



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

Inspection of Pollard-Kelley Auditing Services, Inc.

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. 104-2009-016A
(Includes portions of Parts II and IV of the full report that
were not included in PCAOB Release No. 104-2009-016)



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 POLLARD-KELLEY AUDITING SERVICES, INC.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Pollard-Kelley Auditing Services, Inc. ("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 May 14, 2007 to May 17, 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 (Independence, Ohio)
Ownership structure	Corporation
Number of partners	2
Number of professional staff ^{3/}	2
Number of issuer audit clients ^{4/}	23

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 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.^{7/} The deficiencies identified in both 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, in two audits, to perform sufficient procedures to test the value of the issuer's recorded goodwill;
- (2) the failure, in two audits, to perform sufficient procedures to test the valuation of assets acquired and liabilities assumed, and the consideration paid, in business combinations;
- (3) the failure to perform sufficient procedures to test investments in unconsolidated entities;
- (4) the failure to perform sufficient procedures to test revenue; and
- (5) the failure to perform sufficient procedures to test forgiveness of debt.

Three of the deficiencies described above related to auditing an aspect of the issuer's financial statements that the issuer revised in a restatement subsequent to the primary inspection procedures.^{9/}

^{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.

^{9/} The Board inspection process did not include review of any additional audit work related to the restatements.

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. 104-2009-016A
Inspection of Pollard-Kelley Auditing Services, Inc.
January 30, 2009
Page 6

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.^{10/} 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. Fraud Procedures

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will perform all required procedures in accordance with the provisions of AU 316, *Consideration of Fraud in a Financial Statement Audit*. Specifically, the Firm

^{10/} 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.

did not perform audit procedures to test journal entries and other adjustments for evidence of possible material misstatements due to fraud, failed to obtain an understanding of the issuers' financial reporting process and the controls over journal entries, failed to address the presumption that there is a risk of material misstatement due to fraud relating to revenue recognition, and failed to perform a retrospective review of significant accounting estimates reflected in the financial statements of the prior year to determine whether management judgments and assumptions relating to the estimates indicated a possible bias on the part of management. [Issuers A and B]

c. 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]

d. Financial Statement Disclosures

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will identify any missing or incomplete financial statement disclosures. Specifically, required disclosures relating to business combinations and goodwill were noted as missing in issuers' financial statements. [Issuers A and B]

e. Auditor Communications

The Firm's system of quality control appears not to provide sufficient assurance that all of the required auditor communications to the audit committee, or equivalent, occur and are appropriately documented. Specifically, the Firm did not communicate its judgments about the quality, not just the acceptability, of the entity's accounting principles as applied in its financial reporting and did not provide information about audit adjustments made and those proposed by the auditor but not made by the issuer. [Issuers A and B]

f. Appropriate Procedures

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. The information

reported by the inspection team suggests an apparent pattern of failures to perform the appropriate procedures related to the testing of business combinations and of goodwill impairment. [Issuers A and B]

g. Concurring Partner Review

The Firm was not subject to the concurring partner review requirement in the Board's interim standards; however, the Firm's practice has been to require a concurring partner review on audits of the financial statements of issuers. Questions exist about the effectiveness of the Firm's existing arrangement for concurring partner reviews. 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 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. Apparent deficiencies in documentation of the scope and results of the concurring partner's reviews make it difficult to identify the principal cause of the problem, but potential causes include 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's findings.

* * * *

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.^{11/}

^{11/} 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.

VIA FAX AND UPS

November 17, 2008

PCAOB

RESPONSES TO INSPECTION REPORT

Issuer A

Goodwill

The report conclusion is inconsistent with the reviewers' observations. The report states that no audit procedures being performed using a broad interpretation on PCAOB 3. The reviewers' observations, although incomplete, indicate that audit procedures were performed and that there was evidence other than narration, of audit procedures being performed.

The firm also notes that footnotes 11 and 12 of the Inspection Report, though technically correct, are taken out of the context of the entire situation. The clear intended implication was that the restatement was engendered by faulty audit procedures when, in fact, the restatement was a result of supplementary audit work performed by the firm. This work uncovered a totally unique system error that caused the misstatement of goodwill. The firm and client determined the use of an AU390 examination was the appropriate vehicle for handling the situation.

Even the audit work that was reviewed indicated a utilization of professional judgment. The firm is unaware of mandated audit procedures in the area of goodwill. In the future, the firm will continue to utilize professional judgment and in addition perform the audit procedures prescribed.

Investments in unconsolidated entities

The audit procedures performed were documented by our firm standards evidencing utilization of professional judgment, there was additional documentation proffered within the forty-five day limit, and there was a re-audit consistent with the guidelines of AU390 with no restatement deemed necessary.

The firm respectfully points out that the fact that no income or loss was recorded in these investments because the facts and circumstances in this situation, utilizing professional judgment, indicated that any presumption of management control was effectively rebutted, making the cost method of accounting for the investment appropriate.

Revenue

The documentation meets the firms standards proffered for review. In addition, further documentation was offered within the forty-five day period along with additional work within the guidelines of AU390, again with no restatement deemed necessary.

In addition, the firm utilized its professional judgment in examining revenue accounts. In the future the firm will supplement its professional judgment by adopting additional audit procedures.

Business combination

The statement that the firm failed to test the consideration given for the acquisition is incorrect, since the work papers clearly indicated that the consideration given was a note and cash, both of which were tested by the firm. The statement that fair values allocated by the issuer to the assets is incorrect, since the issuer used audited financial statements of the acquired company, such statements being prepared by a competent independent accounting firm associated with a major international auditing and accounting association. The firm relied on these statements and reviewed the underlying books and records. This was proffered to the review team.

Issuer B

Goodwill

The report conclusion is inconsistent with the reviewers' observations. The report states that no audit procedures being performed using a broad interpretation on PCAOB 3. The reviewers' observations, although incomplete, indicate that audit procedures were performed and that there was evidence, other than narration, of audit procedures being performed.

Forgiveness of debt

The firm examined the transaction utilizing its considered professional judgment. An AU390 examination did not create a need for restating that transaction. The firm is unaware of mandated audit procedures, including referring to outside counsel for an opinion that the issuer had been legally released from the obligation to pay the debt. The firm makes no claim to such knowledge, except the note that declaration such as those made by the creditor are normally considered binding.

Business combinations

The report observation and the review observation are incorrect to the extent that they claim no testing of consideration or value to assets assigned.

The consideration was securities of the issuer, which were traced to transfer agent records and market valuation, such item being noted in the working papers.

The assets acquired were based on audited financial statements of the acquired enterprises, such statements and the review thereof by the firm being proffered to the reviewers.

Issues Related to Quality Controls

The firm will review the quality control comments of the report and make necessary adjustments to the firm's documentation and procedures.



Terance L. Kelley
Vice President
Pollard-Kelley Auditing Services, Inc