

**Inspection of  
Stark Winter Schenkein & Co., LLP**

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

**December 22, 2008**

**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 U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure 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 or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.

## **INSPECTION OF STARK WINTER SCHENKEIN & CO., LLP**

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Stark Winter Schenkein & Co., 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.<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 unless a firm specifically requests otherwise. 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 routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement 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 primary procedures for the inspection from November 27, 2006 to December 5, 2006. These procedures were 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	2 (Denver, Colorado; and Tampa, Florida)
Ownership structure	Limited liability partnership
Number of partners	5
Number of professional staff <sup>3/</sup>	11
Number of issuer audit clients <sup>4/</sup>	53

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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. In some circumstances, a Board inspection may include a review of a firm's audit of financial statements of an issuer that ceased to be an audit client before the inspection, and any such former clients are not included in the number shown here.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.<sup>5/</sup> 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 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 inspection procedures included a review of aspects of the Firm's auditing of financial statements of four issuers. The scope of this review was determined according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the scope.

The inspection team identified what it considered to be audit deficiencies.<sup>7/</sup> The deficiencies identified in four of the audits reviewed included deficiencies of such

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<sup>5/</sup> This focus necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools.

<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's practice is to report 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*

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.<sup>8/</sup> Those deficiencies were –

- (1) the failure, in three audits, to perform sufficient audit procedures to test revenue;
- (2) the failure to perform audit procedures to evaluate an issuer's accounting for convertible debt;
- (3) the failure to perform audit procedures to evaluate whether an investee company of an issuer was a variable interest entity and potentially subject to consolidation;
- (4) the failure to perform sufficient audit procedures to test transactions involving derivative instruments;

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*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.

<sup>8/</sup> In some cases, an inspection team's observation that a firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if a firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3"), provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28. For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

(5) the failure to perform audit procedures to test, in connection with a business combination, the purchase price allocation, the fair value of consideration given, and the impact of a management agreement on the purchase accounting; and

(6) the failure to evaluate the appropriateness of the current and long-term liability classifications of convertible debt.

**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



PCAOB Release No. 104-2008-255A  
Inspection of Stark Winter Schenkein & Co., LLP  
December 22, 2008  
Page 6

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.<sup>9/</sup> 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.

#### Independence Procedures

The Firm's independence procedures appear not to meet the requirements of PCAOB Rule 3400T(b),<sup>10/</sup> in that the Firm does not have procedures to verify the completeness and accuracy of independence representations made by the Firm's partners and managers.

#### 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

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<sup>9/</sup> 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.

<sup>10/</sup> PCAOB Rule 3400T(b) requires registered firms to comply with the quality control standards described in section 1000.08(o) of the American Institute of Certified Public Accountants SEC Practice Section Reference Manual, which in turn requires that a firm have policies and procedures in place to comply with Appendix L, section 1000.46 of that manual.

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 –

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#### Documentation

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will adequately document its audit work. Two of the audits reviewed were performed in one of the Firm's offices. For these two audits, the Firm's primary source of evidence of its performance of audit procedures was signed audit program steps. The Firm's audit work papers should be sufficiently detailed to enable supervisory members of the Firm to understand the nature, timing, extent, and results of the audit procedures performed and the evidence obtained. Although there may be circumstances when a sufficiently detailed audit step on an audit program will adequately document the evidence obtained from the procedure, such instances generally are rare. In the circumstances observed by the inspection team, the sign-offs were not an adequate indication of the procedures performed, evidence obtained, and conclusions reached. [Issuers C and D]

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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 Firm provided a written response to a draft of this 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.<sup>11/</sup>

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<sup>11/</sup> 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 unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm's response is made publicly available.



STARK • WINTER • SCHENKEIN

October 27, 2008

Public Company Accounting  
Oversight Board  
1666 K Street N.W.  
Washington, D.C. 20006

RE: Draft Report, Stark Winter Schenkein & Co., LLP

Gentlemen:

This letter is in response to your letter of September 28, 2008 regarding the inspection of our firm made in November and December, 2006. Please accept it as our formal response.

#### PART I

Number of issuer audit clients: As of the date of the inspection, the firm represented 35 issuers. The inspection team only inspected current clients of the firm. The difference between the 35 we represent and 53 appears to be companies that are no longer clients of the firm. The number of issuer clients should be changed to 35.

The firm takes exception to what the inspection team considered audit deficiencies and that such deficiencies are of such significance that the firm did not obtain sufficient competent evidential matters to enable us to express our opinion on the financial statements of issuers A,B,C&D.

1. The firm disagrees with the inspection team that it failed to test revenue. The specifics will be discussed in the individual engagements.
2. The firm disagrees with the inspection team that it failed to evaluate the issuers accounting for convertible debt. This will be discussed in the response the individual company that was inspected.
3. The firm disagrees with the inspection team in that it failed to perform audit procedures to evaluate whether or not an investee company of an issuer was a variable interest entity and potentially subject to consolidation. This issue will be discussed in the response to the individual company inspected.
4. The firm disagrees that it failed to perform sufficient audit procedures to test transactions involving derivative instruments. This issue will be discussed in the response to the individual issuer.

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STARK • WINTER • SCHENKEIN & CO., LLP • *Certified Public Accountants • Financial Consultants*

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Public Company Accounting Oversight Board

October 27, 2008

Page 2

5. The firm disagrees that in connection with a business combination it failed to test the purchase price allocation, the fair value of the consideration given and the impact of a management agreement on the purchase accounting. This issue will be discussed in the response to the individual company inspected.
6. The firm disagrees that it failed to evaluate the appropriateness of the classifications of current and long-term debt. This issue will be discussed in the response to the individual company inspected.

This response is to the public portion of the report

END OF PART I

REDACTED. Comments on Non-public Aspects of Report

B. Issues related to quality control

1. Independence procedures – The firm has implemented additional procedures to test the accuracy of independence representations made by partners and managers.

2. Audit performance

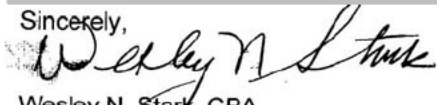
REDACTED. Comments on Non-public Aspects of Report

f. The firm believes that all procedures required by GAAS and PCAOB standards have been performed. The firm has instituted procedures to insure that it includes required documentation on workpapers as well as having signed off on audit programs.

REDACTED. Comments on Non-public Aspects of Report

REDACTED. Comments on Non-public Aspects of Report

Sincerely,

A handwritten signature in black ink that reads "Wesley N. Stark". The signature is written in a cursive style with a large, prominent "W" and "S".

Wesley N. Stark, CPA  
Managing Partner