

United States General Accounting Office

GAO

Report to the Chairman, Legislation and
National Security Subcommittee,
Committee on Government Operations,
House of Representatives

April 1988

CPA AUDIT QUALITY

A Status Report on the Accounting Profession's Enforcement Efforts



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**Accounting and Financial
Management Division**

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April 25, 1988

The Honorable Jack Brooks
Chairman, Legislation and National
Security Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

In response to your January 20, 1987, letter, this report describes the results of actions taken by the accounting profession on referrals made by the General Accounting Office (GAO) and the inspectors general (IGs) of certified public accountants (CPAs) who performed poor quality governmental audits. The referrals were made to the state board of accountancy in which the CPA was licensed and to the American Institute of Certified Public Accountants (AICPA) for review and possible disciplinary action.

Our review showed that the accounting profession is demonstrating a commitment to strengthening its enforcement efforts. The state boards of accountancy and the AICPA have acted on over 70 percent of GAO's referrals, and on 35 percent of the IGs' referrals, which were submitted subsequent to GAO's. In most cases, we concluded that the disciplinary actions taken were reasonable in light of the investigative findings. This report also describes ongoing initiatives by state boards of accountancy, the AICPA, and the IGs to improve audit oversight and their enforcement processes.

As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from the date of this report. At that time, we will send copies of the report to the Director, Office of Management and Budget; federal inspectors general; President, American Institute of Certified Public Accountants; Executive Director, National Association of State Boards of Accountancy; and to interested congressional committees. We will also make copies available to others upon request.

Sincerely yours,

Frederick D. Wolf
Director

Results in Brief

Actions taken by state boards of accountancy and the AICPA demonstrate a commitment to improving the quality of governmental audits performed by CPAs. GAO found that state boards of accountancy and the AICPA's Governmental Technical Standards Subcommittee had completed action on many of the GAO and IG referrals. In most cases, the disciplinary actions taken were commensurate with the cited problems, and the enforcement processes were not unjustifiably delayed.

GAO also found that state boards of accountancy, the AICPA, and the IGs are developing programs to improve audit quality by enhancing the enforcement process. These initiatives include streamlining the referral process, taking a more proactive role in reviewing CPAs' work, and taking actions such as debarring CPAs who perform poor quality audits from governmental audits for specified periods. Although most of these initiatives have not been fully implemented, GAO believes that these efforts are constructive and should enhance the enforcement process.

Principal Findings

State Boards of Accountancy

State boards of accountancy have made progress in responding to the 64 GAO and IG referrals. As of November 15, 1987, they had completed action on 24 GAO referrals and 12 IG referrals. Most of the IG referrals were made more recently than GAO's, which accounts for the lower number that have been completed. The remaining 28 referrals were in various stages of state boards' enforcement processes, ranging from awaiting investigation to being scheduled for formal hearings.

State boards operate under their own state laws regulating public accountancy and thus differ in the way they investigate referrals, decide on disciplinary actions, and publicly disclose these actions. For example, GAO determined that while most state boards it reviewed disclosed all disciplinary actions, some limited the amount of information for public disclosure. However, GAO found that they took similar disciplinary actions to educate or discipline CPAs licensed in their states, such as continuing professional education requirements, follow-up reviews, fines, suspensions, and license revocations.

membership. In the fifth case, the AICPA determined that the CPA responsible for the audit was not in its jurisdiction. (See chapter 2.)

Ongoing Initiatives

State boards of accountancy, the AICPA, and the IGS have ongoing initiatives to improve audit oversight and their enforcement processes. A number of these initiatives are directed at efforts to (1) improve and streamline the audit referral process, (2) initiate more audit referrals and take a proactive role in reviewing CPAS' work, and (3) temporarily debar CPAS from performing governmental audits. For example, a number of state boards are adopting positive enforcement programs which emphasize active monitoring of the CPAS' work products. As none of these efforts had been fully implemented at the time of GAO's review, GAO did not evaluate their effectiveness, other than to determine that, in general, these initiatives appear constructive and seem to address a number of the past concerns about the enforcement process. (See chapter 3.)

Recommendations

This report contains no recommendations for actions by either the Congress or a federal agency.

Agency Comments

Throughout the course of this review, GAO discussed its work with responsible officials of the organizations involved in order to ensure the accuracy and completeness of the information in this report. Their comments were considered in preparing the report. In accordance with the requester's wishes, GAO did not request official comments on a draft of the report.

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Abbreviations

AICPA	American Institute of Certified Public Accountants
CPA	certified public accountant
CPE	continuing professional education
GAGAS	generally accepted government auditing standards
GAO	General Accounting Office
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
IG	inspector general
NASBA	National Association of State Boards of Accountancy
PCIE	President's Council on Integrity and Efficiency
SAS	statement on auditing standards

of governmental audits performed by CPAs. In our earlier reviews of CPA audit quality, we reported that 34 percent of CPA audits of federal financial assistance funds did not meet audit standards. As a result, in April and May 1986, we referred 57 poor quality audits to the AICPA for its review and possible disciplinary action. Additionally, 32 of the same audits—those with the more severe standards violations—were also referred to the 15 state boards of accountancy where the CPAs were licensed.

Our earlier reviews showed that many of these audits did not satisfactorily comply with standards involving fieldwork, reporting, or due professional care. For example, in some instances there was little or no evidence that the CPA tested whether (1) recipients were eligible for federal assistance, (2) costs charged to federal programs were allowable under law or regulation, or (3) requirements for matching assistance were met. In other instances, there was little or no evidence supporting the CPA's report that the CPA studied and evaluated internal controls, or that the CPA appropriately tested financial transactions to support the opinion on the financial statements. In several instances, the CPAs stated that they did not complete all the audit work they were required to perform. And, in other instances, the lack of evidence in their working-paper files led GAO to question whether the required audit work was performed.

Some IGs also have made referrals to state boards and to the AICPA. The IGs at 4 federal agencies—the Department of Housing and Urban Development (HUD), the Department of Education, the Department of Health and Human Services (HHS), and the Department of Agriculture—recently made 32 referrals to 16 state boards,³ including 9 of the same state boards to which we made referrals. (A listing of the state boards and the number of GAO and IG referrals to each board is provided in appendix I.) In addition, the IGs recently made 16 referrals to the AICPA.

In January 1987, Representative Jack Brooks, Chairman, Legislation and National Security Subcommittee, House Committee on Government Operations, asked us to follow up and report on referrals of poor quality audits we made to state boards of accountancy and to the AICPA. Specifically, Chairman Brooks asked us to determine state board and AICPA actions taken as a result of the referrals and to provide our views on the

³For the purposes of this study, we included any IG referrals made from January 1, 1986 to May 1, 1987.

The Public Accounting Profession and Its Role in the Enforcement Process

In the context of our work, the public accounting profession includes CPAs and the organizations that directly influence them, including the state boards of accountancy, the AICPA, and state societies of CPAs. CPAs operate either as independent individual practitioners or firms of individual practitioners who hold themselves out to the public as qualified to perform auditing services. In addition, IGA play an important role in the accounting profession's enforcement process.

The state boards of accountancy are established by statute, under which they exercise the central authority regulating the practice of public accountancy within their jurisdictions. State boards of accountancy, unlike voluntary professional accounting associations, are the only regulatory entities that have legal jurisdiction over all who are licensed to practice public accounting. Each state board has adopted rules of professional conduct, including audit standards, and can take disciplinary action against licensees who violate these rules or standards. This includes the authority to revoke, suspend, or otherwise impair a CPA's license to practice, as well as to take actions that are more remedial in nature. The National Association of State Boards of Accountancy (NASBA), a voluntary organization of the 54 state boards,⁴ assists in the enforcement processes of the state boards by facilitating the exchange of information among the boards.

The AICPA, as a national professional association of over 250,000 CPAs, also plays a key role in the enforcement process. Although the AICPA can bring CPAs before its trial board and recommend expulsion from its membership, its enforcement process usually emphasizes remedial actions. This is consistent with the AICPA's goal of improving the conduct of CPAs' work to meet the standards and ethics of the profession. Among its various activities, the AICPA issues generally accepted auditing standards and interpretative statements on those auditing standards, publishes quality control standards which define the appropriate conduct for CPA firms' overall operations, and develops and maintains a code of professional ethics in cooperation with state accounting societies.

Referrals to state boards and to the AICPA are separate processes and do not impact on each other. However, the AICPA will defer action, at the auditor's request, if the referral has also been made to a state board. A referral can be reviewed by both a state board of accountancy and the AICPA and may result in different disciplinary actions.

⁴Boards of accountancy have been established by statute in each of the 50 states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands.

action on the referrals and, (3) completed their disciplinary actions without unjustifiable delays. No absolute measurement criteria exist for determining the reasonableness of disciplinary actions. Consequently, we relied heavily on professional judgment. However, in making these judgments we did consider factors such as whether similar audit problems were handled consistently by a state board or the AICPA.

In addition to our work with state boards of accountancy and the AICPA, we also met with other groups, such as NASBA and the PCIE, concerning their ongoing efforts to enhance the audit referral and enforcement processes.

We conducted our work between April 1987 and November 1987 in accordance with generally accepted government auditing standards. Throughout the course of this review, we discussed our work with responsible officials of the organizations involved in order to ensure the accuracy and completeness of the information in this report. Their comments were considered in preparing the report. In accordance with the requester's wishes, we did not request official comments on a draft of the report.

were awaiting final action by state boards through either a stipulated settlement or a consent order agreement (legal documents that outline the conditions of the settlement and the disciplinary actions to be taken). The other three cases were not completed because (1) the referral was sent to a state attorney general to prepare for a formal hearing, (2) a state board agreed to a conference with the CPA to determine the violations and the disciplinary actions to be taken, or (3) a state board was proceeding in its efforts to revoke the license of a CPA.

Fewer IG referrals have been completed because most were made more recently than ours. Many of the IG referrals were either under investigation or were awaiting the assignment of an investigator. A list of the state boards involved in our study, the number of referrals made, and the number of completed actions by each appears in appendix I.

Types of State Board Disciplinary Actions

State boards of accountancy, for the most part, took disciplinary actions on the GAO and IG referrals commensurate with the severity of their investigative findings. Accordingly, state boards used a variety of disciplinary actions to either educate or discipline CPAs licensed in their states. We did not attempt to make comparisons among the different disciplinary actions taken by various state boards because each state board operates under its own laws regulating public accountancy and is permitted to take different disciplinary actions.

Depending on the authority granted to them by statute, state boards may revoke, suspend, or refuse to renew CPA certificates or licenses; reprimand, censure, or limit the scope of practice of any licensee (including firms); impose administrative fines; or place any licensee on probation, with or without terms, conditions, and limitations. State boards can take any one or a combination of these actions against CPAs for failure to comply with auditing standards and for acts involving dishonesty, fraud, or gross negligence in the practice of public accountancy. Typically, state boards have imposed a number of different actions for standards violations. Figure 2.1 shows the types of disciplinary actions taken by state boards on the 36 completed referrals.

As the figure shows, one state board has revoked a CPA's license. Others suspended the licenses of CPAs until certain conditions were met, such as completion of continuing professional education requirements. In other cases, license suspensions were stayed, or postponed, and probation was imposed for a specified period. In some cases, state boards imposed several disciplinary actions on the CPA. For example, in one case where GAO

We found that state boards appropriately considered mitigating factors when taking action on referrals. For example, in one case, the state board investigated the referral and substantiated the standards violations, but, due to special circumstances, took no disciplinary action. Specifically, the GAO referral alleged, and the state board agreed, that a Colorado CPA firm violated standards pertaining to planning and supervision, evidence, and due professional care. However, the state board dismissed the case because both of the firm's partners and the auditor responsible for the work took disciplinary actions on their own initiative that the state board would have ordered, including changing the firm's audit procedures and completing state-sponsored courses that, in the state board's opinion, adequately addressed the audit problems. Although it is not required by state boards' enforcement processes, we were told by several state board officials that state boards normally consider mitigating circumstances when determining actions on audit referrals.

