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Inspection of Livingston & Haynes, P.C.

**Issued by the
Public Company Accounting Oversight Board**

March 9, 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**

PCAOB RELEASE NO. 104-2006-061

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 LIVINGSTON & HAYNES, P.C.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Livingston & Haynes, 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 June 27, 2005 to June 28, 2005. 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	3 (Wellesley, Ware, and Quincy, Massachusetts)
Ownership structure	Professional corporation
Number of partners	6
Number of professional staff ^{3/}	11
Number of issuer audit clients ^{4/}	3

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 Engagements

The scope of the inspection procedures performed included reviews of aspects of the performance of all three of the Firm's audits of the financial statements of issuers. 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 in one of the audits reviewed included a deficiency 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. That deficiency was the failure to perform and document tests of the issuer's method of determining the cost basis of investments.

^{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.



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November 8, 2005

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

Re: Report of Inspection

Dear Mr. Diacont:

Livingston & Haynes, P.C. is pleased for the opportunity to respond to the report of the PCAOB inspection team. We support the role of the Board and the inspection process in restoring the confidence in financial reporting that is necessary to the successful functioning of the capital markets.

In response to the observation of the inspection team in Part 1 of the draft report concerning performing and documenting testing of the cost basis used in determining net realized gains and losses on securities transactions, we wish to submit the following:

We accepted the output of the client's software system and agreed the net gains and losses to various reconciliations of the overall investment account values. The system for portfolio management consists of a commercial program, common in the asset management industry, that is supplied in binary form and is not modifiable by the end user. Support is provided by the software developers only and not through value added resellers or other outside parties that would have access to the source code. The reports that were considered were standard reports and not custom report-writer generated reports. The method of assigning basis to individual trades is established when the portfolio is initiated through the account master file. Different methods can be applied to different portfolios, but once established cannot be changed except through initiating another portfolio and transferring all of the data to the new file. Based on the above, we tested three sales transactions to establish that the prior period's method was still being applied. This is a small sample size, representing three of eleven trades for the year in total (in addition to the eleven manager initiated trades there were two immaterial sales related to fractional shares in a stock dividend) or 27% of all trades. The testing, we believe, is adequate to test the method currently being applied by the portfolio management system software.

We have considered whether it was necessary to perform additional procedures in accordance with AU 390, *Consideration of Omitted Procedures After the Report Date*, and, in accordance with our policy of taking all feasible steps to resolve issues raised by reviews and inspections, decided to perform the only steps that we felt would satisfy the inspection team's concerns that the "specific certificate" method, allowable under Rule 2a-2(a) of the Investment Company Act of 1940, had not been consistently applied as required. We examined all trades made during the year and traced the valuation of the elimination basis of each trade to the original trade notice. The basis of each trade was traced to the cost of a specific stock purchase and recalculated as to the per share price applied. The basis of all trades consistently agreed to specific certificates without averaging or other modifications. No modification is needed to our report or the client's financial statements.

We concur that our documentation can be improved and we are reviewing our documentation policies and procedures. In the future, in the absence of an ability to certify the packaged software used by the client and the need to test consistent application of an approved method, we will verify each transaction to original documentation.

We wish to meet the standards of audit quality expected by the Board to the fullest extent. Our response to Part II of the report is included in separate correspondence.

Sincerely,

A handwritten signature in cursive script that reads "Livingston & Haynes, P.C.".

Livingston & Haynes, P.C.