PCAOB
Public Company Accounting Oversight Board

1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8430
www.pcaobus.org

Report on

2005 Inspection of McGladrey & Pullen, LLP

Issued by the

Public Company Accounting Oversight Board

November 30, 2006

THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

PORTIONS OF THE COMPLETE REPORT ARE OMITTED FROM THIS DOCUMENT IN ORDER TO COMPLY WITH SECTIONS 104(g)(2) AND 105(b)(5)(A) OF THE SARBANES-OXLEY ACT OF 2002

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Preface to Reports Concerning Annually Inspected Firms

The Sarbanes-Oxley Act of 2002 requires the Public Company Accounting Oversight Board ("PCAOB" or "the Board") to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers. The Board's report on any such inspection includes this preface to provide context for information in the public portion of the report.

A Board inspection includes, among other things, a review of selected audits of financial statements and of internal control over financial reporting. If the Board inspection team identifies deficiencies in those audits, it alerts the firm to the deficiencies during the inspection process. Deficiencies that exceed a certain significance threshold are also summarized in the public portion of the Board's inspection report. The Board encourages readers to bear in mind two points concerning those reported deficiencies.

First, inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, a firm must take appropriate action to assess the importance of the deficiency to the firm's present ability to support its previously expressed audit opinions. Depending upon the circumstances, compliance with these standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

Second, the Board cautions against drawing conclusions about the comparative merits of the annually inspected firms based on the number of reported deficiencies in any given year. The total number of audits reviewed is a small portion of the total audits performed by these firms, and the frequency of deficiencies identified does not necessarily represent the frequency of deficiencies throughout the firm's practice. Moreover, if the Board discovers a potential weakness during an inspection, the Board may revise its inspection plan to target additional audits that may be affected by that weakness, and this may increase the number of deficiencies reported for that firm in that year. Such weaknesses may emerge in varying degrees at different firms in

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different years.

During 2005, the Board monitored the implementation of the provisions of Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* ("AS No. 2") by annually inspected U.S. firms. Among other things, that monitoring included Board staff meetings with these firms to discuss their methodology and to discuss opportunities to enhance the effectiveness and efficiency of audits of internal control. As the Board has previously stated, the Board believes that audits performed under the difficult circumstances of the first year of implementation of AS No. 2 were often not as efficient as the standard intends, and as the Board expects them to be in future years. The primary reasons for this failure to achieve expected efficiencies are described in the Board's Report on the Initial Implementation of Auditing Standard No. 2 ("the Report").[1/] In general, as described in the Report, in the 2005 inspections of certain firms, the Board's inspectors observed that, in a significant number of the engagements they selected for inspection of the application of AS No. 2, the auditors did not integrate their audits of internal control with their audits of the financial statements; did not use a top-down approach; and did not alter the nature, timing, and extent of their procedures to reflect the level of risk within a given area.

[1/] See PCAOB Release No. 2005-023, Report on the Initial Implementation of Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* (November 30, 2005).

Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.

2. Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.

3. Board inspections encompass, among other things, whether the firm has failed to identify departures from U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.

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2005 INSPECTION OF McGLADREY & PULLEN, LLP

In 2005, the Board conducted an inspection of McGladrey & Pullen, LLP ("McGladrey" or "the Firm"). The Board is today issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report, Appendix A, and portions of Appendix B. Appendix A provides an overview of the inspection process. Appendix B includes the Firm's comments, if any, on a draft of the report.[2/]

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.[3/] A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

[2/] The Board does not make public any of a firm's comments that address a nonpublic portion of the report. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

[3/] See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") performed an inspection of the Firm from July 2005 to November 2005. The inspection team performed field work at the Firm's National Office and at six of its 70 U.S. practice offices,[4/] and, because McGladrey is a participant in an Alternative Practice Structure ("APS"), conducted interviews at another office of an entity involved in the APS.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits. To achieve that goal, Board inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system. Appendix A to this report provides a description of the steps the inspection team took with respect to the review of audits of financial statements and of internal control over financial reporting and the review of seven functional areas related to quality control, along with a brief description of the APS.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.[5/] It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements or reporting on

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[4/] This represents McGladrey's total number of practice offices; however, only approximately 35 of the Firm's practice offices have primary responsibility for issuer audit clients.

