

Auditing the Auditors: A Case on PCAOB Inspection Reports of Registered Public Accounting Firms

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SUMMARY: We present a timely practice-oriented case related to the inspection process of registered firms by the Public Company Accounting Oversight Board (PCAOB). This case allows auditing students an opportunity to explore the unique challenges that public accounting firms auditing U.S. public companies face with respect to the PCAOB inspection process. The case focuses on large and small registered firms (inspected annually and triennially, respectively) receiving an inspection report where the PCAOB identified certain matters considered to be audit deficiencies of such significance that the inspection team believed the audit firm did not obtain sufficient competent evidential matter to support the auditor's opinion. The case exposes students to the PCAOB inspection process, highlights many deficiencies noted to date by the PCAOB inspectors, and emphasizes the importance of sufficient and appropriately documented audit evidence to support audit opinions. By reviewing 'deficient' inspection reports, students gain an appreciation for common audit deficiencies as well as the subjective nature of portions of the authoritative literature and the inspection process itself. The case reinforces students' understanding of the practical matters involved in appropriately obtaining, evaluating, and documenting audit evidence, as well as educates students on the PCAOB inspection process in order to address important competencies required of Sarbanes-Oxley era audit professionals.

INTRODUCTION

Section 104 of the Sarbanes-Oxley Act of 2002 (SOX) requires the Public Company Accounting Oversight Board (PCAOB) to conduct annual inspections of public accounting firms that regularly provide audit reports for more than 100 issuer clients (public entities), and at least triennial inspections for firms with 100 or fewer issuer clients ([U.S. House of Representatives, Committee on Financial Services 2002](#)). Firms not registered with the PCAOB are prohibited from issuing

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Note: For faculty interested in administering this case, teaching notes and suggested solutions to the discussion questions are available from the first author, daughert@uwm.edu, upon request. Faculty may also request a sample Excel template from the first author for the purpose of creating a grading rubric for the objective discussion questions. This author will also provide a limited list of triennially inspected firms' inspection findings to interested faculty.

audit reports on public entities in the United States. As of March 2009, over 1,900 firms (and their affiliates) were registered with the PCAOB (PCAOB 2009a), with approximately 850 inspection reports released on the PCAOB's website, <http://www.pcaobus.org>.¹

Prior to SOX, the auditing profession was self-regulated through "peer review" whereby auditing firms reviewed the audit quality of other auditing firms and issued a report (opinion) on auditing quality and controls of the inspected firm. While these reports ultimately became a matter of public record, separate letters (not in the public domain) were issued by the reviewing firm discussing non-compliance with matters not deemed to be of sufficient importance to impact the opinion. Some criticized this fraternal process, as no major accounting firm ever failed a peer review (Ribstein 2002).

The PCAOB inspection process fundamentally changed the oversight mechanism related to audit quality for firms issuing opinions on U.S. public entities, and PCAOB inspection reports are more transparent than the prior peer review process.² In 2004, the PCAOB issued Auditing Standard No. 3 (AS No. 3), *Audit Documentation*, establishing the requirements for audit documentation for registered firms (PCAOB 2004); however, many inspection reports released subsequent to AS No. 3 identify instances in which registered firms purportedly failed to obtain and/or document sufficient competent evidential matter to support the audit opinion(s) rendered (PCAOB 2005, 2006a, 2007a, 2008a).³

The impact of SOX and the PCAOB has been far-reaching, and the new inspection process has dramatically impacted auditing practices. This practice-oriented case highlights and addresses important competencies expected of the SOX-era audit professional. These competencies are important as the auditing profession is now subject to external inspection by the PCAOB, and inspection results are more transparent than under the peer review process. Miller (2007) asserts PCAOB inspection reports are a useful tool to establish the relevance and credibility of many topics in auditing courses.

This case exposes students to the PCAOB inspection process, highlights numerous deficiencies noted to date by the PCAOB inspectors, and emphasizes the importance of obtaining sufficient and appropriately documented audit evidence to support audit opinions. By reviewing "deficient" inspection reports, students gain an appreciation for common audit deficiencies as well as the subjective nature of portions of the authoritative literature and the inspection process itself. Further, students completing the case learn that PCAOB observations and guidance stemming from the inspection process are not always released on a timely basis, though auditors are often expected to quickly adopt and incorporate authoritative mandates impacting the profession.

The case emphasizes to students the importance of every member of audit engagement teams following the audit documentation requirements of AS No. 3. Given the preponderance of firms cited by the PCAOB for failure to obtain sufficient competent evidential matter, students are sensitized to the critical role that documentation plays in memorializing the appropriate performance of an audit. Due in large part to time pressures and the assignment of staff to other engagements prior to the wrap-up phase of an audit, it is likely often the case that required audit procedures were appropriately performed, but were not documented in their entirety, or were not

¹ Approximately 55 percent are U.S. based firms with roughly 65 percent of this group subject to triennial inspection since they had issued at least one audit report on an issuer client since registration with the PCAOB. Well over 1,000 registered firms (and their affiliates) do not issue audit reports on U.S. public companies (PCAOB 2007b).