We found five cases involving one GAO referral and four IG referrals where the actions taken by the state boards seemed unreasonable given the severity of the violations. The IGs involved in these referrals share our views and either have already requested or will be requesting that the state boards reconsider their decisions. During our study, we could not identify the basis for the state boards' actions in these cases. We did not find a different level of commitment in state board investigations of GAO referrals as compared with IG referrals.

For example, in Arkansas, the HUD IG office reviewed three separate audits by the same CPA and made a referral based on problems with all three in the areas of evidence, reporting on internal accounting controls, and clarity of the audit reports. As a result of its review, the state board required that the CPA take 24 hours of continuing professional education. This action is lenient, in our opinion, because the auditor had committed the same errors on three separate audits. The HUD IG has debarred this CPA from future HUD work.

In another case, HUD's Assistant IG for Audit referred a CPA in West Virginia because of problems in the areas of evaluation of internal controls, evidence, and reporting standards. Although the state board's investigation substantiated the findings of the IG, the final action was a letter warning the CPA to correct these problems on future audits. This action is lenient, in our opinion, because no remedial actions, such as education or follow-up review, were taken to give the CPA an incentive to improve

Once an audit referral is received, most state boards take a series of steps to investigate the complaint and decide on the appropriate action. A typical process used by state boards is described in appendix IV. Usually, the first step in the process is for the state board to have an investigator review the audit in question and the specific complaints made in the referral. The investigator usually reviews the audit report and supporting working papers and interviews the auditor and responsible audit firm partners, as well as the referring agency officials. At the conclusion of the investigation, a written report is made to the state board outlining the specific findings and, in some cases, recommending disciplinary actions. State boards use the investigative reports to determine both the severity of the standards violations and any disciplinary actions to be imposed on the auditor.

In addition to settling referrals informally—where the CPA and the state board agree on the proposed actions—state boards use several different formal methods to finalize disciplinary actions. For example, many state boards use either a consent order or a stipulated settlement to finalize their actions. For both documents, the state boards allow the CPA, with limitations, to be involved in negotiating the final action. The CPA is then given a specified amount of time to accept or reject the conditions set forth. The use of either document allows state boards to avoid a formal hearing, which is typically a more time-consuming process. Of the 36 completed referrals, 14 cases were settled informally, and 19 were settled through consent orders.

The remaining three referrals were settled through a formal hearing process.⁶ Hearings are often used when a CPA rejects a consent order or stipulated settlement, or when disciplinary actions, such as revocation or suspension of the CPA's certificate and license are involved. During the formal hearing, a state board is authorized to reach a final decision on the severity of the auditing standards violations. If warranted, it can also impose disciplinary actions. The CPA usually has legal counsel during the hearings, while the state board is generally represented by the state attorney general's office. All decisions reached through a board's formal hearing process are subject to further appeal through the state's legal system.

All of the 22 state boards of accountancy we reviewed have a policy for publicly disclosing the auditing standards violations and any specific

⁶We did not review the proceedings at individual formal hearings and, therefore, our evaluation is limited to assessing whether the investigative process was followed

other cases, states often use the same investigators for public accounting referrals as they use to investigate complaints of medical, legal, and other professional groups licensed by the state. In these states, most investigators place priority on investigating those complaints which could later result in bodily harm, such as medical malpractice. In addition, in some states the investigative workload can be large. For example, the typical workload for an investigator in Utah can range from 40 to 50 cases at any one time, including accounting, medical, and other professional referrals.

Also, as previously indicated, many of the IG referrals were made after GAO's, and the state boards have not had sufficient time to complete many of these cases. Also, with regard to GAO referrals that were not completed, most were in the final stages, i.e., awaiting a formal hearing or a consent order or stipulated settlement agreement.

The American Institute of Certified Public Accountants

This section describes the actions taken on GAO and IG referrals made to the AICPA. We sent all audits that may have had standards violations to the AICPA for its review and possible disciplinary actions. The IGs, for the most part, made referrals to the AICPA only when they knew the individual was an AICPA member. The AICPA's Professional Ethics Division, through its Governmental Technical Standards Subcommittee—comprised of AICPA members experienced in governmental auditing—performed all of these investigations. This subcommittee was established for the sole purpose of investigating and, if warranted, recommending or taking disciplinary actions on all of the referrals from GAO and other federal agencies.

As of November 15, 1987, the AICPA had completed 40 of the 57 GAO referrals. It did not investigate five of these referrals because they involved four individuals who were not AICPA or state CPA society members and one individual who was deceased. For purposes of this review, we defined completed cases as those for which the investigation was finished and the AICPA had either planned or ordered disciplinary actions.⁸ Eight investigations were in progress. For the four remaining referrals, the AICPA's investigations were deferred, at the request of the CPAs, due to ongoing state board investigations or other pending litigation.

⁸AICPA officials stated that in almost all cases, state societies of CPAs (which are given an opportunity to comment on AICPA recommendations), as well as trial board hearing results, uphold the initial AICPA findings and the recommended disciplinary actions.

complete 80 hours of continuing professional education in auditing and accounting over a 2-year period and to have a peer review by another CPA or firm within the next 2 years.

In the third case, the CPA accepted employment with another firm, and the trial board relied on assurances from the new firm's lawyer that the CPA would no longer perform governmental audits. Although the board required that the CPA take 104 hours of continuing professional education over a 2-year period, it decided against an AICPA internal recommendation for a peer review and an annual AICPA follow-up review for one audit in each of 3 years because, we believe, the board did not want to penalize the new firm. In this case, we believe that the trial board should have made a provision for a follow-up review of the CPA's work, if the CPA subsequently decides to perform governmental audits.

In addition to the six trial board hearings, the AICPA determined that the violations in another 20 cases warranted an administrative reprimand letter, which typically requires that the CPA complete specific continuing professional education courses. The administrative reprimand letters also frequently require that the CPA submit copies of future work products to the AICPA for review. The AICPA selects the audit for review and if the work still does not meet appropriate standards, it can take additional action. In all 20 cases, the AICPA required continuing professional education ranging from 16 hours to 56 hours over a 1-year period or, in one case, 90 hours during a 2-year period.

In 13 of the remaining 14 cases, the AICPA found violations that resulted in the issuance of minor violation letters informing the CPAs of the findings but not requiring any specific action. In the one remaining case, the AICPA found no violation. GAO made this referral because the CPA could not produce the working papers for the audit. While the AICPA agreed that the audit referral should have been made, its investigation showed that the working papers were inadvertently lost when the CPA relocated offices and, therefore, it decided not to pursue the matter. The AICPA's investigation included a review of the moving company's records, as well as other audits performed by the individual.

Although the AICPA initiated its investigation of GAO referrals based on standards violations GAO identified, some of its investigations identified different or additional violations. The AICPA substantiated GAO violations findings on 32 of these 40 closed cases and on a number of these found additional violations. In seven cases, the AICPA's investigative findings confirmed violations other than those on which the GAO referral was

an AICPA or state CPA society member. However, the cognizant state board of accountancy was investigating this case.

AICPA's Enforcement Process

We found that the AICPA's Governmental Technical Standards Subcommittee was thorough in its investigation of the completed GAO and IG referrals.⁹ We also found that all of the AICPA's investigations on the GAO and IG referrals were performed under AICPA and state CPA society bylaws and procedures, known as the Joint Ethics Enforcement Program. This process is illustrated in appendix V.

Under this enforcement process, state CPA societies usually handle issues pertaining to their members. However, matters of broad national interest, such as complaints made by GAO or the IGs, are handled by the AICPA. The AICPA and state CPA societies usually concur on all disciplinary actions and, therefore, decisions are considered joint actions.

In 1986, the AICPA made several changes in the way it handles referrals, the most noteworthy being changes to its investigative procedures. First, in June 1986, the AICPA established a Governmental Technical Standards Subcommittee of its Professional Ethics Division, comprised of members experienced in auditing federal grants, to conduct investigations of referrals from GAO and other federal audit agencies. Also, at the same time, the AICPA changed its procedures concerning confidentiality to allow discussions with referring agencies on the status of their referrals. The AICPA's Governmental Technical Standards Subcommittee, as a result of this change, has provided several briefings to us and to the IG community on the results of its investigations of our referrals.

The House Committee on Government Operations stated in its October 7, 1986, report on CPA audit quality that the AICPA should make public the results of all cases in which disciplinary actions are taken. The Committee stated that full disclosure is necessary to serve as a deterrent to others against producing poor quality work, and, in addition, to provide important information to any entity that procures audit services. Currently, AICPA investigations are not publicly disclosed unless the matter is referred to a trial board and a guilty finding is reached.

⁹We did not review the proceedings at individual trial board hearings and, therefore, our evaluation is limited to assessing whether the investigative process was followed.

Current Efforts to Improve Audit Oversight and Enforcement

During our review, we found that the state boards of accountancy, the American Institute of Certified Public Accountants, and the federal inspectors general have ongoing initiatives to improve governmental audit quality through enhancing the enforcement process. A number of these initiatives are directed at efforts to (1) improve and streamline the referral process, (2) initiate more audit referrals and take a more proactive role in reviewing CPAS' work, and (3) temporarily debar CPAS from performing governmental audits. As none of these efforts had been fully implemented at the time of our review, we cannot comment on their effectiveness other than that, in general, they appear constructive and seem to address a number of the past concerns about the enforcement process.

Earlier Enforcement Efforts Received Little Attention

Prior to the attention of the House Government Operations Committee and our reports on audit quality, the accounting profession had not relied heavily on the enforcement process to help sustain high quality governmental auditing. From late 1980 until November 1985, the IGS referred only about 11 cases to the AICPA. We did not determine the number of referrals to the state boards over that period; however, we understand it was not a substantial number. Because the enforcement process has historically been dependent on referrals to operate, the lack of referrals from federal agencies and other users of audit reports limited the extent to which the state boards and the AICPA could identify and discipline those CPAS who performed poor quality governmental audits.

We found that the limited number of referrals prior to 1985 was due, in part, to two reasons. First, the IGS' policy at that time was to concentrate on correcting the problems found in poor quality audits. As a result, in those cases where the firms involved were willing to correct the audits, the IGS were reluctant to refer them for disciplinary action. Secondly, many IGS were frustrated with the referral process. Their principal complaints involved the amount of documentation they believed was required in referring a case and the lack of feedback on their referrals due to the confidentiality policies of the state boards and the AICPA. For example, until June 1986, the AICPA would provide information to the IGS only on cases which resulted in a guilty verdict by its trial board. Additionally, some state boards considered most information pertaining to a referral to be confidential and would not provide information on their investigation and disciplinary actions to the IGS.

boards in our study, 11 had adopted a positive enforcement program, another 7 were at various stages of implementation and 4 state boards were undecided on whether they would adopt such a program.

These efforts are consistent with our March 1986 recommendation to the accounting profession that it establish and maintain positive enforcement programs to randomly or periodically review CPAs performing governmental audits.

The Florida Experiment

In April 1986, the Florida state board of accountancy began a new initiative with the cooperation of several IGs. Under this experiment, the regional IGs send the Florida state board copies of all correspondence sent to Florida CPAs on any audit deficiency discovered during IG reviews. The Florida board then provides the IGs with information about actions initiated based on this correspondence.

The Florida experiment has the advantage of reducing the amount of effort that would normally be required to prepare a referral package. This approach allows the IGs to notify the state board of problems they discover in their reviews of audit reports without having to analyze the auditor's working papers or prepare a detailed referral outlining possible standards violations. Based on the correspondence it receives, the state board can determine whether the audit deficiency warrants further investigation and can assign its own investigator to determine if the CPA has performed poor quality work.

Due to the early success of the program, the President's Council on Integrity and Efficiency, whose membership includes the IGs, is proposing an expansion of the Florida experiment to 12 additional state boards which have expressed interest in participating. The PCIE hopes to implement this expanded program by early spring 1988.