[5/] When the Board becomes aware 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 GAAP, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

internal control, are free of any deficiencies not specifically described in an inspection report.

A. Review of Audit Engagements

The scope of the inspection procedures performed included reviews of aspects of selected audits of financial statements and of internal control over financial reporting performed by the Firm. Those audits and aspects were selected according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the selection process.

In reviewing the audits, the inspection team identified matters that it considered to be audit deficiencies. Those deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

In some cases, the conclusion that the Firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claims to have performed the procedure. PCAOB Auditing Standard No. 3 ("AS No. 3"), in effect for most of the audits reviewed in the inspection,[6/] provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence.[7/] For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

When audit deficiencies are identified after the date of the audit report, PCAOB standards require a firm to take appropriate actions to assess the importance of the deficiencies to the firm's present ability to support its previously expressed opinions,[8/]

[6/] Auditing Standard No. 3, *Audit Documentation*, applies to audits with respect to fiscal years ending on or after November 15, 2004.

[7/] See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28.

[8/] See AU 390, *Consideration of Omitted Procedures After the Report Date,* and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* and failure to take such actions could be a basis for Board disciplinary sanctions. In response to the inspection team's identification of deficiencies, the Firm, in some cases, performed additional procedures or supplemented its work papers.[9/]

In some cases, the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient competent evidential matter to support its opinion on the issuer's financial statements. In some of those audits, that conclusion followed from the omission, or insufficient performance, of a single procedure, while other audits included more than one such failure. The deficiencies that reached this degree of significance are described below, on an audit-by-audit basis (without identifying the issuers).[10/]

Issuer A

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion -

- The Firm failed to consider and evaluate all available evidence, including negative evidence, in assessing the need for a valuation allowance on the issuer's deferred tax assets, and the Firm failed to obtain corroboration for, or otherwise to test, management's assumptions and assertions related to the conclusion that no valuation allowance was necessary. Further, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested the issuer's income tax provision and related income tax accounts and disclosures.

(both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T).

[9/] The Board inspection process generally did not include review of such additional procedures or documentation, or of such revised accounting, although future Board inspections of the Firm may, as appropriate, include further review of any of these matters.

[10/] The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process.

- The Firm relied on a third-party insurance broker, retained by the issuer, to estimate workers' compensation self-insurance reserves; however, it did not obtain an understanding of the methods and assumptions used by, or test the data the issuer provided to, the third party. In addition, for the group health insurance self-insurance reserve, the Firm did not obtain corroboration of the assumptions management used to calculate the accrual.

- The Firm did not test the issuer's payroll costs.

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated all criteria necessary to conclude on the appropriateness of the changes in the issuer's operating or reportable segments and related segment information disclosures.

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested the issuer's journal entries relating to consolidation.

Issuer B

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion –

- The issuer completed a significant business acquisition on December 31, 2003. The purchase price allocation was finalized in 2004, the first year for which the Firm audited the issuer's financial statements. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the appropriateness of the cost that the issuer had assigned to the acquired entity and that the issuer had used to allocate the purchase price to the assets acquired and liabilities assumed. Specifically, the Firm failed to evaluate whether a significant amount of notes and accrued interest owed to the issuer by the acquired entity should have been written off by the issuer prior to the business combination, and, therefore, excluded from the total consideration for the acquisition.

- The issuer engaged a specialist to value identifiable intangible assets related to the business acquisition described above. The issuer also engaged the specialist to value goodwill for the related reporting unit as of December 31, 2004, which resulted in an adjustment for impairment representing 16 percent of the goodwill. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested management's assumptions and the data that the issuer had provided to the specialist for use in the valuations, including the cash flow projections and the discount rate. In addition, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the specialist's qualifications, reputation, and relationships with the issuer.

- With respect to another business acquisition, there was no evidence that the Firm had evaluated the issuer's estimates of the fair value of the assets acquired and liabilities assumed, and the basis for and method of determining the purchase price of the acquired entity. In addition, the Firm did not evaluate the issuer's assignment of assets acquired and liabilities assumed, including goodwill, to a reporting unit. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had reviewed the acquisition agreement and evaluated its effect on the amounts recorded by the issuer.

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested the assumptions used by the issuer to estimate the fair value of the warrants it issued during the year.

