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**Inspection of  
Scharf Pera & Co., PLLC  
(Headquartered in Charlotte, North Carolina)**

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

**November 19, 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. 104-2009-187



### **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 SCHARF PERA & CO., PLLC

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Scharf Pera & Co., PLLC ("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 June 16, 2008 to June 27, 2008. 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 (Charlotte, North Carolina)
Ownership structure	Professional limited liability company
Number of partners	4
Number of professional staff <sup>3/</sup>	10
Number of issuer audit clients <sup>4/</sup>	2

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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 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.

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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.

The inspection team identified what it considered to be audit deficiencies.<sup>7/</sup> The deficiencies identified in one of the audits reviewed included a deficiency 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.<sup>8/</sup> That deficiency was the Firm's failure to identify, or to address appropriately, a departure from GAAP that related to potentially material misstatements in the audited financial statements concerning the accounting for convertible debentures issued with detachable common stock purchase warrants.

**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

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<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.

<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.

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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PARTS II AND III OF THIS REPORT ARE NONPUBLIC  
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

**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>9/</sup>

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<sup>9/</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.



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September 3, 2009

Mr. George H. Diacont  
Director  
Division of Registrations and Inspections  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006

RE: Response to Draft Report of Inspection

Dear Mr. Diacont:

Scharf Pera & Co., PLLC (the "Firm") is pleased to have the opportunity to respond to the PCAOB draft report (the "Report") on its inspection of the Firm. We are supportive of the PCAOB's mission and believe the inspections by the Board are of significant benefit to the public and our profession.

We respectfully disagree with the overall conclusion that the firm did not obtain sufficient evidential matter to base our opinions on the issuer's financial statements and we believe the audit evidence accumulated during our audit of the issuer was in the aggregate sufficient and competent to provide us with a reasonable basis for forming an opinion on the financial statements as a whole.

The draft report identifies two issues in our audit regarding the accounting for the issuance of convertible debt issued with detachable common stock warrants :

1. The issuer did utilize the guidance provided in EITF 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*. Based on that guidance, the issuer recorded interest expense immediately for the amount allocated to the beneficial conversion feature because the debentures were convertible on issuance. EITF 00-27 did change the guidance to change the amortization period from the earliest conversion date to the

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stated redemption date, however, the EITF board acknowledged in EITF 08-4 that "Certain consensus in Issue 00-27 nullified portions of the guidance in Issue 98-5. A general status update that included transition guidance was added to Issue 98-5 to acknowledge the issuance of Issue 00-27. **However, the portions of Issue 98-5 that were nullified by Issue 00-27 were not specifically identified in Issue 98-5, nor were the illustrative examples in Issue 98-5 updated for the effects of Issue 00-27.**" Specifically, the EITF board acknowledged that the change in amortization from the earliest conversion date to the stated redemption date was not specifically identified in 98-5 and therefore established transition guidance **that conforming changes made to Issue 98-5 that resulted from Issue 00-27 were to be effective for financial statements issued for fiscal year ending after December 31, 2008.** We believe that, based on EITF 08-04, that the immediate recording of interest expense based on the earliest conversion date (the issuance date) would not be in conflict with the EITF board guidance for the issuer's financial statements for the year ending **July 31, 2006 and 2007.**

2. The issuer did not allocate proceeds of the sale received from the sale of the debentures to the detachable common stock warrants. EITF 98-5 provides guidance that an issuer should allocate the proceeds on a relative fair value basis to the convertible instrument and to any detachable instruments included. The issuer did not attribute any material value to the warrants in its issuance, and therefore, no allocation of the proceeds was made. As proof of the issuer's fair value assertion, at July 31, 2007, approximately 38 percent of the common stock were shares issued on conversion of debentures and no warrants had been exercised at that time and none were ever exercised. Regardless, based on the preceding justification for interest expense to be immediately recorded equal to the total proceeds of the debentures, any amount allocated to the warrants would be accounted exactly the same as the issuer did for the beneficial conversion feature and the **financial statement effect would be \$0.**

We appreciate the opportunity to provide our response to the draft report. We will be pleased to discuss our comments or answer any questions the Board may have.

Sincerely,



Scharf Pera & Co., PLLC