The AICPA Is Responding to Audit Quality Concerns

In July 1985, the AICPA formed a task force to develop a comprehensive action plan to improve the quality of audits of governmental units. In March 1987, the task force issued its report, which contained 25 recommendations. The task force had two primary recommendations in regard to the enforcement process:

- improve the system for referring poor quality audits and
- inform government oversight officials about the improved referral system.

to see in federal inspector general referral packages for substandard audits. According to the director of this study, future work by the PCIE may include (1) developing criteria for defining poor quality work, (2) establishing a uniform governmentwide system for recording and reporting poor quality work, (3) developing uniform penalties and referral procedures, and (4) devising methods of tracking disciplinary actions.

The Department of Housing and Urban Development—Limiting CPAs From Future Work

The HUD IG has taken a lead role in preventing CPAs who perform poor quality audits from participating in future HUD work through its active debarment program. Normally, a referral made by the HUD IG results in an immediate request, at the local level, for a temporary denial of participation. This action prohibits the CPA from performing accounting or auditing services for HUD-related programs for a 12-month period within a specific geographic area. HUD's policy emphasizes the temporary denial of participation because it is more immediate than any other disciplinary action.

However, in more severe cases, such as those in which the HUD IG believes that the standard violation was especially serious, the HUD IG also seeks debarment of the CPA—exclusion from participation in all HUD programs, regardless of the geographic area, for a specified period usually not exceeding 5 years. A HUD official stated that as of November 15, 1987, of the 20 CPAs referred by the HUD IG during our review period, 8 had been debarred and 8 others were in the process of being debarred.

In May 1987, the Office of Management and Budget issued guidelines for nonprocurement, debarment, and suspension, which state that debarment or suspension of a participant in a program by one agency shall have governmentwide effect. These guidelines specifically exclude a debarred or suspended person from being selected to perform governmental audits. Executive departments and agencies must issue regulations, based on these guidelines, by May 28, 1988.

The Department of Health and Human Services and Others—Increasing the Number of Referrals

As of July 1987, the HHS IG implemented, on a trial basis, a new policy to increase the number of referrals made to state boards and to the AICPA. In the past, the HHS IG policy, similar to other IGs, was to work closely with the CPAs to make necessary corrections to audit reports and working papers. The only cases referred to the state board for possible disciplinary action were those in which the CPAs were not responsive to technical assistance provided by the IG.

Chapter 3
Current Efforts to Improve Audit Oversight
and Enforcement

While none of these initiatives are fully implemented, we believe that they are positive steps towards correcting several of the past concerns about the enforcement process.

GAO and IG Referrals Completed by State Boards of Accountancy

This appendix contains two tables which summarize the GAO and IG referrals completed by state boards of accountancy. The referral numbers in the first columns of tables II.1 and II.2 are cross-referenced to the completed AICPA referrals listed in tables III.1 and III.2 in appendix III. The violations listed in the third column of table II.1 are those which were determined by GAO when the referral was made. The violations listed in table II.2 are those which were determined by the referring IG.

Table II.1: GAO Referrals Completed by State Boards of Accountancy

Referral number	State	Violations	Actions
CA-1	California	Evidence Due professional care	All partners and staff members involved in government engagements must complete AICPA government auditing standards course or similar course sponsored by state CPA foundation. Firm must develop and use a documentation policy on all new engagements which sets forth its industry knowledge and qualifications.
CO-1	Colorado	Evidence Statement on internal control Due professional care	None GAO note: State board's consultant did not support GAO-determined violations
CO-2	Colorado	Planning and supervision Evidence Due professional care	None GAO note. State board's consultant confirmed that standards relating to evidence, working paper preparation, and due professional care were violated. However, no action was taken because the firm, on its own initiative, took remedial action to correct the identified problems.
FL-1	Florida	Evidence Due professional care	Obtain 8 hours continuing professional education (CPE) in government accounting CPA license to practice public accounting shall be placed on probation for 1 year. During probation, the CPA shall have three audits, three reviews, and three compilations reviewed by a state board consultant paid for at the CPA's expense.

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
GA-2	Georgia	Evidence Due professional care	All partners and staff involved in government auditing must: <ul style="list-style-type: none"> —obtain 8 hours of professional education in government auditing, —complete a course in professional ethics, —take an open-book examination on GAGAS, —perform no government auditing until above requirements are met, and —submit all government audit reports for an independent preissuance review for 1 year <p>Fined \$200</p> <p>Violations of these terms are grounds to revoke registration to practice</p> <p>The consent order serves as a public reprimand.</p>

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
GA-4	Georgia	Testing of compliance with laws and regulations Evidence Due professional care	All appropriate partners and staff involved in government auditing must: —obtain 8 hours of professional education in government auditing, —complete a course in professional ethics, —take an open-book examination on GAGAS, —perform no government auditing until above requirements are met, and —submit all government audit reports for an independent preissuance review for 1 year. Fined \$200. Violations of these terms are grounds to revoke registration to practice The consent order serves as a public reprimand.
IN-1	Indiana	Evidence Due professional care	None (Affidavit signed to explain failure to produce working papers.)
KY-1	Kentucky	Evidence Due professional care	Must concentrate FY 86-87 professional education efforts on courses in auditing and reporting on government audits
KY-2	Kentucky	Evidence Due professional care	All personnel involved in auditing will complete FY 86-87 professional education efforts in areas of auditing, reporting, and working paper preparation. Next audit involving federal funds must be reviewed by the state auditor for a determination of quality
NY-1	New York	Evidence Due professional care	Administrative warning.

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
NC-3	North Carolina	Evidence	Consent order signed
		Due professional care	Public censure 24 hours CPE in 1 year —16 hours statement on auditing standards review —8 hours government update. \$1,557 reimbursement for cost of investigation.
OH-1	Ohio	Due professional care	Required to submit the audit's engagement letter and audit program to the state board CPE must be in auditing standards. Take examination on GAGAS. Board actions taken are published without CPA's name
PA-1	Pennsylvania	Planning and supervision	Public reprimand.
		Testing compliance with laws and regulations Statement of internal accounting controls	\$800 civil penalty. 16 hours CPE in government auditing
PR-1	Puerto Rico	Due professional care	
		Planning and supervision	Suspend CPA's license until he passes a refresher course in auditing
TN-1	Tennessee	Evidence	Must complete seminar on auditing federal funds.
		Due professional care	Probation for 1 year. Required to submit working papers on two selected audits of state contracts for state board's review 24 hours CPE. State board actions published.

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

**Table II.2: IG Referrals Completed by
State Boards of Accountancy**

Referral number	State	Violations	Actions
AR-1	Arkansas	Testing of internal controls Statement on internal accounting controls Evidence Due professional care Reporting	Must take an additional 24 hours of CPE as follows: —8 hours in auditing and accounting standards, —8 hours in government area, and —8 hours in working paper organization and preparation.
GA-5	Georgia	Evidence Due professional care	None GAO note: State board concluded that its investigative report did not substantiate alleged substandard work and therefore did not warrant corrective actions
ID-1	Idaho	Testing of compliance with laws and regulations Testing of internal controls Evidence Due professional care	16 hours CPE in auditing. Correction of audit deficiencies to the HUD IG's satisfaction
LA-1	Louisiana	Planning and supervision Testing of internal controls Evidence Due professional care	CPA's certification and license suspended for a 2-year period
LA-2	Louisiana	Evidence Due professional care Testing of internal controls Planning and supervision Testing of compliance with laws and regulations	CPA certification and license were revoked.

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
OR-1	Oregon	Due professional care Planning and supervision Statement on internal accounting controls Evidence Testing of internal controls	Issued letter of warning requiring CPA to have a preissuance review of working papers if he performs future audits. Recommended that the CPE be specified to working paper preparation. Must submit to the board the first audit report completed following the letter of warning
WV-1	West Virginia	Testing of internal controls Evidence Due professional care Planning and supervision Statement on internal control	Letter warning against future auditing failures

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
AR-2	Lack of due professional care. Inadequate planning No compliance tests performed	Person A's administrative reprimand letter requiring 90 hours of CPE in 2 years: —8 hours audit evidence, —8 hours single audit, —8 hours audit of small business, —8 hours designing audit programs for small businesses, —8 hours government accounting and audit update, —8 hours management letters and report on internal controls, —8 hours audit reports, —16 hours SAS review, —16 hours local government auditing and reporting, and —2 hours in any other course of accounting and auditing AICPA review of one set of financial statements with report and working papers of a similar engagement after completion of CPE. Person B No violation.
CA-1	Internal control and compliance report does not comply with GAGAS	Minor violation letter requiring no corrective action
CA-2	Lack of due professional care Inadequate planning. Inadequate documentation of audit work performed and conclusions reached Internal control report does not comply with GAGAS	Administrative reprimand letter requiring 48 hours of CPE in 1 year: —8 hours audit evidence, —8 hours management letters, —8 hours auditor's report, —8 hours government accounting and audit update, and —16 hours accounting and auditing update workshop.

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
GA-1	<p>Report does not comply with standards for cash basis reporting and makes no reference to consistency</p> <p>No notes to the financial statements</p> <p>No audit program.</p> <p>No evidence of supervision.</p> <p>The working papers do not evidence the nature and extent of financial and compliance testing without oral explanation</p> <p>The report on internal control is not restricted to its use.</p> <p>The report on internal control does not disclose that no study was made of the system and the reason thereof</p> <p>No negative assurance on compliance</p>	<p>Administrative reprimand letter requiring</p> <p>64 hours of CPE in 2 years:</p> <p>—8 hours audit evidence,</p> <p>—16 hours accounting and auditing update workshop,</p> <p>—16 hours SAS review,</p> <p>—8 hours reporting and disclosure,</p> <p>—8 hours compliance audit, and</p> <p>—8 hours analytical techniques</p> <p>Review of one set of financial statements with report and working papers of a similar (or commercial) engagement after completion of CPE, each year.</p>
GA-3	<p>No disclosure of accounting practices used</p> <p>No update of internal control review and no evidence of testing.</p> <p>No management representation letter</p> <p>The working papers do not evidence the nature and extent of financial and compliance testing without oral explanations.</p> <p>The working papers do not fully comply with HUD requirements</p> <p>Report on internal control and compliance does not comply with GAGAS</p>	<p>Administrative reprimand letter requiring</p> <p>80 hours of CPE in 2 years.</p> <p>—8 hours government accounting and auditing,</p> <p>—8 hours compliance auditing,</p> <p>—8 hours single audit,</p> <p>—16 hours SAS review, 16 hours accounting and auditing update workshop,</p> <p>—8 hours audit evidence,</p> <p>—8 hours accounting for governmental units, and</p> <p>—8 hours analytical techniques.</p> <p>Review of one set of financial statements with report and working papers of a similar engagement after completion of CPE, each year.</p>

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
KY-1	Documentation of certain compliance procedures was insufficient Internal control report did not comply with GAGAS.	Administrative reprimand letter requiring 24 hours of CPE in 1 year: —8 hours how to satisfy compliance auditing requirements and —16 hours government audits. Review of financial statements with report and working papers for similar engagement 6 months after completion of CPE.
KY-2	Documentation lacking regarding internal control review. Insufficient documentation of compliance testing Report on internal control and compliance does not comply with GAGAS.	Administrative reprimand letter requiring 20 hours of CPE in 1 year and AICPA review of one similar audit engagement.
MI-1	Certain compliance tests were not documented Report on internal controls does not comply with GAGAS	Administrative reprimand letter requiring 24 hours of CPE in 1 year: —8 hours government accounting and audit update, —8 hours single audit, and —8 hours audit evidence.
MI-2	Documentation of certain compliance procedures was insufficient Internal control report did not comply with GAGAS.	Minor violation letter requiring no corrective action.
NV-1	Internal control report does not comply with GAGAS.	Minor violation letter requiring no corrective action.