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the appropriateness of the issuer's operating or reportable segments and related segment information disclosures.

Issuer C

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion –

- The Firm's assessment of control risk as low was inappropriate because it failed to evaluate and test certain critical information technology ("IT") user controls in order to rely on the controls in place and support its low risk assessment. As a result, the Firm did not have a sufficient basis to support the use of negative confirmations to test deposits.

- The Firm failed to perform its own tests of the valuation of the marketable securities or, in the alternative, to obtain an understanding and perform tests of the third-party service provider's pricing of the marketable securities.

- The Firm used analytical procedures as the primary audit test of interest income and expense and secondary audit evidence for deposits, loans, payroll, and allowance for loan losses. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had met the requirements for substantive analytical procedures, including, but not limited to, establishing variance thresholds. Further, the Firm failed to obtain corroboration for management's explanations of certain of the issues identified as a result of the analytical procedures.

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed either procedures to determine whether the loss factors the issuer used to calculate the allowance for loan losses were supportable or, in the alternative, procedures to develop an independent expectation of the allowance.

Issuer D

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion –

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the effect on revenue recognition of all significant terms included in two amendments to an arrangement with a customer.

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed adequate tests of controls related to the valuation of inventories to support a control risk assessment of low. Specifically, tests of controls over the pricing of raw materials, direct labor, and overhead cost allocations were limited to inquiry and observation. Because the Firm did not adequately support its control risk assessment of low, it likewise did not have a sufficient basis for the corresponding adjustments to the nature and extent of its substantive procedures regarding inventory valuation.

Issuer E

In this audit, the Firm assessed control risk with respect to the valuation of inventory as low. There was, however, no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed adequate tests of controls related to the valuation of inventories. For example, the Firm failed to perform sufficient tests of controls over the pricing of raw materials, direct labor, and overhead cost allocations because the Firm did not perform tests of controls relating to significant documents used during the inventory valuation process, such as bills of materials, batch receipts, and variance reports, other than comparing the information on them to the issuer's general ledger. Because the Firm did not adequately support its control risk assessment of low, it likewise did not have a sufficient basis for the corresponding adjustments to the nature and extent of its substantive procedures regarding inventory valuation.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following seven functional areas (1) tone at the top; (2) practices for partner evaluation, compensation, admission, assignment of responsibilities, and disciplinary actions; (3) independence implications of non-audit services; business ventures, alliances, and arrangements; personal financial interests; commissions and contingent fees; and the alternative practice structure; (4) practices for client acceptance and retention; (5) practices for consultations on accounting, auditing, and SEC matters; (6) the Firm's internal inspection program; and (7) practices for establishment and communication of audit policies, procedures, and methodologies, including training. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

PARTS II AND III OF THIS REPORT ARE NONPUBLIC
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

Appendix A

The Inspection Process

The inspection process was designed and performed to provide a basis for assessing the degree of compliance of the Firm with applicable requirements and standards related to auditing issuers. This process included reviews of components of selected issuer audit engagements completed by the Firm. These reviews were intended both to identify deficiencies, if any, in the conduct of those audits and to determine whether the results of those audits indicated deficiencies in the design or operation of the Firm's system of quality control over audits. In addition, the inspection included reviews of the design of, and in some cases the application of, policies and procedures related to certain functional areas of the Firm that could be expected to influence audit quality.

1. Review of Selected Audit Engagements

The inspection team reviewed aspects of selected audits performed by the Firm. The inspection team chose the engagements according to the Board's criteria. The Firm was not allowed an opportunity to limit or influence the engagement selection process or any other aspect of the review.

For each audit engagement selected, the inspection team reviewed the issuer's financial statements and certain SEC filings. The inspection team selected certain higher-risk areas for review and, at the practice offices, inspected the engagement team's work papers and interviewed engagement personnel regarding those areas. The areas subject to review included, but were not limited to, revenues, reserves or estimated liabilities, allowance for loan losses, derivatives, income taxes, related party transactions, assessment of risk by the audit team, and testing and documentation of internal controls by the audit team. The inspection team also analyzed potential adjustments to the issuer's financial statements that had been identified during the audit but not recorded in the financial statements. For certain selected engagements, the inspection team reviewed written communications between the Firm and the issuer's audit committee and also interviewed the chairperson of the issuer's audit committee.

