

**Report on**

**2010 Inspection of David S. Hall, P.C.  
(Headquartered in Lewisville, Texas)**

**Issued by the**

**Public Company Accounting Oversight Board**

**December 5, 2011**

**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**



### **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.



## 2010 INSPECTION OF DAVID S. HALL, P.C.

In 2010, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm David S. Hall, P.C.<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 The Hall Group, CPAs.

<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 18, 2010 to October 22, 2010. 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	2 (Dallas and Lewisville, Texas)
Ownership structure	Professional corporation
Number of partners	1
Number of professional staff <sup>4/</sup>	3
Number of issuer audit clients <sup>5/</sup>	13

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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 and internal control over financial reporting ("ICFR") 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 or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

In addition, inclusion of a deficiency in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, when audit deficiencies are discovered after the date of the audit report, a firm must take appropriate action to assess the importance of the deficiencies to the firm's present ability to support its previously expressed audit opinions.<sup>8/</sup> Depending upon the circumstances, compliance with these standards may

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<sup>6/</sup> This focus on weaknesses and deficiencies 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> 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), and PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over*

require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

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. Those deficiencies included failures by the Firm to identify or appropriately address errors in the issuer's application of GAAP, including, in some cases, errors that appeared likely to be material to the issuer's financial statements. In addition, the deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

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 and Appendix A to AS No. 3, paragraph A28. For purposes of the inspection, an observation that the Firm did not perform a

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*Financial Reporting That is Integrated with An Audit of Financial Statements* ("AS No. 5"), ¶ 98.

procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

The deficiencies identified in both of the audits reviewed included deficiencies of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient competent evidential matter to support its opinion on the issuer's financial statements. Those deficiencies were –

- (1) the Firm's failure to identify, or to address appropriately, a departure from GAAP that related to a potentially material misstatement in the audited financial statements concerning the accounting for and disclosure of oil and gas properties;
- (2) the failure to perform sufficient audit procedures related to the valuation of oil and gas properties;
- (3) the failure, in two audits, to perform sufficient audit procedures to test revenue recognition;
- (4) the failure to perform sufficient audit procedures to evaluate an asset retirement obligation;
- (5) the failure to perform sufficient audit procedures related to the use of the work of a specialist; and
- (6) the failure to perform sufficient audit procedures with respect to related party transactions.

#### 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. 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

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.



The Hall Group  
Certified Public Accountants

September 19, 2011

VIA EMAIL

Ms. Helen A. Munter  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006

Dear Ms. Munter:

We are pleased to submit our response to the Public Company Accounting Oversight Board's ("PCAOB") August 17, 2011 draft of its Report on the October 2010 Inspection of David S. Hall, P.C. (the "Firm"), (aka, The Hall Group, CPAs). We are committed to the highest standards of audit and continually monitor our systems and processes, including quality control, and make changes to methodologies, policies and procedures when we identify opportunities for improvement.

The Inspection identified perceived deficiencies in the engagements reviewed. In each instance we believe that sufficient procedures were performed to support our audit opinion on the issuer's financial statements. We acknowledge that the interpretation of sufficient audit procedures and their documentation is a matter of professional judgment and, in these instances, we have differences of opinion with the Inspection Team on the sufficiency of the procedures performed.

For the matters identified, we fully considered the Board's comments and this letter represents our response to the public portion of the draft report of the Inspection. We request that this letter be made part of the final Report. Specifically, we have the following comments and/or responses to the comments outlined in Part I of the Inspection Report:

1. *The Firm's failure to identify, or to address appropriately, a departure of GAAP that related to a potentially material misstatement in the audited financial statements concerning the accounting for and disclosure of oil and gas properties.*

We respectfully disagree that a potential material misstatement exists or that a departure from GAAP was present. Issuer A is a developer of solvents and technologies that are utilized in the extraction of oil and gas. The Company purchased two leaseholds in order to have a controlled environment in which to perform their testing on oil with various attributes, such as high viscosity or with paraffin or asphaltine issues. Any marginal production of oil and gas from these leaseholds is a by-product of their testing, and the excess is put into containers on-site for disposal from the site. The amount of revenue generated from the oil removal is not significant (\$71,000 for the year ended June 30, 2010) and is incidental to their business model, as they have funded their operations through stock issuances and not revenue. The Issuer does not consider themselves an oil and gas company, nor do they have a need to have reserve reports prepared, as the quantity of oil in these leaseholds is not of significance to them for their testing purposes. It is the opinion of the Issuer and the Firm that to present the Issuer as an oil and gas company would be misleading to their investors and the public. Therefore, we maintain that the Issuer's financial statements do not contain a potentially material misstatement from GAAP by not including the disclosures regarding oil and gas properties that are discussed in ASC 932.

