

Report on

**2013 Inspection of Sarna & Company,
Certified Public Accountants
(Headquartered in Thousand Oaks, California)**

Issued by the

Public Company Accounting Oversight Board

December 18, 2014

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**



2013 INSPECTION OF SARNA & COMPANY, CERTIFIED PUBLIC ACCOUNTANTS

In 2013, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Sarna & Company, Certified Public Accountants¹ ("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 inspection process is designed, and inspections are performed, to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. The inspection process included reviews of aspects of four issuer audits completed by the inspected firm. The reviews were intended to identify whether deficiencies existed in those aspects of the audits, and whether such deficiencies indicated weaknesses or defects in the firm's system of quality control over audits. In addition, the inspection included review of policies and procedures related to certain quality control processes of the firm that could be expected to affect audit quality.

The issuer audits and aspects of those audits inspected were selected based on a number of risk-related and other factors. Due to the selection process, the deficiencies included in this report are not necessarily representative of the Firm's issuer audit practice.

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.²

¹ The Firm has issued audit reports under the name of Sarna & Company Certified Public Accountants.

² In its *Statement Concerning the Issuance of Inspection Reports*, PCAOB Release No. 104-2004-001 (August 26, 2004), the Board described its approach to making inspection-related information publicly available consistent with legal restrictions. As described there, if the nonpublic portions of any inspection report discuss criticisms of or potential defects in a firm's system of quality control, those discussions also could eventually be made public, but only to the extent a firm fails to address the criticisms to the Board's satisfaction within 12 months of the issuance of the report.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from November 18, 2013 to December 2, 2013. 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 (Thousand Oaks, California)
Ownership structure	Sole practitioner
Number of partners	1
Number of professional staff ³	2
Number of issuer audit clients ⁴	2

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. For information about audit reports issued by the Firm, see Item 4.1 of the Firm's annual reports on PCAOB Form 2, available at www.pcaobus.org.

A. Review of Audit Engagements

The inspection procedures included a review of aspects of the Firm's auditing of financial statements of four issuers. The inspection team identified what it considered to be audit deficiencies. The deficiencies identified in two of the audits reviewed included deficiencies of such significance that it appeared to the inspection team that the Firm, at the time it issued each audit report, had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements. Those deficiencies were –

Issuer A

the failure to perform sufficient procedures to test the occurrence, allocation, and presentation and disclosure of revenue.

Issuer B

the failure to perform sufficient procedures to test the valuation, and presentation and disclosure of convertible debt.

B. Auditing Standards

Each deficiency described above relates to several applicable standards that govern the conduct of audits.

AU 230, *Due Professional Care in the Performance of Work* ("AU 230"), requires the independent auditor to plan and perform his or her work with due professional care. AU 230 and PCAOB Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13"), specify that due professional care requires the exercise of professional skepticism. This is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13 requires the auditor to design and implement audit responses that address the identified risks of material misstatement, and PCAOB Auditing Standard No. 15, *Audit Evidence* ("AS No. 15"), requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement and the quality of

the audit evidence obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in support of the related conclusions.

AS No. 13 also requires that, if the auditor plans to assess control risk at less than the maximum and to base the nature, timing, and extent of substantive procedures on that lower assessment, the auditor must obtain evidence that the controls tested were designed and operating effectively during the entire period for which the auditor plans to rely on controls to modify the substantive procedures.

Each deficiency described in Part I.A of this report involves, in the inspection team's view, a failure to comply with one or more of the provisions cited above and also a failure to perform, or perform sufficiently, certain specific audit procedures that are required by other applicable auditing standards. The table below lists the other specific auditing standard that is primarily implicated by the deficiencies identified in Part I.A of this report.⁵

PCAOB Auditing Standard	Issuers
AS No. 14, <i>Evaluating Audit Results</i>	A, B

C. 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.

⁵ This table does not necessarily include reference to every auditing standard that may have been implicated by the deficiencies included in Part I.A.