² Hermanson et al. (2007) provide an overview of audit firm oversight in the pre- and post-SOX eras. Miller and Pashkoff (2002) provide an overview of the PCAOB's responsibilities and discuss certain differences between peer reviews and PCAOB inspections.

³ AS No. 3 was effective for audits with respect to fiscal years ending on or after November 15, 2004 (PCAOB 2004). Therefore certain of the 2004 audits discussed in the PCAOB's 2005 inspection reports may not have been subject to the requirements of AS No. 3.

documented on a timely basis.⁴ At a minimum, this lack of documentation can negatively influence the efficiency of an audit if procedures must be re-performed or documented by others. Of greater concern (to both the auditor performing and/or documenting the audit procedures as well as the auditing firm) is the possibility of receiving a deficient inspection report from the PCAOB.

The case is valuable to students choosing to enter public accounting (with either an annually inspected or a triennially inspected firm), as well as students beginning their careers in industry at companies audited by a registered firm. Exposure to inspection reports may also benefit students as they consider internship and full-time employment opportunities. The early portions of the case familiarize students with the basic format of PCAOB inspection reports, while the latter portions require students to critically evaluate and address specific shortcomings cited by the inspectors, assess potential biases that the inspection teams may possess, and evaluate the documentation requirements of AS No. 3.

ASSIGNMENT

Assign students (individually or in teams) the task of obtaining and analyzing a specific inspection report of a triennially inspected firm (chosen by the instructor to ensure the inspection report contained deficiencies) posted on the PCAOB's website, the inspection report of PricewaterhouseCoopers (PwC) issued in December 2006 (PCAOB 2006b), and AS No. 3.⁵ Have students use these resources, other links on the PCAOB website, and an auditing textbook to address Discussion Questions 1–28 listed in Appendix A.

OBJECTIVES

Intended Audience and Learning Objectives

The practice-oriented case is designed for use in either undergraduate or graduate auditing courses to illustrate the PCAOB oversight process for registered public accounting firms that were previously self-regulated through the peer review process. Discussion Questions 1 through 14 are designed to familiarize students with the standard layout of a PCAOB inspection report. These questions require the student to provide firm-specific responses related to inspection parameters, identification and magnitude of specific deficiencies, GAAS and GAAP violations, PCAOB enforcement mechanisms, and registered firm response opportunities.

The remaining Discussion Questions (15 through 28) are more in-depth and challenging, requiring students to engage in critical thinking as they examine and compare the assigned inspection reports. Students are asked to assess their assigned firms' relative quality, rank order (and support) their assessment of deficiency magnitudes, identify specific audit procedures the firm could have performed to avoid the deficient inspection report, select a firm to perform a financial statement audit, identify certain AS No. 3 requirements, and recognize recurring deficiencies noted by the inspectors. Finally, students are asked to address some of the criticisms of the

⁴ The American Institute of Certified Public Accountants' (AICPA) *Smaller Firm PCAOB Inspection Deficiency Analysis* notes documentation failures related to "resolving discrepancies between information in the Firm's work papers and the issuer's disclosures, pervasive failure to document audit procedures, and failure to perform and document an appropriate evaluation of audit differences identified in the work papers" (AICPA 2006a, 27). A number of inspected firms' responses to inspections, appended to the PCAOB inspection report, indicate the firm performed relevant procedures but acknowledge that the documentation was either missing or lacking. AS No. 3 requires finalization of audit documentation within 45 days of the report release date (PCAOB 2004).

⁵ For consistency, the same report of PwC was used to validate this case. Any of the PCAOB inspection reports for the 'Big' firms may be used to achieve the learning objectives. To date, all of the inspection reports for the annually inspected firms have contained criticisms of the firms' audit processes on a number of engagements, including the failure to obtain sufficient competent evidential matter.

PCAOB inspection process including potential inspector bias, equity of triennial firm inspections, inspection transparency, and delayed release of many inspection reports. An alternative approach would have students analyze both reports side-by-side.⁶ Specific learning objectives, linked to the suggested discussion questions, are summarized in Exhibit 1.

Case Contribution

This case contributes to auditing students' understanding of the "real world" (PCAOB inspection process and reports) implications of a "textbook" description of an auditor's failure to obtain sufficient evidence to support the auditor's opinion. It provides a timely setting focusing on potential (and in some cases actual) audit failures detected through the PCAOB inspection process. In a number of inspection reports, the PCAOB notes that client financial statements were restated (an implicit audit failure) to address matter(s) identified by the inspection teams.⁷

Auditing textbooks discuss quantitative and qualitative aspects of audit evidence and related documentation. The PCAOB inspection reports used in the case provide specific and detailed citations of firm-specific deficiencies (on a client-by-client basis) noted in the inspection process. Since the PCAOB's inspection of registered firms is an ongoing process, the case has timely and continuing relevance to auditing students. Deficiencies noted in PCAOB inspection reports vary year-to-year, and the use of recent inspection reports allows students to see the inspectors' current focus as well as the trend of audit shortcomings of registered firms with deficient inspection reports.

