

**Inspection of  
StarkSchenkein, LLP  
(Headquartered in Denver, Colorado)**

**Issued by the  
Public Company Accounting Oversight Board  
January 28, 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.

## **INSPECTION OF STARKSCHENKEIN, LLP**

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm StarkSchenkein, LLP<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.

---

<sup>1/</sup> The Firm has issued audit reports under the name of Stark Winter Schenkein & Co., LLP.

<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 June 1, 2009 to June 12, 2009. 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 (Denver, Colorado; and Dunedin, Florida)
Ownership structure	Limited liability partnership
Number of partners	6
Number of professional staff <sup>4/</sup>	7
Number of issuer audit clients <sup>5/</sup>	34

---

<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 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, 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 seven 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.<sup>8/</sup> The deficiencies identified in five of the audits reviewed included deficiencies of such

---

<sup>6/</sup> This focus necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools.

<sup>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> 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*

significance that it appeared to the inspection team that the Firm did not obtain sufficient competent evidential matter to support its opinion on the issuer's financial statements.<sup>9/</sup> Those deficiencies were –

- (1) the failure to perform sufficient audit procedures to test share-based payments to employees and non-employees;
- (2) the failure, in two audits, to perform sufficient audit procedures related to the testing of equity transactions;
- (3) the failure, in two audits, to perform sufficient audit procedures related to using the work of a specialist;
- (4) the failure to perform sufficient audit procedures related to the testing of the valuation of common stock issued for payment of debt principal and interest;
- (5) the failure to perform sufficient audit procedures related to the testing of convertible debt with warrants;

---

*of Omitted Procedures After the Report Date, and AU 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T). Failure to comply with these PCAOB standards could be a basis for Board disciplinary sanctions.

<sup>9/</sup> In some cases, an inspection team's observation that a firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if a firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3"), provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28. For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

- (6) the failure to perform sufficient audit procedures related to the acquisition and impairment of an investment in an entity;
- (7) the failure to perform sufficient audit procedures related to the acquisition and impairment of an intangible asset;
- (8) the failure to perform sufficient audit procedures related to a business combination;
- (9) the failure to perform sufficient audit procedures related to the testing of revenue; and
- (10) the failure to perform sufficient audit procedures related to the evaluation of uncorrected misstatements.

**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



PCAOB Release No. 104-2011-065A  
Inspection of StarkSchenkein, LLP  
January 28, 2011  
Page 6

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.<sup>10/</sup> 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 summarized in Part I.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 –

#### **Testing Appropriate to the Audit**

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will conduct all testing appropriate to a particular audit, specifically with respect to the following issues:

---

<sup>10/</sup> 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.

(i) Stock-Based Compensation

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to testing stock-based compensation expense. This information provides cause for concern regarding the Firm's quality control policies and procedures related to auditing stock-based compensation expense. [Issuer A]

(ii) Stockholders' Equity

As discussed above, in two of the audits reviewed, the inspection team identified significant deficiencies related to the testing of stockholders' equity transactions. This information provides cause for concern regarding the Firm's quality control policies and procedures related to the Firm's auditing of stockholders' equity. [Issuers A and E]

(iii) Using the Work of Specialists

As discussed above, in two of the audits reviewed, the inspection team identified significant deficiencies related to the Firm's audit procedures related to the use of the work of specialists. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its use of the work of specialists. [Issuers B and E]

(iv) Common Stock Issued for Debt Repayment

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the valuation of common stock issued for debt repayment. This information provides cause for concern regarding the Firm's quality control policies and procedures related to the Firm's auditing of the valuation of common stock. [Issuer C]

(v) Convertible Debt with Warrants

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the issuance of convertible debt with warrants. This information provides cause for concern regarding the Firm's quality control policies and procedures related to the Firm's auditing of convertible debt with warrants. [Issuer C]

(vi) Acquisition and Impairment of Assets

As discussed above, in one of the audits reviewed, the inspection team identified significant deficiencies related to the audit of the initial acquisition and the subsequent testing of impairments for an investment in an entity and an intangible asset. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its auditing of assets acquired and subsequent testing of impairment charges. [Issuer D]

(vii) Business Combination

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the Firm's audit procedures to test business combination transactions. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its auditing of business combinations. [Issuer E]

