



1666 K Street, N.W.  
Washington, DC 20006  
Telephone: (202) 207-9100  
Facsimile: (202) 862-8430  
[www.pcaobus.org](http://www.pcaobus.org)

**Inspection of  
Mark Bailey & Company, Ltd.**

**Issued by the  
Public Company Accounting Oversight Board  
May 11, 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. 104-2006-115



### 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 MARK BAILEY & COMPANY, LTD.**

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Mark Bailey & Company, Ltd. ("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 October 11, 2005 to October 14, 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	1 (Reno, Nevada)
Ownership structure	Corporation
Number of partners	1
Number of professional staff <sup>3/</sup>	6
Number of issuer audit clients <sup>4/</sup>	None <sup>5/</sup>

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.

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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.

<sup>5/</sup> Prior to the beginning of inspection fieldwork, the Firm ceased to be the auditor of both of its issuer clients. The inspection team reviewed aspects of the Firm's most recent audits of both former clients.

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 conformity with GAAP.<sup>6/</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 both 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.<sup>7/</sup> 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 –

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<sup>6/</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>7/</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.

- (1) the failure to perform and document sufficient testing of the issuer's recognition of revenue; and
- (2) the failure to perform and document sufficient testing of the issuer's allowance for inventory obsolescence.

**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



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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.

# MARK BAILEY & COMPANY, LTD.

Certified Public Accountants  
Management Consultants

Office Address:  
1495 Ridgeview Drive, Ste. 200  
Reno, Nevada 89509-6634

Phone: 775/332.4200  
Fax: 775/332.4210  
E-Fax: 775/201.0907

March 10, 2006

By Facsimile

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

Subject: Response to Draft Report of Inspection

Dear Mr. Diacont:

In response to the draft report of the firm of Mark Bailey and Company, Ltd. (Firm), by the Public Company Accounting Oversight Board (PCAOB or "the Board"), we submit the following comment in order and referenced to Parts I, II and III of the draft.

## Part I

### A. Review of Audit Engagements

The inspection team identified matters they considered to be audit deficiencies of such significance that it appeared that the Firm did not obtain sufficient competent evidential matter to support our opinion. We disagree.

- (1) "the failure to perform and document sufficient testing of the issuer's recognition of revenue".

The work papers and procedures testing revenue recognition and cut-off in this area were not included in the area with other revenue and expense procedures, but rather in the area documenting accounts receivable. The audit team identified the two contracts with approval language. For one of the two accounts, the invoices for which a release had not yet been received were summarized (totaling approximately \$50,000) on the confirmation lead schedule; reversed by the client in a post closing adjustment; and the 'net' account receivable was confirmed by the client. The other balance was clearly immaterial.

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- (2) "the failure to perform and document sufficient testing of the issuer's allowance for inventory obsolescence."

We believe sufficient procedures were performed to substantiate and support our opinion. In planning the procedures for the conduct of this engagement, the audit team reviewed the predecessor auditor's work papers in this area. Our Firm had also conducted an audit of the prior year's financial statements concurrent with this engagement. The audit team reviewed the history of adjustments to this area, and determined it had been historically accurate. Simultaneous with the audit, the Company was the subject of a due diligence review by other outside accountants employed by the acquiring company. They performed additional substantive procedures and found no adjustment necessary. The sale of the Company closed several months later without any further adjustments.

While there was no specific price testing related to obsolescence documented, the audit manager reviewed each balance, on-line, with the CFO. We evaluated the change in reserve, and noted the direct write off of \$449,000, all of which had been previously reserved; the balances between years was consistent; and the methodology was consistently applied. We have previously documented other procedures in our response to the Inspection Team.

While we believe sufficient procedures were performed, in conjunction with other mitigating factors, including the review and sale of the company, we agree that the documentation included in the work papers was not sufficient, or in compliance with the Board's standard in this area. We have discussed this deficiency further in our comments regarding quality control in Part II of our response.

REDACTED

Comments on Non-public Aspects of Report

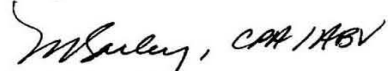
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REDACTED

Comments on Non-public Aspects of Report

Finally, as a Firm, we believe we benefited from the process. For that we thank you.

Best regards.

A handwritten signature in black ink that reads "M Bailey, CPA/ABV". The signature is written in a cursive style with a large initial 'M'.

Mark Bailey, CPA/ABV  
Mark Bailey and Company, Ltd.