The inspection team also reviewed aspects of certain of the Firm's audits of internal control over financial reporting. For each audit engagement selected for this purpose, the inspection team reviewed the Firm's work papers and interviewed engagement personnel regarding the audit approach, including the use of a top-down approach, the assessment of risk, the evaluation of management's assessment of internal control, and the integration of the audit of internal control over financial reporting with the audit of the financial statements. The inspection team also selected certain significant processes and, for those processes, reviewed the Firm's evaluation of the design effectiveness of controls, including the performance of walkthroughs, and the performance of tests of operating effectiveness of controls. For the selected engagements, the inspection team also reviewed the Firm's evaluation of any control deficiencies that the Firm identified during the Firm's audit of the issuer's financial statements.

When the inspection team identified a potential issue, it discussed the issue with members of the engagement team. If the inspection team was unable to resolve the issue through this discussion and any review of additional work papers or other documentation, the inspection team issued a comment form on the matter and the Firm provided a written response to the comment form. In certain instances, if the inspection team was unable to resolve the issue, the inspection team requested that the engagement team consult with the Firm's National Office of Audit & Accounting. In many cases, this process resulted in resolution of the matter, either because the Firm agreed with the position the inspection team had taken and the Firm or the issuer took steps in light of the significance of the error to remedy the exception, or because the Firm was able to provide additional information that effectively addressed the inspection team's concerns.

2. Review of Seven Functional Areas

The inspection team conducted the procedures related to the review of the seven functional areas primarily at the Firm's National Office. With respect to six of the seven functional areas, the inspection team also conducted procedures at certain of the Firm's practice offices. The inspection team performed these procedures both to identify possible defects in the Firm's system of quality control and, where applicable, to update the Board's knowledge of the Firm's policies and procedures in the functional areas. A more detailed description of the scope with respect to each of the seven functional areas follows.

As reflected in the descriptions that follow, the inspection team's procedures took account of the fact that McGladrey is part of an APS with H&R Block, Inc. ("H&R Block"). H&R Block, through its wholly-owned subsidiary, RSM McGladrey Business Services, Inc., owns the non-attest businesses and assets of many certified public accounting firms, including RSM McGladrey, Inc. ("RSMI"). RSMI performs accounting, tax, and consulting services for corporate clients. McGladrey performs audits and other attest services. H&R Block does not have an ownership interest in McGladrey; however, RSMI provides working capital financing to McGladrey under a loan agreement, and the partners of McGladrey are employed as managing directors of RSMI. In addition, through an administrative services agreement, RSMI provides accounting, payroll, human resources, and other services to McGladrey and receives a management fee for these services.

As a consequence, the inspection procedures included interviews with certain personnel of RSMI and RSM McGladrey Business Services, Inc. The inspection team also performed interviews at H&R Block's national headquarters and interviewed, by telephone, certain members of the management of other H&R Block subsidiaries.

a. Review of Partner Evaluation, Compensation, Admission, Assignment of Responsibilities, and Disciplinary Actions

The inspection team reviewed the Firm's policies and procedures related to partner evaluation, partner compensation, nomination and admission of new partners, assignment of responsibilities, disciplinary actions, and termination of partners. The objective of the inspection procedures was to assess whether the design of these processes, as documented and communicated, could be expected to encourage an appropriate emphasis on audit quality and technical competence, as compared to marketing or other activities of the Firm.

The inspection team interviewed 11 members of the Firm's and RSMI's leadership teams, as well as members of leadership and audit partners in practice offices, regarding these topics. In addition, the inspection team analyzed schedules provided by the Firm that detailed information on each partner, including the partner's office location, recent evaluation history, and compensation history. The inspection team also reviewed a sample of partners' personnel files, including files of newly admitted partners, partners who resigned or took early retirement, and partners who received bonus compensation.

b. Review of Independence Policies and the Alternative Practice Structure

The objectives of the inspection procedures in this area included evaluating the Firm's policies and procedures relating to its compliance with independence requirements with respect to the provision of non-audit services to issuer audit clients; the Firm's participation in the APS, business ventures, alliances, and arrangements;

commissions and contingent fee arrangements; personal financial interests and the relationships of Firm professionals with issuer audit clients; and the provision of non-audit services related to issuer audit clients' compliance with Section 404 of the Act. To accomplish these objectives, the inspection team reviewed the Firm's policies, procedures, guidance, and training materials pertaining to these independence matters. The inspection team also reviewed the Firm's internal inspection program as it relates to monitoring compliance with the Firm's independence policies and procedures; tested the Firm's independence consultation process; and reviewed information concerning the Firm's existing business ventures, alliances, and arrangements, as well as the Firm's process for establishing such enterprises. The inspection team also interviewed numerous National Office and practice office personnel regarding the Firm's independence policies, practices, and procedures.

