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EXPOSURE DRAFT

PROPOSED STATEMENT ON QUALITY CONTROL STANDARDS: System of Quality Control for a CPA Firm

JULY 15, 1978

**Issued by the Quality Control Review Division
American Institute of Certified Public Accountants
For Comments From Persons Interested in the Quality of
Auditing and Accounting and Review Services Provided by CPA Firms**

**Comments Should Be Received by September 15, 1978, and Addressed to
Quality Control Review Division, File Ref. no. 13-1
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036**

Quality Control Standards Committee

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Chairman

LEONARD H. BRANTLEY, SR.

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WILLIAM C. BRUSCHI, *Vice-President, Review and Regulation*

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TED M. FELIX, *Manager, Quality Control Review*



American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

July 15, 1978

To Practice Offices of CPA Firms; Members of Council; Technical Committee Chairmen; State Society and Chapter Presidents, Directors, and Committee Chairmen; Organizations Concerned With Regulatory or Supervisory Activities Relating to the Quality of Auditing and Accounting and Review Services Provided by CPA Firms; Persons Who Have Requested Copies:

An exposure draft of a proposed statement on quality control standards entitled System of Quality Control for a CPA Firm accompanies this letter.

The proposed statement has been prepared by the quality control standards committee. The committee is the senior technical committee of the Institute designated to issue pronouncements on quality control standards. Firms that are members of the AICPA division for CPA firms are obligated to adhere to quality control standards promulgated by the Institute.

The proposed statement provides that a CPA firm shall have a system of quality control for its auditing and accounting and review services. The system would comprehend all applicable elements of Statement on Auditing Standards no. 4, Quality Control Considerations for a Firm of Independent Auditors. The system would include the establishment of quality control policies and procedures, the assignment of responsibilities to the extent required for effective implementation of those policies and procedures, communication of those policies and procedures to personnel to provide reasonable assurance that the policies and procedures are understood, and monitoring of the effectiveness of the system of quality control.

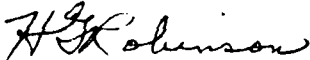
The proposed statement provides that the system of quality control shall be appropriately comprehensive and suitably designed in relation to a CPA firm's organizational structure, its quality control policies, and the nature of its practice. The proposed statement provides, also, that the nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its people and its practice offices, the nature of its practice, its organization, and economic considerations, including appropriate cost/benefit considerations.

The proposed statement, issued in final form, would be the first statement on quality control standards and, as such, would provide a framework for future pronouncements on quality control standards.

Comments and suggestions on any aspect of the enclosed draft are sought and will be appreciated. They should be addressed to the Quality Control Review Division, File Ref. no. 13-1, at the AICPA in time to be received by September 15, 1978. The quality control standards committee will be particularly interested in the reasoning underlying comments and suggestions.

Written comments on the exposure draft will become a part of the public record of the Quality Control Review Division and will be available for public inspection at the offices of the American Institute of Certified Public Accountants on and after September 22, 1978.

Sincerely,



Haldon G. Robinson, Chairman
Quality Control Standards Committee



William C. Bruschi, Vice-President
Review and Regulation

PROPOSED STATEMENT ON QUALITY CONTROL STANDARDS

SYSTEM OF QUALITY CONTROL FOR A CPA FIRM

This statement provides that a CPA firm shall have a system of quality control that comprehends all applicable elements of quality control discussed in Statement on Auditing Standards no. 4. Also, this statement describes other matters essential to the effective implementation of the system.

1. Quality control for a CPA firm,¹ as referred to in this statement, applies to all auditing and accounting and review services for which professional standards² have been established, except that the accounting and review services to which such controls apply are limited to those that result in the association of a firm's name with unaudited financial statements. Although the provisions of this statement may be applied to other segments of a firm's practice, such as providing tax services or management advisory services, their applicability to those segments of practice is not prescribed by this statement, except to the extent that such services are a part of the above-mentioned auditing and accounting and review services.

2. A basic objective of a CPA firm is to conform with professional standards in providing professional services. Underlying this objective is the presumption that the CPA firm will be selective in determining its professional relationships, that the firm and its personnel will

be independent of its clients to the extent required by the AICPA's rules of conduct, and that the firm will assure itself that its personnel³ will be professionally competent, will be objective, and will exercise due professional care. To provide itself with reasonable assurance of achieving this basic objective, a CPA firm shall have a system of quality control.

