



1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8430
www.pcaobus.org

Inspection of Shelley International CPA

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. 104-2006-198A
(Includes portions of Parts II and IV of the full report that
were not included in PCAOB Release No. 104-2006-198)



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 SHELLEY INTERNATIONAL CPA

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Shelley International CPA ("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. 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.

^{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 fieldwork for the inspection from May 3, 2005 to May 6, 2005. The fieldwork included procedures 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 (Mesa, Arizona)
Ownership structure	Sole proprietorship
Number of partners	1
Number of professional staff ^{3/}	1
Number of issuer audit clients ^{4/}	14

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 address appropriately, respects in which an issuer's financial statements do not present

^{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.

fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.^{5/} 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 were selected according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the selection process.

The inspection team identified matters that it considered to be audit deficiencies.^{6/} The deficiencies identified in all four 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 Firm's failure to identify, or to address appropriately, departures from GAAP that related to potentially material misstatements in the audited financial

^{5/} 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 issuers' financial statements.

^{6/} 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.

statements related to a business combination and the consolidation of an acquired subsidiary;

- (2) the failure to perform and document procedures to test two issuers' accounting treatment for stock issuances;
- (3) the failure to perform and document procedures to test an issuer's accounting for a business combination;
- (4) the failure to perform and document procedures to test revenues; and
- (5) the failure to perform and document procedures to test the assets and liabilities of a subsidiary.

The auditing deficiencies described above include deficiencies in auditing an aspect of an issuer's financial statements that the issuer later made substantial adjustments to correct.^{7/}

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

^{7/} The issuer's disclosure of the adjustments followed correspondence between the SEC staff and the issuer, which occurred separate from the Board's inspection. The Board inspection process did not include any review of any additional audit work related to the adjustments.



PCAOB Release No. 104-2006-198A
Inspection of Shelley International CPA
November 30, 2006
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.^{8/} 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.

* * * *

^{8/} 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.

c. Appropriate Procedures

The Firm's system of quality control appears not to provide reasonable 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 the valuation of stock transactions. [Issuers A and B]

d. Concurring Partner Review

Questions exist about the effectiveness of the Firm's existing arrangement for concurring partner reviews. Having procedures for concurring partner review by a competent reviewer is an important element of quality control. 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 Firm used the services of accountants not affiliated with the Firm to perform the concurring partner review of the four issuer audits included in the inspection. 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. This may result from a lack of competency, due care or professional skepticism on the part of the concurring partners; deficiencies in the scope of the concurring partners' procedures; and/or the Firm's failure to properly address the concurring partner findings. Apparent deficiencies in documentation of the scope and results of the concurring partners' reviews preclude the Board from determining the relative contribution of each of these potential causes to the failure of the concurring partner process to prevent the deficiencies reported by the inspection team.

* * * *

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.

Shelley International

144 S. Mesa Dr. #E
Mesa AZ 85210

June 28, 2006

Mr. George H. Durant
Director
Division of Registration and Inspections
PCAOB
1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8430
www.pcaobus.org

Dear Mr. Durant:

We are pleased to respond to your Draft Report of Inspection of June 13, 2006. Our firm strongly supports the PCAOB in their mission to improve the quality of the public company financial statements.

Shelley International is committed to improvement in its audit quality and your inspection comments contribute directly to that process. To that end, we will continue to enhance our audit methodology as well as our engagement documentation and execution.

The comments that follow respond to Part I – Inspection Procedures and Certain Observations of your 2006 Inspection Report. The PCAOB's inspection of each of the engagements selected was performed thoroughly and was based upon the PCAOB staff's assessment of audit risk and financial statement materiality. While we may have differing views on specific issues relative to the scope of the audit procedures and documentation necessary to comply with applicable professional standards, we recognize that judgments are involved in both the performance of an audit and the subsequent inspection process, and the view the PCAOB's comments as positive and helpful.

We accept the PCAOB's findings in the Report.

With regard to the specific comments of the report. The inspectors found three items of concern for them. First was the lack of adequate documentation on certain audit procedures performed. As explained to the inspectors, the procedures were performed, just not documented to the satisfaction of the inspectors. Documentation has been increased and procedures put in place to assure adequate recording of all work done in the future. In addition, procedures were performed to currently comply.