\* \* \* \*

Monitoring and Addressing Identified Weaknesses

The Firm's system of quality control appears to lack a monitoring element sufficient to provide the Firm with reasonable assurance that the Firm's policies and procedures for engagement performance are suitably designed and effectively applied. The Firm's monitoring appears to have been deficient with respect to at least three types of previously identified weaknesses. In a report dated December 22, 2008, which related to a 2006 inspection during which the inspection staff informed the Firm of the deficiencies, the Board noted that the Firm's procedures appear not to provide sufficient assurance that the Firm performed audit procedures to test convertible debt with warrants, revenues, and business combinations. In addition, the Firm's system of system of quality control appears not to provide sufficient assurance that the Firm will meet the requirements of PCAOB Rule 3400T(b) as the Firm does not have procedures in place to verify the completeness and accuracy of independence representations. An appropriate approach to monitoring would have resulted in the Firm avoiding these deficiencies in audits performed after they were brought to the Firm's attention, yet the same deficiencies were noted in this inspection.

\* \* \* \*

## **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>11/</sup>

---

<sup>11/</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.



November 19, 2010

**Via Federal Express**

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

Re: Draft Report of Inspection

Dear Mr. Diacont:

We are in receipt of your draft report of the Public Company Accounting Oversight Board inspection of Stark Winter Schenkein & Co., LLP ("the Firm") in June 2009 pursuant to section 104 of the Sarbanes-Oxley Act of 2002.

The Firm now has an opportunity to submit a written response to the draft report. We understand that this written response will be taken into account in determining the content of the final inspection report and will be attached to, and made part of, that final report.

The following contains the description of the inspection results as included in the draft report with the Firm's responses. Secondly, a section describes the Board's concerns about potential defects in the Firm's quality control system.

A. Inspection Results

The inspection of the Firm included a review of aspects of the Firm's auditing of financial statements of seven issuers. In five of the engagements reviewed, the inspection team found what it considered audit deficiencies, the Firm's response to the inspection team's observations are included below in blue.

1. Issuer A

a. Share-based payments to employees and non-employees

REDACTED. Comments on Non-public Aspects of Report

The workpapers do contain evidence of the reading and analysis of the option agreements as well as whether the expense was in accordance with EITF 96-18. Please refer to Exhibit A, Part A. Please note that the audit procedures and related documentation evidences that the Firm evaluated the difference in the estimated fair value of the stock options as determined by the issuer and the estimated fair value of the stock options as determined by the Firm noting that the resultant difference was material and proposed an audit adjustment. The issuer recorded the audit adjustment. As such there was no material misstatement as adjustment was recorded.

b. Stockholders' equity transactions

REDACTED. Comments on Non-public Aspects of Report

REDACTED. Comments on Non-public Aspects of Report

Received listings of PPM. Commissions' percentage was agreed to related agreements in permanent file. Agreed amounts received to deposits, without exception.

We performed a reasonableness test of compared beginning currency of Columbian Peso's (COP) to US Dollars (USD) to ending currency of COP to USD amounts. Currency translation testing was also performed in the subsidiary workpapers.

2. Issuer B

Using the work of a specialist

REDACTED. Comments on Non-public Aspects of Report



REDACTED. Comments on Non-public Aspects of Report

The firm has added the memo attached as Exhibit B to its files for this issuer in response to this comment.

3. Issuer C

a. Common stock issued for debt repayment

REDACTED. Comments on Non-public Aspects of Report

During the year ended June 30, 2008 the issuer issued common stock in exchange for as payment of principal and interest on senior secured convertible notes. This stock was issued during the first quarter of the fiscal year. The audit testing of this transaction was done during the audit for the year ended June 30, 2007. The audit work was performed during the subsequent events testing as the transaction was completed before the sign off date for that year's audit.

Attached as Exhibit C, Part A are the workpapers from the June 30, 2007 as well as the subsequent events memo. This work paper has also been placed in the June 30, 2008 audit work papers as audit evidence of the work performed. The same workpaper was left in the review work papers for the quarter ended September 30, 2007. It is also referenced back to the September 30, 2007 work papers.

Going forward the managers and staff will be instructed to place work papers from quarterly



reviews that represent audit work done at that time into the audit workpaper file. This procedure will also be added to our quality control document.

b. Convertible debt with warrants

REDACTED. Comments on Non-public Aspects of Report

The firm performed substantive testing of the allocation of the proceeds between the respective instruments and the amortization of the debt discount during the quarters in which the transactions arose. Attached at Exhibit C, Part B please find the work papers that support this test work.

The classification of the warrants as a liability is proper. As the warrants have registration rights penalties and ratchet provisions, the EITF 00-19 tests are failed and the warrants should be classified as a liability.

The firm has cross referenced the audit test work performed in the quarterly files to the audit work papers. The firm will add a step to its Quality Control Manual that requires cross referencing to year end audit work papers for audit testing performed and documented in the quarterly files.

