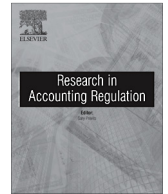


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Including audit regulation in the accounting curriculum



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ABSTRACT

Audits and auditors are regulated to uphold audit quality, thus regulation is important to the public interest and clearly impacts firms and CPAs. Moreover, the reach of audit regulation has expanded greatly in the last decade with the establishment of the Public Company Accounting Oversight Board (PCAOB). Recent research and calls from the profession point to enhancing the coverage of audit regulation in the accounting curriculum so that students understand the consequences of failing to adhere to professional standards. In this paper, we propose regulatory content for inclusion in the curriculum, we survey and catalog existing auditing textbooks and other educational materials for regulatory content, and we suggest flexible alternatives for incorporating this topic into the curriculum. It is our hope that, with these resources, faculty can more effectively include audit regulation in the classroom and achieve a high level of student comprehension and learning on the topic.

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1. Introduction/motivation

With the passage of the Sarbanes–Oxley Act in 2002 (hereafter “the Act”) and the birth of the Public Company Accounting Oversight Board (PCAOB or the “Board”) shortly thereafter, a multi-faceted regulatory model has emerged for the auditing profession, governing auditors themselves and the audits that they perform. Though states are the final regulators of CPAs licensed in their jurisdictions, and the Securities and Exchange Commission (SEC) regulates auditors as needed, the PCAOB and the American Institute of Certified Public Accountants (AICPA or the “Institute”) regulate the profession through routine inspections and the fielding and investigation of complaints. The PCAOB’s periodic inspection program applies to a firm’s public company audit practice; the AICPA’s Peer Review Program (PRP) applies to a firm’s non-public client

audit practice. AICPA members must also comply with the AICPA’s ethics standards through a separate Professional Ethics program. Firms and CPAs with negative findings in inspection, PRP, or ethics investigations risk fines, penalties, or losing their ability to practice in the public company audit arena and/or their membership in the AICPA. These consequences may result in the loss of licensure if a state board so acts.

The PCAOB was created in 2002 by the Sarbanes–Oxley Act (SOX), in response to public outrage over financial statement frauds perpetrated by major companies such as Enron, WorldCom and Tyco. The Board inspects auditors, establishes audit standards and disciplines lawbreakers. The same public scrutiny of the audit profession led the AICPA to overhaul its Quality Control Standards in 2010. PCAOB Chairman James Doty has stated “the global audit firm is not too big to fail; it is too important to leave unregulated” (Doty, 2011). In short, accounting regulation is a topic vitally important to both firms and individuals in the profession.¹

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¹ See Appendix D for a list of acronyms related to audit regulation.

Regulation is imposed to uphold audit quality, thus it is important to the public interest and clearly impacts firms and CPAs. Something of such importance should be incorporated into the accounting curriculum (Arens & Elder, 2006), but typically it receives only tangential coverage. AACSB's Accounting Accreditation Standards include "the ethical and regulatory environment for accountants" in its list of curriculum content areas in Standard A6 (AACSB, 2013). In January 2007, the American Accounting Association's Auditing Midyear Conference included a panel titled "The PCAOB Inspection Process: What Your Auditing Students Should Know." The goal of the discussion was to offer educators suggestions to prepare students for careers in auditing. "Panel members emphasized that students, especially those planning to take positions at firms that audit public companies, should have knowledge of SOX, the PCAOB, and its inspection process, as well as the SEC's regulatory role, including an understanding of the regulations affecting auditors of public companies." (Riley, Jenkins, Roush, & Thibodeau, 2008, pA20). A more recent survey of staff/senior auditors at five large firms confirmed the importance of studying regulation, ranking SEC regulation² as ninth out of the 23 topics considered most important to their positions as auditors and as sixth for needing more emphasis in the accounting curriculum (Frecka & Reckers, 2010).

