

***AU 100–230* The Auditor’s
Responsibilities and
Functions, Introduction to
GAAS, and the General
Standards (Including the
Quality Control Standards)**

***AU-C 200* Overall Objectives of the
Independent Auditor and the
Conduct of an Audit in
Accordance with Generally
Accepted Auditing Standards**

***AU-C 220* Quality Control for an
Engagement Conducted in
Accordance with Generally
Accepted Auditing Standards**

AU EFFECTIVE DATE AND APPLICABILITY

Original Pronouncements Statements on Auditing Standards (SASs) 1, 5, 25, 41, 43, 78, 82, 95, 98, 99, 102, 104, 105, and 113.

Effective Date All standards currently are effective.

Applicability

All audits in accordance with generally accepted auditing standards (GAAS) and other services covered by SASs.

NOTE: All sections apply whether the financial statements are presented in conformity with generally accepted accounting principles (GAAP) or other comprehensive basis of accounting (OCBOA) unless otherwise noted.

AU-C EFFECTIVE DATE AND SUMMARY OF CHANGES

SAS No. 122, *Codification of Auditing Standards and Procedures*, is effective for audits of financial statements with periods ending on or after December 15, 2012.

AU-C 200 supersedes AU sections 110, 201, 210, 220, and 330. What is required of the auditor is not substantially changed. However, the structure is changed by the clarified SAS, and new terminology is used.

SAS No. 95 (AU Section 150), which contains the general, field work, and reporting standards, is superseded. In its place, each clarified standard has objectives. These objectives provide a link to the overall objective of the auditor. If the auditor fulfills the objectives and the ethical requirements, then the auditor will have fulfilled the requirements stated in the ten standards.

AU-C 220 supersedes AU Section 161. AU-C 220 addresses specific responsibilities of the auditor regarding quality control standards for an audit of financial statements. Quality control is the responsibility of the audit firm. Because quality control procedures are required by Statements on Quality Control Standards (SQCS) No. 7, *A Firm's System of Quality Control*, the clarified standards should not change current practice but strengthen existing standards by making it easier to understand and apply those standards. Note that SQCS No. 8, *A Firm's System of Quality Control* (redrafted), is effective as of January 1, 2012. However, no substantive differences existed between the two quality control standards. Firms who reference SQCS No. 7 will have to update paragraph references.

AU-C 220 also addresses AU-311.28–.32, *Supervision of an Audit Requirement*.

AU DEFINITIONS OF TERMS

Auditing procedures. Acts to be performed by the auditor during the course of an audit to comply with auditing standards.

Auditing standards. Measures of audit quality and the objectives to be achieved in an audit.

Practitioner-in-charge. An individual responsible for supervising an audit engagement or signing the report on such an engagement.

Professional skepticism. An attitude that includes a questioning mind and a critical assessment of audit evidence.

Reasonable assurance. A high, but not absolute, level of assurance.

AU-C 200 DEFINITIONS OF TERMS

Source: AU-C 200.14

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the prepa-

ration and fair presentation of the financial statements, that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. *Sufficiency of audit evidence* is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence. *Appropriateness of audit evidence* is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

Audit risk. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

Auditor. The term used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. When an AU-C section expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term *engagement partner* rather than *auditor* is used. *Engagement partner* and *firm* are to be read as referring to their governmental equivalents when relevant.

Detection risk. The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements; for example, U.S. generally accepted accounting principles, International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board (IASB), or a special purpose framework.

The term *fair presentation framework* is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and

1. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
2. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

A financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgments in 1 or 2 is not a fair presentation framework.

Financial statements. A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement.

Historical financial information. Information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Interpretive publications. Auditing interpretations of generally accepted accounting standards (GAAS), exhibits to GAAS, auditing guidance included in the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guides, and the AICPA Auditing Statements of Position (SOPs).

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance; for example, executive members of a governance board or an owner-manager.

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Other auditing publications. Publications other than interpretive publications; these include AICPA auditing publications not defined as interpretive publications; auditing articles in the *Journal of Accountancy* and other professional journals; continuing professional education programs and other instruction materials, textbooks, guide books, audit programs, and checklists; and other auditing publications from state certified public accountant (CPA) societies, other organizations, and individuals.

Premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted (the premise). Management and, when appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with GAAS; that is, responsibility

1. For the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
2. For the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
3. To provide the auditor with
 - a. Access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - b. Additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and
 - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

The premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted may also be referred to as the premise.

Professional judgment. The application of relevant training, knowledge, and experience within the context provided by auditing, accounting, and ethical standards, in making

informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence.