2. *The failure to perform sufficient audit procedures related to the valuation of oil and gas properties.*

We respectfully disagree with this comment and the conclusion. In the year prior to the Inspection, the Issuer's former audit firm had made a determination that the oil and gas properties needed to be written down to salvage value, and the Issuer's Chief Executive Officer ("CEO") agreed and prepared a memorandum stating such. We reviewed the memorandum, and had significant discussions with the CEO regarding this issue, including their calculation of salvage value, and agreed the write down was reasonable and appropriate, based upon the usage of the properties as testing sites and not as producing oil and gas properties, as discussed above. We have updated our workpaper documentation to further describe the procedures and discussions that were indeed performed during our audit.

3. *The failure, in two audits, to perform sufficient audit procedures to test revenue recognition.*

We respectfully disagree with this comment and conclusion. On Issuer A, the issuer's payment against a receivable had not been properly applied and therefore was showing as a debit and an offsetting credit (i.e., "grossed up"). We reviewed the documentation the client had, noted the instance was isolated, deemed they should have been offset and no additional procedures were deemed necessary. We maintain that revenues, and the related receivable balance, were fairly stated and in accordance with GAAP and that revenue recognition was appropriately tested.

On Issuer B, the Issuer had nominal revenue (\$41,000) that was generated from services provided to a related party for the year. We had noted this revenue during our quarterly reviews of the Issuer, and had discussed the arrangement and specifics regarding revenue recognition with the Issuer's CEO and CFO.

4. *The failure to perform sufficient audit procedures to evaluate an asset retirement obligation.*

We respectfully disagree with this comment and conclusion. The Issuer develops solvents which need to be tested in a controlled environment and across multiple types of wells. As a result, the Issuer purchases oil and gas interests (so they have control of the production and the site for the testing), performs the testing, and then markets the properties for sale, generally within a short period of time. The audit testing of the asset retirement obligation ("ARO") had indicated that there were to be no changes to the ARO from the prior year, however, the workpaper documentation did not specifically mention two wells in which there was no ARO responsibility. We have updated our workpaper documentation to describe the results of the procedures performed regarding that no additional liability existed related to those wells.

5. *The failure to perform sufficient audit procedures related to the use of the work of a specialist*

We respectfully disagree with this comment and the conclusion. On multiple occasions, the Firm had met with the independent specialist of Issuer B that was utilized in the preparation of the reserve reports that were prepared on the mineral deposits in the concessions held by the Issuer. The Firm's partner and manager were present in an hour long presentation to management and shareholders that discussed the assumptions and methodologies, which were consistent with prior years. We have added a memorandum regarding the use of the specialist in the workpapers, so someone without the history and background that we have with the Issuer would have the same level of comfort with the use of the specialist.

6. *The failure to perform sufficient audit procedures with respect to related party transactions*

We respectfully disagree with this comment and the conclusion. The audit team had received details of the related party receivable amount from Issuer B's chairman and chief financial officer, who also served in those same roles for the unconsolidated affiliate. This receivable was confirmed during our procedures with both the chairman and chief financial officer during our quarterly reviews and during the audit. Our workpaper documentation has been updated to reflect this discussion and confirmation.

This process did not change our original audit conclusions or affect our reports on any of the issuers' financial statements.

We appreciate the opportunity to provide our response to the report and we look forward to continuing to work with the PCAOB on matters of interest to our public company audit practice.

Sincerely,

Handwritten signature in blue ink that reads "D S Hall, P.C., aka The Hall Group, CPAs". The signature is written in a cursive, flowing style.

David S. Hall, P.C.