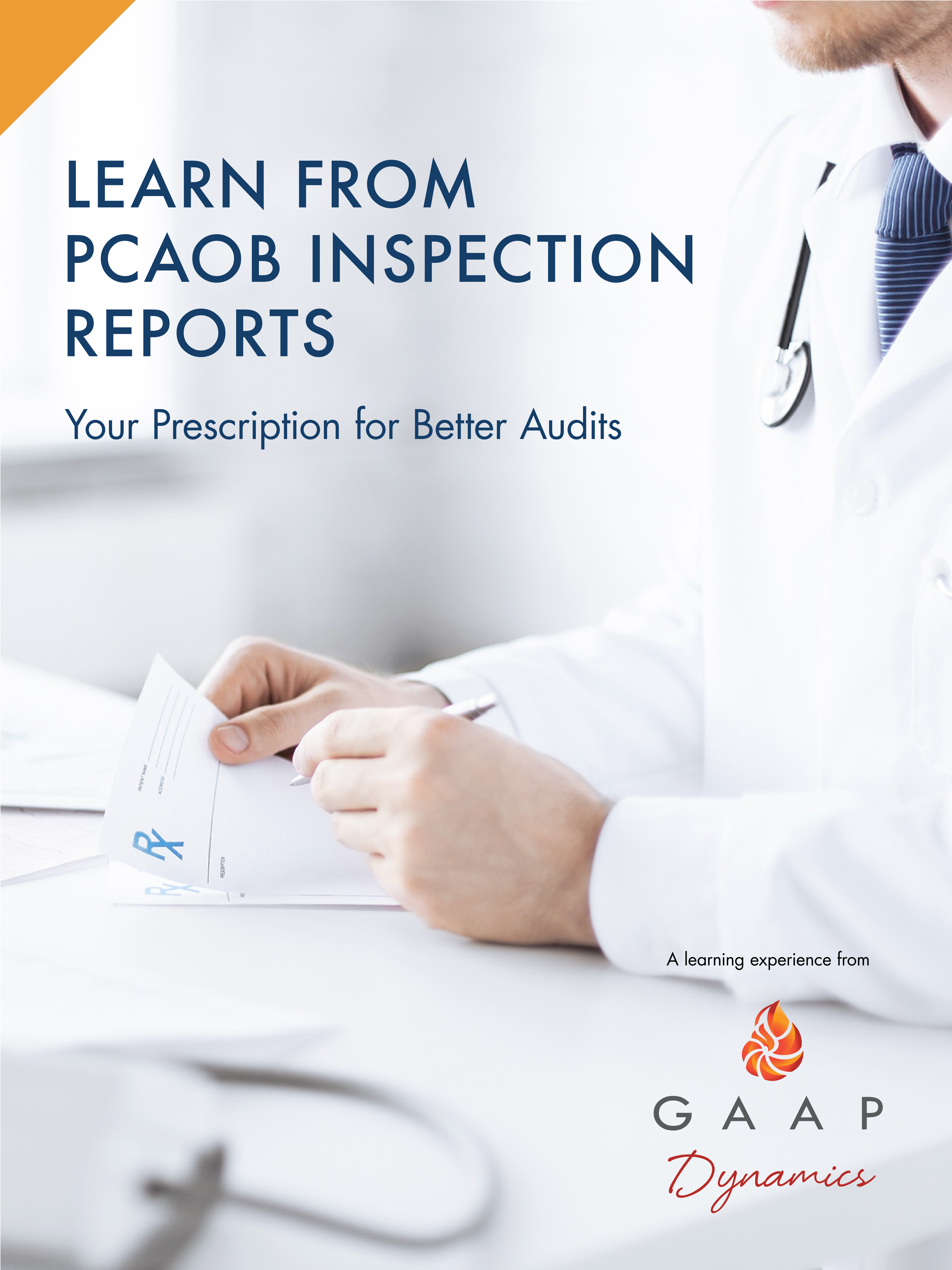


LEARN FROM PCAOB INSPECTION REPORTS

Your Prescription for Better Audits

A learning experience from

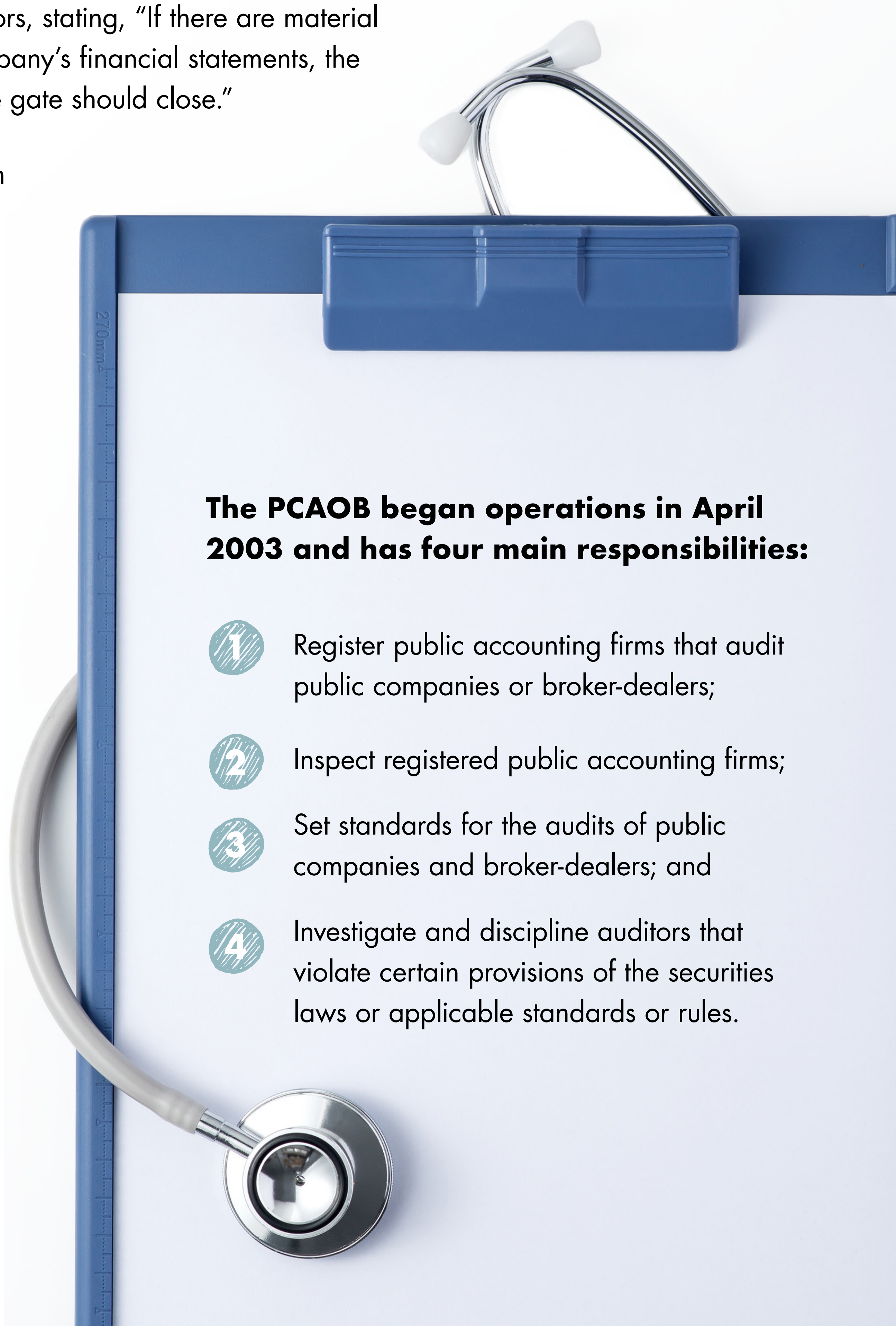
GAAP Dynamics

Preface

Confidence in public company financial reporting is essential to the strength and vitality of our nation's securities markets. James Doty knows the importance of high-quality, independent audits, referring to them as the "linchpin" of the financial markets. He refers to auditors as "gatekeepers" who protect investors, stating, "If there are material misstatements or omissions in a company's financial statements, the auditor must qualify the opinion. The gate should close."