Accounting educators have also emphasized the value of regulatory materials in the classroom. Miller (2007) suggests using PCAOB inspection reports as a way to underscore the relevance of topics covered in an auditing course. Daughterty and Pitman (2009, p81) propose using cases based on PCAOB inspection reports to "reinforce students' understanding of the practical matters involved in appropriately obtaining, evaluating, and documenting audit evidence." Gilbertson and Herron (2009, pA16) find similar outcomes using PCAOB enforcements as case studies of audit failures. They report that "this 'watching the train wreck' approach is a very vivid, effective teaching method." Gramling and Watson (2009, pA2) argue that analysis of peer review deficiencies "provides educators of current and future auditors of non-public clients with areas of focus for improving audit quality."

The purpose of this paper is to provide alternatives for including auditor³ regulation in the accounting curriculum. First, we propose regulatory content for inclusion in the curriculum. Second, we survey and catalog existing auditing textbooks and other educational materials for regulatory content. Third, we propose flexible alternatives for incorporating the content into the curriculum.

2. Regulation of auditors – What students should know

Regulation of the auditing profession is a complex maze of various groups responsible for promulgating standards or monitoring compliance with various rules, while the ultimate authority to license individuals and firms rests with

State Boards of Accountancy. Some of the rules apply to audit engagements, some apply to firm practices, and yet others apply to behavior of individual CPAs. To start, students should know which regulatory bodies do what in this regulatory puzzle. We have grouped these regulators into three functional categories: Gatekeepers, Standard Setters, and Enforcement Authorities. Gatekeepers are bodies that have authority to admit auditors to practice or to bar them. Standard Setters establish standards that govern the firms' quality control, conduct of audit engagements, and individual CPA behavior. Enforcement Authorities monitor firms' and CPAs' compliance with those standards. Note that some entities play multiple roles in accounting regulation. Fig. 1 depicts these bodies and their roles.

3. Auditor regulation curriculum resources

The above discussion demonstrates the multi-dimensional nature of auditing regulation. Many bodies are charged with multiple roles. Faculty need to facilitate the inclusion of audit regulation in the accounting curriculum. Partial motivation for this paper is the authors' conviction that there are very few resources to support faculty who wish to include auditor regulation in their classes and that resources that do exist are highly fragmented. To assess this belief, we surveyed the content of six leading auditing textbooks⁴, and summarized the results in three ways: number of in-chapter pages in each textbook devoted to discussion of regulatory bodies and programs with regulatory roles (Table 1); extent of end-of-chapter (EoC) items available in each textbook (Table 2); and an overall summary of the learning domain distribution addressed in EoC materials for all six textbooks combined (Table 3).⁵

We reviewed the six chosen textbooks and tallied the number of cumulative pages that related to *bodies* with regulatory roles (Table 1, Panel A) or the regulatory *programs* (Table 1, Panel B). We excluded pages that discussed actual audit standards for public, private, or nonprofit entities, since this is the primary role of auditing textbooks, and most of an audit text's pages are devoted to these standards. The exception was Generally Accepted Government Auditing Standards (GAGAS); because some audit textbooks cover GAGAS while most do not, we included coverage of actual GAGAS in the page count for the Government Accountability Office (GAO) presented in Table 1 combined with coverage of the GAO *per se*. Overall, coverage of regulatory topics varied widely between textbooks and between topics. Instructors can review this table as an initial cue on regulatory topics included and emphasized in a particular textbook, then use this information in selecting curriculum resources to enhance the textbook. It should be noted that, without exception, regulatory

⁴ We surveyed the five most popular texts according to a 2003 AAA study [10], plus one new text.

⁵ In providing information on regulatory topics within textbooks, we do not intend to reflect positively or negatively on any single book. We took a quantitative approach and limited our evaluation to regulatory topics, admittedly a very minor portion of auditing textbooks. The analysis is intended to provide a picture of regulatory coverage for these textbook's adopters. It is not intended to direct an adoption decision, as many factors are considered in this decision.

² No other topics on the list referred to regulation.

³ We use the terms auditor regulation and audit regulation interchangeably to refer to regulation applicable to firms conducting audits and individuals holding a CPA license.

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