Reasonable assurance. In the context of an audit of financial statements, a high, but not absolute, level of assurance.

Risk of material misstatement. The risk that the financial statements are materially misstated prior to the audit. This consists of two components, described as follows at the assertion level:

- **Inherent risk.** The susceptibility of an assertion about a class of transaction, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
- **Control risk.** The risk that a misstatement that could occur in an assertion about a class of transaction, account balance, or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel; for example, executive members of a governance board or an owner-manager.

AU-C 220 DEFINITIONS OF TERMS

Source: AU-C 220.09

Engagement partner. The partner or other person in the firm who is responsible for the audit engagement and its performance and for the auditor's report issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality control review. A process designed to provide an objective evaluation, before the report is released, of the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report. The engagement quality control review process is only for those audit engagements, if any, for which the firm has determined that an engagement quality control review is required, in accordance with its policies and procedures.

Engagement quality control reviewer. A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments that the engagement team made and the conclusions it reached in formulating the auditor's report.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor's external specialist engaged by the firm or a network firm.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and which is engaged in the practice of public accounting.

Monitoring. A process comprising an ongoing consideration and evaluation of the firm’s system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients’ financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

Network. An association of entities, as defined in ET Section 92, *Definitions*.

Network firm. A firm or other entity that belongs to a network, as defined in ET Section 92.

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

Personnel. Partners and staff.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under Rule 201, *General Standards* (ET sec. 201 par. .01), or Rule 202, *Compliance with Standards* (ET sec. 202 par. .01), of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Relevant ethical requirements. Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Staff. Professionals, other than partners, including any specialists that the firm employs.

Suitably qualified external person. An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

OBJECTIVES OF AU SECTIONS 100–230

Sections 100 through 230 clarify the difference between the responsibilities of the auditor and management, the nature of auditing standards, and their relationship to quality control standards. The Sections also provide guidelines for the training, independence, and proficiency of the independent auditor, as well as the level of professional care (including the use of professional skepticism and reasonable assurance) required in the performance of audit work.

OBJECTIVES OF AU-C SECTION 200

AU-C Section 200.12 states that:

. . . The overall objectives of the auditor, in conducting an audit of financial statements, are to

- a. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to*

- express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework; and*
- b. report on the financial statements, and communicate as required by GAAS, in accordance with the auditor's findings.*

OBJECTIVES OF AU-C SECTION 220

AU-C Section 220.08 states that:

... the objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that

- a. the audit complies with professional standards and applicable legal and regulatory requirements and*
- b. the auditor's report issued is appropriate in the circumstances.*

FUNDAMENTAL REQUIREMENTS

OBJECTIVE OF ORDINARY AUDIT

To express an opinion on the fairness, in all material respects, with which the financial statements present financial position, results of operations, and cash flows in conformity with GAAP.

AUDITOR RESPONSIBILITIES

In every audit, the auditor has to obtain reasonable assurance about whether the financial statements are free of material misstatement. Material misstatement includes:

1. Material error (See Section 312)
2. Material fraud (See Section 316)
3. Illegal acts by clients (See Section 317)

MANAGEMENT RESPONSIBILITIES

The fairness of the representations made through financial statements is an implicit and integral part of management's responsibility. Management is responsible for:

1. Adopting sound accounting policies
2. Establishing and maintaining internal control that will, among other things, record, process, and report financial data that are consistent with management's assertions embodied in the financial statements

The auditor's participation in preparing financial statements does not change the character of the statements as representations of management. In brief, management is responsible for the financial statements; the auditor is responsible for expressing an opinion on those financial statements.

DEFINING PROFESSIONAL REQUIREMENTS IN STATEMENTS ON AUDITING STANDARDS

AU Section 120 clarifies that the SASs use two categories of professional requirements to describe the degree of responsibility the standards impose on auditors.

- *Unconditional requirements.* The auditor is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SASs use the words *must* or *is required* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The auditor is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the auditor may depart from a presumptively mandatory requirement provided the auditor documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SASs use the word *should* to indicate a presumptively mandatory requirement.

The term “should consider” means that the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not.

AU Section 120 also clarifies that explanatory material, is intended to explain the objective of the professional requirements, rather than imposing a professional requirement for the auditor to perform.