IMPLEMENTATION GUIDANCE

Case Administration

We recommend the case be administered contemporaneous with classroom coverage of chapter topics on any combination of auditing standards, audit reports, ethics and liability issues, and auditors' acquisition, evaluation, and documentation of audit evidence, typically concurrent with the coverage in the first six or seven chapters of most auditing textbooks.⁸ The large number of inspection reports released on the PCAOB's website allows firm-specific assignments to students, with no overlap, resulting in unique answers to certain of the discussion questions.

We suggest only deficient inspections be assigned to enhance the learning process.⁹ Exclusion of registered firms that received clean inspection reports is recommended for two reasons. First, clean reports are very short (providing limited learning opportunities) as the inspection teams did not identify any audit deficiencies warranting discussion in the inspection reports. Second, we believe limiting the population to firms receiving deficient inspections reinforces to the student what the phrase "obtaining sufficient competent evidential matter to support an audit opinion" entails, while providing specific examples of actual auditor shortcomings. We recommend the use of recent inspection reports each semester as matters emphasized by the inspectors change periodically.

⁶ An alternative format is presented at the end of Appendix A. We thank both anonymous reviewers for this observation.

⁷ Arens et al. (2008, 113) suggest, "Audit failure occurs when the auditor issues an incorrect audit opinion because it failed to comply with the requirements of auditing standards." Thus, it is possible that an auditor fails to comply with auditing standards yet still issues the *correct* audit opinion. While the PCAOB does not use the term 'audit failure' in its inspection reports, we view financial restatements resulting from the PCAOB's identification of failure(s) to comply with professional standards as an implicit audit failure.

⁸ We have found it most beneficial to make the assignment approximately a third to halfway through a typical undergraduate auditing semester.

⁹ Daugherty and Tervo (2009) document that 54 percent of triennially inspected firms' initial inspection reports, released through December 2007, contain one or more deficiencies identified by the PCAOB.

EXHIBIT 1**Summary of Learning Objectives Linked to Suggested Discussion Questions**

Learning Objectives	Related Discussion Question(s)
(1) Enable the student to describe the basic format of PCAOB inspection reports	Q1 (date), Q2 (offices), Q3 (personnel), Q4 (public clients), Q5 (audit aspects), Q6 (audits selected), and Q7 (selection criteria)
(2) Have the student discuss the magnitude of deficient audits	Q8 (number of engagements with significant deficiencies)
(3) Require the student to relate identified deficiencies to Generally Accepted Auditing Standards (GAAS)	Q9 (GAAS category violated by failure to obtain sufficient competent evidence)
(4) Students should identify specific audit deficiencies	Q10 (number of specific matters identified as audit deficiencies)
(5) Students should appropriately describe the PCAOB's enforcement provisions	Q11 (investigation of disciplinary proceedings for inspected firm)
(6) The student should identify Generally Accepted Accounting Principles (GAAP) violations	Q12 (PCAOB reporting mechanism for GAAP non-conformity)
(7) Have students evaluate the tone and substance of inspected firms' responses to deficient PCAOB inspections	Q13 (firms' opportunities to review and comment on inspection reports) and Q14 (specific firm response)
(8) The student should be able to perform a critical evaluation of the overall PCAOB inspection report and assessment of the inspected firm's audit quality	Q15 (assessment of quality of firm's work and consideration of invitation to bid for a financial statement audit)
(9) The student should be able to assess the magnitude of deficiencies identified by the PCAOB	Q16 (rank ordering—and support—of audit deficiencies from most to least concerning)
(10) Students should identify auditing procedures to avoid receipt of a deficient inspection report	Q17 (identification of specific audit procedures that should be performed)
(11) Students should identify differences in inspection reports for annually and triennially inspected firms	Q18 (comparison of small and large firm reports with judgment of most favorable)
(12) Enable the student to assess the ability of a specific firm to perform an audit	Q19 (selection and support for firm favored to perform financial statement audit)
(13) Have students consider potential biases that PCAOB inspectors may have due to prior employment as a practicing auditor	Q20 (assessment of pros and cons of former Arthur Andersen personnel performing PCAOB inspections)
(14) Students should assess the equity of small firm inspections by former Big 4 auditors	Q21 (perceived fairness of former Big 4 personnel inspecting smaller firms)

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EXHIBIT 1 (continued)

Learning Objectives	Related Discussion Question(s)
(15) Students should critically analyze the level of transparency provided by PCAOB inspection reports	Q22 (critical analysis of inspection transparency, specifically portions accorded confidential treatment)
(16) The student should describe the requirements of Auditing Standard No. 3 (AS No. 3) and how failure to comply with AS No. 3 requirements may result in a deficient PCAOB inspection report	Q23 (AS No. 3 completion and retention of audit documentation), Q26 (purpose and requirement of audit documentation), and Q28 (fact specific AS No. 3 compliance)
(17) Students should evaluate PCAOB inspection report release timeliness and evaluate the importance of relevance versus reliability	Q24 (critical analysis of factors contributing to delays) and Q25 (inquiry if PCAOB should have deadline to release)
(18) Students should identify common PCAOB criticisms associated with a specific inspection report	Q27 (identification of recurring deficiency)

Annually inspected firms have a higher number of audits inspected (in total), resulting in proportionately longer inspection reports.¹⁰ These reports tend to provide lengthy and specific detail regarding deficiencies on a client-by-client basis. To avoid onerous grading burdens, we recommend the same large firm be assigned to the students for purposes of comparison with their specific smaller firm.