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
NC-4	Lack of due professional care Inadequate planning Inadequate documentation of audit work and conclusions reached No compliance testing performed	Administrative reprimand letter requiring 56 hours of CPE in 1 year. —8 hours audit evidence, —8 hours single audit, —16 hours local government auditing and reporting, —8 hours government accounting and audit update, and —16 hours SAS review. AICPA review of one set of financial statements with report and working papers of a single audit upon completion of CPE.
NC-5	Internal control and compliance report does not comply with GAGAS	Minor violation letter requiring no corrective action.
ND-1	Internal control report does not comply with GAGAS	Minor violation letter requiring no corrective action.
OH-1	Lack of professional competence as to audit requirements of grants. Lack of adequate planning. Insufficient documentation of financial audit work No client representation letter and no inquiries of attorneys No consistency statement in auditor's report	Administrative reprimand letter requiring 32 hours of CPE in 1 year: —8 hours audit evidence, —16 hours SAS review, and —8 hours single audit. AICPA review of one set of financial statements with report and working papers of a similar engagement after completing CPE.

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
TN-2	<p>Insufficient documentation of testing expenditures and testing for compliance with internal controls and with laws and regulations</p> <p>Auditor's report fails to refer to GAGAS</p>	<p>Administrative reprimand letter requiring</p> <p>40 hours of CPE in 1 year:</p> <ul style="list-style-type: none"> —8 hours audit evidence, —16 hours local government auditing and reporting, —8 hours single audit, and —8 hours audit report. <p>AICPA review of financial statements with report and audit working papers of two similar audit engagements after completion of CPE</p>
TN-3	<p>No audit program</p> <p>No management representation letter</p> <p>Did not restrict the report on internal control as to its use.</p> <p>Omission of reserve for bad debts.</p> <p>Insufficient documentation of testing for compliance and internal control</p>	<p>Administrative reprimand letter requiring</p> <p>40 hours of CPE over 1 year:</p> <ul style="list-style-type: none"> —8 hours single audit concepts, —8 hours government accounting and auditing workshop, —8 hours audit reports, and —16 hours SAS review. <p>AICPA review of one set of financial statements with report and working papers of a similar engagement after completion of CPE</p>

(continued)

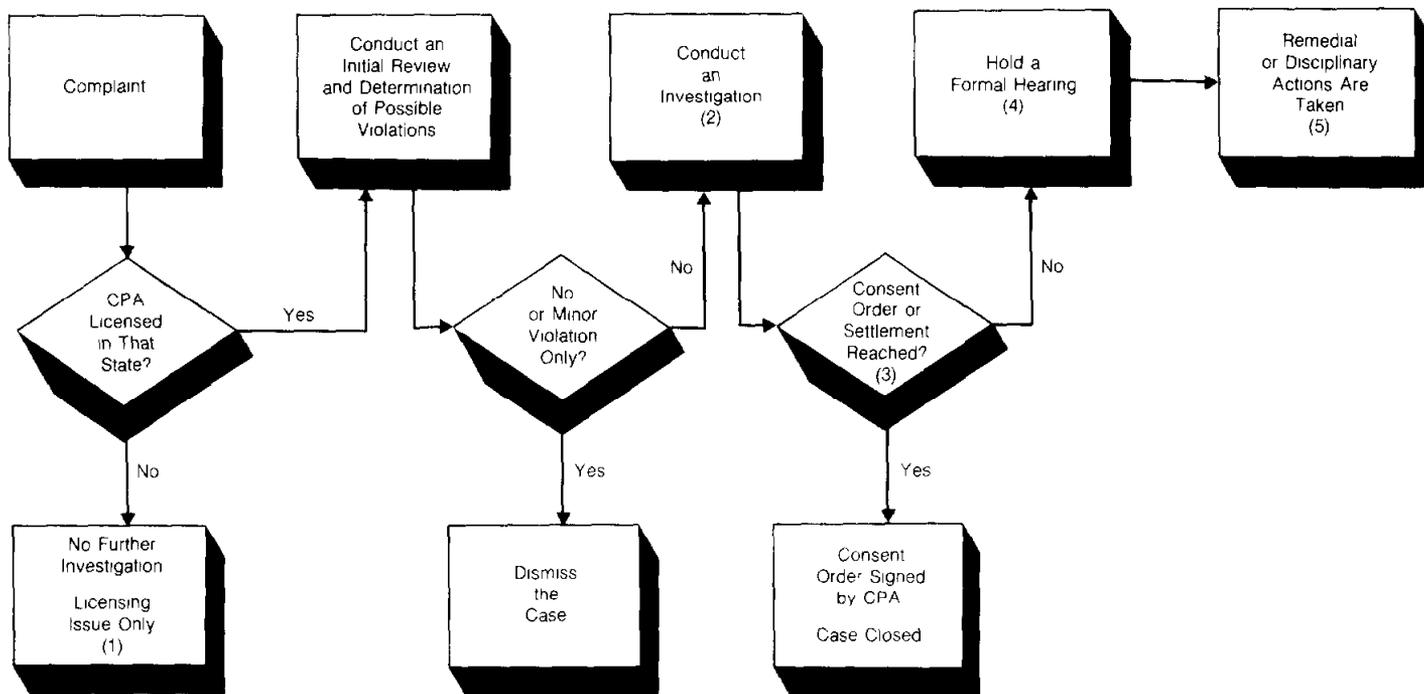
**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
TX-4	Inadequate planning Lack of documentation of certain compliance testing	Administrative reprimand letter requiring 90 hours of CPE in 2 years: —8 hours management letters and reporting on internal controls, —8 hours government accounting and audit update, —8 hours single audit concepts, —16 hours local government auditing and reporting, —16 hours SAS review, —8 hours audit reports, —8 hours audit evidence, —16 hours audit risk, sampling, and materiality, and —2 hours in any other accounting and auditing course AICPA review of one set of financial statements with report and working papers of a single audit 1 year after completion of CPE.
TX-5	Insufficient documentation of certain compliance tests.	Minor violation letter requiring no corrective action.
UT-1	Internal control and compliance report does not comply with GAGAS	Minor violation letter requiring no corrective action
WY-1	Auditor's report does not comply with reporting standards for special reports Internal control and compliance report does not comply with GAGAS	Minor violation letter requiring no corrective action.

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

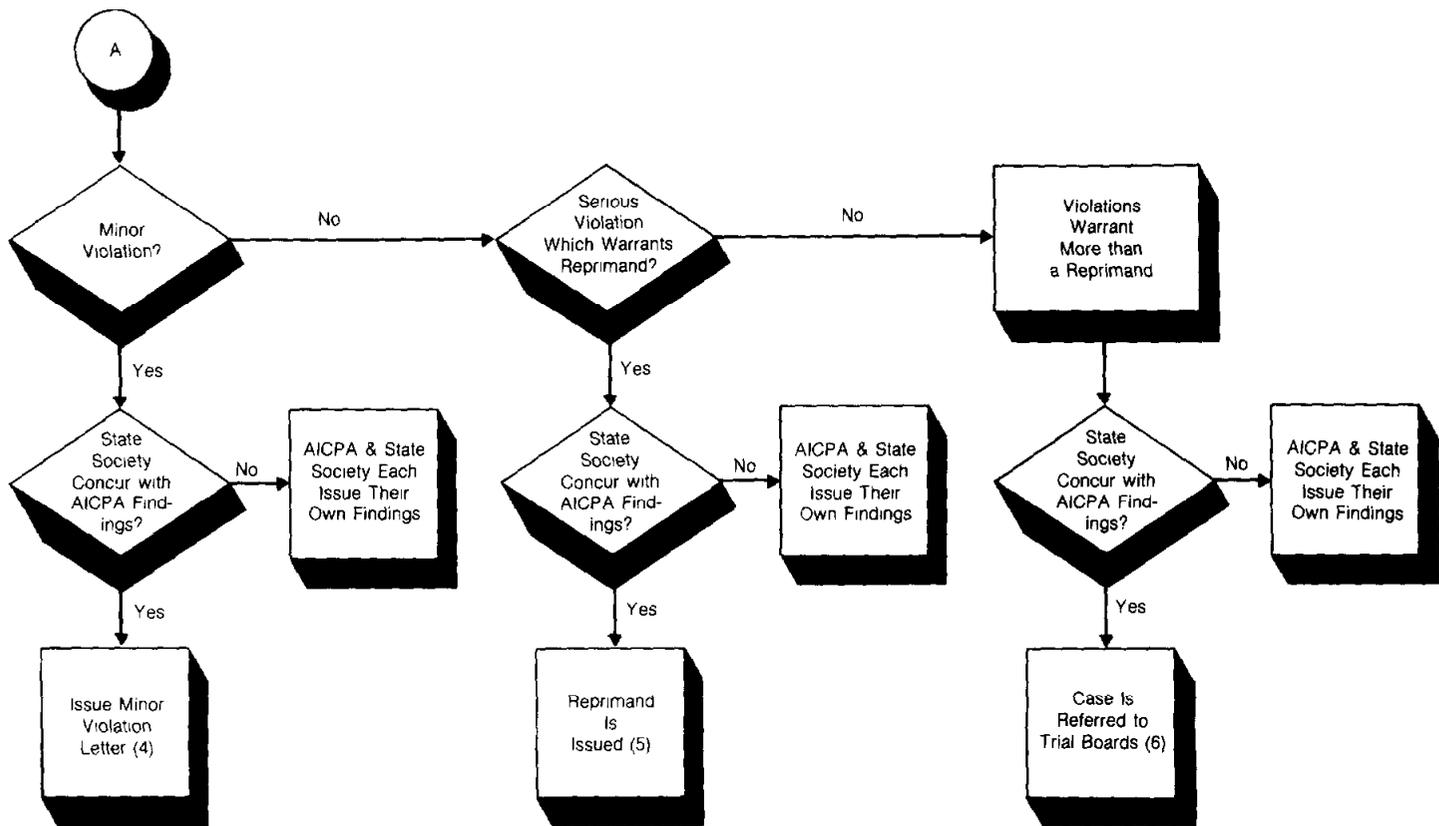
Referral number	Violations	Actions
TX-6	<p>Lack of professional competence.</p> <p>No audit program</p> <p>No disclosure of related party transactions</p> <p>Inadequate disclosure of long-term debt obligations</p> <p>No subsequent event review.</p> <p>No audit program for compliance.</p> <p>No documentation of internal control and compliance review</p> <p>Report on internal control does not comply with GAGAS</p>	<p>Referred to the trial board with the following recommendations.</p> <p>88 hours of CPE in 2 years:</p> <p>—8 hours government accounting and auditing,</p> <p>—8 hours compliance auditing,</p> <p>—8 hours single audit,</p> <p>—16 hours SAS review,</p> <p>—16 hours accounting and auditing update workshop,</p> <p>—8 hours audit evidence,</p> <p>—8 hours accounting for governmental units,</p> <p>—8 hours analytical techniques, and</p> <p>—8 hours reporting and disclosure problems for small businesses.</p> <p>AICPA should inform HUD Assistant Inspector General for Audit that CPA corrected few if any deficiencies noted by inspector general.</p>

Typical Enforcement Process Used by State Boards of Accountancy



- (1) The state board receives a complaint (audit referral) and determines whether it has jurisdiction over the CPA involved. If the CPA does not hold a license to practice public accountancy from the state, the state board does not investigate the complaint because the board has no jurisdiction over the CPA and cannot impose disciplinary action. However, the state board may seek an injunction if the CPA is required to have a license to practice in the state.
- (2) An investigator for the state board reviews the audit in question and the specific charges made in a complaint. In some states, the investigator may examine previous audits by the CPA to determine if the problem is a recurring one and whether any mitigating circumstances exist. At the conclusion of the investigation, a report is made to the state board outlining specific findings and, in some cases, recommending disciplinary actions.
- (3) A state board often uses a consent order or a stipulated settlement to resolve a complaint. These legal documents describe actions, usually remedial, which the CPA agrees to take rather than proceed to a formal hearing. With either document, the state board allows the CPA, within limitations, to be involved in negotiating the final disciplinary actions.
- (4) During a formal hearing, the state board, as a quasi-judicial body, has authority to reach final decisions on the severity of the auditing standards violations. If warranted, the state board can impose disciplinary actions.
- (5) All decisions reached through a state board's formal hearing process are subject to appeal.

