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Public Company Accounting Oversight Board

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# Inspection of
# Liebman Goldberg & Drogin, 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. 104-2005-102A
(Includes portions of Parts II and IV of the full report that were not included in PCAOB Release No. 104-2005-102)

PCAOB Release No. 104-2005-102A

**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. 104-2005-102A

PCAOB
Public Company Accounting Oversight Board

# INSPECTION OF LIEBMAN GOLDBERG & DROGIN, LLP

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Liebman Goldberg & Drogin, 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.

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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 May 19, 2004 to May 27, 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:

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|---|---|
| Number of offices | 1 (Garden City, New York) |
| Ownership structure | Limited liability partnership |
| Number of partners | 3 |
| Number of professional staff[3/] | 5 |
| Number of issuer audit clients[4/] | 5 |

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. 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.

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 the three 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 adequate tests of the accounting for a sale of real estate;

(2) the failure to perform and document adequate tests of accrued liabilities in two of the audits reviewed;

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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.

(3) the failure to perform and document adequate tests of a liability related to income taxes;

(4) the failure to perform and document adequate tests of mortgage notes receivable;

(5) the failure to perform and document an analysis of the need for a valuation allowance for deferred tax assets;

(6) the failure to perform and document adequate procedures to evaluate the accounting treatment and disclosures of a note receivable;

(7) the failure to perform and document adequate tests of accounts receivable, revenue and/or related accounts for two issuers; and

(8) the failure to perform and document adequate tests of expenses in two audits reviewed.

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

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.

1. 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. In addition to the deficiencies noted in Part II.A, the inspection team reported deficiencies in disclosures of transactions with related parties in the financial statements that had not been appropriately identified and/or addressed by the Firm. [Issuers B and C]

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[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.

b. Appropriate Procedures

The Firm's system of quality control appears not to provide reasonable assurance that the Firm will conduct all testing appropriate to a particular audit. The information reported by the inspection team suggests an apparent pattern of failures to perform the appropriate procedures related to the testing of accrued liabilities [Issuers A and B] and testing of accounts receivable, revenue and/or related accounts [Issuers B and C] and selling, general and administrative expenses [Issuers B and C].

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 partners, deficiencies in the scope of the concurring partners' 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 reviewing partners' reviews preclude the Board from determining the relative contribution of each of these potential causes to the failure of the reviewing partner process to prevent the deficiencies reported by the inspection team.

2. Monitoring and Addressing Identified Weaknesses

A firm should monitor the adequacy of its policies and procedures and meaningfully address weaknesses in its audit practice. The Firm's policies and procedures appear to be deficient in this regard. The nature of the problems reported by the inspection team suggests that the Firm has not responded meaningfully to related weaknesses that have been identified to the Firm in the past, including in the Firm's 2002 peer review report and in the SEC May 6, 2003 administrative order against a partner of the Firm.[8/]

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[8/] On May 6, 2003, the SEC issued a settled administrative order against Michael R. Drogin, finding that he had engaged in improper professional conduct by failing to obtain sufficient competent evidential matter and failing to exercise due care and professional skepticism in connection with the Firm's audit of an issuer. *In the Matter of Michael R. Drogin, CPA,* Ad. Proc. No. 3-10762 (May 6, 2003).

## 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.

*LIEBMAN GOLDBERG & DROGIN LLP*
*Certified Public Accountants*
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Garden City, New York 11530

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August 11, 2005

Via: UPS Overnight
Tracking # 1Z1075X62210075698

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

Re: Draft Report of Inspection

Gentlemen:

Attached to this letter is our response (3 pages) to your "Draft Report of Inspection" dated July 14, 2005.

Our response includes the firm's comments to Part I – public portion and Part II – non-public.

Thank you for your attention to this matter.

Sincerely,
Liebman, Goldberg & Drogin, LLP

By: Elliot Goldberg
Partner

**DRAFT RESPONSE – PCAOB**

The firm is in receipt of your draft report of inspection dated July 14, 2005. We have reviewed your discussion of inspection procedures and certain observations "Part I".