GAAS AND THE GAAS HIERARCHY

The auditor is responsible for planning, conducting, and reporting the results of an audit according to GAAS. The hierarchy of GAAS consists of the following three tiers:

- Tier 1: Auditing Standards (which include the Statements on Auditing Standards)¹
- Tier 2: Interpretive publications
- Tier 3: Other auditing publications

Tier 1: Auditing Standards¹

Tier 1 consists of (1) the ten general, fieldwork, and reporting standards, and (2) the SASs. As stated in AU 150.02 the GAAS approved by the AICPA membership are:

A. General Standards

1. *Training and proficiency.* The audit must be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. *Independence.* In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
3. *Due care.* Due professional care is to be exercised in the planning and performance of the audit and the preparation of the report.

¹ AICPA has designated the Public Company Accounting Oversight Board (PCAOB) as a body to promulgate auditing and related professional practice standards relating to the preparation and issuance of audit reports of issuers.

B. Fieldwork Standards

4. *Planning and supervising.* The auditor must adequately plan the work and must supervise any assistants.
5. *The entity and its environment, including its internal control.* The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements due to error or fraud and to design the nature, timing, and extent of further audit procedures.
6. *Evidential matter.* The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.

C. Reporting Standards

7. *GAAP.* The report shall state whether the financial statements are presented in accordance with GAAP.
8. *Consistency.* The report shall identify those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.
9. *Disclosure.* Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
10. *Reporting obligation.* The report shall contain either an expression of opinion regarding the financial statements taken as a whole or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain:
 - a. A clear-cut indication of the character of the auditor's work, if any
 - b. The degree of responsibility the auditor is taking

NOTE: Materiality and audit risk underlie the application of the ten standards and the SASs (see Section 312).

The preceding ten formal standards apply to all other services covered by SASs unless they are clearly not relevant or the SAS specifies that they do not apply.

These ten general, fieldwork, and reporting standards provide the framework for the SASs promulgated by the Auditing Standards Board (ASB). Auditors are required under Rule 202, *Compliance with Standards*, of the AICPA Code of Professional Conduct to comply with these standards. Auditors should have sufficient knowledge of the SASs to determine when they apply and should be prepared to justify departures from the SASs.

Tier 2: Interpretive Publications

Interpretive publications are recommendations, issued under the authority of the ASB, on how to apply the SASs in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are not auditing standards. They consist of the following:

- Auditing Interpretations of SASs
- Auditing guidance in AICPA Audit and Accounting Guides
- Auditing Statements of Positions
- Appendices to the SASs

NOTE: SAS 95 notes that certain “previously issued appendices to original pronouncements” that modified other SASs are Tier 1 publications, not interpretative publications.

Auditors should be aware of and consider interpretive publications that apply to their audits. Auditors who do not follow the guidance in an applicable interpretive publication should be prepared to explain how they complied with the relevant SAS requirements addressed by such guidance.

Tier 3: Other Auditing Publications

Other auditing publications are not authoritative but may help auditors to understand and apply SASs. Such publications include all AICPA auditing publications not included under Tier 1 or Tier 2 and other auditing publications, including

- Auditing articles in professional journals, such as the *Journal of Accountancy*
- Continuing professional education programs and other instructional materials
- Textbooks and guidebooks
- Audit programs and checklists
- Other auditing publications from state CPA societies, other organizations, and individuals

An auditor should evaluate such guidance to determine whether it is both (1) *relevant* for a particular engagement and (2) *appropriate* for the particular situation. When evaluating whether the guidance is appropriate, the auditor should consider whether the publication is recognized as helpful in understanding and applying SASs, and whether the author is recognized as an auditing authority. (AICPA auditing publications that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate.)

QUALITY CONTROL STANDARDS

An audit firm should establish a quality control system to provide it with reasonable assurance that its staff meets the requirements of GAAS in its audit engagements. The nature of this system depends on such factors as an audit firm's size, the nature of its practice, its organizational structure, the degree of autonomy allowed its personnel and office, and cost-benefit considerations.

TRAINING AND PROFICIENCY OF THE INDEPENDENT AUDITOR

The auditor holds out himself or herself as being proficient in accounting and auditing. Attaining proficiency begins with formal education and continues through later experience. The auditor must be aware of and understand new authoritative pronouncements on accounting and auditing.

INDEPENDENCE²

To *be* independent, the auditor must be intellectually honest; to be *recognized* as independent, he or she must be free from any obligation to or interest in the client, its management, or its owners. For specific guidance, the auditor should look to AICPA and the state society rules of conduct and, if relevant, the requirements of the Securities and Exchange Commission (SEC).