4. Issuer D

a. Acquisition and impairment of investment

REDACTED. Comments on Non-public Aspects of Report

REDACTED. Comments on Non-public Aspects of Report

The firm has documented the results of its impairment considerations in the audit work papers. Please see Exhibit D, Part A.

- b. Acquisition and impairment of intangible asset

REDACTED. Comments on Non-public Aspects of Report

Proper documentation of acquisition and impairment of assets was not included in the audit work papers. The firm has added the necessary documentation to the file. There was no effect on the audit. Please see Exhibit D, Part B.

- 5. Issuer E

- a. Using the work of a specialist

REDACTED. Comments on Non-public Aspects of Report

REDACTED. Comments on Non-public Aspects of Report

The firm has added the memo attached as Exhibit E, Part A to its files for this issuer in response to this comment.

b. Business combination

REDACTED. Comments on Non-public Aspects of Report

The firm performed the relevant procedures during the interim periods and upon receipt of the specialists' final reports. Please refer to Exhibit E, Part B.

REDACTED. Comments on Non-public Aspects of Report

REDACTED. Comments on Non-public Aspects of Report

d. Stockholders' equity transactions

REDACTED. Comments on Non-public Aspects of Report

The firm performed the relevant procedures during the interim period. The firm has cross referenced the audit test work performed in the quarterly files to the audit work papers. The firm will add a step to its Quality Control Manual that requires cross referencing to year end audit work papers for audit testing performed and documented in the quarterly files.

REDACTED. Comments on Non-public Aspects of Report

B. Issues Related to Quality Controls

REDACTED. Comments on Non-public Aspects of Report

2. 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 11.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. Testing Appropriate to the Audit

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will conduct all testing appropriate to a particular audit, specifically with respect to the following issues:

(i). Stock-based compensation

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to testing stock-based compensation expense. This information provides cause for concern regarding the Firm's quality control policies and procedures related to auditing stock-based compensation expense. [Issuer A]

[Please see the response to A. 1. Issuer A above.](#)

(ii). Stockholders' Equity

As discussed above, in two of the audits reviewed, the inspection team identified significant deficiencies related to the testing of stockholders' equity transactions. This information provides cause for concern regarding the Firm's quality control policies and procedures related to the Firm's auditing of stockholders' equity. [Issuers A and E]

[Please see the response to A. 1. Issuer A and A.5. Issuer E above.](#)

(iii). Using the Work of Specialists

As discussed above, in two of the audits reviewed, the inspection team identified significant deficiencies related to the Firm's audit procedures related to the use of the work of specialists. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its use of the work of specialists. [Issuers B and E]

[Please see the response to A. 2. Issuer B and A.5. Issuer E above](#)

(iv). Common Stock Issued for Debt Repayment

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the valuation of common stock issued for debt repayment. This information provides cause for concern regarding the Firm's quality control policies and procedures related to the Firm's auditing of the valuation of common stock. [Issuer C]

[Please see the response to A. 3. Issuer C above.](#)

(v). Convertible Debt with Warrants

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the issuance of convertible debt with warrants. This information provides cause for concern regarding the Firm's quality control policies and procedures related to the Firm's auditing of convertible debt with warrants. [Issuer C]

[Please see the response to A. 3. Issuer C above.](#)

(vi). Acquisition and Impairment of Assets

As discussed above, in one of the audits reviewed, the inspection team identified significant deficiencies related to the audit of the initial acquisition and the subsequent testing of impairments for an investment in an entity and an intangible asset. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its auditing of assets acquired and subsequent testing of impairment charges. [Issuer D]

[Please see the response to A. 4. Issuer D above.](#)

(vii). Business Combination

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the Firm's audit procedures to test business combination transactions. This information provides cause for concern regarding the Firm's quality control policies and procedures related to its auditing of business combinations. [Issuer E]

[Please see the response to A. 5. Issuer E above.](#)

REDACTED. Comments on Non-public Aspects of Report

REDACTED. Comments on Non-public Aspects of Report



PCAOB Inspection Response Letter  
November 19, 2010  
Page 13

Conclusion

The information contain herein, and in the Exhibits support our audit work but are not a substitute for the audit workpapers or the audits taken as a whole. The partners and staff of Stark Winter Schenkein & Co., LLP take the PCAOB inspection report seriously and are working hard to address noted issues. Please contact me with any questions or comments.

Sincerely,

A handwritten signature in cursive script, reading "Wesley N. Stark". The signature is written in dark ink and is positioned above the printed name and title.

Wesley N. Stark, CPA  
Partner