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Inspection of
S.E. Clark & Company, P.C.
(Headquartered in Tucson, Arizona)

Issued by the

Public Company Accounting Oversight Board

October 1, 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. 104-2009-160

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PCAOB
Public Company Accounting Oversight Board

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 S.E. CLARK & COMPANY, P.C.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm S.E. Clark & Company, P.C. ("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 10, 2008 to June 18, 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 (Tucson, Arizona)
Ownership structure	Professional corporation
Number of partners	1
Number of professional staff[3/]	None
Number of issuer audit clients[4/]	3

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.[5/] 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.

3/ "Professional staff" includes all personnel of the Firm, except partners or shareholders and administrative support personnel.

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.

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 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.[8/]

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.

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

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 statement of cash flows.

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

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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.

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.[9/]

[9/] 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.

S.E.Clark & Company, P.C.
Registered Firm: Public Company Accounting Oversight Board

July 30, 2009

PCAOB
Division of Registration
and Inspections
1666 K. Street, NW
Washington, DC 2006

We are responding to the Draft Report of Inspection of our firm, dated June 30, 2009.

Relevance of the Statement of Cash Flows

The statement of sources and uses of funds (subsequently superseded by the Statement of Cash Flows in 1987) was added as one of the basic statements in 1971. The statement was added as a tool for analysts to use in evaluating operating cash flows of a company. The investing and financing cash flows are included as a tool to allow reconciliation to the cash balances but are not as significant a consideration to the analyst as cash flows from operations.

Market analysts play a major role in affecting market price of traded stocks. Brokerage houses allocate their analyst resources to cover companies with the greatest market impact. Very few resources are allocated to fund analyst coverage of penny stocks, particularly those whose trading is largely speculative. In the case of Issuer A, there is virtually no analyst coverage. Additionally, the stock is thinly traded on a speculative basis. These considerations combined with the substantial cumulative losses make the Statement of Cash Flows irrelevant for all practical purposes.

Additionally, our managing shareholder, Steven E. Clark, CPA is also a Certified Valuation Analyst. As such he is intimately aware of the relevance and usefulness of the Statement of Cash Flows. The only caption in the statement that affects valuation is the caption "Cash flows from operating activities" and its various components. The captions "Cash flows from investing activities" and "Cash flows from financing activities" have little or no usefulness or effect in establishing the value of common stock.

Furthermore, the statement was added as a basic statement prior to the era of personal computers. As a result, most analysts today perform their software based valuation analysis utilizing the balance sheet and statement of operations. The Statement of Cash Flows is primarily used to isolate non-cash operating captions such as depreciation, amortization, and stock-based compensation.

Member: National Association of Certified Valuation Analysts
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The "Deficiency"

The issue that the inspection team is citing as a significant deficiency pertains to the inclusion of stock issued to retire notes payable in the cash flows caption "Stock issued for cash" in the financing section of the Statement of Cash Flows.

The CFO of Issuer A had primarily a finance background. During the audit we identified the inclusion of non-cash transactions in the caption, as documented in our workpapers. We brought the matter to the attention of the CFO who responded that he preferred to gross the transactions, believing it was more informative to disclose the stock issuance and related debt retirement in the face of the financial statements rather than in note disclosure.

We noted that the more meaningful subtotal caption "cash provided by financing activities" is correctly stated whether the non-cash transactions are grossed or netted. We also noted that the offsetting captions "stock issued for cash" and "payment of notes payable", both overstated for the non-cash transactions, are not significant to an investor's investment decision. We further noted that the Statement of Cash Flows is principally included for the benefit of financial analysts and that no analysts were actively tracking the stock of Issuer A. We accordingly reached a judgment decision that the issuer's preferred presentation, while not in accordance with GAAP, did not represent a material misstatement to the financial statements, requiring disclosure as a GAAP departure in our opinion.

It should be further noted that the successor CFO for Issuer A, a CPA, has excluded non-cash transactions from the cash flows statement for subsequent periods, in accordance with GAAP. We concur with his presentation but do not consider the presentations of the former CFO to represent a material misstatement.

