

**Report on**  
  
**2014 Inspection of S.E. Clark & Company, P.C.**  
**(Headquartered in Tucson, Arizona)**

**Issued by the**  
  
**Public Company Accounting Oversight Board**

**April 2, 2015**

**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**



## **2014 INSPECTION OF S.E. CLARK & COMPANY, P.C.**

### Preface

In 2014, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm S.E. Clark & Company, P.C. ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. For a description of the procedures the Board's inspectors may perform to fulfill this responsibility, see Part I.C of this report (which also contains additional information concerning PCAOB inspections generally). Overall, the inspection process included reviews of portions of selected issuer audits completed by the Firm. These reviews were intended to identify whether deficiencies existed in those portions of the inspected audits, and whether such deficiencies indicated defects or potential defects in the Firm's system of quality control over audits. In addition, the inspection included a review of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

The Board is issuing this report in accordance with the requirements of the Act. 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. If the nonpublic portions of the report discuss criticisms of or potential defects in the firm's system of quality control, those discussions also could eventually be made public, but only to the extent the firm fails to address the criticisms to the Board's satisfaction within 12 months of the issuance of the report.

**PROFILE OF THE FIRM<sup>1</sup>**

Number of offices	1 (Tucson, Arizona)
Ownership structure	Professional corporation
Number of partners	1
Number of professional staff <sup>2</sup>	1
Number of issuer audit clients	1

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<sup>1</sup> The information presented here is as understood by the inspection team, generally as of the outset of the inspection, based on the Firm's self-reporting and the inspection team's review of certain information. Additional information, including additional detail on audit reports issued by the Firm, is available in the Firm's filings with the Board, available at [http://pcaobus.org/Registration/rasr/Pages/RASR\\_Search.aspx](http://pcaobus.org/Registration/rasr/Pages/RASR_Search.aspx).

<sup>2</sup> 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.

## **PART I**

### **INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS**

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from August 25, 2014 to August 29, 2014.<sup>3</sup>

#### **A. Review of Audit Engagements**

The inspection procedures included a review of portions of two issuer audits performed by the Firm. The inspection team identified matters that it considered to be a deficiency in the performance of the work it reviewed.

The description of the deficiency in Part I.A of this report includes, at the end of the description of the deficiency, references to specific paragraphs of the auditing standards that relate to that deficiency. The text of those paragraphs is set forth in Appendix A to this report. The references in this sub-Part include only standards that primarily relate to the deficiency; they do not present a comprehensive list of every auditing standard that applies to the deficiency. Further, certain broadly applicable aspects of the auditing standards that may be relevant to a deficiency, such as provisions requiring due professional care, including the exercise of professional skepticism; the accumulation of sufficient appropriate audit evidence; and the performance of procedures that address risks, are not included in any references to the auditing standards in this sub-Part, unless the lack of compliance with these standards is the primary reason for the deficiency. These broadly applicable provisions are described in Part I.B of this report.

One of the deficiencies identified was 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 appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with the applicable

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<sup>3</sup> For this purpose, "primary procedures" include field work, other review of audit work papers, and the evaluation of the Firm's quality control policies and procedures through review of documentation and interviews of Firm personnel. Primary procedures do not include (1) inspection planning, which is performed prior to primary procedures, and (2) inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which extend beyond the primary procedures.

financial reporting framework. In other words, in this audit, the auditor issued an opinion without satisfying its fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement.

The fact that the deficiency reaches this level of significance does not necessarily indicate that the financial statements are misstated. It is often not possible for the inspection team, based only on the information available from the auditor, to reach a conclusion on those points.

Whether or not associated with a disclosed financial reporting misstatement, an auditor's failure to obtain the reasonable assurance that the auditor is required to obtain is a serious matter. It is a failure to accomplish the essential purpose of the audit, and it means that, based on the audit work performed, the audit opinion should not have been issued.<sup>4</sup>

The audit deficiency that reached this level of significance is described below –

Issuer A

the failure to perform sufficient procedures to test the historical cost basis underlying the reported carrying value of a proprietary intangible asset. (AS No. 12, paragraphs 4 and 59; AS No. 13, paragraph 8).

## B. Auditing Standards

The deficiency described above could relate to several applicable provisions of the standards that govern the conduct of audits, including both the paragraphs of the standards that are cited at the end of the description of the deficiency included in Part I.A of this report and one or more of the specific paragraphs discussed below.

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<sup>4</sup> Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the Firm's attention. Depending upon the circumstances, compliance with PCAOB standards may 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 its previously expressed audit opinions. The Board expects that firms will comply with these standards, and the inspections staff may include in its procedures monitoring or assessing a firm's compliance.

