to control the work of that staff. A set of substandards should serve to clarify existing standards and provide new insight to existing accounting standards which would aid the professional staff in completing their work in accordance with the standards of the profession.

The accounting profession, with its enhanced review system of the quality of a firm's operations, has taken a bold step forward to assure that accounting standards and procedures are being effectively applied as they were intended to be applied.

It is expected that eventually all firms will volunteer for some sort of standardized review of the quality of their work. In the light of the public eye, the volunteering firms will be the most desirable to engage for audits as the public will be aware that these firms have been "inspected" and their practices concur with the profession's requirements as to standards of performance.

We have seen an era of a great number of court cases involving clients and third parties suing accountants and accounting firms for investment and financial events occurring as a result of decisions based on audits conducted and the firm's opinion on the financial statements. Many accountants feared government regulation to assure that firms met specified requirements. In several cases involving SEC violations, the Securities and Exchange Commission has given firms probationary periods with the stipulation that the probation period began from the most recent violation in the case of more than one violation. The Commission has also prohibited acceptance of any new SEC clients for specified periods of time following certain SEC violations.

It is somewhat of a relief to see the accounting profession implement its own form of review to assure its house is in order. Self-regulation appears to be far superior to government regulation and it should be more successful in promoting enthusiasm to encourage that professional service to the public and the client is practiced at a level of proficiency, integrity, and independence commensurate with the highest standards of professional excellence.

In every facet of the accounting profession's practice, quality control is considered an essential element. Throughout the accounting and auditing practice, the accounting profession will continue to adapt to an ever changing operating environment. They must be ready to adapt to the needs of the public and of its clients while always maintaining the highest degree of quality control and control of professional practice standards.

Whether a sole practitioner, an employee, or a partner in a firm, there is no substitute for consistent high quality performance. The rewards of excellence go far beyond the minimizing of litigation. They lead to professional satisfaction in serving the public well and also to financial success.[47]

ENDNOTES

[46]Horn, pp. 67-68.

[47]Layton, p. 22.

APPENDIX A

Rule 101 - Independence

A member or a firm of which he is a partner or shareholder shall not express an opinion on financial statements of an enterprise unless he and his firm are independent with respect to such enterprise. Independence will be considered to be impaired if, for example:

A. During the period of his professional engagement, or at the time of expressing his opinion, he or his firm
   1. Had or was committed to acquire any direct or material indirect financial interest in the enterprise; or
   2. Had any joint closely held business investment with the enterprise or any officer, director or principal stockholder thereof which was material in relation to his or his firm's net worth; or
   3. Had any loan to or from the enterprise or any officer, director or principal stockholder thereof. This latter proscription does not apply to the following loans from a financial institution when made under normal lending procedures, terms and requirements:
      (a) Loans obtained by a member or his firm which are not material in relation to the net worth of such borrower.
      (b) Home mortgages.
      (c) Other secured loans, except loans guaranteed by a member's firm which are otherwise unsecured.

B. During the period covered by the financial statements, during the period of the professional engagement or at the time of expressing an opinion, he or his firm
   1. Was connected with the enterprise as a promoter, underwriter or voting trustee, a director or officer or in any capacity equivalent to that of a member of management or of an employee; or
   2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had a direct or material indirect financial interest in the enterprise; or was a trustee for any pension or profit-sharing trust of the enterprise.

The above examples are not intended to be all-inclusive.

SOURCE: AICPA Code of Professional Ethics, American Institute of Certified Public Accountants (New York: AICPA, 1975), p. 18.

APPENDIX B

EXAMPLES OF QUALITY CONTROL POLICIES AND PROCEDURES FOR LOCAL CPA FIRMS

This appendix provides examples of quality control policies and procedures for local firms. Specific policies and procedures of a particular firm would be based on that firm's overall system of quality control and would not necessarily include all of the examples listed. Some aspects of the policies and procedures for multi-office firms set forth in Appendix D would be applicable to single-office firms of substantial size with SEC clients.

Independence

1. Periodic confirmation with personnel that prohibited relationships with clients do not exist.
2. Emphasis of independence of mental attitude in supervision and review of work.
3. Avoidance of assignment of partners and employees to engagements which would raise independence or conflict of interest problems.
4. Prohibition of partners and employees from accepting personal benefits from clients which would impair the credibility of their independence in the minds of reasonable persons familiar with the facts.

Assigning Personnel to Engagements

1. Advance planning for the total personnel needs for the firm's audit engagements on an overall basis.
2. Timely identification of the staffing requirements of specific engagements.
3. Time budgets to establish manpower requirements and to schedule field work.
4. Evaluation of an individual's experience and background before assignment to an engagement.