Citations

We would like to direct the PCAOB staff to consider AU 312, AU 9312, and the SEC SAB Codification Topic 1, Title M regarding materiality. For your benefit, we have included relevant excerpts below:

> **312.03** "The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles, while other matters are not important. The representation in the auditor's standard report regarding fair presentation, in all material respects, in conformity with generally accepted accounting principles indicates the auditor's belief that the financial statements taken as a whole are not materially misstated."

> **312.10** " The auditor's consideration of materiality is a matter of professional judgment and is influenced by his or her perception of the needs of a reasonable person who will rely on

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the financial statements. The perceived needs of a reasonable person are recognized in the discussion of materiality in Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*, which defines materiality as "the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement." That discussion recognizes that materiality judgments are made in light of surrounding circumstances and necessarily involve both quantitative and qualitative considerations."

M. Materiality, 1. Assessing materiality

"But quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations. Materiality concerns the significance of an item to users of a registrant's financial statements. A matter is "material" if there is a substantial likelihood that a reasonable person would consider it important."

"The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item."

"This formulation in the accounting literature is in substance identical to the formulation used by the courts in interpreting the federal securities laws. The Supreme Court has held that a fact is material if there is - a substantial likelihood that the...fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available."

"Under the governing principles, an assessment of materiality requires that one views the facts in the context of the "surrounding circumstances," as the accounting literature puts it, or the "total mix" of information, in the words of the Supreme Court. In the context of a misstatement of a financial statement item, while the "total mix" includes the size in numerical or percentage terms of the misstatement, it also includes the factual context in which the user of financial statements would view the financial statement item. The shorthand in the accounting and auditing literature for this analysis is that financial management and the auditor must consider both "quantitative" and "qualitative" factors in assessing an item's materiality."

"The predominant view is that materiality judgments can properly be made only by those who have all the facts. The Board's (FASB) present position is that no general standards of materiality could be formulated to take into account all the considerations that enter into an experienced human judgment."

"Magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment."

"Among other factors, the demonstrated volatility of the price of a registrant's securities in response to certain types of disclosures may provide guidance as to whether investors regard quantitatively small misstatements as material. Consideration of potential market reaction to disclosure of a misstatement is by itself "too blunt an instrument to be depended on" in considering whether a fact is material. When, however, management or the independent auditor expects (based, for example, on a pattern of market performance) that a known misstatement may result in a significant positive or negative market reaction, that expected reaction should be taken into account when considering whether a misstatement is material."

"The materiality of a misstatement may turn on where it appears in the financial statements."

"A registrant and its auditor should evaluate misstatements in light of quantitative and qualitative factors and "consider whether, in relation to individual amounts, subtotals, or totals in the financial statements, they materially misstate the financial statements taken as a whole."

"This requires consideration of - the significance of an item to a particular entity (for example, inventories to a manufacturing company), the pervasiveness of the misstatement (such as whether it affects the presentation of numerous financial statement items), and the effect of the misstatement on the financial statements taken as a whole...."

"The auditor should aggregate all misstatements that affect each subtotal or total and consider whether the misstatements in the aggregate affect the subtotal or total in a way that causes the registrant's financial statements taken as a whole to be materially misleading."

Further, although qualified or adverse opinions are not accepted for SEC registrants, AU 508 further illuminates the logic of determining when a GAAP misstatement is material enough to warrant a qualified or adverse opinion.

.36 "In deciding whether the effects of a departure from generally accepted accounting principles are sufficiently material to require either a qualified or adverse opinion, one factor to be considered is the dollar magnitude of such effects. However, the concept of materiality does not depend entirely on relative size; it involves qualitative as well as quantitative judgments. The significance of an item to a particular entity (for example, inventories to a manufacturing company), the pervasiveness of the misstatement (such as whether it affects the amounts and presentation of numerous financial statement items), and the effect of the misstatement on the financial statements taken as a whole are all factors to be considered in making a judgment regarding materiality."

Rebuttal

We disagree strongly with the findings of the inspection team that we failed to obtain sufficient competent evidential matter to support our opinion on the issuer's financial statements.

Please note the surrounding circumstances, or "total mix", relevant to our judgment decision:

- During the financial statement period and subsequently the stock of Issuer A has been, and is, a thinly traded penny stock.

- There are no analysts actively tracking the stock and there are no market makers actively promoting the stock.

- The issuer has sustained substantial operating losses since its inception.