**Appendix V
The AICPA's Joint Ethics
Enforcement Procedures**



- (4) The minor violation letter informs the CPA of the violation. This does not require any disciplinary actions
- (5) Issuance of a reprimand letter is usually accompanied by a requirement to take specific CPE courses and/or submit future work to the AICPA for review.
- (6) A trial board referral is accompanied by a specific recommendation for disciplinary actions. All findings of guilt are published in "The CPA Letter" along with the name of the member and the disciplinary actions taken

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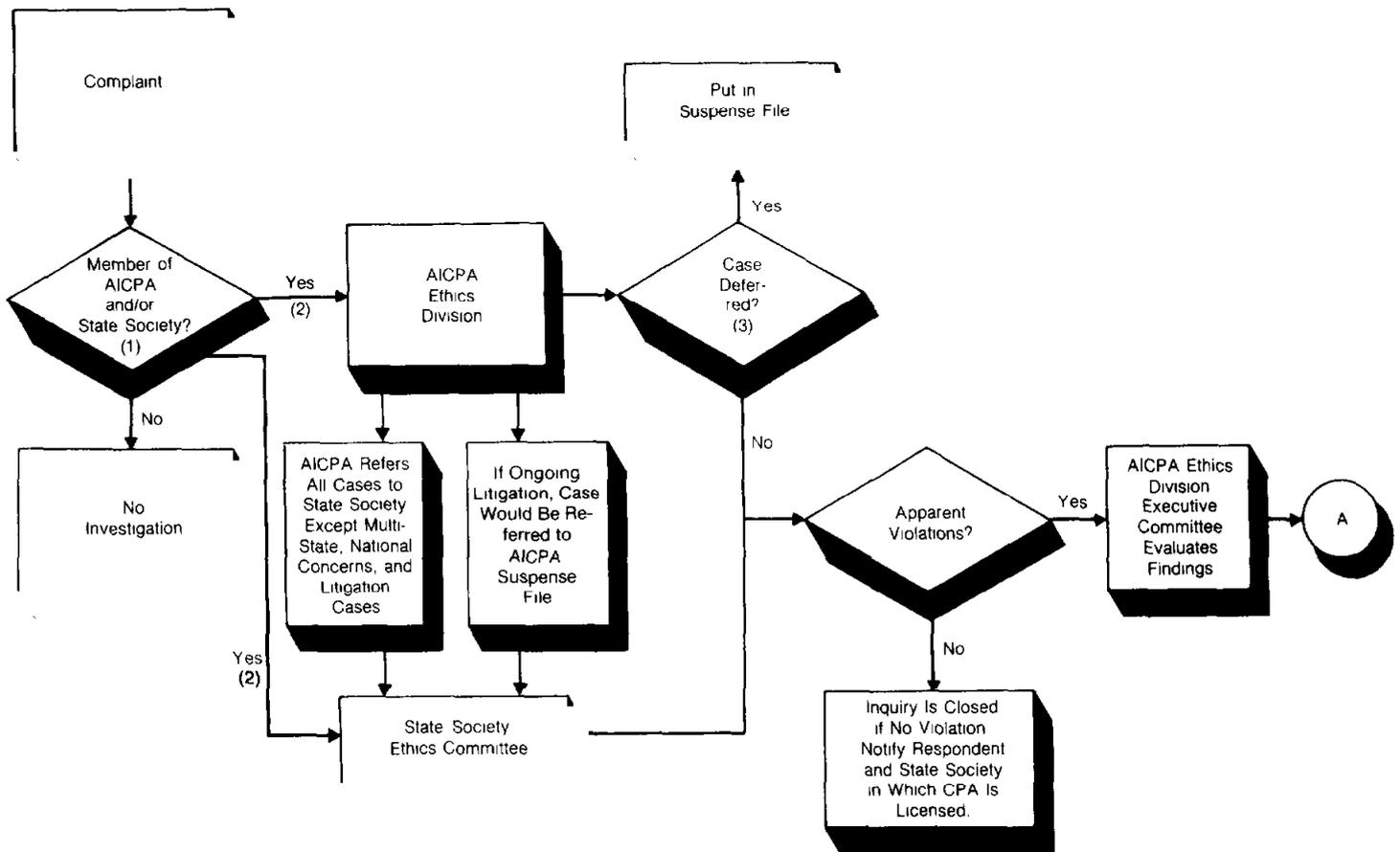
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The AICPA's Joint Ethics Enforcement Procedures



- (1) If the CPA is a member of the state CPA society, but not the AICPA, the state society must perform the investigation and take the disciplinary actions. If the CPA is not a member of either organization, he is not investigated by the AICPA or state society.
- (2) The complaint can be filed with either the AICPA or the state society
- (3) The CPA can request that the AICPA defer its investigation until the state board has completed its investigation and, if warranted, determined disciplinary action

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

**Table III.2: IG Referrals Completed by the
AICPA**

Referral number	Violations	Actions
CA-5	Planning and supervision Due professional care.	Referred to trial board with recommendation for expulsion from membership
LA-1	Lack of adequate planning. Insufficient documentation of financial audit. No management representation letter No documentation of internal control and compliance review Report on internal control and compliance does not comply with GAGAS	Referred to the trial board with the following recommended actions. AICPA recommends suspension be affirmed and, as a condition for re-admission, the following 88 hours of CPE be completed by April 30, 1989. —8 hours government accounting and auditing, —8 hours compliance auditing, —8 hours single audit, —16 hours SAS review, —16 hours accounting and auditing update workshop, —8 hours audit evidence, —8 hours accounting for governmental units, —8 hours report and disclosure problems for small business, and —8 hours analytical techniques For readmission to the AICPA, the CPA must have work products reviewed
MI-3	Noncooperation with AICPA's ethics division in the disciplinary investigation	Referred to the trial board with the following recommendations: Expulsion from state association of CPAs. Notify appropriate state board of accountancy of expulsion
TN-4	No violation	None GAO note AICPA determined that CPA performed under the direction of a partner who is not a member of the AICPA or state CPA society

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
TX-2	<p>Lack of due professional care</p> <p>No audit program</p> <p>No evidence of supervisory review of working papers.</p> <p>No management representation letter</p> <p>Inadequate documentation of internal control work.</p> <p>Inadequate documentation of compliance review</p> <p>No evidence that National Direct Student Loan Program was reviewed.</p> <p>The auditor's report did not comply with the inspector general's audit guide</p> <p>The report on internal control did not comply with GAGAS.</p>	<p>Referred to trial board with the following recommendations</p> <p>80 hours CPE in 2 years:</p> <p>—8 hours government accounting and auditing,</p> <p>—8 hours compliance auditing,</p> <p>—8 hours single audit,</p> <p>—16 hours SAS review,</p> <p>—16 hours accounting and auditing update,</p> <p>—8 hours audit evidence,</p> <p>—8 hours analytical techniques, and</p> <p>—8 hours accounting for governmental units</p> <p>Review of one compliance audit and working papers in each year.</p> <p>Admonish.</p>
TX-3	<p>Lack of due professional care.</p> <p>Inadequate planning.</p> <p>Inadequate documentation of audit work and conclusions relating to internal control and compliance</p> <p>Internal control report does not comply with GAGAS</p>	<p>Person A's administrative reprimand letter requiring</p> <p>32 hours of CPE.</p> <p>—16 hours SAS review,</p> <p>—8 hours audit evidence, and</p> <p>—8 hours management letter and reporting on internal controls</p> <p>Person B referred to trial board with the following recommendations</p> <p>96 hours of CPE over 2 years and AICPA follow-up review of financial statements and working papers on one single audit engagement in each year.</p>

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
OH-7	<p>Lack of planning in various areas.</p> <p>Insufficient documentation of testing of internal controls.</p> <p>Insufficient documentation of compliance testing.</p> <p>Auditor's report is not qualified for inadequate financial statement disclosures</p> <p>Internal control report does not comply with GAGAS.</p>	<p>Administrative reprimand letter requiring</p> <p>56 hours of CPE in 2 years:</p> <p>—16 hours SAS review,</p> <p>—8 hours audit of small business,</p> <p>—8 hours audit evidence,</p> <p>—8 hours single audit, and</p> <p>—16 hours local government auditing and reporting.</p> <p>AICPA review of one set of financial statements with report and working papers of a similar engagement after completion of CPE.</p>
OH-8	<p>No management representation letter.</p> <p>Checklists and internal control questionnaire only partially completed.</p> <p>Disclosure of significant accounting controls omitted from report.</p>	<p>Minor violation letter requiring no corrective action.</p>
OK-1	<p>Insufficient documentation of certain compliance tests.</p>	<p>Minor violation letter requiring no corrective action.</p>
PA-1	<p>Financial statements were not in conformity with applicable governmental accounting principles.</p> <p>No compliance testing performed.</p>	<p>Referred to trial board with recommendation for peer review and 120 hours of CPE over 3 years.</p>
TN-1	<p>Insufficient documentation of testing for compliance with internal control and with laws and regulations.</p>	<p>Administrative reprimand letter requiring</p> <p>16 hours of CPE:</p> <p>—8 hours government accounting and auditing update and</p> <p>—8 hours audit evidence.</p> <p>AICPA review of financial statements with report and working papers of one similar audit engagement after completion of CPE.</p>

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
NY-1	<p>Lack of due professional care.</p> <p>Insufficient documentation on compliance testing.</p> <p>Failure to test and evaluate certain internal controls</p> <p>Internal control report does not comply with GAGAS.</p>	<p>Administrative reprimand letter requiring</p> <p>32 hours CPE in 1 year:</p> <p>—8 hours single audit concept,</p> <p>—8 hours audit evidence,</p> <p>—8 hours audit report, and</p> <p>—8 hours government accounting and auditing update.</p> <p>AICPA review of one set of financial statements with report and working papers of a similar engagement after completion of CPE.</p>
NY-3	<p>Lack of due professional care.</p> <p>Inadequate audit program.</p> <p>Insufficient documentation on financial audit.</p> <p>No management representation letter.</p> <p>Inadequate documentation on internal control and compliance work</p>	<p>Administrative reprimand letter requiring</p> <p>80 hours of CPE in 2 years:</p> <p>—8 hours government accounting and auditing,</p> <p>—8 hours compliance audit,</p> <p>—16 hours SAS review,</p> <p>—16 hours accounting and auditing update workshop,</p> <p>—8 hours audit evidence,</p> <p>—8 hours accounting for governmental units,</p> <p>—8 hours analytical techniques, and</p> <p>—8 hours single audit.</p> <p>Review of one set of financial statements with report and working papers of a similar engagement after completion of CPE, each year.</p>
NC-3	<p>Lack of documentation of compliance testing.</p>	<p>Administrative reprimand letter requiring</p> <p>24 hours of CPE in 1 year:</p> <p>—16 hours SAS review and</p> <p>—8 hours government accounting and audit update.</p>

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
GA-6	<p>Lack of due professional care</p> <p>Substantial lack of documentation of audit work.</p> <p>Lack of documentation of test and review of internal controls.</p> <p>Lack of documentation of compliance testing.</p> <p>Internal control and compliance reports do not comply with GAGAS</p> <p>Auditor's reports fail to refer to generally accepted auditing standards.</p>	<p>Trial board finding:</p> <p>Admonished and required to submit to the AICPA any audits done over the next 2 years for review</p>
GA-7	<p>No documentation of compliance testing.</p> <p>Report on internal control and compliance does not comply with GAGAS.</p>	<p>Trial board finding:</p> <p>Admonished, required 80 hours of CPE in auditing and accounting over 2 years, and peer review within 2 years.</p>
IN-1	No violation	<p>None</p> <p>GAO note: Working papers were lost when the firm relocated. The AICPA determined that loss of working papers was inadvertent.</p>
IN-2	<p>Lack of professional competence and due professional care.</p> <p>Failure to adequately plan and supervise the engagement.</p> <p>Failure to adequately review and evaluate internal control.</p> <p>Lack of documentation on substantive testing.</p> <p>Lack of documentation on compliance testing.</p> <p>Auditor's report does not comply with reporting standards for special reports and does not contain adequate financial statement disclosures.</p> <p>Failure to report material weaknesses in internal control and findings of noncompliance.</p>	<p>Trial board findings include the following.</p> <p>24 hours of CPE by 12/31/88 in addition to 80 hours required for licensing:</p> <p>—8 hours auditor's report,</p> <p>—8 hours audit evidence, and</p> <p>—8 hours management letter and reporting on internal control.</p> <p>In case of noncompliance, suspension of membership for 18 months</p> <p>Admonish.</p>

