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## **Inspection of Aaron Stein**

**Issued by the**

**Public Company Accounting Oversight Board**

**November 30, 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. 104-2006-181A  
(Includes portions of Parts II and IV of the full report that  
were not included in PCAOB Release No. 104-2006-181)



### **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 AARON STEIN

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Aaron Stein ("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 January 18, 2005 to January 20, 2005. The fieldwork included procedures tailored to the nature of the Firm, certain aspects of which are summarized as follows:

Number of offices	1 (Woodmere, New York)
Ownership structure	Sole practitioner
Number of partners	1
Number of professional staff <sup>3/</sup>	None
Number of issuer audit clients <sup>4/</sup>	3 <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.

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

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<sup>3/</sup> "Professional staff" includes all personnel of the Firm, except partners or shareholders and administrative support personnel.

<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 the inspection field work, the Firm ceased to be the auditor of two issuer clients. The inspection team reviewed aspects of the Firm's most recent complete audit of one of these former clients.

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 four of the Firm's audits of the financial statements of issuers. Those audits and aspects that were inspected were selected according to the Board's own criteria, and the Firm was not allowed an opportunity to limit or influence the audits reviewed.

The inspection team identified matters that it considered to be audit deficiencies.<sup>7/</sup> The deficiencies identified in two 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 failure to perform and document adequate audit procedures to test liabilities; and

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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 the 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.

(2) the failure to perform and document adequate testing of equity transactions

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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Inspection of Aaron Stein  
November 30, 2006  
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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 a 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>8/</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.

#### 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<sup>9/</sup> –

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<sup>8/</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>9/</sup> In addition to the points described in the text, the Board notes that the Firm did not obtain concurring partner reviews in the engagements reviewed by the inspection team. Because the Firm was not a member of the SEC Practice Section of the American Institute of Certified Public Accountants and therefore is not subject to the concurring partner review requirement in the Board's interim standards, the Board is not here addressing the lack of concurring partner review in terms of a criticism of, or a potential defect in, the Firm's quality control systems for purposes of PCAOB Rule 4009 (discussed in Part III below). Nevertheless, the Board notes the important role that a concurring partner review can play in ensuring that an audit is performed in compliance with PCAOB standards, and encourages the Firm to obtain a concurring partner review in connection with audits of issuers. A meaningful concurring partner review procedure

a. Technical Competence, Due Care, and Professional Skepticism

The Firm's approach to 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 that the Firm's work papers failed to demonstrate that the issuers' accounting records agreed with or reconciled to the financial statements on which the Firm had issued an audit report. [Issuers A, B, C, and D]

b. Auditor Communications

The Firm's system of quality control does not provide sufficient assurance that the Firm will make or document all required auditor communications with audit committees, including making independence confirmations required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*, and formally documenting communications with audit committees. [Issuers A, B, C, and D]

c. Retention and Provision of Records

The Firm's system of quality control does not provide sufficient assurance that the Firm will retain appropriate documentation of its audit work and its compliance with standards relating to quality control. Before and during the inspection field work, the inspection team requested that the Firm provide it with the audit work papers for an audit of an issuer that the Firm had performed. The Firm claimed that it was unable to provide these requested documents, stating that they were in the possession of the issuer, a former client. In addition, the firm failed to provide certain continuing education ("CPE") records of its owner. The requested work papers and CPE records should be maintained by the Firm.

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would likely have identified the deficiencies described in this report before the Firm issued the reports.

## **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.

*Aaron Stein*  
Certified Public Accountant

PO Box 406  
981 Allen Lane  
Woodmere, NY 11598  
516-569-0520

September 15, 2006

Via Facsimile and US Mail

Mr. George H. Diacount  
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 ("PCAOB" or the "Board") Draft Report of  
Inspection of Aaron Stein, CPA Part I

Dear Mr. Diacount:

Aaron Stein, CPA is pleased to have the opportunity to respond to the PCAOB draft report of the inspection (the "Report") Dated September 28, 2005, covering the inspection of Aaron Stein, CPA by the Board. I believe that inspection of firms can be an effective means of monitoring and improving audit quality. I support the PCAOB's mission and believe inspections by the Board are of significant benefit to both the public and our profession.

Aaron Stein, CPA is committed to conducting audit work of the highest quality and believes that the results of PCAOB inspections assist in that process. I have reviewed the results of the inspection and have taken steps to improve the audit process and quality of the audit work including changes in procedures, training and communications with clients.

Audit issues described in the Report, and to which the findings relate, concerned the lack of sufficient competent evidential matter necessary to render opinions on two issuers' financial statements. Although I generally agree with the specific findings reported, I do not agree in both instances with the overall conclusion that the firm did not obtain sufficient competent evidential matter to render an opinion on the issuers' financial statements. While some of the issues involved the application of professional judgment the other issues can be characterized as documentation deficiencies where documentation of auditing procedures or results could have been improved.

I appreciate the opportunity to provide my response to the draft report.

Sincerely,

  
Aaron Stein

*Aaron Stein*  
Certified Public Accountant

PO Box 406  
981 Allen Lane  
Woodmere, NY 11598  
516-569-0520

September 15, 2006

Via Facsimile and US Mail

Mr. George H. Diacount  
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 ("PCAOB" or the "Board" Draft Report of  
Inspection of Aaron Stein, CPA Part II

Dear Mr. Diacount:

Aaron Stein, CPA is pleased to have the opportunity to respond to the PCAOB draft report of the inspection (the "Report") Dated September 28, 2005, covering the inspection of Aaron Stein, CPA by the Board. I believe that inspection of firms can be an effective means of monitoring and improving audit quality. I support the PCAOB's mission and believe inspections by the Board are of significant benefit to both the public and our profession.

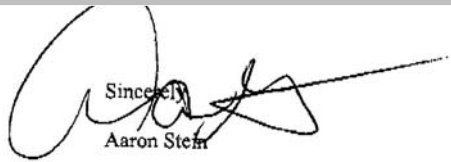
Before addressing some specific comments in the Report I would like to take this opportunity to discuss several effective tools and changes that I have implemented in order to improve my audit quality which were directly as a result of some of the comments made in the Report. I have made arrangements for concurring reviews of my engagements with other PCAOB approved auditors in an effort to improve my audit quality. I have also reviewed the issues raised by your Report with them in order to take positive corrective action. My engagement checklists and disclosure checklist currently being used are for public companies as opposed to the nonpublic business checklist that I had previously been using. I have also made sure that all correspondence including Independence Disclosures with Audit Committees and communications required under AU380, Communication With Audit Committees have been made part of my engagements. I have also made sure to retain all documentation of audit work and workpapers from my engagements and to provide only copies should they be requested. I have also kept better documentation of CPE records.

REDACTED

Comments on Non-public Aspects of Report

REDACTED

Comments on Non-public Aspects of Report



Sincerely  
Aaron Stein