At the practice offices, the inspection team selected a sample from the engagements it reviewed and, for that sample, reviewed relevant information to identify any non-audit services performed for the issuer, including whether any of the services involved commissions or contingent fee arrangements; to determine whether the fees for the services provided were classified appropriately in the issuer's proxy statement; and to determine whether the Firm was involved in any business ventures, alliances, or arrangements with the issuer. In addition, for the sample, the inspection team read and evaluated the most recent letter pursuant to Independence Standards Board ("ISB") Standard No. 1, *Independence Discussions with Audit Committees.*

The objectives of the inspection procedures in this area also included gaining an understanding of McGladrey's APS relationship with H&R Block and certain of its subsidiaries. The inspection team focused on independence issues related to the provision of non-audit services to issuer clients; whether the personnel of H&R Block and its subsidiaries were familiar with the applicable policies and procedures regarding independence, integrity, and objectivity; and whether H&R Block has implemented an appropriate system of quality controls to ensure compliance with such policies and procedures. The inspection team reviewed, analyzed, and evaluated McGladrey's and RSMI's policies, procedures, and guidance materials related to independence (including independence consultations) for non-audit services to audit clients; their training programs on independence; and their procedures for independence consultations, which included reviewing the results of a sample of independence inquiries.

In addition, the inspection team interviewed the Chief Executive Officer/Chairman of the Board and the Chief Operating Officer of H&R Block; the President of RSM McGladrey Business Services, Inc./RSMI; the COO of RSMI; and five other leaders of certain H&R Block subsidiaries.

c. Review of Client Acceptance and Retention Policies

The objectives of the inspection procedures in this area were to evaluate whether the Firm's client acceptance and retention policies and procedures reasonably assure that it is not associated with issuers whose management lacks integrity, that it undertakes only engagements within its professional competence, and that it appropriately considers the risks involved in accepting and retaining clients in the particular circumstances. Toward those objectives, the inspection team reviewed the Firm's policies, procedures, and forms related to client acceptance and continuance; evaluated documentation related to new clients and to clients that had recently changed auditors from the Firm; and interviewed members of the Firm's leadership.

At the practice offices, the inspection team selected a sample from the engagements it reviewed and, for that sample, evaluated whether the client acceptance or continuance documentation was completed and approved in accordance with Firm policies; interviewed the audit partners and managers on these engagements concerning the reasons for accepting the issuer as a client or continuing to serve the issuer, the approval process, and whether specific risk mitigation steps were performed and documented in response to any identified risks; and assessed whether the audit planning documentation incorporated the specific actions, if any, contemplated in response to any identified risks.

d. Review of Practices for Consultations

The objective of the inspection procedures in this area was to assess the Firm's compliance with professional requirements regarding consultations on accounting, auditing, and SEC matters. Toward this objective, the inspection team gained an understanding of and evaluated the Firm's policies and procedures relating to its consultation process. The inspection team also reviewed a sample of consultations that occurred during the inspection period to evaluate the effectiveness of the Firm's consultation process, the Firm's compliance with its policies and procedures, whether the conclusions were in accordance with professional standards, and whether the engagement teams acted in accordance with the conclusions.

e. Review of Internal Inspection Program

The objectives of the inspection procedures in this area were to evaluate the effectiveness of the Firm's annual internal inspection program in enhancing audit quality, as well as to assess the Firm's compliance with the quality control standards adopted by the Board. To meet those objectives, the inspection team reviewed policies, procedures, guidance, and forms related to the Firm's internal inspection program, documentation of the results of the current year's inspection program, and steps the Firm took in response to those results. The inspection team also interviewed the Firm's leadership concerning the process and effectiveness of its internal inspection program.