Consultation

1. Maintenance of an adequate technical research library.
2. Referral of questions to a division or group in the AICPA or state CPA society established to handle technical inquiries.
3. Consultation arrangements with other CPA firms having special expertise.

Supervision

1. Instructions as to the adequacy of documentation and

appropriateness of audit programs in relation to systems of internal control.
2. Use of audit forms, checklists, and questionnaires.
3. Review of working papers by qualified supervisory personnel.
4. Pre-issuance reviews of certain reports by partners not otherwise associated with the engagements.
5. Advice to clients that the firm must review before publication all financial statements associated with the firm's report.
6. Requirement that memoranda and working papers explain the basis for resolution of difficult accounting and auditing problems.

Hiring
1. Standards or objectives as to academic preparation and practical experience for new personnel.
2. Background investigations of new personnel.
3. Instructions to persons involved in recruiting as to the firm's recruiting objectives.

Professional Development
1. Instruction of personnel during the performance of engagements.
2. Requirement that personnel attend training sessions conducted by the AICPA or a state society, by a college or university, or by organizations whose courses are accepted as meeting continuing professional education requirements.
3. Distribution to personnel of professional literature on current developments in accounting and auditing.
4. Orientation of all newly employed professional personnel.
5. Records of training sessions attended by personnel and periodic review of those records to determine that the sessions are meeting the firm's needs adequately and providing for the professional growth of the individuals.

Advancement
1. Periodic appraisals of the work of assistants.
2. Advice to personnel of their evaluations and discussion of their overall progress, strengths, and weaknesses.
3. Encouragement to pass the CPA examination.

Acceptance and Continuance of Clients
1. Review of prior year's financial statements prior to acceptance of new clients.
2. Inquiries of third parties having business relationships with a proposed client.
3. Evaluation of the firm's ability to service a potential client properly with particular reference to industry expertise and size of engagement.
4. Periodic evaluation of existing clients and when significant changes in management or ownership or other events suggest that reevaluations would be appropriate.
5. Authority for the acceptance or rejection of potential new clients vested in a designated partner.

Inspection

1. Post-issuance review of reports.
2. Submission of reports for review to the practice review committee of a state society or the AICPA.
3. Utilization of a quality review program of an association of CPA firms, the AICPA, or a state society.

SOURCE: American Institute of Certified Public Accountants, Proposed Plan for Voluntary Quality Control Review Program for CPA Firms with SEC Practices (New York: AICPA, 1976).

APPENDIX C

ILLUSTRATIVE TIMETABLE FOR A REVIEW

The sequence of events under the voluntary program for reviews of quality control procedures of multi-office firms will not always be the same for all reviews made under the plan. The following timetable, however, illustrates what might be the sequence of events for a review that allows a period of time to implement changes in the quality control document.

Firm requests review	May 15, 1974
Supervisory committee acknowledges request	May 20, 1974
Supervisory committee selects review team captain	June 14, 1974
Reviewed firm approves review team captain	July 1, 1974
Review team captain selects other members of executive committee	July 10, 1974
Reviewed firm approves other members of executive committee	July 15, 1974
Executive committee reviews quality control document of the reviewed firm's type of practice	August 5-16, 1974
Executive committee and reviewed firm agree on any changes to quality control document	September 2, 1974
Reviewed firm implements the agreed-upon changes in quality control procedures	September 2, 1974 to April 30, 1975
Executive committee plans review and submits proposal (engagement letter) to reviewed firm	September 9-11, 1974
Reviewed firm accepts proposal	September 20, 1974
Executive committee selects review team and obtains reviewed firm's approval of review team	February 1975
Executive committee reviews procedures at national office and prepared instructions for lead reviewers and reminder checklist of selected aspects of reviewed firm's quality control procedures	April 1975

Review team has pre-review meeting to plan review	April 30, 1975
Reviews made	May 1 to July 31, 1975
Executive committee drafts report	August 11, 1975
Review team has post-review meeting	August 25, 1975
Review team captain discusses draft report with managing partner of reviewed firm	September 1, 1975
Report issued to reviewed firm	September 15, 1975
Report issued to supervisory committee	September 20, 1975
Reviewed firm reports program suggestions to supervisory committee	October 15, 1975

SOURCE: Joseph T. Boyle and Thomas L. Holton, "Peer Review in the Accounting Profession--Who Audits the Auditor?," CPA Journal, January 1975.

APPENDIX D

EXAMPLES OF QUALITY CONTROL POLICIES AND

PROCEDURES FOR MULTI-OFFICE FIRMS

This appendix provides examples of quality control policies and procedures for multi-office firms with SEC clients. Specific policies and procedures of a particular firm would be based on that firm's over-all system of quality control and would not necessarily include all of the examples listed.