D. General Information Concerning PCAOB Inspections

Board inspections are designed to identify whether weaknesses and deficiencies exist related to how a firm conducts audits and addresses any such weaknesses and deficiencies. 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. The scope of the inspection procedures is determined according to the Board's criteria, and the firm is not allowed an opportunity to limit or influence the scope. The 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. Further, the inclusion in an inspection report of certain deficiencies and potential deficiencies should not be construed as an indication that the Board has made any determination about other aspects of the firm's systems, policies, procedures, practices, or conduct not included within the report.

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 Generally Accepted Accounting Principles ("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 or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

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 applicable accounting principles, the Board's practice is to report that information to the Securities and Exchange Commission ("SEC" or "Commission"), which has jurisdiction to determine proper accounting in issuers' financial statements. Any description in this report of financial statement misstatements or failures to comply with SEC disclosure requirements should not be understood as an indication that the SEC has considered or made any determination regarding these issues unless otherwise expressly stated.

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

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.⁷ Depending upon the circumstances, compliance with these standards may require the firm to perform additional 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.

END OF PART I

⁷ See AU 390, *Consideration of Omitted Procedures After the Report Date* ("AU 390"), and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* ("AU 561") (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T).

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.⁸

⁸ 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 some cases, the result may be that none of a firm's response is made publicly available. 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.

SARNA & COMPANY

Certified
Public
Accountants

October 20, 2014

Ms. Helen A. Munter
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
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RE: Response to PCAOB Draft Report of Inspection dated September 2014

Dear Ms. Munter:

Sarna & Company, Certified Public Accountants (Sarna & Company) is pleased to provide the following response to the Public Company Accounting Oversight Board's (PCAOB) Draft Report of Inspection for the 2013 inspection of Sarna & Company, Certified Public Accountants.

Sarna & Company supports and respects the PCAOB and their inspection process. We recognize the PCAOB's intent to encourage independence, accuracy, and integrity in public company audits and issuer's financial statements. However, Sarna & Company acknowledges that given the same evidence, highly competent professionals may form differing opinions as they apply their knowledge, experience, training, and judgment to a particular issue. As such, Sarna & Company disagrees with the inspection team's findings as follows:

1. *Performance of Sufficient Procedures to Test the Occurrence, Allocation, and Presentation and Disclosure of Revenue.* It is the opinion of Sarna & Company that the inspection team had difficulty in completely understanding the complex nature of revenue generation of the issuer in question. For example, the team asked questions more applicable to a bank, concentrated on a class of revenue that was not materially significant, and still posed questions as late as May 2014 on an inspection initiated November 2013.

It is noted that Sarna & Company correctly identified revenue as a significant risk factor and treated it as such throughout the audit process. Sarna & Company fully tested 90% of all revenue transactions and concurred with the issuer's presentation of revenues, which was in agreement with previous SEC guidance given to that issuer.

2. *Performance of Sufficient Procedures to Test the Valuation, and Presentation and Disclosure of Convertible Debt.* Sarna & Company correctly identified convertible debt as a significant risk factor and, accordingly, tested and confirmed 100% of all convertible notes payable. At the time of the audit, Sarna & Company had also tested and verified the amortization of debt discount and interest expense.

Sarna & Company, in accordance with AU Section 390 *Consideration of Omitted Procedures After the Report Date*, also provided subsequent evidence to the inspection team verifying the accuracy of revenue and convertible debt as presented by the issuers. It is the opinion of Sarna & Company that the issue was not the accuracy of the numbers as presented, but the amount of discussion documented in the workpapers. In response, Sarna & Company has taken affirmative action to clarify and expand its commentary. Sarna & Company is confident in its opinion that the inspection team's comments will not result in the restatement of any revenue or convertible debt items as originally presented in the financial statements of the issuers.

Sarna & Company's response should not be considered as a negative comment on the inspection team or the PCAOB inspection process. We found the inspection team conducted themselves with the utmost professionalism in their dedication to maintain the highest standards throughout the inspection process.

Sarna & Company encourages, supports, and respects the inspection process and mission of the PCAOB. We regard the observations and comments of the PCAOB as a means to continually improve our profession and the methodology of our firm as auditors. We commend and thank the PCAOB staff on their efforts and on the continuing contribution they make to our profession.

Respectfully,

A handwritten signature in black ink, appearing to read 'Dennis Sarna', with a long horizontal line extending to the right.

Dennis Sarna, CPA
Sarna & Company
Certified Public Accountants