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## **Inspection of Haskell & White LLP**

**Issued by the**

**Public Company Accounting Oversight Board**

**July 25, 2005**

**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**

**PCAOB RELEASE NO. 104-2005-045**

**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 Generally Accepted Accounting Principles ("GAAP") in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP 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, rests with the Securities and Exchange Commission ("SEC" or "Commission"). Any description, in this report, of perceived departures from GAAP should not be understood as an indication that the Commission has considered or made any determination regarding these GAAP issues unless otherwise expressly stated.

## **INSPECTION OF HASKELL & WHITE LLP**

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Haskell & White LLP ("the Firm"). The Board is 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 and portions of Part IV of the report. Part IV of the report consists of the Firm's comments, if any, on a draft of the report.<sup>1/</sup>

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.<sup>2/</sup> 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.

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<sup>1/</sup> 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 notes that it routinely grants confidential treatment, if requested, for any of a firm's comments that identify factually inaccurate statements in the draft that the Board corrects in the final report.

<sup>2/</sup> 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") conducted fieldwork for the inspection from June 21, 2004 to June 25, 2004. The fieldwork included procedures tailored to the nature of the Firm, certain aspects of which the inspection team understood at the outset of the inspection to be as follows:

Number of Offices	1 (Irvine, California)
Ownership structure	Limited liability partnership
Number of partners	5
Number of professional staff <sup>3/</sup>	35
Number of issuer audit clients <sup>4/</sup>	11

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.

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

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<sup>3/</sup> "Professional staff" includes all personnel of the Firm, except partners or shareholders and administrative support personnel. The number of partners and professional staff is provided here as an indication of the size of the Firm, and does not necessarily represent the number of the Firm's professionals who participate in audits of issuers or are "associated persons" (as defined in the Act) of the Firm.

<sup>4/</sup> The number of issuer audit clients shown here is based on the Firm's self-reporting and the inspection team's review of certain information for inspection planning purposes. It does not reflect any Board determination concerning which, or how many, of the Firm's audit clients are "issuers" as defined in the Act

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.<sup>5/</sup> 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, 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 the performance of five of the Firm's audits of the financial statements of issuers. 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.

The inspection team identified matters that it considered to be audit deficiencies.<sup>6/</sup> The deficiencies identified in two of the audits reviewed were of such significance that it appeared to the inspection team that the Firm did not obtain sufficient competent evidential matter to support its opinion on the issuers' financial statements. Those deficiencies included –

- (1) the failure to perform and document adequate procedures related to revenue;

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<sup>5/</sup> When it comes to the Board'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 GAAP, the Board reports that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

<sup>6/</sup> PCAOB standards require a firm to take appropriate actions to assess the importance of audit deficiencies identified after the date of the audit report to the firm's present ability to support its previously expressed opinions. *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* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T). Failure to comply with these PCAOB standards could be a basis for Board disciplinary sanctions.

(2) the failure to perform and document adequate testing of two of the issuer's investments; and

(3) the failure to test adequately information technology controls.

**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, training, compliance with independence standards, client acceptance and retention, and the establishment of policies and procedures. As described above, 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

**PART IV**

**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 Board provided the Firm an opportunity to review and comment on a draft of this report. The Firm provided a written response.

Pursuant to section 104(f) of the Act 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. The Board routinely grants confidential treatment, if requested, for any of a firm's comments that identify factually inaccurate statements in the draft that the Board corrects in the final 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. 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.

END OF PART IV

HASKELL  
&  
WHITE<sup>LLP</sup>  
CERTIFIED PUBLIC ACCOUNTANTS

January 7, 2004

Mr. George Diacont  
Director  
Division of Registration and Inspections  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006

VIA OVERNIGHT MAIL

RE: Inspection of Haskell & White LLP

Dear Mr. Diacont:

Enclosed please find two separate letters containing our responses to each of Part I and Part II of the Board's Draft Report of Inspection.

Please contact me directly at (949) 450-6314, should you have comments or questions.

Sincerely,



Wayne R. Pinnell, CPA  
Managing Partner

Enclosure



member

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January 7, 2004

Mr. George Diacont  
Director  
Division of Registration and Inspections  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006

RE: Response to Part I of Draft Report of Inspection

Dear Mr. Diacont:

We appreciate the opportunity to respond to the Board's Draft Report of Inspection (the "Report") dated December 9, 2004 in accordance with Section 104(f) of the Sarbanes-Oxley Act of 2002. We recognize the importance of the inspection process in restoring the public's trust in the independent audit process.