(continued)

**Appendix III
GAO and IG Referrals Completed by
the AICPA**

Referral number	Violations	Actions
CA-3	Internal control and compliance report does not comply with GAGAS	Minor violation letter requiring no corrective action.
	No client representation letter.	
CA-4	Internal control report did not comply with GAGAS	Minor violation letter requiring no corrective action.
CO-1	Person A. Financial statement lacked informative disclosure	Person A's administrative reprimand letter requiring 24 hours of CPE in 1 year.
	Internal control report does not comply with GAGAS	—8 hours accounting and auditing annual standards refresher and —16 hours SAS review.
	Person B Inadequate documentation of review of compliance and internal control	Person B's administrative reprimand letter requiring 40 hours of CPE in 1 year
	Financial statements lacked informative disclosures	—16 hours SAS review. —8 hours accounting and auditing annual standards refresher,
	Internal control report does not comply with GAGAS.	—8 hours government accounting and audit update, and —8 hours single audit
		AICPA review of one set of financial statements with report and working papers of a similar engagement within 6 months after completion of CPE.
CO-2	Auditor s report does not refer to GAGAS.	Minor violation letter requiring no corrective action
	Internal control report does not comply with GAGAS	

(continued)

GAO and IG Referrals Completed by the AICPA

This appendix contains two tables which summarize the GAO and IG referrals completed by the AICPA. The referral numbers in the first columns of tables III.1 and III.2 are cross-referenced to the completed state board referrals in appendix II. However, additional referrals are included in appendix III because, as explained in our report, not all cases were referred to both the AICPA and the state boards. The violations listed in the second column of tables III.1 and III.2 are those which were determined by the AICPA following its investigation. Although the AICPA initiated its investigation of GAO and IG referrals based on standards violations GAO and the IGS identified, some of its investigations identified different or additional violations.

Table III.1: GAO Referrals Completed by the AICPA

Referral number	Violations	Actions
AL-1	Reports on internal control and on compliance did not comply with GAGAS	Administrative reprimand letter requiring 16 hours CPE. —8 hours single audit and —8 hours government accounting and audit update.
AL-2	Lack of overall planning Insufficient documentation on compliance testing. Substantial lack of documentation of test and evaluation of internal control. Internal control and compliance report does not comply with GAGAS	Administrative reprimand letter requiring 48 hours of CPE in 1 year: —16 hours statement on auditing standards (SAS) review, —8 hours audit evidence, —8 hours government accounting and audit update, —8 hours single audit, and —8 hours working paper review. AICPA review of one set of financial statements with report and working papers of a similar engagement after completion of CPE.

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
OH-2	Ohio	Testing of internal controls Evidence Due professional care	Must pass examination on government auditing standards. Must take 40 additional hours of professional education in accounting and auditing. Fined \$250 Cannot sign audit reports until above conditions are met.
OH-3	Ohio	Testing of internal controls Evidence Due professional care	Must pass examination on government auditing standards. Must take 40 hours of CPE in accounting and auditing. Fined \$250. Sign no audit reports until above conditions are met
OH-4	Ohio	Due professional care	None GAO note: State board found the CPA had performed poor quality work but took no corrective action because the CPA pledged to do no future federal work and indicated he was retiring.
OH-5	Ohio	Evidence Due professional care Testing of internal controls Planning and supervision Testing of compliance with laws and regulations	Must take 40 hours of professional education in auditing and accounting during 1986. Must pass examination on government auditing standards. May issue no audit reports until he passes auditing portion of the CPA exam Fined \$500; possibly reduced to \$100 if above conditions met.
OH-6	Ohio	Evidence Due professional care	No immediate penalty; however, if respondent wishes to perform future government audits he must pass examination on government auditing standards.

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
TX-1	Texas	Planning and supervision Testing of compliance with laws and regulations Due professional care	Person A Suspension of certificate and license for 5 years or until he completes 40 hours of professional education requirements in government auditing and accounting. Person B: Reprimand letter
TX-2	Texas	Evidence Due professional care	Reprimand letter Firm must have peer review.
TX-3	Texas	Planning and supervision Evidence Statement on internal controls Due professional care	Person A Reprimand letter Person B Reprimand letter Firm must have peer review before accepting any new government work

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
NY-2	New York	Evidence Due professional care GAO note. Charged by the New York state board with committing unprofessional conduct	Agreed to consent order requiring. —1 year license suspension, but execution of suspension stayed, —1 year probation, and —24 hours of professional education, including courses in auditing of government and not-for-profit organizations The CPA must pay the education costs
NY-3	New York	Planning and supervision Evidence Due professional care GAO note. Charged by the New York state board with practicing the profession with gross negligence.	1 year license suspension, but execution of suspension stayed 1 year probation 24 hours of professional education including courses in auditing of government and not-for-profit organizations Provide written proof that all fees and fines are paid
NC-1	North Carolina	Evidence Due professional care	Public censure Pay cost of state board's investigation Submit each audit report for state board's review until CPA retakes and passes the auditing portion of the CPA exam. The CPA must pay the cost of each review Probation until terms of consent order are completed
NC-2	North Carolina	Evidence Due professional care	Public censure Pay cost of state board's investigation Submit each financial statement audit report to an independent CPA firm for review until the CPA retakes and passes the auditing portion of the CPA exam. The CPA must pay the cost of each review. Probation until terms of consent order are completed.

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
GA-3	Georgia	Evidence Due professional care	All partners and staff involved in government auditing must: —obtain 8 hours of professional education in government auditing, —complete a course in professional ethics, —take an open-book examination on GAGAS, —perform no government auditing until above requirements are met, and —submit all government audit reports for an independent preissuance review for 1 year. Fined \$200 Violations of these terms are grounds to revoke registration to practice The consent order serves as a public reprimand.

(continued)

**Appendix II
GAO and IG Referrals Completed by State
Boards of Accountancy**

Referral number	State	Violations	Actions
GA-1	Georgia	Testing of compliance with laws and regulations Evidence Due professional care	All partners and staff involved in government auditing must: —obtain 8 hours of professional education in government auditing, —complete a course in professional ethics, —take an open-book examination on GAGAS, —perform no government auditing until above requirements are met, and —submit all government audit reports for an independent preissuance review for 1 year. Fined \$200. Violations of these terms are grounds to revoke registration to practice. The consent order serves as a public reprimand.

(continued)

State Boards of Accountancy Included in GAO's Study

State board of accountancy	Number of GAO referrals	Number of GAO referrals completed ^a	Number of IG referrals	Number of IG referrals completed ^a
Arkansas	0	0	1	1
California	3	1	2	0
Colorado	5	2	0	0
Florida	1	1	0	0
Georgia	4	4	3	1
Idaho	0	0	2	1
Indiana	1	1	0	0
Kansas	0	0	1	0
Kentucky	2	2	0	0
Louisiana	0	0	2	2
Michigan	1	0	3	0
New Jersey	0	0	1	0
New York	3	3	2	0
North Carolina	3	3	0	0
Ohio	1	1	5	5
Oregon	0	0	1	1
Pennsylvania	1	1	2	0
Puerto Rico	1	1	0	0
Tennessee	1	1	2	0
Texas	3	3	2	0
Utah	2	0	2	0
West Virginia	0	0	1	1
Total	32	24	32	12

^aRepresents referrals completed as of November 15, 1987, which was the end of our review period

However, the HHS IG is implementing new initiatives which recognize that the nonfederal audit community needs to accept responsibility for adherence to audit standards. Under this draft policy, the IG is able to make two types of referrals—informational and disciplinary. Informational referrals are made to inform professional bodies, such as state boards and the AICPA, of specific types of audit deficiencies so that appropriate training may be designed and provided to CPAs to improve the quality of their work. Generally, an informational referral is based on a desk review of the audit report without a subsequent review of the CPA's working papers. These referrals most often occur when the audit reports require significant revision. Referring CPAs based on IG desk reviews notifies state boards and the AICPA about auditors who do not comply with reporting standards. An HHS IG official believes that this policy enables state boards, especially those with positive enforcement programs, to focus on these auditors and, as a result, enhance the overall effectiveness of the state board enforcement programs.

Disciplinary referrals are similar to those referrals made by IGs in the past. That is, audits which materially violate standards are referred to the appropriate state boards and to the AICPA for disciplinary actions. Disciplinary referrals are generally the result of a review of the audit report and the auditor's working papers.

In addition to the HHS IG, other IGs are continuing to make referrals when they identify poor quality work. Four IGs have made 29 referrals to the AICPA from May 1, 1987, to November 15, 1987 (Department of Agriculture, 16; Education, 5; HHS, 7; and HUD, 1). We did not follow up with the 54 state boards of accountancy to obtain corresponding data.

Conclusions

We found that several organizations have ongoing initiatives to improve governmental audit oversight and enforcement. The state boards of accountancy have started to look beyond their traditional role of responding to complaints. Now, many boards are beginning to take a more proactive role through their positive enforcement programs by seeking out CPAs who are not performing quality work. Additionally, the AICPA, in its task force study, has formally recognized that the enforcement process is a major link in ensuring audit quality and has taken lead responsibility in strengthening this process. Finally, several IGs are seeking ways to increase their reliance on the profession's enforcement process by streamlining the referral process and increasing the number of their referrals. In several cases, the IGs have temporarily debarred CPAs from performing future government work.

These recommendations focused on the referral process and the previously expressed concerns of the IGS—the time it takes to prepare a referral and the lack of feedback on ongoing investigations.

The task force specifically stated that the system for referring allegedly “substandard” audits to licensing authorities and professional organizations should be modified to lessen the paperwork required to initiate a referral, enable the investigation to be completed in less time, and provide feedback to the referring and other appropriate officials. Once this system is modified, the task force recommended that guidelines be developed and distributed to explain the referral process to organizations that would be making referrals. The AICPA assigned itself the lead responsibility in implementing these recommendations, has established a monitoring mechanism to ensure that the recommendations are acted upon, and intends to identify and address additional problems that may arise.

According to an AICPA official, both primary recommendations have been implemented. The AICPA has improved its system for referring poor quality audits by having its Government Technical Standards Subcommittee communicate to GAO and to the IGS the status of audit referrals and ways to improve the referral process. Also, the AICPA has emphasized to the IG community that audit referrals need not be too detailed, and that a one-page document highlighting any deficiencies noted is sufficient.

IGs Have Taken a More Active Role in the Enforcement Area

Some of the IGS, along with the PCIE, now view the enforcement process as a means to improve audit quality. While not all IGS have made referrals for remedial or punitive action, some are becoming more active in making referrals and limiting the work of those CPAs who do not perform audits in accordance with audit standards from obtaining further government work. Additionally, the PCIE is currently studying ways to streamline the referral process.

PCIE Study

Because of the widespread concern about quality problems associated with CPA audits of governmental programs, the PCIE initiated a study to evaluate the state boards' role in the disciplinary process. The objectives of the study were to identify obstacles to the timely and effective processing of IG referrals and to offer suggestions for improvements. This study, issued in February 1988, provides an overview of the functions and structure of the 54 state boards of accountancy. Additionally, the study discusses the type of information the state boards would like

In our earlier reports on audit quality, we recommended that when the IGS find problems with audit work, they should refer the auditor to a regulatory or professional body for disciplinary action. This was based on our view that disciplinary actions would increase the audit community's awareness of the consequences of performing unacceptable work and should ultimately improve the quality of audits performed on federal funds recipients.

Recently, several organizations have responded with increased interest and activity. The National Association of State Boards of Accountancy (NASBA) focused on the area of audit quality and the enforcement process in its recent meetings. Additionally, the AICPA also focused on the issue of audit quality at its national convention in September 1987. The following sections describe some of the initiatives currently underway by the IGS and these groups.