He should know. He is the Chairman of the Public Company Accounting Oversight Board ("PCAOB" or "the Board"), the "watchdog" of the external auditors of SEC registrants. Congress created the PCAOB to protect investors and to further the public interest by overseeing the work of accounting firms that audit publicly traded companies.

Trust us;
with this kind of power
and authority, you do
not want to be on their
"naughty list!"



The PCAOB began operations in April 2003 and has four main responsibilities:

1. Register public accounting firms that audit public companies or broker-dealers;
2. Inspect registered public accounting firms;
3. Set standards for the audits of public companies and broker-dealers; and
4. Investigate and discipline auditors that violate certain provisions of the securities laws or applicable standards or rules.

This eBook focuses on PCAOB inspections. These inspections identify deficiencies in how accounting firms perform their audits and detect weaknesses in quality controls over their audits of public companies. Some deficiencies are deemed so significant that the audit firm did not obtain sufficient appropriate audit evidence at the time it issued its audit report to support its opinion that:

- The financial statements were presented fairly, in all material respects, in accordance with the applicable reporting framework
- The issuer had maintained, in all material respects, effective internal control over financial reporting ("ICFR")

PCAOB inspection reports describe audit deficiencies noted during inspections of accounting firms and are made public for all to see!

The PCAOB takes a risk-based approach in selecting engagements for inspection, and you can bet that it will continue to focus on areas it believes to be the highest risk. You do not need a doctorate to figure out that the Board will continue to pummel audit firms in the areas where they've made mistakes in the past.

"Those who do not remember the past are condemned to repeat it."

George Santayana wrote this quote in his book, *The Life of Reason*, in 1905. Here we are, over 100 years later, and audit firms would be wise to heed his words!

We published this eBook to help auditors:

- Learn from findings in recent PCAOB inspection reports,
- Improve audit training,
- Prevent recurring audit deficiencies, and
- Strengthen the quality of their audits.