The case provides great flexibility in tailoring to the interests of students at a given institution. Faculty may choose to assign firms with high visibility on campus (through the interview and hiring process), or with large alumni constituencies, so that students may have an opportunity to access “inside” participants as they evaluate the reports. We believe students take a greater interest in firms with local name recognition. Faculty may also consider inviting firm representatives in for a classroom discussion after the case has been completed.¹¹ The case has been used predominately in undergraduate auditing classes in conjunction with a standard auditing text. Both participating universities tend to use case studies, including fraud cases, at the graduate auditing level.

Additional Resources

Faculty may desire to refer students to additional resources beyond the assigned inspection reports and AS No. 3 to further facilitate awareness of issues surrounding the PCAOB inspection process. Such resources might include the so-called “Rule 4010” reports (PCAOB [2007b] is an example). These reports, published at the Board’s discretion, include summaries of the proce-

¹⁰ For the 2004–2007 inspection cycles, eight firms were inspected annually with 521, 348, 351, and 442 audits inspected, respectively, resulting in a simple average of approximately 52 audits inspected per firm (PCAOB 2008b). The average number of audits inspected in the initial round of inspections for 467 triennially inspected firms through December 31, 2007 was 2.87 (Daugherty and Tervo 2009).

¹¹ This has been well received by both students and the participating firms. Completion of the project prior to firm participation in the classroom has resulted in substantive Q&A sessions. PCAOB representatives were invited to participate in the discussions but declined.

dures, findings, and results of the various inspections performed to date. While the comments in Rule 4010 reports are not specific to a particular registered firm, they do address recurring matters discovered during the inspection process and serve to illustrate issues of broad concern to the PCAOB.

Another potential resource would be the inspection deficiency analysis reports (for triennially and annually inspected firms) issued by the AICPA's Center for Public Company Audit Firms (AICPA 2006a, 2006b, respectively). Exhibit 2 summarizes recurring GAAP and GAAS matters noted by the PCAOB inspectors for these differing size firms. Faculty might also assign the PCAOB's document describing inspections (PCAOB 2003) and the PCAOB's reports on the inspections of triennially and annually inspected firms (PCAOB 2007b, 2008b). Exhibit 3 provides links to a number of resources faculty may wish to use.

Case Validation

Collectively, students reacted favorably to the case and exhibited an interest in the PCAOB inspection process. Written comments indicate they found the case to be informative, "real world" representative, a good learning tool with transferable skills, practical, interesting, challenging, and worthy. Students appreciate the name recognition of the Big 4 firm used in validating the case. The case has been administered during two sessions of undergraduate auditing at a large university in the Southwest (101 students), and in seven sections of undergraduate auditing (339 students) and in one session of graduate auditing (23 students) at a large university in the Midwest. The ten sessions of auditing (463 students) were instructed by three different professors. Students worked on the project individually at the Southwest university and individually (164 students) or in teams of two (198 students, 99 teams) at the Midwest university.

Participants were asked to complete a questionnaire (Appendix B) following completion of the project. The questionnaire was completed by 323 (70 percent) students, and collected their opinions on the project including their beliefs on the project's influence of their knowledge of the PCAOB's inspection process, their knowledge of auditors' responsibilities, and their knowledge of the documentation requirements of AS No. 3.¹² Table 1 provides the results of the debriefing questionnaire.

Using a five-point Likert scale, with points labeled as 1 = Strongly Agree, 2 = Agree, 3 = Neutral, 4 = Disagree, and 5 = Strongly Disagree, students found the case to be generally enjoyable (2.57) and to increase their knowledge of the PCAOB's inspection process (1.67), auditors' responsibilities (1.91), and audit documentation requirements of AS No. 3 (1.86). Students also found the project to require a strong level of critical thinking skills (1.88) and did not find the case to be inappropriately difficult (3.54). Students' self-reporting suggests the mean (standard deviation) time per student to complete the project was 5.95 (4.32) hours for students working individually and 4.70 (4.15) hours for students working in teams of two. These time-to-complete parameters should be useful to faculty in assigning point values to the case as compared to other assignments.

¹² A potential limitation presented by the non-responding students is that their responses may have differed from those who did respond. We believe this limitation is mitigated by the high percentage of students completing the debriefing questionnaire. All responses were anonymous in an effort to increase response rates and to minimize potential pressure to respond favorably to the questionnaire.