State Boards Are Expanding Their Enforcement Processes

Currently, the state boards and their national association, NASBA, have two ongoing initiatives to strengthen the enforcement process. The first is the positive enforcement program and the other is referred to as "the Florida experiment."

Positive Enforcement Program

In 1986, NASBA began developing a model positive enforcement program which will provide more comprehensive guidelines for implementing a uniform positive enforcement program for all state boards of accountancy. A positive enforcement program emphasizes active monitoring of licensees' work products, in addition to responding to complaints. The model positive enforcement program will require that all CPA firms, including sole practitioners, undergo a periodic review of their audit reports as a condition for renewing their permits to practice public accountancy. These reviews may include an examination of the supporting working papers to determine compliance with applicable audit standards.

The program is designed to identify poor quality work and, in turn, to impose corrective measures. Depending upon the severity of the case, actions such as requirements for supervised education and training, limitations on the scope of practice, preissuance reviews of audit reports and working papers, fines, assessment of investigative costs, and suspension or revocation of licenses could be imposed. Of the 22 state

Timeliness of AICPA Actions

We believe that the AICPA's Governmental Technical Standards Subcommittee has completed its investigations and approved disciplinary action on all completed referrals without unjustifiable delays. The AICPA took, on average, about 11 months to complete GAO and IG referrals, with the disposition of individual referrals ranging from 7 months to 19 months. This includes the time it takes to complete cases deferred from investigation.

The AICPA's Joint Ethics Enforcement Program procedures manual provides for an investigation to be deferred at the CPA's request. Specifically, any CPA referred to both the AICPA and a state board of accountancy is permitted to defer the AICPA's investigation if the issues involved are also the subject of a state board's investigation. The AICPA reported that 22 of the 57 GAO referrals were deferred at some point during its investigation. These deferrals, although justified, account for some of the time required to complete these cases.

Conclusions

We believe that for the most part, state boards of accountancy have demonstrated a commitment to strengthening their enforcement efforts to ensure quality governmental auditing. Further, the AICPA's Governmental Technical Standards Subcommittee, in our opinion, has expeditiously handled both GAO and IG referrals. State boards and the AICPA took a number of different disciplinary actions available to them in addressing the severity of the CPAs' errors, followed their enforcement processes, and completed their investigations and took actions without unjustifiable delays.

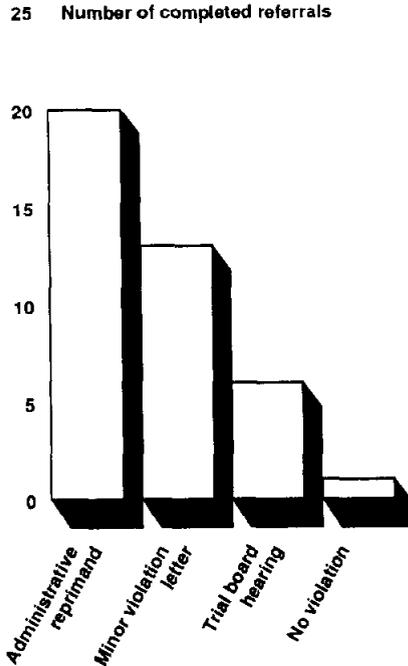
We found, with some exceptions, that the disciplinary actions taken by state boards and the AICPA were reasonable. These actions, in our opinion, will help prevent CPAs from making the same types of errors in the conduct and reporting of future governmental audits. We also believe that these enforcement efforts will demonstrate the importance of performing high quality work on governmental audits and will act as a deterrent for those CPAs who previously may not have satisfactorily complied with applicable governmental auditing standards.

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based. In these cases, the CPAs provided additional evidence to the AICPA during its investigation. The remaining case, as discussed earlier, was dropped because the AICPA confirmed that the supporting working papers were lost during an office move.

Figure 2.2 summarizes the AICPA's actions on its completed investigations of the GAO referrals.

Figure 2.2: Disciplinary Actions Taken by the AICPA on Completed GAO Referrals



Note: Sixteen of the 20 administrative reprimands required that the CPA take continuing professional education and have a follow-up work product reviewed by the AICPA. The remaining four required only continuing professional education.

AICPA Actions on IG Referrals

For the five completed investigations based on IG referrals, the AICPA recommended that four be advanced for trial board hearings. In one of these cases, the AICPA found the violation to be so egregious that the case was referred with a recommendation for expulsion from AICPA membership. The fifth case was dismissed because the partner involved was not

actions taken against CPAs. We were told by state board officials that most of these boards disclosed all disciplinary actions. However, there were several state boards that either limited the amount of information disclosed, published only results of public hearings, or disclosed disciplinary actions only upon request. In many cases, this information is published in the state board's newsletter. Typically, these newsletters are sent to the AICPA, NASBA, other state boards, state CPA societies, and any other requesters, such as public libraries. State boards that do not have newsletters often send the information to their state CPA society for publication in its newsletter. In most cases, these publications include the CPA's name.

The House Committee on Government Operations, in its October 7, 1986, report⁷ on CPA audit quality, recommended that state boards of accountancy make public the results of all cases in which disciplinary actions are taken. To comply with the Committee's recommendation, some state boards would have to revise their disclosure policies, and in some cases, state laws governing these disclosure activities would have to be changed.

Timeliness of State Board Actions

We concluded that state boards have investigated and taken action on the completed GAO and IG referrals without unjustifiable delays. Although we found no criteria for measuring timeliness, our conclusion is based on discussions with several state board officials who agreed that referrals should proceed through the enforcement process without inordinate delays.

We found that from the referral date to the completion date, state boards took an average of 10 months to investigate and decide on actions. Although the time spent to resolve a case ranged from 1 month to 20 months, we did not identify any state board actions for which the amount of time taken was, in our opinion, unjustified.

There are a variety of factors that can influence the amount of time needed to complete an investigation. For example, we found that some state boards take longer to complete actions on audit referrals because they do not always have the resources to conduct investigations. In

⁷Substandard CPA Audits of Federal Financial Assistance Funds: The Public Accounting Profession Is Failing the Taxpayers, report by the Committee on Government Operations, based on a study by the Legislation and National Security Subcommittee

The AICPA had completed its investigation on 5 of the 16 IG referrals. Many of these referrals were still undergoing investigation because the AICPA investigates audit referrals in the order they are received and all but one of the IG referrals were made more recently than our referrals. The results of the AICPA subcommittee's completed investigations on each GAO and IG referral are included in appendix III.

We believe that the AICPA's Governmental Technical Standards Subcommittee has expeditiously handled the large number of GAO and IG referrals it received during our review period, and that the disciplinary actions imposed by the AICPA on all but one of the completed cases were reasonable. Our findings are based on the fact that the AICPA (1) generally took disciplinary actions commensurate with the problem, (2) followed its enforcement procedures, and (3) investigated and completed action on the referrals without unjustifiable delays.

The AICPA Has Taken Disciplinary Actions on GAO Referrals

We believe that the AICPA's Governmental Technical Standards Subcommittee has taken disciplinary actions commensurate with the severity of its investigative findings on all but one of the 40 completed GAO referrals.

On six referrals, the AICPA found that the audit violations were serious enough to refer the CPA to a trial board. Trial boards are hearing boards established to adjudicate complaints made under the ethics code of the AICPA or participating state CPA societies. If the AICPA believes that a violation warrants more than an administrative reprimand requiring education and/or follow-up work product review, it must refer the case to a trial board. A trial board referral is usually accompanied by a specific recommendation for disciplinary action, such as prescribed continuing professional education, peer review of the member's practice, censure, or suspension of, or expulsion from, AICPA membership. All findings of guilt by a trial board are published in "The CPA Letter," the AICPA's biweekly newsletter, which is sent to its 250,000 members, including the name of the offending member and the disciplinary actions taken.

As of November 15, 1987, three of the six scheduled trial board hearings had taken place. In one case, the CPA was requested to submit any audits completed over the next 2 years to the AICPA for review. In addition, the individual was admonished through an AICPA letter summarizing the trial board findings and by having his name published in "The CPA Letter" together with the findings of violations and the actions taken. In the second case, the AICPA also admonished the CPA and required him to

his performance on future audits. The HUD IG was in the process of debarring this CPA from future HUD work at the time of our review.

Two referrals were made by IGs to the Ohio state board which resulted in no action on one case and, in the other, a requirement that the CPA take a state board test on generally accepted government auditing standards (GAGAS) if the individual planned to perform future governmental audits. These referrals were made because of a lack of due professional care and, in one case, GAO also found inadequate evidence to support the audit results. The CPAs involved in both referrals stated that they would not perform future governmental audits and this factor was considered by the state board in its decision to impose lenient sanctions. However, one of these CPAs later contested HUD actions to debar him from its work and he has expressed a desire to work as a government consultant. In the other case, the CPA has passed the GAGAS test and, therefore, can now continue his work in governmental auditing. We do not believe that the CPAs' assurances, and passing the GAGAS test in one case, were sufficient reason for the board to impose lenient sanctions in these cases. Also, actions taken by the Ohio state board on other similar cases were generally more severe.

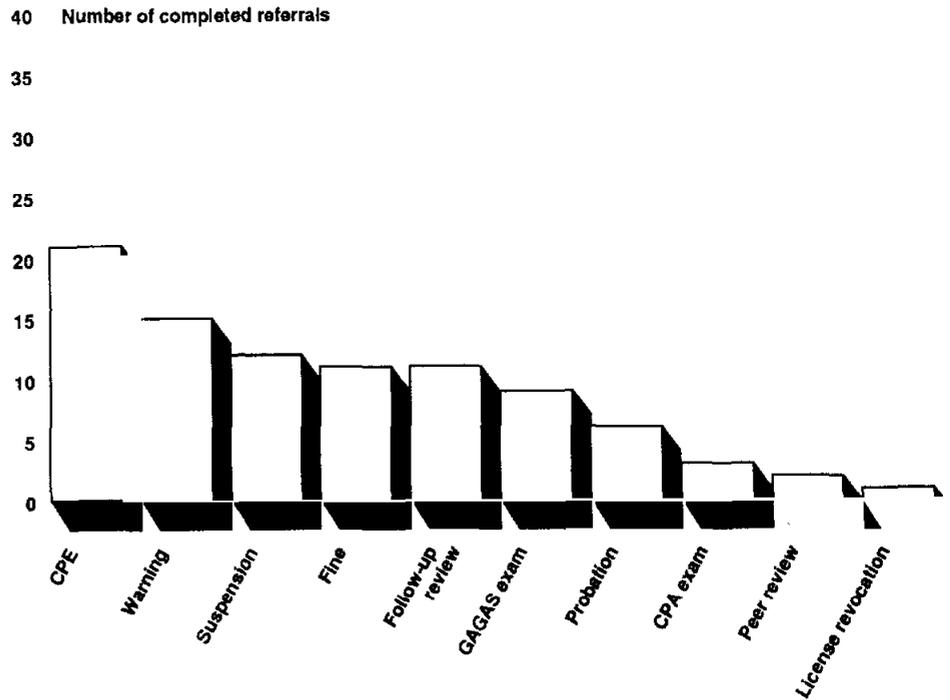
Finally, we referred a CPA to the New York state board for violating standards in the area of planning and supervision, evidence, and due professional care. The state board found the CPA to be in "gross negligence" in the practice of public accountancy and, as a result, suspended the CPA's license and registration to practice for 1 year. However, the suspension was immediately stayed, and the CPA was placed on probation for 1 year and allowed to continue to practice. As a result, the CPA was only required to take 24 hours of continuing professional education and pay any outstanding fines. This case is particularly noteworthy because, in our March 1986 testimony on audit quality, we were critical of the New York state board for taking a similar lenient action on another violation involving gross negligence.

State Boards' Enforcement Processes Differ

Each state board differs in the way it investigates audit referrals and decides on disciplinary actions. We found that even though the procedures used by the 22 state boards differ, each, in our judgment, followed its established process for investigating the referrals. Also, we found that in most cases the state boards performed thorough investigations of the alleged poor quality work and acted responsibly in deciding on the necessary actions to address the problems.