- The stock is traded, not on the basis of an analyst's report of projected EPS, but speculatively based on press releases and revenue trends.

- Accordingly, <u>the most significant disclosure and aspect of the audit was the fair statement of revenues</u>, which we adequately addressed in our engagement scope. We examined all individually significant revenue transactions and related receivables, and many other less relevant financial statement line items and disclosures.

<u>**We also disagree with the assertion as to the materiality of the "deficiency"**</u>.

We considered both the quantitative and qualitative aspects of the known misstatement, which included consideration of the surrounding circumstances and "total mix."

- The know misstatement had no effect on the caption "cash flows from operations," the most significant caption in the Statement of Cash Flows.

- The known offsetting misstatements occurred in the financing section of the Statement of Cash Flows which has no affect on stock valuation.

- In accordance with the SEC guidance on materiality, we considered how the misstatements affected the various subtotals, and totals. The caption "Cash Flows from Financing Activities" was unaffected by the misstatements since they offset each other within the caption.

- The known misstatement had no effect on revenues, the most critical caption in the statements.

- The known misstatement had no effect on the fair statement of either the balance sheet or statement of operations.

- It had no effect on the number of outstanding shares or the loss per share computation.

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In our judgment, the known misstatement would have zero effect on the investment decision of any reasonable person relying upon the issuer's financial statements. We determined that the known misstatement was clearly inconsequential.

The PCAOB staff has failed to demonstrate, either factually or hypothetically, how the investment decision of a reasonable person would have been adversely impacted by the known misstatement when considering all of the facts and circumstances.

We further disagree with the assertion that we failed to identify the "deficiency" or had not appropriately addressed the "deficiency" during the audit.

Our equity section workpaper 39100 clearly identified the misstatement related to managements inclusion of shares issued related to the note conversions in the financing section of the Statement of Cash Flows. We further noted that we passed on the restatement. Although our memo did not go into the depth of this response in explaining the reasons for our decision, all of the "total mix" of information or "surrounding circumstances" discussed in our responses to the finding and the draft inspection report were fully considered at the time of the decision.

We further strongly disagree with the findings of the inspection team that our system of quality control appears not to provide sufficient assurance that our firm will conduct all testing appropriate to a particular audit.

If we had not detected or considered the matter in our audit or workpapers, we would concur with the inspection teams' assessment that our system of quality control appeared not to provide sufficient assurance that our firm would conduct all testing appropriate to a particular audit. However, that is not the case.

We clearly identified the "deficiency", discussed it with the Issuer CFO, and based on the facts and circumstances determined that it did not represent a material deficiency, even though not in accordance with GAAP. Furthermore, our audit specifically and adequately addressed the relevant audit issue on this engagement, the fair statement of revenues. We accordingly believe that our quality control system does provide sufficient assurance that our firm conducts testing appropriate to a particular audit.

We accordingly believe that the inspection team has mischaracterized the "deficiency" as a control weakness when in fact they are questioning the soundness of our audit judgment, with which we vehemently disagree. Our audit adequately detected the issue. After thoughtful consideration of all relevant facts, we determined it did not represent a material misstatement warranting restatement or disclosure.

Summary Comments

As identified in the audit opinion and PCAOB standards, management of the issuer is responsible for the fair presentation of the financial statements in accordance with generally accepted accounting principles of the United States of America. It is the auditor's responsibility to determine that management's assertions in the financial statements are fairly stated in all material respects.

The auditor's judgment is the determinant of which assertions are material to the fair presentation of the financial statements, and which are not. **A material misstatement of an immaterial or inconsequential fact does not result in a material misstatement to the financial statements**. In the context of a public company, a material misstatement is one that would have affected an investor's decision to invest or not invest in the stock of that entity, or have affected the trading price of the stock.

The PCAOB staff has failed to demonstrate, either factually or hypothetically, how the investment decision of a reasonable person would have been adversely impacted by the known misstatement when considering all of the relevant facts and circumstances. If they can do so, we will gladly reconsider our response. The absence of such explanation should highlight that the matter is inconsequential and does not warrant such a stern response by the inspection team.

Sincerely,

S.E. Clark & Company, PC

S.E. Clark & Company, P.C.
By Steven E. Clark, CPA/CFF, CVA