Many audit deficiencies involve a lack of due professional care. AU 230, *Due Professional Care in the Performance of Work* ("AU 230"), paragraphs .02, .05, and .06, requires the independent auditor to plan and perform his or her work with due professional care and sets forth aspects of that requirement. AU 230, paragraphs .07 through .09, and Auditing Standard ("AS") No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13"), paragraph 7, specify that due professional care requires the exercise of professional skepticism. These standards state that professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13, paragraphs 3, 5, and 8, requires the auditor to design and implement audit responses that address the risks of material misstatement, and AS No. 15, *Audit Evidence* ("AS No. 15"), paragraph 4, 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 (in the audit of financial statements) 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.

The table below lists the specific auditing standard that is referenced for the deficiency included in Part I.A of this report. See the description of the deficiency in Part I.A for identification of the specific paragraphs, in addition to those noted above, that relate to that deficiency.

PCAOB Auditing Standard	Issuer
AS No. 12, <i>Identifying and Assessing Risks of Material Misstatement</i>	A

C. Information Concerning PCAOB Inspections Generally Applicable to Triennially Inspected Firms

Board inspections include reviews of certain portions of selected audit work performed by the inspected firm and reviews of certain aspects of the firm's quality control system. The inspections are designed to identify deficiencies in audits and defects or potential defects in the firm's system of quality control related to the firm's audits. The focus on deficiencies, defects, and potential defects 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, defects, and potential defects should not be construed as an indication that the Board has made any determination about other aspects of the inspected firm's systems, policies, procedures, practices, or conduct not included within the report.

#### C.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of internal control over financial reporting ("ICFR"). For these audits, the inspection team selects certain portions of the audits for inspection, and it reviews the engagement team's work papers and interviews engagement personnel regarding those portions. If the inspection team identifies a potential issue that it is unable to resolve through discussion with the firm and any review of additional work papers or other documentation, the inspection team ordinarily provides the firm with a written comment form on the matter and the firm is allowed the opportunity to provide a written response to the comment form. If the response does not resolve the inspection team's concerns, the matter is considered a deficiency and is evaluated for inclusion in the inspection report.

The inspection team selects the audits, and the specific portions of those audits, that it will review, and the inspected firm is not allowed an opportunity to limit or influence the selections. Audit deficiencies that the inspection team may identify include a firm's failure to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,<sup>5</sup> as well as a firm's failures to perform, or to perform sufficiently, certain necessary audit procedures. The inspection may not involve the review of all of a firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, a Board inspection report

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<sup>5</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 applicable accounting principles, the Board's practice is to report that information to the Securities and Exchange Commission ("SEC" or "the 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.



should not be understood to provide any assurance that a firm's audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the firm claimed to have performed the procedure. AS 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. In reaching its conclusions, the inspection team considers whether audit documentation or any persuasive other evidence that a firm might provide to the inspection team supports a firm's contention that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In the case of every matter cited in the public portion of a final inspection report, the inspection team has carefully considered any contention by the firm that it did so but just did not document its work, and the inspection team has concluded that the available evidence does not support the contention that the firm sufficiently performed the necessary work.

Identified deficiencies in the audit work that exceed a significance threshold (which is described in Part I.A of the inspection report) are summarized in the public portion of the inspection report.<sup>6</sup>

The Board cautions against extrapolating from the results presented in the public portion of a report to broader conclusions about the frequency of deficiencies throughout the firm's practice. Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Thus, the audit work is generally selected for inspection

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<sup>6</sup> The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process. In addition, any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.



based on factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

## C.2. Review of a Firm's Quality Control System

QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, provides that an auditing firm has a responsibility to ensure that its personnel comply with the applicable professional standards. This standard specifies that a firm's system of quality control should encompass the following elements: (1) independence, integrity, and objectivity; (2) personnel management; (3) acceptance and continuance of issuer audit engagements; (4) engagement performance; and (5) monitoring.

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when aggregated, may indicate areas where a firm's system has failed to provide reasonable assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion may indicate a defect or potential defect in a firm's quality control system.<sup>7</sup> If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of deficiencies;<sup>8</sup> related firm methodology, guidance, and practices; and possible root causes.

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<sup>7</sup> Not every audit deficiency suggests a defect or potential defect in a firm's quality control system.

<sup>8</sup> An evaluation of the frequency of a type of deficiency may include consideration of how often the inspection team reviewed audit work that presented the opportunity for similar deficiencies to occur. In some cases, even a type of deficiency that is observed infrequently in a particular inspection may, because of some combination of its nature, its significance, and the frequency with which it has been observed in previous inspections of the firm, be cause for concern about a quality control defect or potential defect.