The inspection team reviewed and tested the conduct of the internal inspection program by performing field work in one practice office where the Firm had conducted internal inspections. These procedures included evaluating the qualifications of the Firm's inspectors, reading the inspectors' comments, reviewing the results of the inspectors' review of certain Firm-wide functional areas, and interviewing both area leadership and selected audit personnel concerning the internal inspection program. In addition, for the engagements that the internal inspectors had reviewed at this practice office, the inspection team reviewed documentation of the internal inspectors' review of the engagements, reviewed certain aspects of the audit work papers, and discussed with the Firm any significant differences in the results of the inspection team's review and that of the Firm's internal inspectors.

f. Review of Practices for Establishment and Communication of Audit Policies, Procedures, and Methodologies, Including Training

The objectives of the inspection procedures in this area were to update the inspection team's understanding of the Firm's processes for establishing and communicating audit policies, procedures, and methodologies, including training; to evaluate whether the design of these processes could be expected to promote audit quality and enhance compliance; and to evaluate changes in audit policies that the Firm had made since the Board's most recent inspection of the Firm.

Toward those objectives, the inspection team reviewed documentation relating to the Firm's method for developing policies and procedures, as well as internal guidance and/or training materials distributed to audit personnel with respect to recent changes in requirements and with respect to selected specific areas. The inspection team also evaluated the effectiveness of the design of the Firm's processes for monitoring developments that could affect the Firm's audit policies, procedures, and methodologies.

g. Review of Tone at the Top

The objective of the review of the Firm's "tone at the top" was to assess whether actions and communications by the Firm's leadership, as well as relevant actions and communications by H&R Block and RSMI, demonstrate a commitment to audit quality and compliance with the Act, the rules of the Board, the rules of the SEC, and PCAOB standards in connection with the Firm's performance of audits, issuance of audit reports, and related matters involving issuers. Toward that end, the inspection team reviewed and analyzed information at the Firm's National Office. Such information included the Firm's code of conduct; documents relating to measuring and monitoring audit quality; descriptions of the duties of, and relationships between and among, the Firm's staff and leadership; public company audit proposals; internal and external communications from management; descriptions of the Firm's financial structure and business plan; and agendas and minutes of the Firm's governing board. In addition, the inspection team interviewed numerous members of the Firm's and RSMI's leadership teams, as well as members of senior management of the Firm's APS affiliates.

The inspection team conducted interviews at five of the Firm's practice offices to obtain perspectives on communications from the Firm's, H&R Block's, and RSMI's leaderships relating to audit quality and tone at the top. The inspection team interviewed members of the leadership at certain of these offices, as well as certain audit partners assigned to engagements that were reviewed.

APPENDIX B

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.[11/]

[11/] In any version of this report that the Board makes publicly available, any portions of the Firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of the Firm's response is made publicly available.

McGladrey & Pullen
Certified Public Accountants

October 25, 2006

Mr. George H. Diacont
Director
Division of Registration and Inspection
Public Company Accounting Oversight Board
1666 K Street, N. W.
Washington DC 20006

Re: Response to the Public Company Accounting Oversight Board (PCAOB) Report of 2005 Inspection of McGladrey & Pullen, LLP

Dear Mr. Diacont:

Thank you for the opportunity to submit our response to the PCAOB's September 29, 2006 draft of its Report of Inspection of McGladrey & Pullen, LLP. We support the PCAOB's inspection process and believe that inspection comments and observations will help us enhance the quality of audit engagements.

We have taken appropriate actions to address the deficiencies identified by the PCAOB's inspection team, including, in certain instances, performing additional procedures in accordance with AU 390, *Consideration of Omitted Procedures after the Report Date,* and in other instances, adding currently dated documentation to our workpapers to more completely and accurately describe the procedures performed, evidence obtained and conclusions reached. We note that none of the comments resulted in the restatement of financial statements. We have also enhanced the Firm's internal processes, training programs and practice aids to address the PCAOB's findings.

McGladrey & Pullen is committed to working with the PCAOB staff to improve our system of quality controls. We have a long history of audit quality founded on our commitment to integrity, objectivity and excellence.

Please contact Leroy Dennis (952) 921-7627 with any questions regarding this letter.

Sincerely,

McGladrey & Pullen, LLP