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Figure 2.1: Disciplinary Actions Taken by State Boards on Completed Referrals



Notes

1 CPE refers to continuing professional education

2 GAGAS refer to generally accepted government auditing standards

3 The number of completed referrals does not total 36 because most state boards imposed more than one disciplinary action on each referral

referred the CPA for inadequate evidence and due professional care, the state board (1) publicly censured the CPA and listed the violations in the board's newsletter, (2) required the CPA to pay about \$2,000 for the cost of the state board's investigation, and (3) required all future audit reports to be reviewed by the state board, at the CPA's expense, for adherence to standards until he passed the auditing portion of the CPA exam. The CPA was placed on probation until he completed these actions, during which time his license could be revoked if another violation occurred.

The Accounting Profession Is Taking Reasonable Actions on Referrals of Poor Quality Audits

State boards of accountancy and the AICPA are demonstrating a commitment to strengthening enforcement efforts in the area of CPA governmental audit quality. We found that state boards of accountancy and the AICPA have taken or will soon take disciplinary action—either remedial or punitive—on over 70 percent of the audit referrals made by GAO and on 35 percent of the IG referrals.⁵ We believe that their efforts will help prevent CPAs from making the same types of errors on future governmental audits.

For most completed cases, state boards and the AICPA acted reasonably in investigating and acting on the referrals. In these cases, we believe that the disciplinary actions taken usually were commensurate with the severity of the CPAs' errors, and the enforcement procedures used by state boards and the AICPA were adequately followed and were not unjustifiably delayed. We found five cases, involving four state boards, where we did not consider the actions taken on the referrals made to state boards to be reasonable. Also, we found one case for which we believe that the AICPA did not take reasonable actions. In each case, we believe that the disciplinary actions taken were either too lenient or did not include adequate assurance that the CPA would comply with the disciplinary action agreed upon. These referrals are discussed later in this chapter.

The following sections of this chapter, as well as appendixes II and III, describe in detail state board and AICPA actions on the GAO and IG referrals.

State Boards of Accountancy

As of November 15, 1987, state boards of accountancy had completed actions on 36 of the 64 GAO and IG referrals. In some cases, state boards consider a case completed only after all state board disciplinary actions are met; however, for the purpose of this review, we considered a case completed if the state board had finished its investigation and either planned or ordered disciplinary actions. The completed cases include 24 referrals made by GAO and 12 made by IGs. We believe that the actions taken on all but five of the completed referrals were reasonable.

Eight of the 32 GAO referrals were not completed by November 15, 1987, the end of our review period. Five of these cases involved referrals that

⁵Referrals are usually handled in the order they are received. As a result, the percentage of IG completed cases is lower than that for GAO referrals because most of the IG referrals in our study were made more recently than GAO's referrals.

Although not directly affiliated with the AICPA, 50 of the 54 state societies—voluntary professional associations of CPAs in various states and jurisdictions—work in conjunction with the AICPA on enforcement activities. The state societies also participate with the AICPA on professional development activities by sponsoring AICPA training courses.

In addition, the IGS play an important role in the enforcement process. First, by virtue of the Inspector General Act of 1978, IGS are responsible for reviewing the quality of CPAs' governmental audit work. Secondly, the IGS make referrals of those CPAs who do not perform quality governmental audits to the appropriate groups for disciplinary actions. Other individuals or organizations, such as government agencies or private citizens, can also make referrals of poor quality work, but they rarely exercise this option. As a result, the IGS serve a key role in initiating the enforcement process. Additionally, the President's Council on Integrity and Efficiency (PCIE), whose membership includes the IGS, has worked to improve the accounting profession's enforcement process by studying ways to expedite the referral of auditors performing poor quality government work.

Objectives, Scope, and Methodology

Our objectives in this review were to (1) determine the results of the audit referrals we made to state boards of accountancy and to the AICPA, (2) determine the results of recent referrals made by IGS to state boards of accountancy and to the AICPA, (3) provide our views on the reasonableness of any disciplinary actions taken by these groups, and (4) identify ongoing efforts to improve the enforcement process.

The scope of our work consisted of performing work at 22 state boards of accountancy and at the AICPA to determine the status of each audit referral made either by us or by an IG. Our work consisted of determining the status of each referral, detailing the chronology of actions taken on the referral, and obtaining a description of any disciplinary actions. To ensure that we obtained accurate information, we received written confirmation from state boards and the AICPA on the status of, and disciplinary actions taken for, each referral as of November 15, 1987, which was the end of our review period.

In addressing our third objective, we determined the "reasonableness" of disciplinary actions taken by these groups on the GAO and IG referrals by considering the extent to which state boards and the AICPA (1) took disciplinary actions commensurate with the severity of their investigative findings, (2) followed their own policies in investigating and taking

reasonableness of any disciplinary actions. He also requested that we report on the status of referrals made to these groups by IGS.

This report addresses the status of the 137 referrals, 89 from GAO and 48 from the IGS.

The Enforcement Process

The enforcement process begins with a complaint, or referral, of an alleged poor quality audit to a state board of accountancy, the AICPA, or both. Referrals can be made by IGS, GAO, other government officials, or an individual.

IGS usually identify poor quality audits as a result of a regional IG evaluation of an audit report (desk review), or through an evaluation of the report and the associated working papers (quality control review). Traditionally, IGS have worked with the auditors to correct problems in the audit identified by their reviews. However, when the problems are not corrected or the auditor continuously produces poor quality work, the IGS then refer auditors to the appropriate state board of accountancy, the AICPA, or both. The enforcement processes used by state boards and the AICPA are included in appendixes IV and V.

The subject of the referral can be the audit, the individuals performing the audit, or the audit firm. However, once the referral is made, state boards and the AICPA determine the responsible individuals involved in performing the audit. The enforcement process ends with a decision on whether there was a violation of audit standards, and, if warranted, disciplinary actions—either remedial or punitive—are taken against the individual auditors. Remedial action includes requiring that the CPA take additional continuing professional education or requiring a follow-up review of another audit. It also includes the issuance of minor violation letters where no action by the CPA is required. State board punitive action includes penalties such as fines, probation, or the suspension or revocation of the CPA's license. AICPA punitive action includes suspension of, or expulsion from, membership.

Introduction

Background

Over the last few years, the General Accounting Office (GAO), several inspectors general (IGs), state boards of accountancy and the American Institute of Certified Public Accountants (AICPA) have increased their attention to improving the quality of audits of state and local governments' use of federal financial assistance. These audits are required by legislation and help to assure program managers that they have reliable reports on (1) financial activities, (2) compliance with applicable laws and regulations, and, in many cases, (3) the adequacy of internal controls over federal expenditures. Although many factors affect audit quality, it is ultimately the responsibility of the individual certified public accountant (CPA) to conduct an audit in accordance with applicable audit standards. If the auditor does not comply with these standards, the accounting profession has a responsibility to use its enforcement processes to discipline the auditor in order to maintain public confidence in the integrity of the profession.

The federal government administers domestic assistance programs with outlays exceeding \$100 billion per year through state and local governments. Each year, federal funds recipients at the state and local level pay CPAs between \$100 million and \$200 million to perform these audits. In two recent reports,¹ we focused on the quality of work performed by nonfederal auditors—mostly CPAs—who contracted to perform governmental audits. In these reports, we found that many of these CPAs did not comply with audit standards and that the credibility and usefulness of these audits were questionable. In congressional hearings associated with our work on audit quality, we testified² that governmental organizations should refer CPAs who perform poor quality audits to the state boards of accountancy in which the CPAs are licensed and to the AICPA, and that these groups should have enforcement processes which address the referrals promptly and decisively.

Our policy is to refer auditors who perform poor quality work to the AICPA and state boards of accountancy for their review and possible disciplinary action. Also, these referrals will increase the accounting community's awareness of the consequences of performing poor quality audits. We also believe that referrals will eventually improve the quality

¹CPA Audit Quality: Inspectors General Find Significant Problems (GAO/AFMD-86-20, December 5, 1985) and CPA Audit Quality: Many Governmental Audits Do Not Comply With Professional Standards (GAO/AFMD-86-33, March 19, 1986).

²Statement of Frederick D. Wolf, Director, Accounting and Financial Management Division, November 13, 1985, and statement of Charles A. Bowsler, Comptroller General, March 19, 1986, before the Legislation and National Security Subcommittee, Committee on Government Operations, House of Representatives

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GAO believes that the actions taken by state boards were reasonable. For the most part, they

- followed their procedures in investigating referrals,
- took actions that were commensurate with the audit deficiencies, and
- completed their enforcement processes without unjustifiable delays.

However, in five cases, GAO considered the boards' actions to be too lenient in view of (1) the serious and repetitive nature of audit weaknesses, (2) the lack of punitive or remedial action to improve future performance, and (3) actions taken on other similar cases. In fact, the inspectors general who referred four of these cases requested that the state boards reconsider their actions.

AICPA

The AICPA's Governmental Technical Standards Subcommittee had completed 40 of the 57 GAO referrals as of November 15, 1987, in addition to 5 that were not investigated because they were out of the AICPA's jurisdiction. GAO believes that the disciplinary actions taken by the AICPA subcommittee on all but one of the completed referrals were reasonable. In this case, the AICPA relied only on oral assurances from the CPA that he would no longer perform governmental audits.

Eight of the 12 referrals not completed were still under investigation on November 15, 1987, which was the end of GAO's review period. The remaining four referrals not completed by the AICPA were deferred, at the request of the CPAs, due to ongoing state board investigations.

In 39 of the 40 completed cases, the AICPA found problems which were serious enough to warrant disciplinary actions. These actions include 6 recommendations for hearings, of which 3 hearings have been held and the results published in the AICPA's newsletter. The other 3 hearings were scheduled after the end of GAO's review period. In addition, the AICPA issued 20 administrative reprimands and 13 minor violation letters, which have not been publicly disclosed. In one case, the AICPA found no violation.

In addition to the GAO referrals, the AICPA completed its investigation on 5 of 16 IG referrals. Most of the IG referrals were made more recently than those made by GAO and were still undergoing investigation at the conclusion of GAO's review. The AICPA requested a hearing on 4 of the 5 completed cases and, in one case, is recommending expulsion from its

Executive Summary

Purpose

During the last few years, GAO, several inspectors general (IGs), state boards of accountancy, and the American Institute of Certified Public Accountants (AICPA) have focused their attention on improving the quality of governmental audits. Each year, federal funds recipients at the state and local level pay nonfederal auditors—mostly certified public accountants (CPAs)—between \$100 million and \$200 million to perform these audits of billions of dollars in federal assistance. GAO previously found that some of these audits were not conducted in accordance with established audit standards and, accordingly, referred a number of CPAs to the cognizant state boards of accountancy or to the AICPA.

In January 1987, the Chairman, Legislation and National Security Subcommittee, House Committee on Government Operations, asked that GAO review the disciplinary actions taken by state boards and by the AICPA on these GAO referrals and on more recent IG referrals. The Chairman also asked that GAO provide its views on the reasonableness of state board and AICPA disciplinary actions. In addition, GAO identified the ongoing efforts of the accounting profession and the IGs to improve the enforcement process.

Background

During April and May 1986, GAO referred 57 poor quality audits to the AICPA for its review and possible disciplinary action. Thirty-two of these which involved more severe standards violations were also referred to the state board of accountancy in which the CPA was licensed.

GAO's referrals resulted from its earlier work on audit quality, where it reported that an estimated 34 percent of governmental audits performed by CPAs did not meet audit standards. GAO made these referrals of poor quality audits to state boards and the AICPA for their review and possible disciplinary action in an effort to improve the quality of future governmental audits. Subsequently, 4 inspectors general referred 32 poor quality audits to state boards of accountancy and 16 to the AICPA.

In this review, GAO determined the status of the GAO and IG audit referrals and assessed the reasonableness of disciplinary actions by considering the extent to which state boards and the AICPA (1) took disciplinary actions commensurate with the severity of their investigative findings, (2) followed their own enforcement procedures, and (3) completed their investigations and either planned or took disciplinary actions without unjustifiable delays.