We are responding to the deficiencies outlined under part A; Review of Audit Engagements of Part I. In accordance with PCAOB standards, the firm has taken appropriate actions to assess whether the identified audit deficiencies after the date of the audit report, affects our ability to support our previously expressed opinions. (As per AU390, Consideration of Omitted Procedures after the report date); and in conjunction with AU561, (subsequent discovery of facts existing at the date of the auditors report).

Our response is as follows:

1. Subsequent audit procedures performed, provided us with sufficient documentation and audit evidence to support the previously expressed opinion regarding a sale of real estate. Additionally, in performing the subsequent years audit and quarterly reviews, the firm's analysis and documentation supports substantial receipts from the mortgagee who acquired the real estate.

2. Subsequent interim review procedures document original audit workpapers that satisfy the accrued liability and render the issuers CFO memorandum to have no effect on the liability. Additionally, there is documentation that includes analysis of the value of the assets transferred. The liability was settled in full as per the proposed settlement.

   As it relates to the second of three audits, the issuer did have site closings/relocations in a subsequent period. The firm has documented and performed additional procedures regarding the appropriateness and valuation of this liability.

   With regards to the third audit, the issuer's subsequent year-end was audited by a successor firm. Our firm cooperated with the successor regarding a restatement and our audit opinion. None of the restatements related to accrued liabilities or revenue issues. Since the successor firm did not restate regarding any items that was discussed in the inspection, we believe there was no effect on our report opinion even if adequate tests of the accrued liabilities were not performed or documented.

3. In a subsequent review period, management advised the firm that they engaged an outside consultant to negotiate a settlement of this liability. Subsequent to the audit under inspection the liability was expunged in its entirety.

4. The subsequent audit contains documentation that supports the collectibility of the notes as evidenced by a real estate appraisal and other transactions. The current note receivable was collectible, as it became part of a settlement package related to the accrued liability. The remainder of the mortgage note receivable was classified as a long-term asset, to reflect slow collectibility.

5. While the firm did not document information from the issuer regarding this item, communications from the issuer implied a possibility that the sale of a subsidiary would result in capital gain. In the subsequent audit period, the issuer wrote off the deferred tax asset completely as it believed no gain offsets would occur. Reliance on the subsequent audit appears to be realistic regarding this matter.

6. In the subsequent audit period, the firm has documented procedures regarding the prior audit period note receivable. It believes based upon collections that the allowance and note receivable shown as long-term were properly classified.

7&8. -

With regards to the first issuer, during the firm's subsequent audit and interim reviews, documentation of testing and analysis provides acceptance as to the reasonableness of accounts receivable, revenue allowance accounts and expenses. The firm performed substantially more testing and documentation and believes that the revenue, allowances and expenses reported in the subsequent year are properly reported. Based upon the accuracy of the subsequent year, no effect or change to the audit reports discussed is deemed necessary.

Matters discussed in items 7 & 8 relating to the second issuer also do not require any restatement or change to our audit opinion. The subsequent year audit was performed by a successor firm. As previously stated, their report did not require any restatement regarding these matters.

It should be noted that our firm response regarding items 1-8 we assessed and considered whether action was necessary regarding our audit opinions and our ability to support those previously issued opinions.

**DRAFT RESPONSE – PCAOB**
**PART II – NON-PUBLIC**

The firm is in receipt of your draft inspection report dated July 14, 2005. We have reviewed your detailed discussion of inspection results. Our comments regarding part A; Insufficiently Supported Audit Opinions is a part of our response to Part "I". With regards to Part B; "Issues Related to Quality Controls" we respond as follows:

We are aware of the PCAOB's concerns as to the firm's system of quality controls and failures therein. The firm intends to address these criticisms and defects and embark on an aggressive program to ensure that the standards of technical competence, due care, professional skepticism, concurring partner review and monitoring of the firm's policies and procedures are improved and remedied within the required twelve month period after the issuance of the Board's final inspection report. In following the Board's recommendation, the firm intends to obtain a reputable and qualified reviewer to review its recent audit reports and obtain support in implanting all necessary procedures to ensure compliance with the Board's requirements.