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**Inspection of
Steakley, Gilbert & Morgan, P.C.**

**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**

PCAOB RELEASE NO. 104-2005-063A
(Includes portions of Parts II and IV of the full report that
were not included in PCAOB Release No. 104-2005-063)



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 STEAKLEY, GILBERT & MORGAN, P.C.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Steakley, Gilbert & Morgan, P.C. ("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 July 19, 2004 to July 21, 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 (Oklahoma City, Oklahoma)
Ownership structure	Professional corporation
Number of partners	3
Number of professional staff ^{3/}	5
Number of issuer audit clients ^{4/}	1

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

^{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.

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 Engagement

The scope of the inspection procedures performed included a review of aspects of the performance of the Firm's audit of the financial statements of its issuer audit client. Those 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 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 issuer's financial statements. Those deficiencies included –

- (1) the Firm's failure to identify, or to address appropriately, a departure from GAAP that related to potentially material misstatements in the audited financial statements with respect to the classification of revolving line-of-credit arrangements;

^{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 appropriate procedures to audit an equity transaction with a related party; and

(3) the failure to test the issuer's goodwill balance for impairment.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on a specific audit, the inspection team 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

PORTIONS OF THE REST OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED
FROM THIS PUBLIC DOCUMENT

PART II

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B. Issues Related to Quality Controls

The inspection of the Firm included consideration of aspects of the Firm's system of quality control. Assessment of a firm's quality control system rests both on review of a firm's stated quality control policies and procedures and on inferences that can be drawn from respects in which a firm's system has failed to assure quality in the actual performance of engagements.^{7/} On the basis of the information reported by the inspection team, the Board has the following concerns about aspects of the Firm's system of quality control.

Audit Performance

A firm's system of quality control should provide reasonable assurance that the work performed on an audit engagement will meet applicable professional standards and regulatory requirements. On the basis of the information reported by the inspection team, including the audit performance deficiencies described in Part II.A and any other deficiencies identified below, the Board has concerns that the Firm's system of quality control fails to provide such reasonable assurance in at least the following respects –

a. Technical Competence, Due Care, and Professional Skepticism

The Firm's system of quality control appears not to do enough to ensure technical competence and the exercise of due care or professional skepticism.

b. Auditor Communications

The Firm's system of quality control does not provide sufficient assurance that the Firm would document all required auditor communications with audit committees,

^{7/} A firm's failure to comply with the requirements of PCAOB standards when performing an audit may be an indication of a potentially significant defect in a firm's quality control system even if that failure did not result in an insufficiently supported audit opinion.

including independence confirmations required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*.

c. Concurring Partner Review

Questions exist about the effectiveness of the Firm's existing arrangement for concurring partner reviews. Having procedures for concurring partner review by a competent reviewer is an important element of quality control. Such reviews should involve the performance of appropriate procedures using due care and professional skepticism, with the Firm appropriately addressing the reviewer's findings and documenting the process. The information reported by the inspection team suggests that there is no evidence that the concurring partner review procedure used by the Firm resulted in the identification of any of the deficiencies noted by the inspection team. This may result from a lack of competency, due care or professional skepticism on the part of the concurring partner; deficiencies in the scope of the concurring partner's procedures; and/or the Firm's failure to properly address the concurring partner findings. Apparent deficiencies in documentation of the scope and results of the concurring partner's reviews precludes the Board from determining the relative contribution of each of these potential causes to the failure of the concurring partner process to prevent the deficiencies reported by the inspection team.

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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.

STEAKLEY, GILBERT & MORGAN, P.C.

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March 29, 2005

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

Re: Response to Draft Report of Inspection
of Steakley, Gilbert & Morgan, P.C.

Dear Mr. Diacont:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB's") February 25, 2005 draft report on its inspection of Steakley, Gilbert & Morgan, P.C. (the "Firm") in July 2004. Our Firm is committed to conducting the highest quality audits and we are always open and responsive to constructive criticism and welcome fair and constructive observation of our policies and procedures and their implementation. We take seriously PCAOB's observations included in the draft report. You should note that the inspection conducted of our Firm was chosen because of our small size and limited number of public clients since the inspection team involved only had a limited time available for an inspection, and we voluntarily agreed to submit to this review with only two days notice.