EXHIBIT 2**Summary of Recurring Financial Statement and Audit Performance Matters Noted in PCAOB Inspection Reports****Smaller Firm PCAOB Inspection Analysis****Financial Statement Matters (10)**

- Revenue recognition, analytical procedures, and cut-off
- Substantive testing of expenses and analytical procedures
- Accounts receivable matters, including failure to resolve confirmation exceptions
- Inventory valuation and observation
- Allowance for loan loss testing
- Accrued expenses, reserves, and contingencies
- Business combinations and acquisitions
- Going concern opinion issues
- Investment testing
- Failure to appropriately address certain equity transactions

Audit Performance Matters (5)

- Failures related to performance and documentation of controls at service organizations
- Failures related to use of other auditors
- Failures to plan, perform, and/or document audits and quarterly reviews
- Failures related to reliance on the work of specialists
- Failures to evaluate and test effectiveness of internal controls

Large Firm PCAOB Inspection Analysis**Financial Statement Matters (10)**

- Confirmation inadequacies, including improper use of negative confirmations
- Insufficient testing of estimates
- Failure to perform substantive and analytical procedures
- Inadequate documentation
- Failure to align control testing with risk assessment
- Improper GAAP accounting
- Inconsistent application and documentation of materiality
- Improper reliance on controls of third-party service organizations
- Use of inadequate sample sizes
- Failure to identify side agreements and multiple-element arrangements

Audit Performance Matters (9)

- Failures related to consideration of internal control in a financial statement audit
- Inappropriate procedures to consider an entity's ability to continue as a going concern
- Failures related to reliance on the work of specialists
- Failures related to auditing accounting estimates
- Inappropriate uses of clients' internal audit functions
- Inappropriate fraud consideration techniques
- Inappropriate evaluations of materiality
- Failures related to performance and documentation of controls at service organizations
- Failures to employ appropriate analytical procedures

Sources: AICPA's Center for Public Company Audit Firms *Smaller Firm PCAOB Inspection Deficiency Analysis* and *Large Firm PCAOB Inspection Deficiency Analysis* reports ([AICPA 2006a](#), [2006b](#), respectively)

EXHIBIT 3
Links to Helpful Resources

Resource	Website Links
AICPA <i>Smaller Firm PCAOB Inspection Deficiency Analysis</i> based on inspection reports issued as of August 15, 2006 (AICPA 2006a)	http://www.aicpa.org/cpcf/download/Small_Firm_PCAOB_Inspection_Deficiency_Analysis_v2006_2.pdf
AICPA <i>Large Firm PCAOB Inspection Deficiency Analysis</i> based on inspection reports issued as of January 19, 2006 (AICPA 2006b)	http://www.aicpa.org/cpcf/download/PCAOB_inspection_deficiency_analysis_january2006.pdf
Auditing Standard No. 3 (PCAOB 2004)	http://www.pcaobus.org/Rules/Rules_of_the_Board/Auditing_Standard_3.pdf
PCAOB's Disciplinary Proceedings (PCAOB 2009b)	http://www.pcaobus.org/Enforcement/Disciplinary_Proceedings/index.aspx
PCAOB's Inspection of Registered Firms (PCAOB 2003)	http://www.pcaobus.org/Rules/Docket_006/Release2003-019.pdf
PCAOB Inspection Report Releases (PCAOB 2005, 2006a, 2007a, 2008a)	http://www.pcaobus.org/Inspections/Public_Reports/index.aspx
PCAOB's website homepage (PCAOB 2009c)	http://www.pcaobus.org/index.aspx
Registered Public Accounting Firms with the PCAOB (PCAOB 2009a)	http://www.pcaobus.org/Registration/Registered_Firms.pdf
Regulations under the Sarbanes-Oxley Act (Miller and Pashkoff 2002)	http://www.aicpa.org/pubs/jofa/oct2002/miller.htm
Report on 2005 <i>Inspection of PricewaterhouseCoopers LLP Issued by the PCAOB</i> , Release No. 104-2006-205 (PCAOB 2006b)	http://www.pcaobus.org/Inspections/Public_Reports/2006/PricewaterhouseCoopers.pdf
<i>Report on the PCAOB's 2004, 2005, and 2006 Inspections of Domestic Triennially Inspected Firms</i> , Release No. 2007-010 (PCAOB 2007b)	http://www.pcaobus.org/Inspections/Other/2007/10-22_4010_Report.pdf
<i>Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms</i> , Release No. 2008-008 (PCAOB 2008b)	http://www.pcaobus.org/inspections/other/2008/12-05_release_2008-008.pdf
Revenue Recognition Deficiencies of Inspected Firms (Leone 2008)	http://www.cfo.com/article.cfm/12236991?f=search
Sarbanes-Oxley Act of 2002 (U.S. House of Representatives, Committee on Financial Services 2002)	http://www.pcaobus.org/About_the_PCAOB/Sarbanes_Oxley_Act_of_2002.pdf
Using PCAOB Inspection Reports to Add Credibility and Relevance While Teaching Auditing Concepts (Miller 2007)	http://aaahq.org/audit/Pubs/Audrep/07summer/item01.htm

