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## **Inspection of Baum & Company, P.A.**

**Issued by the**

**Public Company Accounting Oversight Board**

**January 30, 2009**

**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. 104-2009-006A  
(Includes portions of Parts II and IV of the full report that  
were not included in PCAOB Release No. 104-2009-006)



### **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 BAUM & COMPANY, P.A.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Baum & Company, P.A.<sup>1/</sup> ("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>2/</sup>

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.<sup>3/</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 Firm has issued audit reports under the name of Baum & Company, PA.

<sup>2/</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>3/</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 October 22, 2007 to October 25, 2007. 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	3 (Coral Springs, Hollywood, and Miami, Florida)
Ownership structure	Corporation
Number of partners	1
Number of professional staff <sup>4/</sup>	6
Number of issuer audit clients <sup>5/</sup>	17

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<sup>4/</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>5/</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>6/</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>7/</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 two 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>8/</sup> The deficiencies identified in one of the audits reviewed included deficiencies of such

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<sup>6/</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>7/</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>8/</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>9/</sup> Those deficiencies were –

- (1) the failure to perform sufficient audit procedures related to the accounting for convertible debt with stock purchase warrants;
- (2) the failure to perform sufficient audit procedures related to the valuation of stock issued for services and other expenses; and
- (3) the failure to perform sufficient audit procedures related to inventory valuation.

Two of the deficiencies described above related to auditing an aspect of an issuer's financial statements that the issuer revised in a restatement subsequent to the primary inspection procedures.<sup>10/</sup>

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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>9/</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.

<sup>10/</sup> The Board inspection process did not include review of any additional audit work related to the restatement.

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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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>11/</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.

#### 1. Design of Quality Control System

##### Independence Procedures

The Firm's independence procedures appear not to meet the requirements of PCAOB Rule 3400T(b),<sup>12/</sup> in that the Firm does not have procedures to verify the completeness and accuracy of independence representations made by the Firm's managers.

#### 2. 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

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<sup>11/</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>12/</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.

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. Testing Appropriate to the Audit

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will conduct all testing appropriate to a particular audit, specifically with respect to the following issues:

(i) Accounting for issuances of financial instruments

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the Firm's audit procedures with respect to convertible debt and warrants and subsequent modifications. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its audit procedures for evaluating the accounting for financial instruments. [Issuer A]

(ii) Stock issued for services and other expenses

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the Firm's audit procedures with respect to the values assigned to transactions involving stock issued in payment for services and other expenses. This information provides cause for concern regarding the Firm's quality control policies and procedures for auditing values assigned to stock issued for services and other expenses. [Issuer A]

(iii) Valuation of inventory

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the Firm's audit procedures with respect to the valuation of inventory. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its audit procedures for testing inventory valuations. [Issuer A]

b. Engagement Completion Document

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will prepare an engagement completion document in accordance with AS No. 3, which is necessary to demonstrate that the work performed by engagement personnel addresses the significant findings and issues of the engagement. [Issuers A and B]

c. Auditor Communications

The Firm's system of quality control appears not to provide sufficient assurance that the required auditor communications to the audit committee, or equivalent, occur and are appropriately documented, including the independence confirmations required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*. [Issuers A and B]

3. Monitoring and Addressing Identified Weaknesses

The Firm's system of quality control appears to lack a monitoring element sufficient to provide the firm with reasonable assurance that the Firm's policies and procedures for engagement performance are suitably designed and effectively applied. Appropriate monitoring includes meaningfully addressing identified weaknesses in the Firm's audit practice, which the Firm has failed to do in at least three respects. In a report dated September 28, 2005, which related to an inspection of the Firm conducted in late 2004, the Board noted that the Firm's procedures appeared not to provide sufficient assurance that the firm would perform appropriate procedures with respect to equity transactions. The report also noted audit deficiencies related to the valuation of warrants, stock issued for services, and the valuation of inventory. An appropriate approach to monitoring would have resulted in the Firm avoiding these deficiencies in audits performed after they were brought to the Firm's attention, yet the same deficiencies were noted in this inspection. This indicates that the Firm had not responded meaningfully to the deficiencies identified in its previous PCAOB inspection. [Issuer A]

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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>13/</sup>

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<sup>13/</sup> In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.

**BAUM & COMPANY, P.A.  
CERTIFIED PUBLIC ACCOUNTANTS  
605 LINCOLN ROAD – SUITE 210  
MIAMI BEACH, FLORIDA 33139  
( 954 ) 752-1712**

November 19, 2008

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

RE: Response to firm's inspection report

Dear Mr. Diacont:

In response to my draft inspection report dated October 17, 2008, I have the following thoughts. In retrospect, I acknowledge that my firm's quality control system had lacked certain controls which has substantially improved since the inception of my registration with the PCAOB. I realize that due to the ever changing accounting profession and the evolution of accounting and auditing standards, that the task of maintaining a flawless system of quality control is a never ending process that can't be compromised. To that ends, I have devoted myself and my firm's resources to material improvements to the firm's quality control system.

Upon review of the various issues detailed, I have determined that my staff's judgement and the review function was adequate in most cases. I realized having a third party attempt to review the work of another after the fact, is not always a fair process. The judgement in fieldwork and the cumulative knowledge of an issuer can not always be communicated precisely in workpapers. We are working towards this as a essential part of our quality control process.

REDACTED

Comments on Non-public Aspects of Report

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## REDACTED. Comments on Non-public Aspects of Report

In general, I felt that the findings of the inspection team was fair and has made an impact on my firm's quality control system. As remedial actions, we have strengthened our review procedures and knowledge base of certain areas of accounting per se. We have also broaden our continuing education to achieve these objectives.

In addition, I have reduced our issuers clientele to four as of the quarter ended September 30, 2008. I felt that based on the limitations in professional staff and the demanding deadlines, that our objectives and compliance would be best achieved by downsizing our client base of issuers.

Subsequently, effective September 1, 2008, I have executed a merger with a larger registered accounting firm to perform and administer my issuer clientele. I believe that the combined resources and technical knowledge of this new firm will help me resolve any deficiencies noted in my quality control system.

I look forward to contact with the PCAOB in the subsequent period to communicate my improvements and implementation of sound quality control procedures and systems.

Sincerely,

Joel S. Baum, CPA