

**Inspection of
Perrella & Associates, P.A.**

**Issued by the
Public Company Accounting Oversight Board
April 6, 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**

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 PERRELLA & ASSOCIATES, P.A.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Perrella & Associates, P.A. ("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 7, 2004 to June 10, 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 (Pompano Beach, Florida) |
| Ownership structure | Corporation |
| Number of partners | 1 |
| Number of professional staff ^{3/} | 3 |
| Number of issuer audit clients ^{4/} | 8 |

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 five 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 all five 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 –

- (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 concerning the loss per share;

^{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 appropriate audit procedures related to a business combination;
- (3) on two audits, inappropriately taking responsibility for the work of another auditor when the other auditor performed substantially all of the audit procedures that served as the basis for the Firm's opinion;
- (4) on two audits, the failure to audit appropriately nonmonetary transactions involving issuances of stock;
- (5) the failure to perform and document appropriate tests of inventory;
- (6) the failure to perform and document appropriate audit tests regarding the extinguishment of debt;
- (7) the failure to perform and document a consideration of the implications of the payment of issuer costs by related entities; and
- (8) on one audit, the failure to perform and document any procedures (a) to test three significant balance sheet accounts; (b) related to a write-off of a related party receivable balance, the issuance of shares of common stock in exchange for services, and the computation of weighted average shares outstanding used in computing loss per share; and (c) to search for unrecorded liabilities or to obtain an understanding of the issuer's business, accounting processes, and related internal controls.

Following the inspection fieldwork and the inspection team's discussion with the Firm of the matters identified above, the Firm performed additional audit procedures and identified misstatements in two issuers' financial statements. The issuers subsequently restated their financial statements.^{7/}

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 encompassed practices, policies and

^{7/} The Board inspection process did not include any review of the additional audit work or the restated financial statements.

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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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.^{8/} 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. 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

^{8/} 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.

perform the appropriate procedures related to the testing of equity transactions [Issuers B and C] , as well as an apparent pattern of inappropriate reliance on the work of other auditors to perform substantially all of the audit procedures that serve as the basis for the Firm's opinion. [Issuers A and E]

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 Firm used the services of an accountant not affiliated with the Firm to perform the concurring partner review of the five issuer audits included in the inspection. 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. On one engagement, the concurring review did not take place until after the financial statements had been filed with the SEC. [Issuer D] With respect to the other four engagements, the failure 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 preclude 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.

PERRELLA & ASSOCIATES, P.A.
CERTIFIED PUBLIC ACCOUNTANTS

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September 27, 2006

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

Re: Response to Public Company Accounting Oversight Board Report of
2004 Inspection of Perrella & Associates, P.A.

Dear Mr. Diacont:

We appreciate the opportunity to review and comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") draft Report on 2004 Inspection of Perrella & Associates, P.A. ("Report").

Perrella & Associates, P.A. ("Firm") is committed to improvement in its audit quality and the PCAOB's inspection comments and report contribute directly to that process. The PCAOB has proven its commitment to help restore investor confidence in the capital markets and in the public accounting profession to improve audit quality by having a highly dedicated professional staff. Our Inspections' staff provided constructive dialog and performed an in depth review of issuer's files resulting in quality and detailed comments. We take seriously the findings identified by the Board during the 2004 inspection of our 2003 audit engagements, and we will incorporate these findings into our ongoing audit quality efforts.

We have taken, and are continuing to take, substantive steps to address the Board's findings and concerns that we believe are necessary to improve our audit quality and that are responsive to those findings and concerns. Significant steps taken include more skeptical client acceptance, more extensive audit documentation to support auditor's representations, enhanced concurring reviewer procedures, staff education and better adherence to standards when audit procedures are performed by other auditors. These steps also include changes made to our audit procedures in response to PCAOB Auditing Standard No. 3 related to audit documentation, which became effective in 2004.

The comments that follow respond to Part I - *Inspection Procedures and Certain Observations* of the Firms 2004 Inspection Report. The inspection of each of the engagements selected was performed thoroughly. Professional judgment is involved in both performance of an audit and the subsequent inspection process, and we view the

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Board's comments as positive and helpful. We accept the PCAOB's findings in the Report. With respect to the findings identified by the Board in the Report, we considered whether it was necessary to perform additional procedures in accordance with 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*. For a number of findings, additional procedures were necessary, were performed and or enhanced documentation was obtained or prepared. We and two clients agreed that their financial statements needed to be restated based on findings. As a result of these actions, we have concluded that no new facts came to our attention that caused us to believe that our previously issued reports should be withdrawn. Part II discusses findings and specific procedures.

We take seriously the Board's findings, and recognize the need to have in place the ability to execute and document audit procedures in accordance with PCAOB standards. Appropriate testing was done in some findings, but the work papers did not partially or at all capture the testing or rational underlining all conclusions. Under new audit documentation standards, the outcome is not the judge of audit documentation.

We have taken substantive steps, as mentioned above, to enhance our audit procedures in order to begin to meet the standards of the Board. Additionally, we have significantly reduced our public company client base. At the time of our inspection, we had eight micro-cap issuers. Following our inspection, we decided to reduce the number of issuers. Today we have two. The purpose is to better serve those clients and more importantly, to ensure that quality controls and abilities are in place for our size and resources.

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We have a better understanding of the importance and need to strengthen our Firm as we work with the PCAOB in order to improve audit quality. We would be pleased to discuss our response or answer any questions the Staff or Board may have regarding this response.

Sincerely,

Berella & Associates, P.A.

Redacted
Comments on Non-public Aspects of Report

A. Issues related to Quality Controls

Perrella and Associates, P.A. acknowledges the professional performance of the PCAOB and its staff and what has been accomplished in a short time. We desire to continue our public company audit practice and recognize that we must enhance our professional standards, which consist of auditing, attestation, quality control, ethics, and independence standards and related rules of audit reports for Issuers, as defined by the Sarbanes-Oxley Act.

Significant steps taken to meet those standards include more skeptical client acceptance, more extensive audit documentation to support our auditor's representations, enhanced concurring reviewer procedures, staff education and better adherence to standards when audit procedures are performed by other auditors.

Regarding client acceptance, we had listed eight audit clients during the time of our review. As of today, only one of them is retained. Of the seven, one was not an issuer, one is non-reporting and five were declined. The five declined Issuers were acquired and there were no retaining benefits by the acquirer at acquisition or soon thereafter. Our skepticism of client acceptance will include an issuer's ability to recognize their responsibilities and our ability to meet PCAOB professional standards in regard to the issuer.

Audit documentation will be in compliance with PCAOB Auditing Standard No. 3, Release No. 2004-006, which became effective in 2004. A complete understanding of the nature, purpose and recording of share transactions will be emphasized. Our concurring reviewer has agreed to and will have more involvement in the audit process.

We take this review and report seriously and have responded to all deficiencies in the engagements as best as we could. We have take steps to implement the enhancements of the Firm's quality controls.