

# **Auditing after Sarbanes-Oxley**

**Illustrative Cases**

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**Jay C. Thibodeau**

**Deborah Freier**

**McGraw-Hill**

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AUDITING AFTER SARBANES-OXLEY: ILLUSTRATIVE CASES

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This book is dedicated to Ellen, my extraordinary wife of 15 years, and my children, Jenny, Eric, and Jessica. You have all provided the inspiration for me to undertake and complete this project.

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**Jay C. Thibodeau**

I dedicate this book in loving memory of my father, Martin Freier, who inspired me to work hard and to strive for excellence. He also inspired me and others with his strength, his integrity, his dedication to family and friends, his desire to help others, his deep abiding love for learning, his wide array of talents and interests, and his appreciation for life. He was a great man and will truly be missed.

This book is also dedicated to Matt, who always believed in me and was a constant source of support.

**Deborah Freier**

## **About the Authors**

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Dr. Thibodeau is the Edward F. Gibbons Research Professor at Bentley College. He received his B.S. degree from the University of Connecticut in December 1987 and his Ph.D. from the University of Connecticut in August 1996. He joined the faculty at Bentley College in September of 1996 and has worked there ever since. During his sabbatical in the Fall Semester of 2003, Jay worked with PricewaterhouseCoopers' Learning & Education group to help deliver critical knowledge about the post-Sarbanes-Oxley technical audit guidance to professionals throughout the firm. He has consulted with PricewaterhouseCoopers ever since. At Bentley College, he serves as the coordinator for all audit and assurance curriculum matters.

Dr. Thibodeau currently serves as the Chair of the National Education Committee for the American Accounting Association's Auditing Section. He has been published in *Auditing: A Journal of Practice & Theory*, *Issues in Accounting Education*, *Commercial Lending Review*, *Advances in Accounting Education*, *Asian-Pacific Journal of Accounting*, *Practical Accountant*, and *Journal of Financial Education and Managerial Auditing*. He has received national recognition for his work three times: first, for his doctoral dissertation, winning the 1996 Outstanding Doctoral Dissertation Award presented by the American Accounting Association's ABO Section; second, for curriculum innovation, winning the 2001 Joint AICPA/AAA Collaboration Award; and third, also for curricular innovation, winning the 2003 Innovation in Assurance Education Award.

## **Deborah Freier**

Deborah Freier graduated as the valedictorian of her class at Bentley College. Ms. Freier was also honored by the Financial Executives Institute as the Outstanding Graduating Student and received the *Wall Street Journal* Student Achievement Award. Ms. Freier placed in the semi-finals of the Institute for Management Accountants 2000 National Student Case Competition. She was also inducted into Beta Gamma Sigma, Beta Alpha Psi, Omicron Delta Epsilon, and the Falcon Society. In addition, she was the co-chair of Beta Alpha Psi's student leadership conference her senior year and was a member of the winning teams in the Bentley College Strategy Case and Business Bowl competitions.

Ms. Freier worked several years as a research associate in the Strategy Department at Harvard Business School. She collaborated with professors to create content for cases, presentations, and articles that explored issues related to competitive advantage, intellectual property strategies, network effects and standards wars, and expansion into new geographic and strategic markets. She also developed teaching materials for an elective course about game theory and its application to business strategy. During her time at Harvard Business School, Ms. Freier co-authored more than 15 cases.

Ms. Freier is currently working as a senior analyst in the Strategy and Product Development Department at Tufts Health Plan, where she plays a key role in developing financial and competitive analyses for senior management.

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## **Preface**

After a multitude of high profile business failures and accounting restatements (Enron, WorldCom, and Qwest, to



name a few) in 2001 and early 2002, Congress responded to the eroding investor confidence in audited financial statements by passing the Sarbanes-Oxley Act of 2002 (SOX). This law has required auditors to increase their audit work on internal controls systems and has forced audit firms to revamp their audit processes for publicly traded companies. The changes have been far-reaching and dramatic for both audit firms and their clients.

In the face of these sweeping regulatory changes, as well as other changes in the profession, auditing education needs to rise to the challenge of preparing audit professionals. *Auditing after Sarbanes-Oxley* presents instructors with 35 cases focusing on specific audit issues that were directly impacted by Sarbanes-Oxley, using the actual companies—Enron, WorldCom, Qwest—that have become synonymous with the capital markets’ crisis in confidence. Importantly, the cases provide in-depth, up-to-date coverage of the post-Sarbanes technical audit guidance issued by the PCAOB.

Our approach to this book emphasizes the substantial benefits of using real life case examples in helping to impart knowledge related to the practice of auditing. In the education psychology literature, this type of approach has long been acknowledged as a superior manner in which to impart knowledge. In addition, there is evidence from other disciplines that the use of cases as a mechanism to impart a range of critical auditing skills, including technical skills, interpersonal relations, and ethical analysis, will be quite effective. So, by presenting the concepts of auditing using actual corporate contexts, we seek to provide readers with a real-life appreciation of these issues and clearly demonstrate the value of the Sarbanes-Oxley Act of 2002 and other changes that have been mandated by the PCAOB.

We set out to design a casebook that could be easily adopted by instructors in their classes. The cases run only three to five pages in length, which dramatically reduces the time necessary for students to grasp key learning objectives. In addition, each case focuses on a specific topic to help ensure student mastery of that topic. Our approach can be contrasted with many traditional audit cases that range from 10 to 20 pages in length and introduce multiple learning objectives concurrently.

In addition, our book has been designed to reflect an organization that closely mirrors the leading auditing and assurance textbooks. We have grouped our cases into the following categories: Ethics and Professional Responsibility; Understanding the Client’s Business and Industry; Internal Control Systems; and Audits of Accounts, Processes, and Assertions. In looking over the table of contents for this book, you will note that each category has multiple cases that can be used in the classroom. This was done for two reasons. First, it allows instructors the

opportunity to illustrate the critically important auditing concepts with multiple real-life contexts, if they so choose. And second, it affords instructors with an opportunity to assign the cases on a rotating basis, if they so choose. Consider that with 35 different cases, instructors can assign 8 to 9 different cases for each of four different semesters. This will reduce the possibility of case solutions circulating around campus. Also, we have provided complete company cases to give instructors the option of presenting longer cases that focus on several issues related to a particular company.

Finally, and perhaps most important, each of our cases will contribute to students' understanding of the changes brought about by the Sarbanes-Oxley Act of 2002, a significant objective in any current undergraduate or graduate auditing course. For example, in its Auditing Standard No. 2, "An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements," the PCAOB has made clear that evaluating and documenting the relationship between the internal control activities and the financial statement assertions (PCAOB 2004, Paragraph #84) is instrumental in completing the audit, underscoring the importance of understanding the linkage between internal control activities, internal control objectives, and financial statement assertions. Thus, one important and explicit objective of this book is to help impart knowledge about these linkages through the use of real-life case examples.

## **Technical Audit Guidance**

To maximize a student's knowledge acquisition of this material, this book has been designed to be read in conjunction with the post-Sarbanes-Oxley technical audit guidance. All of the post-Sarbanes-Oxley technical guidance is available for free at <http://www.pcaobus.org/Standards/index.aspx>. In addition, a summary of the Sarbanes-Oxley Act of 2002 is also available for free at [http://www.aicpa.org/info/sarbanes\\_oxley\\_summary.htm](http://www.aicpa.org/info/sarbanes_oxley_summary.htm).

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