

**Inspection of
Schumacher & Associates, Inc.**

Issued by the

Public Company Accounting Oversight Board

August 29, 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**

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 SCHUMACHER & ASSOCIATES, INC.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Schumacher & Associates, Inc. ("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 August 9, 2004 to August 11, 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 (Denver, Colorado)
Ownership structure	Colorado corporation
Number of partners	2
Number of professional staff ^{3/}	None
Number of issuer audit clients ^{4/}	16

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 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

^{3/} "Professional staff" includes all personnel of the Firm, except partners or shareholders and administrative support personnel.

^{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.

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 three 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 one 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 the failure to adequately test unamortized capitalized software development costs and the failure to perform and document an assessment of the issuer's revenue recognition practices.

^{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.

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.

SCHUMACHER & ASSOCIATES, INC.
Certified Public Accountants
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Denver CO 80211
(303) 480-5037 FAX (303) 480-5038

March 10, 2005

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

Dear Mr. Diacont:

This letter is in response to the Part I comments of the Schumacher & Associates, Inc. Report of Inspection.

Even though we were not able to come to an agreement on the matters described in Part I with the inspectors, we would like you express our utmost respect and appreciation for their efforts. The professionalism, experience and knowledge of the inspection team are outstanding.

The inspection team raised two concerns with respect to one issuer. One concern was related to assessment of the issuer's revenue recognition practices and the other was related to testing unamortized capitalized software development costs. The issuer is in the business of selling software licenses and software maintenance agreements.

We disagree with the inspectors' assessment that we failed to obtain sufficient competent evidential matter to support our opinion on one issuer's financial statements.

With respect to the assessment of revenue recognition practices, the issuer first engaged our firm to be their auditor in 2001. At that time we studied extensively and in great detail the issuers' revenue recognition practices. The most significant issue regarding revenue recognition was related to whether sales of software should be reported at gross or net. Based on our review of various analyses, the related contracts and all the facts and circumstances, we concluded that the issuers' revenue recognition practices were appropriate. During the course of the audit of the issuer for 2003 we interviewed issuer management and again discussed revenue recognition practices with them in detail. They represented to us that nothing had changed since 2001 with respect to revenue recognition matters. We documented such representation with audit file memos. In addition, we selected a random sample of over 100 of the issuer's sale transactions. We audited the sales transactions by reviewing copies of the sales invoices and tracing them to cash receipts. There were no exceptions noted and nothing came to our attention that would indicate there were any changes.

With respect to testing unamortized capitalized software development costs, the issues relate to two areas. The first being whether the software product had reached technological feasibility before costs were capitalized, and the second being whether the key assumptions used by the

issuer in determining the amount of costs to capitalize were appropriate.

In early 2003, the issuer acquired the assets of another company, which included intellectual property related to a software product. During 2003, the issuer continued to develop this newly acquired software product and, as of year end, the total software development costs the issuer had capitalized represented approximately 16 percent of total assets. The capitalized development costs principally related to coding and programming changes necessary to allow the software to be used on a different operating system and customer requests for improved functionality.

During the process of reviewing the issuer's interim financial statements to be included in the 2003 Form 10-Q's and during the process of completing the 2003 year end audit, we discussed with management the issue in great detail about whether the software product had reached technological feasibility.

Management represented to us in writing that:

- technological feasibility of the software had been determined prior to its acquisition by the issuer.
- the seller had completed a product design prior to acquisition with functionality determined based upon the seller's experience selling version one, a similar product
- customers of the seller using version 1 had made requests for improvements
- the seller had been marketing version 1 of the product prior to acquisition by the issuer
- the seller had a working model of version 2 of the product prior to acquisition
- the issuer began coding the product within days of acquisition
- coding within days of acquisition would not have been possible had the product design not been complete at that time
- the issuer had confirmed the completeness of the detail program design and its consistency with the product design during the due diligence phase of the acquisition.

During the first quarter of 2004 and prior to the issuance of our audit report, the issuer released the completed version 2 of the software product and commenced sales of it to its customers.

The issuer provided us with copies of the closing documents related to the acquisition which included financial statements of the previous owner. The financial statements indicated that there were software sales revenues.

We were provided with a software development flow chart and a development schedule prepared by seller personnel that showed the status of completion at the time of acquisition and what remained to be completed at the time of acquisition.

Based on our knowledge of prior sales of version 1 of this software product by the previous owner, various discussions with management of relevant facts and circumstances, written management representations, and our review of the development flow chart and development schedule, we concluded that it appeared technological feasibility had been determined prior to the commencement of capitalization of the development costs.

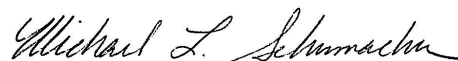
As documentation of this conclusion, we initialed and noted on the various documents that we had reviewed them and that they appeared appropriate.

The issuer, after concluding that technological feasibility had been determined, capitalized certain direct labor and indirect overhead development costs. The allocated capitalized costs were a portion of total costs and expenses incurred by the issuer. As a part of our audit procedures we selected a sample of 120 issuer disbursements and tested them by reviewing support for the disbursements, account coding and proof of the expenditures. The results of this test did not disclose any exceptions. The issuer provided us with analyses supporting the allocated software development costs. Having the knowledge from the results of the test of disbursement transactions that total expenses incurred by the issuer appeared appropriate and after reviewing the analyses detailing the allocated amounts capitalized, we concluded that the amounts capitalized appeared reasonable. We documented this conclusion by initialing and dating, and noting on the schedule that we reviewed it and it appeared reasonable.

SAS No. 96, "Audit Documentation" states that, "Audit documentation should be sufficient to show that sufficient competent evidential matter has been obtained through auditing procedures applied to afford a reasonable basis for an opinion. Examples of audit documentation are audit programs, analyses, memoranda, letters of confirmation and representation, abstracts or copies of entity agreements, and schedules or commentaries prepared or obtained by the auditor. The quantity, type and content of audit documentation are matters of the auditor's professional judgment."

We believe that our audit procedures and documentation are in compliance with SAS No. 96 guidelines and sufficient to show that competent evidential matter has been obtained through auditing procedures applied to afford a reasonable basis for our opinion.

Respectfully submitted,



Michael L. Schumacher
President