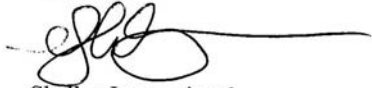
The second and third items related to a position taken by a company of accounting for certain acquisitions and audit procedures for revenues. The accounting treatments for these items were fully disclosed in the financial statements. Policies and procedures have also been put in place assure adequate compliance with the documentation of accounting treatments in the future.

B. Review of Quality Control System

We as a firm are committed to improvement in audit quality and welcome the inspection comments as they relate to our firm quality control. We have made adjustments to our quality control to address all of the issues raised by the inspection. We feel that the changes made and the subsequent improvements that follow will adequately satisfy the Board with our quality control.

Our firm looks forward to working with the PCAOB staff in the future.

Sincerely,

A handwritten signature in black ink, appearing to be 'S. International', with a long horizontal line extending to the right.

Shelley International

144 S. Mesa Dr. #E
Mesa, AZ 85210
office phone (480) 461-8301
facsimile phone (480) 461-8634
mobile phone (480) 266-4685

Response to Part II

Non public portion of response. Paragraph numbers correspond to the paragraph numbers of Part II of the Inspection Report

REDACTED

Comments on Non-public Aspects of Report

REDACTED

Comments on Non-public Aspects of Report

Section B. Issues Related to Quality Control

The PCAOB staff inspectors were very professional and reviewed in detail the four audits which they selected. We discussed at length the problem areas they found in the audits. Although I disagreed with some of the specific findings (that procedures were not performed). It was apparent that the inspectors were not satisfied with the level and quality of the documentation of those procedures.

In light of this, I accepted the findings of the inspection and have initiated significant reforms to enhance the documentation of audit procedures and improve the quality

control of the firm. These procedures are listed below. This process began in August 2005. Many of these have been completed; the remainder is in progress and will be completed by December 2006.

The report divides the quality control section into four areas,

- a. Technical Competence, Due Care, and Professional Skepticism
**
- c. Appropriate Procedures
- d. Concurring Partner Review

Each of these areas will be addressed individually and the various steps which have been taken to correct any deficiencies are listed.

- a. Technical Competence, Due Care, and Professional Skepticism

1. In August 2005 I informed the senior manager/junior partner that we would no longer be together.

2. Beginning in August 2005 I began to transfer all of my clients to colleagues of mine. This was done without remuneration. This process was completed several months ago. Currently I have *no clients* and *no billings* as an auditor. I informed all clients that I was taking a sabbatical. Since auditing was 95% of my practice, my practice is essentially on hold. This has been done at a substantial loss of revenues for myself, but I felt it was necessary. I wanted to not perform any more audits until my new procedures were in place and additional training was received.

3. I have begun an intensive educational process. This will include classes in accounting, audit documentation, valuations and practice management and quality control. I plan to have 240 hours of CPE by the end of December 2006. Currently I have over 95 hours in the areas of valuation and accounting.

** REDACTED

Comments on Non-public Aspects of Report

- c. Appropriate Procedures

1. With the information obtained from the inspection and the ongoing educational process, I am re-writing my three firm manuals, namely the office procedures manual, the firm's quality control manual and the firm's audit procedures manual. As I do this I can insure that I address all comments mentioned by the inspectors and also insure that everything is up to date.

2. Once the manuals are completed, I will be hiring a consultant to inspect my firm's manuals and procedures prior to beginning work again and to assist me with any additional improvements.

3. I am completing the process of making our audit process digital instead of paper based. This will be completed before October 1, 2006. This will also assist us to comply with the new audit requirement to have all of the work papers completed within 45 days of an audit. This will alleviate any future problems with having all of the audit documentation completed and logically filed and referenced.

4. On consolidations, we have established a policy of making all audit adjustments on the Work Trial Balance of the subsidiaries prior to carrying the numbers over to the consolidated Work Trial Balance. This will avoid any potential problems with adjustments not being understood in the future.

5. A procedure has been established to have carry forward schedules in all current year files and not just refer to them.

d. Concurring Partner Review

I have contacted a qualified outside person who will act as our concurring reviewer. It is also my intent contract several accounting professors who will act as our reviewers for specific areas, (for example, Accounting for Income Taxes).

We believe that the procedures listed above have addressed the comments found in the inspection. Our intent is to have the highest quality work produced by our firm. It is our plan to begin auditing again at about October 1, 2006. At that time we do not plan to opine on any former clients, but just acquire new ones.

Thank you for your time and assistance in this matter. If you have any questions, please let us know.

Sincerely,



Shelley International

End of Part II