TABLE 1
Results of Debriefing Questionnaire

	<u>University 1</u>	<u>University 2</u>	<u>Weighted Average</u>
Number of respondents	223	100	
	Mean (Standard Deviation)		
(1) I enjoyed the project.	2.55 (0.81)	2.62 (0.87)	2.57 (0.83)
(2) The project required me to use critical thinking skills.	1.96 (0.64)	1.69 (0.68)	1.88 (0.66)
(3) The project requirements were too difficult.	3.65 (0.73)	3.30 (0.78)	3.54 (0.77)
(4) The project increased my knowledge of the PCAOB inspection process.	1.71 (0.69)	1.59 (0.60)	1.67 (0.67)
(5) The project increased my knowledge of auditors' responsibilities.	1.96 (0.67)	1.80 (0.71)	1.91 (0.68)
(6) The project increased my knowledge of audit documentation required by the PCAOB's Auditing Standard No. 3 (AS No. 3).	1.88 (0.66)	1.81 (0.72)	1.86 (0.68)

Scale: 1 = Strongly Agree, 2 = Agree, 3 = Neutral, 4 = Disagree, 5 = Strongly Disagree.

To formalize validation of the case's usefulness, student participants were asked to complete a debriefing questionnaire following their completion of the project. All questionnaire responses were anonymous as to the particular student completing the feedback. At the first university, the case was administered to seven sections of undergraduate auditing (339 students) and one section of graduate auditing (23 students). At the second university, the case was administered to two sections of undergraduate auditing (101 students). In cases where students completed the project in teams of two (99 teams at the first university), each team member was asked to complete the questionnaire independent of their teammate. The names of the universities and classes are available upon request. The questionnaire itself is included as Appendix B.

APPENDIX A

DISCUSSION QUESTIONS

- (1) What is (are) the date(s) that the PCAOB conducted their fieldwork for the inspection?¹³
- (2) How many offices did the registered firm have?
- (3) How many partners and how many professional staff did the registered firm have?
- (4) What was the number of issuer audit clients at the date of the inspection?
- (5) Did the PCAOB review all aspects of selected audits?
- (6) How many financial statement audits were selected for inspection?
- (7) Was the registered firm allowed an opportunity to limit or influence the selection process?
- (8) For how many *audits* did the PCAOB inspection team identify matters that it considered to

¹³ Faculty may wish to have students identify the date the PCAOB inspection report was publicly released and calculate the time lag from completion of inspection fieldwork to report release to enhance the saliency of delays in releasing inspection reports. We thank an anonymous reviewer for this suggestion.

be deficiencies of such significance that it appeared the registered firm did not obtain sufficient competent evidential matter to support its opinion on the issuers' financial statements?

(9) Which category (general, fieldwork, or reporting) of Generally Accepted Auditing Standards (GAAS) does the failure to obtain sufficient competent evidential matter violate?

(10) How many *specific matters* identified as audit deficiencies did the PCAOB detail in its inspection report on the registered firm?

(11) Has this registered firm been the subject of disciplinary proceedings by the PCAOB?

(12) When it comes to the PCAOB's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with Generally Accepted Accounting Principles (GAAP), to whom does the PCAOB report that information?

(13) Was the registered firm provided an opportunity to review and comment on a draft of the inspection report?

(14) Did the registered firm provide a written response that was appended to the PCAOB's inspection report?

(15) Suppose you are the chairperson of the audit committee of a publicly traded company and you are considering engaging a new registered public accounting firm to audit the company. What is your view (200–250 words) of the quality of the audit work provided by your assigned registered firm and would you consider inviting this firm to submit a proposal for a financial statement audit? Why or why not?

(16) The PCAOB identified nine PwC audits (Issuers A through I) where it appeared to the inspection team that PwC did not obtain sufficient competent evidential matter to support its opinion on the issuer's financial statements. Rank order these nine inspected audits from most concerning to least concerning and support your highest ranking and lowest ranking.

(17) For the three most concerning audit deficiencies identified above, what specific procedure(s) could the audit engagement team have performed to avoid receiving the PCAOB's comments?

(18) Compare and contrast the PCAOB inspection reports for your assigned firm and for PwC (200–250 words). Which firm do you think received the more favorable inspection report? Why?

(19) Which firm (your assigned firm or PwC) would you rather hire to perform a financial statement audit? Why?

(20) Some PCAOB inspectors are former Arthur Andersen partners and senior managers. Some allege these individuals have a "chip on their shoulder" and go overboard in the inspection process, while others maintain these individuals are uniquely qualified to perform inspections since they previously worked for Arthur Andersen, whose massive audit failures (i.e., Enron, WorldCom, etc.) were influential in the passage of SOX. Briefly describe the pros and cons of former Arthur Andersen personnel performing PCAOB inspections. Do you think it is beneficial to have these individuals performing inspections? Why or why not?