Even with our strong commitment to improving our profession and our desire to restore public confidence in the public company audit environment, we are very concerned that the draft report does not adequately portray the overall high level of audit quality that exist within our Firm and the overall presentation of financial information related to the specific issues raised. First the report concentrates on a relatively small number of issues, and, second, the inspectors may not have taken the full time necessary to adequately appreciate and consider all issues involved. We note in particular that the issues raised deal with classification issues, characterization issues and other subjective determinations. While the draft report does raise certain concerns regarding documentation of our analysis with regard to these issues, as we will discuss more fully below, we do not believe those characterizations are accurate.

Failure to Present Debt as Current; EITF 95-22

With respect to requirement of EITF 95-22 that line-of-credit arrangements that contain both a subjective acceleration clause and a requirement to maintain a lock-box arrangement be classified as current liabilities pursuant to EITF 95-22, we agree that a portion of the debt should have been classified as current as opposed to long-term. Without raising this as an excuse, we thought that it was interesting that in the PCAOB's reports with respect to the four major public auditing firms, that this deficiency was noted as to each of them. It is obviously an area on which the PCAOB is rightfully focusing. As a result of this matter, we have alerted all of our partners and staff to reemphasize our Firm's position and guidance with regard to EITF 95-22 and to specifically require that they particularly review debt agreements with respect to this issue.

With respect to the specific issuer that this issue was raised in connection with, it is inaccurate to say that the issuer agreed to restate its financial statements. For the year in questioned, fiscal year ended December 31, 2003, at the time there was only a 15 month term remaining on the debt and this was clearly disclosed in the footnotes to the financial statements. In all subsequent quarterly reports, however, the issuer has changed the classification of all portions of that loan to be classified as current as opposed to long-term debt. As a result, the shareholders are and have been aware of the change in classification. This acceleration clause applied to revolving loans and not to their fixed term loans. As a result, the amount of the debt that may have been mischaracterized was less than 10% of the current liabilities, approximately 5% of the total liabilities and just slightly more than 2% of the total assets. This, coupled with the fact that the maturity of the debt in questioned was disclosed as only being slightly longer than what is considered long-term debt and the fact that the issuer has in all subsequent reporting accurately reported the debt as being current, neither we nor the issuer believe that a restatement is required.

We also believe it is inaccurate to state that all debt instruments with a subjective acceleration clause and a lockbox arrangement must be classified as current liabilities. EITF 95-22 states that borrowings outstanding under a revolving credit agreement that includes both a subjective acceleration clause and a requirement to maintain a lock-box arrangement should be considered short-term obligations. The EITF fails to define the phrase "subjective acceleration clause." The issuer's credit agreement contains a default provision entitled, "adverse change" and defines it as follows: "A material adverse change occurs in Borrower's financial condition, or lender believes the prospect of payment or performance of this note is impaired." The first clause of the definition refers to an event certain, because it has to occur, is measurable, is quantifiable and therefore objective in nature. Even the "or lender believes" clause requires some element of good faith determination by the lender, and we believe there was no justification for such a belief at the time in question.

Forgiveness of CEO Loan

We respectfully disagree with the conclusion concerning the repayment of the Company's loan to its CEO. The nature and reason for the loan was fully disclosed in the Company's 10-Ks and financials statements when the loan was initially made and continued as a disclosure through December 31, 2004. In order to comply with Sarbanes-Oxley Act

requirements, the CEO repaid the \$300,000 loan by surrendering 200,000 shares of Company common stock. The market value of the stock at the time of the initial loan commitment was \$1.50 per share and an average of closing prices in the time period in which the transaction was initiated was somewhat higher. Board minutes for January 31, 2004 note that the CEO had the option to repay using stock at the higher of market at the time of the initial loan commitment or at an amount established by a subsequent independent valuation. Such a valuation was made in early 2003. The market value at the time of the initial loan commitment was used and no compensation to the CEO recognized.

There is little correlation between the Company's financial results and the market value of its stock at any point in time, because the stock is thinly traded. In excess of 70% of the Company's common stock is owned by less than 15 holders. Additionally, there were circumstances besides the stock market value of the stock that gave greater value to recording the transaction in excess of the stock market value at the end of 2004. In 1999, the Board of Directors did not contemplate the Sarbanes-Oxley Act requiring the retirement of all related party receivables. Due to the timing of the loan retirement, the market value of the stock at the time of repayment was not reflective of the Board's intent with respect to repayment. The Board did not contemplate creating compensation to the CEO as a result of the forced transaction.

