



1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8433
www.pcaobus.org

**Inspection of
Cordovano and Honeck LLP
(Headquartered in Englewood, Colorado)**

**Issued by the
Public Company Accounting Oversight Board
June 29, 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. 104-2009-105A
(Includes portions of Parts II and IV of the full report that
were not included in PCAOB Release No. 104-2009-105)



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 CORDOVANO AND HONECK LLP

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Cordovano and Honeck 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.

^{1/} 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.

^{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 primary procedures for the inspection from June 5, 2007 to June 12, 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	1 (Englewood, Colorado)
Ownership structure	Limited liability partnership
Number of partners	2
Number of professional staff ^{3/}	4
Number of issuer audit clients ^{4/}	34

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.^{5/} To achieve that goal, Board

^{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. 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.

^{5/} 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.

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.^{6/} 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.^{7/} 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

^{6/} 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.

^{7/} 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.

competent evidential matter to support its opinion on the issuer's financial statements.^{8/}
Those deficiencies were –

- (1) the failure to perform procedures to evaluate the adequacy of disclosure concerning certain convertible preferred stock and the appropriateness of the accounting for a conversion option embedded in the preferred stock instrument; and
- (2) the failure to perform procedures to evaluate whether revenue arrangements with multiple deliverables were accounted for properly.

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

^{8/} 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.



PCAOB Release No. 104-2009-105A
Inspection of Cordovano and Honeck LLP
June 29, 2009
Page 5

PORTIONS OF THE REST OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED
FROM THIS PUBLIC DOCUMENT

PART II

* * * *

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.^{9/} 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.

* * * *

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 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:

* * * *

^{9/} 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.

(ii) Revenue Recognition

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to revenue recognition. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its testing of revenue arrangements involving multiple deliverables. [Issuer B]

* * * *

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.^{10/}

^{10/} 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.

Cordovano and Honeck LLP

Certified Public Accountants
88 Inverness Circle East, Bldg. M-103
Englewood, CO 80112
(303) 329-0220 Phone
(303) 316-7493 Fax

May 11, 2009

VIA FAX 202-862-8433

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

Re: Response to Report of 2007 Inspection of Cordovano and Honeck, LLP

Dear Mr. Diacont:

Pursuant to PCAOB Rule 2007(a), Cordovano and Honeck, LLP ("the Firm") hereby responds to the draft report dated April 9, 2009 regarding the staff's 2007 inspection of the Firm ("Report"). We are committed to enhancing our firm's audit and quality control policies and procedures based on the findings in the Report. This letter contains the public portion of the Firm's response. The nonpublic portion of its response will be forwarded to you in a separate letter.

Part I of the Report found that the Firm obtained insufficient competent evidential matter to support its opinions regarding two of the four audits reviewed by the PCAOB staff. The staff did not identify any deficiencies regarding the other two audits. Specifically, the report found that audit procedures were not performed regarding: (1) the adequacy of Issuer A's disclosures relating to the dilutive characteristics of its convertible preferred stock; (2) whether Issuer A should have accounted for the preferred stock's conversion option as a derivative at fair value; and (3) whether Issuer B properly recognized revenue from the sale of systems with multiple elements. We note that the first issue addresses the adequacy of the issuer's disclosures, and therefore does not implicate any financial misstatements. We further note that the Report does not indicate that the second and third issues resulted in any material misstatement. *Cf. Inspection of Armando C. Ibarra*, PCAOB Release No. 104-2005-011A (June 30, 2005) (deficiencies included firm's failure "to identify, or to address appropriately, departures from GAAP that related to potentially material misstatements in the audited financial statements").

We respectfully disagree with the Report's finding that Issuer A failed to disclose the dilutive characteristics of its preferred stock. Footnote 1 of Issuer A's financial statements for the relevant fiscal year state that:

[A]t December 31, 2006, there was no variance between basic and diluted earnings per share because any potentially dilutive securities would have been

George H. Diacont, Esq.
May 11, 2009
Page 2

anti-dilutive due to our net loss for the year. Had we not been in an anti-dilutive situation the potential dilution would have been an additional 2,068,000 shares, which relates to the conversion of our outstanding Convertible Preferred Stock and would give us a total 18,104,625 fully diluted common shares outstanding.

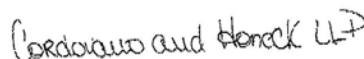
While not a model of clarity, we believe that this disclosure complied with FAS 129, ¶ 4 governing the disclosure of information about outstanding securities, including preferred stock. Therefore, we believe our procedures regarding this disclosure complied with generally accepted auditing standards.