(21) New PCAOB inspectors are primarily hired from the Big 4 public accounting firms (Deloitte, Ernst & Young, KPMG, and PwC). Keeping in mind that there are nearly 1,900 firms registered with the PCAOB (including a number of small firms or sole proprietorships—and many of the firms do not currently audit public companies), do you believe it is "fair" for smaller firms to be inspected by individuals who previously worked for the Big 4? Why or why not?

(22) The PCAOB inspection process is generally viewed as increasing the transparency of the audit process since inspection reports are publicly posted on the PCAOB website. However, any defects in, or criticisms of, the registered firm's quality control system are viewed as "confidential" and are not discussed in the public portion of the PCAOB inspection report. Why do you think a

firm's quality control system is granted confidential treatment? Do you believe defects and criticism of a firm's quality control system should be made public? Why or why not?

(23) AS No. 3 provides guidance to auditors regarding completion and retention of audit documentation. How many days after the report release date does an auditor have to finalize audit documentation? For how many years must the auditor retain the audit documentation?

(24) The PCAOB has been criticized for the lack of timeliness in releasing inspection reports. The PwC report was publicly released approximately nine months after the completion of inspection fieldwork. What factors do you believe contribute to this delay?

(25) Should the PCAOB be required to release the inspection reports within a shorter time-frame? Why or why not?

(26) AS No. 3 specifies that audit documentation is designed for an experienced auditor having no previous connection with the audit engagement. An experienced auditor is described as an individual who has a "reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry." What should audit documentation enable the experienced auditor to do?

(27) Part 1 of the PwC inspection report states that the conclusion that PwC failed to perform an audit procedure may be based on the absence of "documentation" and "persuasive other evidence." As you read through the deficiencies of Issuers A through I in the PwC inspection report, what is the underlying criticism of PwC's audit procedures related to managements' explanations and assumptions?

(28) On one of the PwC audits, the audit engagement team was criticized with respect to reliance on reports generated by a service organization. What audit procedure(s) should PwC have performed and what audit documentation should they have included in the work papers in order to comply with AS No. 3?¹⁴

ALTERNATIVE FORMAT TEMPLATE

Discussion Question ¹⁵	Large Firm Student Response ¹⁶	Small Firm Student Response
(1) What is (are) the date(s) that the PCAOB conducted their fieldwork for the inspection?		
(2) How many offices did the registered firm have?		
(3) How many partners and how many professional staff did the registered firm have?	NA	
(4) What was the number of issuer audit clients at the date of the inspection?	NA	
(5) Did the PCAOB review all aspects of selected audits?		

¹⁴ An alternative format template is provided on the next page if faculty members wish to have their students compare and contrast certain of the discussion questions for both the large firm and small firm inspection report. We thank both anonymous reviewers for this suggestion.

¹⁵ The case was validated where students were assigned Discussion Questions 1 through 15 for their smaller assigned firm and Discussion Questions 16, 17, 27, and 28 for their large assigned firm. The case is adaptable whereby instructors may have students answer most questions for both firms. Minor wording changes would need to be made to some of the discussion questions.

¹⁶ Some information provided for triennially inspected firms is not provided for annually inspected firms.

Discussion Question ¹⁵	Large Firm Student Response ¹⁶	Small Firm Student Response
(6) How many financial statement audits were selected for inspection?	NA	
(7) Was the registered firm allowed an opportunity to limit or influence the selection process?		
(8) For how many <i>audits</i> did the PCAOB inspection team identify matters that it considered to be deficiencies of such significance that it appeared the registered firm did not obtain sufficient competent evidential matter to support its opinion on the issuers' financial statements?		
(9) Which category (general, fieldwork, or reporting) of Generally Accepted Auditing Standards (GAAS) does the failure to obtain sufficient competent evidential matter violate?		
(10) How many <i>specific matters</i> identified as audit deficiencies did the PCAOB detail in its inspection report on the registered firm?		
(11) Has this registered firm been the subject of disciplinary proceedings by the PCAOB?		
(12) When it comes to the PCAOB's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with Generally Accepted Accounting Principles (GAAP), to whom does the PCAOB report that information?		
(13) Was the registered firm provided an opportunity to review and comment on a draft of the inspection report?		
(14) Did the registered firm provide a written response that was appended to the PCAOB's inspection report?		
(15) Suppose you are the chairperson of the audit committee of a publicly traded company and you are considering engaging a new registered public accounting firm to audit the company. What is your view (200–250 words) of the quality of the audit work provided by your assigned registered firm and would you consider inviting this firm to submit a proposal for a financial statement audit? Why or why not?		