DUE PROFESSIONAL CARE IN THE PERFORMANCE OF WORK

The auditor should observe the standards of fieldwork and reporting, possess the degree of skill commonly possessed by other auditors, and should exercise that skill with reasonable care and diligence. The auditor should also exercise *professional skepticism*, that is, an attitude that includes a questioning mind and a critical assessment of audit evidence. However, the auditor is not an insurer, and the audit report does not constitute a guarantee because it is based on *reasonable assurance*. Thus, an audit conducted in accordance with GAAS may not detect a material misstatement. The auditor should be alert to the possibility of collusion when performing the audit and how management may override controls in a way that would make the fraud particularly difficult to detect.

INTERPRETATIONS

There are no interpretations for this section.

TECHNIQUES FOR APPLICATION

MANAGEMENT'S RESPONSIBILITIES

Many times, clients do not understand their responsibilities for the audited financial statements. These financial statements are *management's*. They contain management's representations. The form and content of the financial statements are management's responsibility, even though the auditor may have prepared them or participated in their preparation. The SEC has stated:

*The fundamental and primary responsibility for the accuracy of information filed with the Commission and disseminated among the investors rests upon management. **Management does not discharge its obligations in this respect by the employment of independent accountants, however reputable** (Accounting Series Release No. 62; emphasis added).*

Management also is responsible for implementing and maintaining an effective system of internal control.

² Section 201 of the Sarbanes-Oxley Act of 2002 and the related SEC implementing rules created significant new independence requirements for auditors of public companies. For example, the SEC prohibits certain nonaudit services such as bookkeeping, internal audit outsourcing, and valuation services. All audit and nonaudit services performed by the auditor, including tax services, must be preapproved by the company's audit committee. In March 2003, the SEC issued final rules implementing Section 201 of the Act. The rules, Strengthening the Commission's Requirements Regarding Auditor Independence, can be found at www.sec.gov/rules/final/33-8183.htm.

Management Representation Letter

GAAS require the auditor to obtain a management representation letter (see Section 333). In the letter, management acknowledges its responsibility for the financial statements and states its belief that the financial statements are fairly presented in conformity with GAAP. Sometimes, the client objects to this acknowledgment because of the auditor’s role in the preparation of the financial statements. To avoid this misunderstanding, the auditor’s engagement letter may include a paragraph such as the following:

Generally accepted auditing standards require that we obtain from you a representation letter about the financial statements and the underlying accounting records and an acknowledgment that the financial statements are management’s responsibility, and that they are presented in accordance with generally accepted accounting principles.

The annual reports of many public companies contain statements acknowledging management’s responsibility for the financial statements and the underlying accounting records.

AUDITOR’S RESPONSIBILITIES

The auditor’s responsibility for the financial statements he or she audits is confined to the expression of an opinion on those statements. In performing the audit, the auditor is responsible for compliance with GAAS, including the SASs.

Under the GAAS hierarchy, the auditor has a responsibility to consider SASs and interpretive publications in all audits. If such guidance is not followed, an auditor must be prepared:

- For Tier 1 SASs, to justify a departure from SASs
- For Tier 2 interpretive publications, to explain that an alternative approach achieved the objectives of GAAS

In other words, the first two categories of GAAS are “must know.” When applying the Tier 3 level of GAAS, other auditing publications, the auditor should determine whether such guidance is relevant and appropriate.

To provide reasonable assurance that it is conforming with generally accepted auditing standards in its audit engagements, an accounting firm should establish quality control policies and procedures. These policies and procedures should apply not only to audit engagements but also to attest and accounting and review services for which professional standards have been established.

ESTABLISHMENT OF QUALITY CONTROL POLICIES AND PROCEDURES

The nature and extent of a firm’s quality control policies and procedures depend on the following:

1. Firm size and the number of its offices
2. The degree of autonomy of personnel and practice offices
3. The knowledge and experience of its personnel
4. The nature and complexity of the firm’s practice
5. The cost of developing and implementing quality control policies and procedures in relation to the benefits provided

When a firm establishes quality control policies and procedures, it also should do the following:

1. Assign responsibilities to qualified personnel to implement quality control policies and procedures.
2. Communicate quality control policies and procedures to personnel (see below).
3. Monitor the effectiveness of the quality control system. The purpose is to determine that policies and procedures and the methods of implementing and communicating them are still appropriate.

NOTE: Flaws in, or a violation of, a firm's quality control do not necessarily indicate that an audit was not performed in accordance with GAAS.

ELEMENTS OF QUALITY CONTROL

When a firm establishes its quality control policies and procedures, it should follow the five elements of quality control (see SQCS 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, as amended by SQCS 4, *Amendment to System of Quality Control for a CPA Firm's Accounting and Auditing Practice*).