As a growing Firm that has built a practice on a bedrock of sound quality control principles, based in part on knowledge of our partners and principals garnered during experiences at larger firms, we take pride in both serving clients and adhering to standards of the profession. We have taken, or will be taking steps to address the matters in the Board's Report and believe that future inspections will only serve to further strengthen the quality of our audit practice.

Our comments below are summarized in response to Part I of the Report so that we may provide our views on the particular findings, add context to the findings and discuss the actions we are taking as a Firm. We have provided more detailed responses to each of the findings in an attachment to this letter. We request that you consider this information in preparing your final report on the inspection of our Firm.

***Auditing Comments***

We acknowledge the six findings reported by the PCAOB inspection team and included in the Board's Report. The six findings noted in the Report were identified on three of the five engagements chosen for review; one engagement had one finding, one engagement had two findings and one engagement had three findings.



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Mr. George Diacont  
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January 7, 2004  
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While we generally agree with the summary descriptions of the findings, we would characterize the comments noted by the Board to be, in most cases, areas where our documentation could have been better summarized or areas where our working papers lacked clarity rather than performance "failures" or deficiencies. That is, the concerns raised represent matters where documentation of auditing procedures or results of procedures could be improved.


In the cases where we agree that the documentation clarity could be improved or additional audit procedures are required, we have undertaken steps to incorporate additional documentation into our workpapers in accordance with AU 390, *Consideration of Omitted Procedures After Report Date*. In all cases, however, we do not anticipate that any such additional documentation will lead to any changes in our clients' audited financial statements or our reports thereon and that our present ability to support our previously expressed opinions has not been impaired.

As we do place a high value on the inspection process and strive to maintain an audit practice of superior quality and excellence, we have also conducted internal training sessions with our entire audit department to address the specific and general findings of the inspection team and have implemented a number of changes in our documentation processes.

We respect the PCAOB's inspection process and understand that judgments are involved; judgments that may vary from auditor to auditor and between our Firm and members of the inspection team. During the inspection process, which occurred at a time when a number of our key personnel were not available, we made every effort to cooperate with the inspection team members by responding to questions and providing additional documentation as necessary.

We appreciate the opportunity to respond to the Report and would welcome any opportunity to discuss any matters that may require further explanation before you finalize the Report.

Sincerely,



HASKELL & WHITE LLP

Attachment

**ATTACHMENT TO HASKELL & WHITE RESPONSE  
DETAILED COMMENTS ON PART I**

The following information provides additional detail in response to the specific findings in Part I.A. of the Draft Report of Inspection. The detail is cross-referenced by number and description of the comments in Part I.A.

(1) *Determination of the propriety of the issuer's accounting for debt modification*

In order to put this into context, this particular issuer company had a series of debt and equity transactions that had spanned several reporting periods. Upon receipt of the comment from the inspection team, we realized that the documentation in our files was not summarized in a fashion that was easily reviewed by someone not familiar with the issuer and the related accounting and auditing issues. We subsequently summarized the documentation from procedures that had been performed by the engagement team that indicated that the propriety of the issuer's accounting for debt modification had, in fact been assessed, without the need to perform additional procedures. Such documentation was provided to the inspection team in the due course of responding to the team's observations.

(2) *Obtaining an adequate understanding of internal controls*

We acknowledge this comment as it relates to the revenue recognition methodology of a particular issuer in the service, distribution and software business. However, this finding, in our view, reflects a situation in which we could enhance the form and organization of our documentation rather than a failure to understand the activities of this particular company.

We believe our audit testwork in the revenue recognition area was appropriate in the circumstances and that the nature of the testwork documents our understanding of the revenue recognition process. We have conducted internal training of our personnel since the completion of the inspection to reinforce the importance of clear, complete documentation, generally, and the specific concerns relative to the recognition of revenue.

This particular issuer client is no longer an audit client as it merged with another company in the third quarter of 2004. However, we are undertaking the process to add memorandums to our files to better summarize our understanding of the issuer's revenue recognition process based on procedures we previously performed.

**ATTACHMENT TO HASKELL & WHITE RESPONSE  
DETAILED COMMENTS ON PART I (continued)**

(3) *Performance of adequate procedures related to revenue*

This finding is related to number (2) above as it relates to the same issuer. This particular company, engages in the sale of services and software, and distribution of products under very straight-forward arrangements, except for one large contract. We tested the recurring nature of software sales and the related recognition of revenue for separately identifiable and marketed products and services. We also performed significant testing on the revenues recognized under the unique contract, such revenues comprising 23% of the total revenues reflected in the issuer's annual financial statements. We recognize that revenue is inherently a risk area that demands appropriate procedures. In our judgment, our core procedures were appropriate in the circumstances considering the financial statements taken as a whole.