Goodwill Impairment

The Company acquired two separate entities to expand the market for the sale of its products - educational software. One of the entities is located in the eastern part the United States and one is located in Great Britain. These entities are operated and managed directly by the parent company and the Company's acquisitions provided synergies with respect to the sale of its own products. One of the acquired companies performs technical development support and the other acquired company allowed the issuer to expand into international markets.

Goodwill is evaluated annually for recoverability in conjunction with all other intangible and tangible assets. We believe that our audit work papers do provide an adequate written evaluation of the potential impairment of goodwill. This impairment analysis is prepared by the Company on an annual basis. Based upon our knowledge of the Company's business and markets and in conjunction with audit procedures applied to the Company's assets, liabilities, income and expense on a consolidated basis, we concurred with the client that an impairment allowance was not necessary during the period reviewed by the PCAOB. We do not believe that individual company cash flow models and projections provide the only meaningful information necessary to determine goodwill recoverability because of the inability to bifurcate each company's contribution to sales recorded on a consolidated basis. The Company has, however, reviewed goodwill, as well as other long-term assets, and at December 31, 2004 has decided to recognize impairment of its international assets due to a change in the Company's business strategy for international markets.

We believe the PCAOB draft report's statements and implications that documentation of the analysis of the goodwill impairment was not present is not accurate. Written memoranda was indeed included in the working papers. With respect to the issuer in question, not only are we a small firm, they are a small issuer for which we try very hard to keep our cost as low as possible.

Therefore, while there may not have been the documentation that the PCAOB examiners thought should be there, in our work papers there was documentation of our analysis and conclusions and discussions with the issuer with respect to these issues.

Documentation is an integral part of the audit process, and we recognize that audit documentation must be improved throughout the profession. We are actively reviewing and revising our documentation policies and procedures to address the standards proposed by the PCAOB. We have made and we will continue to make significant improvement in documentation, but we also need to be mindful that expectations regarding documentation are increasing at the same time that new standards and expectations are being imposed on the substantive audit process. We are also mindful of PCAOB Auditing Standard No. 3, paragraph 4, concerning examples of audit documentation.

Issues Related to Quality Controls - Audit Performance

As a part of our registration with the PCAOB, we were required to submit the firms' quality control document. Your review team did not take issue with our quality control document as filed.

Steve Steakley, Greg Gilbert, Scott Morgan & Jane Hresko are responsible for all the firms' audit clients. All have several years' experience with big eight accounting firms and several hold advance degrees in accounting and law. Each of us openly communicate and discuss and review issues, including partner review of audits. We believe that our review and supervision is of the highest quality. We recognize that because of our small nature, we may not have the policies delineated to the fullest extent as larger firms; however, these policies, controls and procedures are utilized and in place, and we will take appropriate steps to more adequately document these policies and procedures.

The firm was peer reviewed in 1996 and 1999 and received unqualified reviews. The next scheduled review will begin in the fall of 2005. The 2002 review was not necessary due to the firm losing its only GAAS audit and the firm is not an AICPA/SECPS member.

The firm complies with the professions' continuing education and peer review requirements and at all times strives to provide its clients with the most professional product within the confines of due professional care and professional skepticism. Because of the firms' size and relatively few audit clients (the firm has one audit client that is publicly held), we are constantly keeping each other up to date on all issues surrounding the audit procedures to be employed in different audit areas with respect to the audit engagements, problems that arise with respect to each audit client and joint resolution of those issues.

Our firm maintains memoranda and research both in hard copy and electronically that relates to our client's accounting policies and practices. Annually the company's accounting practices are reviewed for any changes to such accounting practices and reference to such is made in our audit programs or at specific workpapers, as opposed to reproducing the same memos year after year. We commented to the reviewers that many references to our audit procedures are documented directly on our audit programs in lieu of repetitive memos.

With regard to our firms' policy and procedures weakness with respect to audit committee communications, the sole publicly held audit client does not have an audit committee due to its size and limited staff. We did communicate our recommendations and insights to appropriate client personnel and Board members as we deemed necessary and made note of such verbal communications on our general procedures audit programs.

Due to the firms' size and the fact that we are integrally involved in all aspects of our audit engagements, we are constantly, on an oral basis, performing concurring partner reviews with regard to our audit engagements. These reviews may not take the form and content as expected by PCAOB's engagement team, but they are occurring.

Initiation of Dialogue

We appreciate this opportunity to respond in writing. We will be happy to provide any further information which you may request and to continue a dialogue with the Director.

Very truly yours,

Steeley, Gilbert & Morgan