NOTE: CPA firms or individuals that are enrolled in an AICPA-approved practice-monitoring program are obligated to adhere to quality control standards. In addition, the Principles of Professional Conduct indicate that members should practice in firms that have in place quality control procedures to provide reasonable assurance that services are competently delivered and adequately supervised. The Statements on Quality Control apply to a CPA firm's accounting, auditing, and attest practice.

Personnel Management

Policies and procedures should provide reasonable assurance that personnel:

1. Have the characteristics to enable competent performance
2. Have the technical training and proficiency needed
3. Participate in continuing education to enable them to fulfill responsibilities and satisfy appropriate educational requirements of the AICPA and regulatory agencies
4. Selected for advancement have the necessary qualifications

SQCS 5, *The Personnel Management Element of a Firm's System of Quality Control—Competencies Required by a Practitioner-in-Charge of an Attest Engagement*, clarifies that a partner-in-charge of accounting, auditing, and attestation engagements should ordinarily:

1. Understand the role of a system of quality control and the Code of Professional Conduct
2. Understand the service to be performed
3. Be technically proficient
4. Be familiar with the industry
5. Exercise good professional judgment
6. Understand the organization's information technology systems

Firm policies and procedures should address other competencies necessary in the circumstances.

Acceptance and Continuance of Clients and Engagements

Policies and procedures should provide reasonable assurance that the firm will not be associated with clients whose management lacks integrity. A firm should:

1. Undertake only engagements that can be completed with professional competence
2. Consider the risks associated with the engagement

Moreover, a firm should obtain an understanding with the client regarding the engagement.

Engagement Performance

Policies and procedures should provide reasonable assurance that personnel meet:

1. Professional standards
2. Regulatory requirements
3. The firm's standards
4. Concurring partner review requirements applicable to SEC engagements

Policies and procedures should also provide reasonable assurance that personnel refer to authoritative literature and consult, on a timely basis, with appropriate individuals when dealing with complex, unusual, or unfamiliar issues.

Monitoring

Policies and procedures should provide reasonable assurance that the above elements of quality control are suitably designed and effectively applied. Monitoring involves:

1. Relevant and adequate policies and procedures that are complied with by members of the firm
2. Appropriate guidance and practice aids
3. Effective professional development activities

NOTE: A firm's monitoring procedures may include inspection procedures and preissuance or postissuance reviews of selected engagements by a qualified person not directly associated with performance of the engagement (which may be a partner with final responsibility for the engagement in a small firm) (see SQCS 3, Monitoring a CPA Firm's Accounting and Auditing Practice).

Independence, Integrity, and Objectivity

Policies and procedures should provide reasonable assurance that personnel maintain independence when required and perform all responsibilities with integrity and objectivity.

1. Independence is an impartiality that recognizes an obligation for fairness.
2. Integrity pertains to being honest and candid, and requires that service and public trust not be subordinated to personal gain.
3. Objectivity is a state of mind that imposes an obligation to be impartial, intellectually honest, and free of conflicts of interest.

ADMINISTRATION OF A QUALITY CONTROL SYSTEM

A partner or partners, depending on the size of the firm, should be responsible for monitoring the effectiveness of the firm's quality control system. The objective is to determine on a timely basis that the firm's quality control policies and procedures, assignment of responsibilities, and communication of policies and procedures continue to be appropriate.

AU ILLUSTRATIONS

The following chart illustrates the GAAS hierarchy.

ILLUSTRATION 1. GAAS HIERARCHY

<i>Level</i>	<i>Elements</i>	<i>Authority</i>
Tier 1 Auditing Standards	<ul style="list-style-type: none"> • 10 Formal Standards listed in <i>Fundamental Requirements</i> • SASs 	Auditors must be familiar with all guidance in this category. Any departures must be justified.
Tier 2 Interpretive Publications	<ul style="list-style-type: none"> • Auditing Interpretations of SASs • Auditing guidance in AICPA Audit and Accounting Guides • Auditing Statements of Position • Appendices to SASs 	Auditors must be familiar with all guidance in this category. Any departures must be justified.
Tier 3 Other Auditing Publications	<ul style="list-style-type: none"> • AICPA auditing publications not referred to under Tier 1 or Tier 2, such as Professional Issues Task Force (PITF) Practice Alerts • Auditing articles in professional journals • Continuing professional education programs and other instructional materials • Textbooks and guidebooks • Audit programs and checklists • Other auditing publications from state CPA societies, other organizations, and individuals 	Guidance in this category is not authoritative. Auditors must determine whether guidance is appropriate and relevant in particular circumstances.