(4) *Performance of sufficient testing of the realizability of a significant investment*

With respect to the Board's characterization of the issuer's investment as "significant," it should be noted that the dollar amount of the related investment represented only 0.57% of the issuer's total consolidated assets at December 31, 2003 and that the dollar amount of the investment was less than our calculated "planning materiality" amount.

The issuer's investment is in the form of common shares, for which there is no existing market. The investee company is a private company based in Taiwan and the issuer does not have access to the investee company's financial or operational data. Based on this fact pattern, an assessment of the realizability of the issuer's investment was inherently difficult. However, we designed and executed audit procedures that we felt were appropriate given the specific facts and circumstances of this situation. These procedures included obtaining specific oral and written management representations regarding the realizability of the issuer's investment (note that the investee company is also a supplier of the issuer and, accordingly, management regularly communicates with the investee company), as well as independently searching the Internet and obtaining current available information about the investee company including its self-reported capital of approximately \$17 million. Although the nature and extent of audit procedures is certainly subject to professional judgment, based on the relative materiality of the issuer's investment and the nature of the investment, we believe that our audit procedures were appropriate under the circumstances.

**ATTACHMENT TO HASKELL & WHITE RESPONSE  
DETAILED COMMENTS ON PART I (continued)**

(5) *Adequate testing of information technology controls*

We believe that the first sentence of the second paragraph in which the Board states, "The Firm assessed control risk related to information technology controls below the maximum level based on its conclusions regarding the design of these controls," is not an accurate statement. Our audit working papers do not include an assessment of control risk related to information technology controls, but they do include an assessment of control risk in terms of the financial statement assertions (existence or occurrence, completeness, rights and obligations, valuation or allocation, presentation and disclosure) as required by the standards of the PCAOB.

We believe our audit working papers sufficiently document our understanding of the issuer's internal control, including control environment, risk assessment, control activities, information and communication, and monitoring. Consistent with our firm quality control policy, this understanding is documented using the appropriate PPC checklists and forms and through various narrative descriptions (which include access controls) contained in our audit working papers. Specifically with respect to inventory valuation, we designed and then executed tests of internal control in which we followed sampled transactions selected from throughout the year through the issuer's accounting system from the initial receipt of the customer purchase order to order fulfillment to product shipping and invoice generation and the related cost of sale calculation. We believe that our design and execution of these tests of controls directly tested the financial statement assertions and provided our basis for a below maximum control risk assessment consistent with AU 319.90-104. We also believe that our design of these tests of controls did indeed consider the risk of the system not processing information properly due to breakdowns in IT general controls and that the issuer's IT general controls were indirectly tested by the tests of controls we performed.

Subsequent to receiving the related comment from the inspection team, we studied AU 319 and engaged in audit department discussions regarding an auditor's responsibility to test IT general controls, and the extent of such testing, given the specific fact pattern that existed with this issuer. Although we believe that we indirectly tested the issuer's IT general controls in an amount sufficient to support our audit opinion, we concluded that we could have increased the extent of our testing and designed and executed direct tests of IT general controls, as commented by the inspection team and as an inferred in applicable auditing standards. We are, therefore, performing additional auditing procedures with respect to 2003 concurrently with our in-process 2004 audit of the related issuer and documenting such in our 2003 audit working papers in accordance with AU 390. We do not believe that such additional audit procedures will lead to any changes in the issuer's audited financial statements or our report thereon.

**ATTACHMENT TO HASKELL & WHITE RESPONSE  
DETAILED COMMENTS ON PART I (continued)**

(6) *Performance of sufficient audit testing of an issuer's investment in a subsidiary*

Our determination of the nature and extent of audit procedures applied to the issuer's subsidiary considered both the relative materiality of subsidiary balances to the consolidated totals, as well as the absolute value of subsidiary balances to the consolidated totals. The subsidiary's total assets comprised less than 2% of the issuer's total assets, the subsidiary's total revenues comprised only 6% of the issuer's total revenues and the subsidiary's total operating expenses comprised only 9% of the issuer's total expenses. After considering materiality on this quantitative basis, we also considered materiality on a qualitative basis noting that subsidiary balances were within historical norms (based on absolute and relative levels) and no significant year-over-year variances were determined to exist based on the analytical procedures documented in our audit working papers. Based on the materiality of the issuer's subsidiary account balances, considered on both a quantitative and qualitative basis, we believe that our audit procedures were appropriate under the specific circumstances.