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Public Company Accounting Oversight Board

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Inspection of
Kahn Boyd Levychin, LLP

Issued by the

Public Company Accounting Oversight Board

October 27, 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. 104-2005-098

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Public Company Accounting Oversight Board

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.

PCAOB Release No. 104-2005-098

INSPECTION OF KAHN BOYD LEVYCHIN, LLP

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Kahn Boyd Levychin, 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.[1/]

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

[1/] 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.

[2/] 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 October 19 to October 21, 2004 and November 8 and November 9, 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	2 (New York City and Forest Hills, New York)
Ownership structure	Limited liability partnership
Number of partners	3
Number of professional staff[3/]	1
Number of issuer audit clients[4/]	8

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

[3/] "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.

[4/] 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.[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, 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 four 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.[6/] The deficiencies identified in two of the audits reviewed included deficiencies 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 issuer's financial statements. Those deficiencies included –

(1) the failure to perform and document audit procedures to test the recording of, and disclosures related to, intangible assets;

[5/] 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.

[6/] 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 audit procedures to test the recording of equity transactions for two issuers;

(3) the failure to perform and document audit procedures to test the accounting for operating leases; and

(4) the failure to perform and document audit tests to evaluate capitalized software costs.

Following the inspection fieldwork and the inspection team's discussion with the Firm of the matters identified above, the Firm performed additional audit procedures and identified certain misstatements in an issuer's financial statements. The issuer subsequently restated its financial statements.[7/]

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

[7/] The Board inspection process did not include any review of the additional audit work or the restated financial statements.

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.

KAHN BOYD LEVYCHIN, LLP
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS
67 WALL STREET, 22ND FLOOR, NEW YORK, NY 10005
212.785.9700

August 22, 2005

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

Dear Mr. Diacont:

We are pleased to provide our response to the Board's draft report (the Report) of our firm's inspection completed in November 2004. We appreciate the Board's mission and believe that the inspection process will improve the quality of public company audits and restore public confidence in the accounting profession.

We have summarized our response to Part I of the report to express our understanding of the Board's comments and demonstrate our commitment to improving the quality of our audits. Our responses to Part II are also included and we understand that those responses to Part II will be granted confidential treatment at this time.

A) Review of Audit Engagements: We believe that we have addressed these concerns satisfactorily since receiving the initial draft comments of the inspection team and specifically bring the following to your attention:

   1) Intangible assets: We agree that our routine procedures in respect of the amounts capitalized as Intangible Assets were not sufficient in the circumstances, and could and should have included more procedures to understand whether the issuer had properly accounted for and disclosed it, including any financial ramifications to the issuer arising out of simple transactions that may have been potentially more complicated. Faced with similar circumstances in an audit for this and other issuers, since the question came up in the inspection, we now take greater care to ensure proper accounting and disclosure by the issuer, and to assure our files document that we performed such tests. We still believe, absent financial commitments or contingencies arising out of these transactions, it's likely an uninformed reader might have focused more on the sheer magnitude of the issuer's net loss and shareholders' deficiency at the report date rather than the intangible assets which were small in comparison.

   2) Equity transactions: We agree that our audit procedures for the year ended December 31, 2003 should have included steps performed with respect of Issuer B's employee stock incentive plan that evidenced that: we had evaluated whether the employee grants and exercises occurred in accordance with plan document provisions; the value assigned to the stock options was appropriate; the expense was recorded in the right period; and the difference between the fair value and the intrinsic value was not material. Our firm was replaced by a first successor independent auditing firm for the financial statements for the year ended December 31, 2004 who had the opportunity to review employee stock incentive plan of Issuer B, including the

Issuer's accounting and disclosures for it for the year ended December 31, 2003, during their review of the Issuer's quarter filings and did not propose prior period corrections related to that plan. The first successor resigned before actually completing an audit for the year ended December 31, 2004, was succeeded by a second successor independent auditor who did complete an audit. The second successor also reviewed this plan and did not propose any prior period corrections related to this plan. We would take care to apply the procedures necessary to satisfactorily audit an employee stock incentive plan in any future client issuer audit, including making sure to be well versed in the current literature that applies and specifies the accounting and disclosures for such plan.

3) We have had the opportunity to be reminded of the importance of keeping permanent file documents up to date on a range of matters, including leases, and the need to keep them up to date and to refer to them each time financial statements that we are associated with are presented. These reminders have come in the PCAOB inspection and an annual internal inspection performed as required by the AICPA, as well from our outside current concurring reviewer. Accordingly, we remain vigilant in performing issuer related work to insure that we obtain and consider permanent file documents in evaluating proper accounting and disclosures for issuers, including as to matters related to leases.

4) Since the PCAOB Team's visit took place the engagement partner and assigned staff did sufficient accounting research to document that these software costs come under FASB#86 and we are conversant with the criterion for capitalization laid out therein. The financial statements of that issuer for the year ended December 31, 2003 were restated in a filing with the SEC made on February 28, 2005 under our revised reissued independent auditors' report which, among other things, included a revision to the wording of the issuer's "Summary of Significant Accounting Policies" related to "Capitalized Software Costs." We understand the need to perform audit procedures to determine whether amounts recorded as capitalized software costs meet the criterion for capitalization and are recorded in the correct period. We expect that proper use of audit programs and financial disclosure checklists in this area will help us discern proper issuer accounting and disclosure in this area.

Our responses to Part II of the Report are attached on pages which follow.

We are grateful for the opportunity to provide our response to the Draft Report of Inspection. We wish to assure the Board that we take the responsibility of auditing and reporting on its clients very seriously. We are making the necessary improvements and expect to fully satisfy any follow-up inspection by the Board.

Respectfully submitted,

Kahn Boyd Levychin, LLP

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