HOME

Table of Contents

Executive Summary

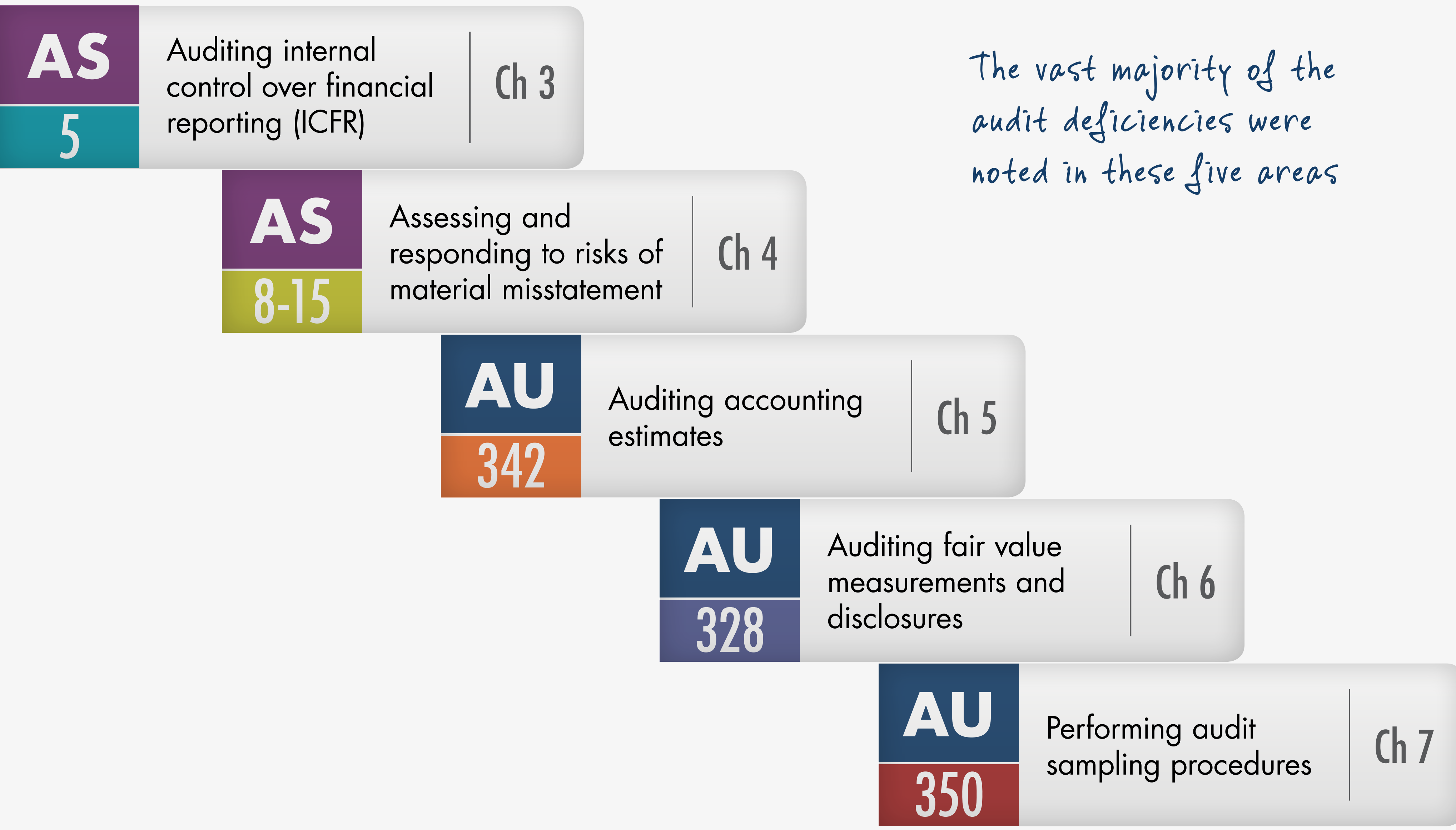
A Diagnosis of PCAOB Inspection Reports

3 **out of** 10 audits are dead on arrival and do not have sufficient audit evidence to support the audit opinion. The prognois is slightly better for Big 4 firms; slightly worse for others!

This statement sounds alarming, but it is accurate based on our in-depth analysis of the PCAOB inspection reports of annually inspected firms over the past seven inspection cycles (2009-2015).

Our analysis of the ten annually inspected firms (Chapter 2) shows:

- The combined audit deficiency rate now stands at 30%, a significant decrease from around 40% where it hovered for a number of years.
- The difference between combined audit deficiences of Big 4 firms (28%) as compared to other annually inspected firms (35%), has narrowed considerably from prior years
- The lowest audit deficiency rate of the annually inspected firms was 0%! The highest was 52%.
- Unfortunately, the types of audit deficiencies noted remain unchanged.



The vast majority of the audit deficiencies were noted in these five areas

In Chapter 8, we talk about the preliminary results of the 2016 inspections. Good news! The PCAOB has noted a decrease in the number of audit deficiencies in the annually inspected firms. However, the causes of deficiencies remains the unchanged.

The PCAOB also inspects non-U.S. firms and, to date, the PCAOB has inspected firms in 48 non-U.S. jurisdictions. However, as we discuss in Chapter 9, there are still certain locations where PCAOB inspections cannot take place for various reasons.

In the final chapter (Chapter 10), we discuss treatment options firms can take now to improve the quality of their audit training and, ultimately, the quality of their audits.

Without further ado, we present the second edition of our PCAOB eBook!