Discussion Question ¹⁵	Large Firm Student Response ¹⁶	Small Firm Student Response
(16) The PCAOB identified nine PwC audits (Issuers A through I) where it appeared to the inspection team that PwC did not obtain sufficient competent evidential matter to support its opinion on the issuer's financial statements. Rank order these nine inspected audits from most concerning to least concerning and support your highest ranking and lowest ranking.		NA ¹⁷
(17) For the three most concerning audit deficiencies identified above, what specific procedure(s) could the audit engagement team have performed to avoid receiving the PCAOB's comments?		NA
(18) Compare and contrast the PCAOB inspection reports for your assigned firm and for PwC (200–250 words). Which firm do you think received the more favorable inspection report? Why?		
(19) Which firm (your assigned firm or PwC) would you rather hire to perform a financial statement audit? Why?		
(20) Some PCAOB inspectors are former Arthur Andersen partners and senior managers. Some allege these individuals have a "chip on their shoulder" and go overboard in the inspection process while others maintain these individuals are uniquely qualified to perform inspections since they previously worked for Arthur Andersen, whose massive audit failures (i.e., Enron, WorldCom, etc.) were influential in the passage of SOX. Briefly describe the pros and cons of former Arthur Andersen personnel performing PCAOB inspections. Do you think it is beneficial to have these individuals performing inspections? Why or why not?		NA ¹⁸

¹⁷ The assignment of a unique smaller firm to each student would likely create undue grading burdens on the instructor to have students answer Discussion Questions 16 and 17 for the smaller firm.

¹⁸ Students should provide a combined response to discussion questions 20 and 22–26, as all of these questions relate to the overall PCAOB inspection process or PCAOB guidance and are equally applicable to large and small firms.

Discussion Question ¹⁵	Large Firm Student Response ¹⁶	Small Firm Student Response
(21) New PCAOB inspectors are primarily hired from the Big 4 public accounting firms (Deloitte, Ernst & Young, KPMG, and PwC). Keeping in mind that there are nearly 1,900 firms registered with the PCAOB (including a number of small firms or sole proprietorships—and many of the firms do not currently audit public companies), do you believe it is “fair” for smaller firms to be inspected by individuals who previously worked for the Big 4? Why or why not?	NA	
(22) The PCAOB inspection process is generally viewed as increasing the transparency of the audit process since inspection reports are publicly posted on the PCAOB website. However, any defects in, or criticisms of, the registered firm’s quality control system are viewed as “confidential” and are not discussed in the public portion of the PCAOB inspection report. Why do you think a firm’s quality control system is granted confidential treatment? Do you believe defects and criticism of a firm’s quality control system should be made public? Why or why not?	NA	
(23) AS No. 3 provides guidance to auditors regarding completion and retention of audit documentation. How many days after the report release date does an auditor have to finalize audit documentation? For how many years must the auditor retain the audit documentation?	NA	
(24) The PCAOB has been criticized for the lack of timeliness in releasing inspection reports. The PwC report was publicly released approximately nine months after the completion of inspection fieldwork. What factors do you believe contribute to this delay?		
(25) Should the PCAOB be required to release the inspection reports within a shorter timeframe? Why or why not?	NA	

Discussion Question ¹⁵	Large Firm Student Response ¹⁶	Small Firm Student Response
(26) AS No. 3 specifies that audit documentation is designed for an experienced auditor having no previous connection with the audit engagement. An experienced auditor is described as an individual who has a “reasonable understanding of audit activities and has studied the company’s industry as well as the accounting and auditing issues relevant to the industry.” What should audit documentation enable the experienced auditor to do?	NA	
(27) Part 1 of the PwC inspection report states that the conclusion that PwC failed to perform an audit procedure may be based on the absence of “documentation” and “persuasive other evidence.” As you read through the deficiencies of Issuers A through I in the PwC inspection report, what is the underlying criticism of PwC’s audit procedures related to managements’ explanations and assumptions?		
(28) On one of the PwC audits, the audit engagement team was criticized with respect to reliance on reports generated by a service organization. What audit procedure(s) should PwC have performed and what audit documentation should they have included in the work papers in order to comply with AS No. 3?		NA ¹⁹

¹⁹ The assignment of a unique smaller firm to each student would likely create undue grading burdens on the instructor to have students answer this Discussion Question for the smaller firm.

APPENDIX B

STUDENT QUESTIONNAIRE PCAOB INSPECTIONS OF REGISTERED FIRMS PROJECT

Your status (check one): _____ Undergraduate student _____ Graduate student

For each of the following, please circle one number on each scale that best indicates your level of agreement with each statement:

(1) I enjoyed the project.

1	2	3	4	5
Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

(2) The project required me to use critical thinking skills.

1	2	3	4	5
Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

(3) The project requirements were too difficult.

1	2	3	4	5
Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

(4) The project increased my knowledge of the PCAOB's inspection process.

1	2	3	4	5
Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

(5) The project increased my knowledge of auditors' responsibilities.

1	2	3	4	5
Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

(6) The project increased my knowledge of audit documentation required by the PCAOB's Auditing Standard No. 3 (AS No. 3).

1	2	3	4	5
Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

I estimate that I spent _____ hours and/or _____ minutes completing this project.

I estimate my partner spent _____ hours and/or _____ minutes completing this project.

Please add any additional comments you desire to provide below or on the reverse side.

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