SYSTEM OF QUALITY CONTROL

3. The system of quality control shall be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its quality control policies, and the nature of its practice. In establishing a system of quality control, a firm shall consider the elements of quality control discussed in Statement on Auditing Standards no. 4, *Quality Control Considerations for a Firm of Independent Auditors* (see Appendix).

4. The system of quality control of a United States firm shall provide the firm with reasonable assurance that the segments of the firm's engagements performed outside of the United States by its foreign offices, affiliates, or correspondents are performed in accordance with professional standards in the United States; compliance by the foreign offices, affiliates, or correspondents of a United States firm with other provisions of this statement is not required.

³ Unless the text states otherwise, *personnel* encompasses all of a firm's professionals performing services to which this statement applies, and includes proprietors, partners, principals, and stockholders or officers of professional corporations, and their professional employees.

5. Any system of quality control has inherent limitations that can reduce its effectiveness. Variance in individual performance and understanding of professional requirements affect the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.

ESTABLISHMENT OF POLICIES AND PROCEDURES

6. A firm shall consider each of the elements of quality control referred to above in establishing its policies and procedures. The nature and extent of a firm's policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its people and its practice offices, the nature of its practice, its organization, and economic considerations, including appropriate cost/benefit considerations.⁴

ASSIGNMENT OF RESPONSIBILITIES

7. A firm shall assign responsibilities to its personnel to the extent required to provide for effective implementation of its quality control policies and procedures. In the assignment of responsibilities within the firm, appropriate consideration should be given to the compe-

¹ *Firm* is defined in the AICPA rules of conduct, as "A proprietorship, partnership, or professional corporation or association engaged in the practice of public accounting, including individual partners or shareholders thereof."

² Professional standards as referred to in this statement are those that relate to the professional qualities and performance of individual members of the AICPA and accordingly include the rules of conduct of the AICPA, pronouncements of the auditing standards executive committee of the AICPA and its predecessor committees (other than Statement on Auditing Standards no. 4, *Quality Control Considerations for a Firm of Independent Auditors*, which relates to firms rather than to individuals), and pronouncements of the accounting and review services committee of the AICPA.

⁴ *The Guide to Implement the Voluntary Quality Control Review Program for CPA Firms—Quality Control Policies and Procedures for Participating CPA Firms*, which has been issued by the AICPA under the voluntary quality control review program for CPA firms, may be useful to a firm in considering its quality control policies and procedures.

tence of the individuals, the authority delegated to them, and the extent of supervision provided.

COMMUNICATION

8. A firm shall communicate to its personnel its policies and procedures in such manner as to provide reasonable assurance that such policies and procedures are understood. The form and extent of such communication should be sufficiently comprehensive to provide the firm's personnel with a readily available source of information concerning the policies and procedures applicable to them. The effectiveness of communication ordinarily is enhanced by documenting the matters communicated. The size, structure, and nature of practice of

the firm should govern the extent of documentation. Normally, documentation of policies and procedures would be expected to be more extensive in a larger firm than in a smaller firm and more extensive in a multi-office firm than in a single-office firm.

MONITORING

9. A firm shall monitor the effectiveness of its system of quality control by evaluating on a continuing basis its policies and procedures, assignment of responsibilities, and communication of policies and procedures. Such monitoring activities include, but are not limited to, the quality control element of inspection. The size, structure, and nature of practice of a firm influence

both the requirements and the limitations of its monitoring function. Implicit in the monitoring function is timely modification of policies and procedures, assignment of responsibilities, and the form and extent of communication as required by new authoritative pronouncements, or by other changes in circumstances, including those resulting from expansion of practice or opening of offices, merging of firms, or acquiring of practices.

EFFECTIVE DATE

10. Although early implementation of this standard is encouraged, the provisions of this statement will be effective for all CPA firms subject to its provisions after (six months after date of issuance).

Note: Statements on quality control standards are issued by the quality control standards committee, the senior technical committee of the Institute designated to issue pronouncements on quality control standards. Firms that are members of the AICPA division for CPA firms are obligated to adhere to quality control standards promulgated by the Institute.

APPENDIX

**ELEMENTS OF QUALITY CONTROL IDENTIFIED IN
STATEMENT ON AUDITING STANDARDS NO. 4**

The nine elements of quality control as identified in Statement on Auditing Standards no. 4, representing considerations in establishing policies and procedures that will provide the firm with reasonable assurance of conforming with generally accepted auditing standards, are as follows:

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 firm's standards 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 firm's auditing practice are being effectively applied.