Regarding issues (2)-(3), we believe that audit testing adequate to support our previously expressed opinions was in fact performed, and no additional procedures are required. *See AU § 390, Consideration of Omitted Procedures After the Report Date, and AU § 591, Subsequent Discovery of Facts Existing at the Date of the Auditor's Reports.* However, we acknowledge that our audit workpaper documentation was inadequate. Accordingly, we have added currently-dated memoranda to our workpapers addressing these issues.

By way of explanation, prior to 2004 there were few audit documentation requirements, the adequacy of workpapers was considered to be a matter of professional judgment, and many firms minimized the scope of their workpapers due to concerns about efficiency and defending against litigation.¹ We understand that PCAOB Accounting Standard No. 3 represents a departure from this approach, and the Firm's workpapers now must document "procedures performed . . . with respect to [all] relevant financial statement assertions." *See PCAOB Auditing Standard No. 3 ¶ 6 and Appendix ¶ A18.* To address this issue, we have required our professional staff members to review the PCAOB standard, and have enhanced the level of detail in our workpapers. Among other things, we will ensure that important oral conversations and reports to clients are contemporaneously documented.

Cordovano and Honeck, LLP is committed to achieving the highest level of audit quality. We appreciate the inspection staff's efforts, and the courteous and professional manner in which they carried out their duties. We support the PCAOB's mission, and believe its inspections provide a significant benefit to the accounting profession and the investing public.

Sincerely,



Cordovano and Honeck, LLP

¹ *Audit Documentation: It's a Whole New World*, Howard B. Levy, CPA Journal Online (June 2005), available at <http://www.nysscpa.org/cpajournal/2005/605/essentials/p30.htm>.

Cordovano and Honeck LLP

Certified Public Accountants
88 Inverness Circle East, Bldg. M-103
Englewood, CO 80112
(303) 329-0220 Phone
(303) 316-7493 Fax

May 11, 2009

VIA FAX 202-862-8433

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

Re: Response to Report of 2007 Inspection of Cordovano and Honeck, LLP

Dear Mr. Diacont:

Pursuant to PCAOB Rule 2007(a), Cordovano and Honeck, LLP ("the Firm") hereby responds to the draft report dated April 9, 2009 regarding the 2007 inspection of the Firm ("Report"). We are committed to enhancing our firm's audit and quality control policies and procedures based on the findings in the report. This letter is intended to be nonpublic since it addresses the staff's nonpublic findings relating to quality controls contained in Part II of the Report. The public portion of its response has been forwarded to you in a separate letter.

REDACTED. Comments on Non-public Aspects of Report

George H. Diacont, Esq.
May 11, 2009
Page 2

REDACTED. Comments on Non-public Aspects of Report

B. Audit Performance.

REDACTED. Comments on Non-public Aspects of Report

2. Testing Appropriate to the Audit

The Report further found that its quality control system was deficient with regard to the lack of testing relating to the three issues identified in Parts I and II. As indicated in the public portion of our response to the Report, the Firm believes it did conduct such testing regarding two of the three issues, albeit without adequate documentation. Further, we believe that any testing deficiencies were isolated in nature and not indicative of a systemic quality control problem. Nonetheless, the Firm intends to address this finding by requiring all professional Firm personnel to review GAAP pronouncements relating to each of the three identified issues, including FAS 133, ¶12 (embedded derivative instruments), FAS 129, ¶ 4 (disclosure of information about outstanding securities), and EITF No. 00-21 (revenue arrangements with multiple deliverables). We will also ensure that all testing is adequately documented in compliance with current PCAOB standards. Moreover, within the next twelve months, all professional Firm personnel will take at least one continuing education course addressing revenue recognition, a major source of financial misstatements implicated by EITF No. 00-21.

REDACTED. Comments on Non-public Aspects of Report

George H. Diacont, Esq.
May 11, 2009
Page 3

REDACTED. Comments on Non-public Aspects of Report

We appreciate the opportunity to improve our audit and quality control policies and procedures. Pursuant to PCAOB Rule 4009, we will notify you within twelve months after the date of the inspection report that the Firm has adopted and implemented the foregoing procedural enhancements, or their substantial equivalent. We understand that the portions of the Report addressing perceived deficiencies in the Firm's quality control systems will not be made public if such deficiencies are deemed addressed by the Firm to the satisfaction of the staff.

Sincerely,

Cordovano and Honeck LLP

Cordovano and Honeck, LLP