Independence

1. Notification to personnel as to the names of audit clients and their affiliates having publicly held securities or, as an alternative, reports from personnel as to security holdings.
2. Periodic confirmation with personnel that prohibited relationships with clients do not exist.
3. Records showing which partners and employees were previously employed be clients or have relatives holding key positions with clients.
4. Emphasis on independence of mental attitude in training programs and in supervision and review of work.
5. Prohibition of partners and employees from accepting personal benefits from clients which would impair the credibility of their independence in the minds of reasonable persons familiar with the facts.
6. Confirmation of independence of personnel upon acceptance of a new client subject to SEC requirements.

Assigning Personnel to Engagements

1. Advance planning for the total personnel needs for the firm's audit engagements on an over-all basis and for individual practice offices.
2. Timely identification of the staffing requirements of specific engagements.
3. Time budgets to establish manpower requirements and to schedule field work.
4. Procedures for evaluation of an individual's experience and background before assignment to engagements.
5. Procedures for determination that an audit team has adequate overall competence in the industry or industries of the client.

6. Requirements for rotation of partners and staff on recurring engagements for specific clients.

Consultation

1. A research staff to assist in the resolution of practice problems.
2. Designation of individuals having expertise in SEC matters to provide advice for reports to be filed with the Commission.
3. Designation of individuals with expertise in particular industries to provide advice for audits of companies in those industries.
4. Maintenance of adequate technical research libraries at executive office and practice offices.
5. Referral of questions to a division or group in the AICPA or state CPA society established to handle technical inquiries.
6. Requirement that appropriate use be made of available consultants and reference services.

Supervision

1. Instructions as to the adequacy of documentation and appropriateness of audit programs in relation to systems of internal control.
2. Development and use of audit forms, checklists, and questionnaires.
3. Review of working papers by qualified supervisory personnel.
4. Pre-issuance reviews of certain reports by partners not otherwise associated with the engagements.
5. Requirements that memoranda and working papers explain the basis for resolutions of difficult accounting and auditing problems.
6. Requirement that federal income tax provision and liability be reviewed by tax department.

Hiring

1. Standards or objectives as to minimum academic preparation and accomplishment for recruiting at beginning levels.
2. Standards and objectives as to practical experience for advanced positions.
3. Background investigations of new personnel.
4. Special procedures for new personnel obtained from other than the usual recruitment channels, such as by recruitment of higher level personnel or through merger or acquisition of an accounting practice, to assure that they become familiar with and conform to the firm's policies and procedures.
5. Evaluation of overall recruiting results to determine whether hiring standards are being maintained.
6. Instructions to persons involved in recruiting as to the firm's recruiting objectives.

Professional Development

1. Instruction of personnel during the performance of engagements.
2. Requirement that personnel attend training sessions conducted by the firm, by a college or university, by the AICPA

or a state society, or by other organizations whose courses are accepted as meeting continuing professional education requirements.

3. Distribution of manuals on the firm's policies and procedures to professional personnel.
4. Distribution of statements on current developments in accounting and auditing to professional personnel.
5. Programs for the development of specialists, such as industry specialists or computer audit specialists.
6. Requirement that all newly employed professional personnel attend a professional orientation program.
7. Periodic review of the firm's professional development programs to determine whether they are meeting the firm's needs adequately and are providing for the professional growth of individuals.

Advancement

1. Periodic appraisals of the work of assistants.
2. Advice to personnel of their evaluations and discussion of their overall progress, strengths, and weaknesses.
3. Committees of partners to review and pass on the qualifications of individuals being considered for promotion.
4. Encouragement to pass the CPA examination.

Acceptance and Continuance of Clients

1. Review of prior year's financial statements before acceptance of new clients.
2. Inquiries of third parties having business relationships with a proposed client.
3. Inquiry of the predecessor audit to ascertain whether there were accounting or auditing disagreements or other problems with the client.
4. Evaluation of the firm's ability to service a potential client properly with particular reference to industry expertise and size of engagement.
5. Periodic evaluations of existing clients and when significant changes in management or ownership or other events suggest that reevaluations would be appropriate.
6. Authority for the acceptance or rejection of potential new clients vested in designated partners.

Inspection

1. Post-issuance review of reports.
2. An inspection program under which teams visit practice offices to review audit engagements.
3. Submittal of written inspection reports to the managing partner.
4. Evaluation of the overall quality control program for its effectiveness based on the findings of the inspections.
5. In lieu of an in-house inspection program, utilization of a quality review program of an association of CPA firms, the AICPA, or a state society.

SOURCE: American Institute of Certified Public Accountants, Proposed Plan for Voluntary Quality Control Review Program for CPA Firms with SEC Practices (New York: AICPA, 1976).

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