Inspections also include a review of certain of the firm's practices, policies, and processes related to audit quality, which constitute a part of the firm's quality control system. This review addresses practices, policies, and procedures concerning audit performance, training, compliance with independence standards, client acceptance and retention, and the establishment of policies and procedures.

END OF PART I



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April 2, 2015  
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PORTIONS OF THE REST OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED  
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## PART II

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### B. Issues Related to Quality Controls

The inspection of the Firm included consideration of aspects of the Firm's system of quality control.<sup>9</sup>

#### 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 deficiency 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 –

#### Valuation of intangible Assets

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. As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the Firm's failure to perform sufficient procedures to test the carrying value of intangible assets. 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 intangible assets. [Issuer A]

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<sup>9</sup> This report's description of quality control issues is based on the inspection team's observations during the primary inspection procedures. Any changes or improvements that the Firm may have made in its system of quality control since that time may not be reflected in this report, but will be taken into account by the Board during the 12-month remediation process following the issuance of this report.

## **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>10</sup>

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<sup>10</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 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.

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**S.E. Clark & Company, P.C.**

Registered Firm: Public Company Accounting Oversight Board

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February 2, 2015

Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006

Dear Colleagues;

Firstly we want to commend the PCAOB staff investigators for the professionalism consistently demonstrated throughout this, our fourth inspection. However, we respectfully disagree with their findings that "we issued an opinion without satisfying our fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement."

While we evidently disagree regarding the sufficiency of the procedures performed, the comments of the inspection team will give the public a perception that no work was done to satisfy ourselves as to the reasonableness of the capitalized costs. If the staff continues with that assertion in the final report, we would like this response to become part of the public record to correct that perception.

The sufficiency of an audit is determined in consideration of the context in which it was performed. Audit planning is done in consideration of the context of the sufficiency of controls over the financial reporting process. The sufficiency of audit evidence and procedures performed is determined in the context of the availability and reliability of the audit evidence.

We believe in the context of the engagement, the procedures performed (including substantive analytical review procedures), and what is viewed as being material to a reasonable investor in his/her investment decision, that our audit evidence was sufficient to enable us to express an opinion that the financial statements were fairly stated.

Auditing Standard No. 11, *Consideration of Materiality in Planning and Performing an Audit*, contains the following:

**MATERIALITY IN THE CONTEXT OF AN AUDIT**

"2. In interpreting the federal securities laws, the Supreme Court of the United States 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."<sup>2/</sup> As the Supreme Court has noted, determinations of materiality require "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him ...."<sup>3/</sup> "

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Let's reexamine the context of the engagement:

The issuer was significantly behind in their 34 Act filings. Time was of the essence in bringing the filings current. During that time they had discontinued their existing line of business and began a new line of business. The issuer's stock continued to be thinly traded speculatively on the pink sheets market during that period, even though no 34 Act filings were being made. Even before we began the audits of the financial statements included in the 10-K's (4) and reviews of the interim period 10-Q's (11) the issuer was generating revenues from the new line of business. None of our audits or reviews to bring them current were used in any subsequent 33 Act filings of the issuer.

At our insistence, the issuer included the following disclosure in the 34 Act filings that we audited or reviewed:

"THE COMPANY PREVIOUSLY HAD INSUFFICIENT WORKING CAPITAL TO PAY FOR THE PROFESSIONAL SERVICES REQUIRED TO PREPARE, AUDIT, AND FILE THE QUARTERLY AND ANNUAL REPORTS REQUIRED BY THE SECURITIES ACT OF 1934. AS A RESULT, THE AUDITORS WHO AUDITED THE SEPTEMBER 30, 2007 FINANCIAL STATEMENTS AND REVIEWED THE QUARTERLY REPORTS THROUGH JUNE 30, 2008 RESIGNED EFFECTIVE DECEMBER 13, 2011.

IN FEBRUARY 2010 THE BOARD OF DIRECTORS VOTED TO DISCONTINUE THE MOBILE DVR AND LOCATION PRODUCTS LINE OF BUSINESS REPORTED IN THESE FINANCIAL STATEMENTS DUE TO THE CUMULATIVE EFFECTS OF SEVERELY DECLINING REVENUES RESULTING FROM THE 2008 RECESSION. SINCE THIS DECISION WAS MADE SUBSEQUENT TO THE YEARS ENDED SEPTEMBER 30, 2008 AND 2009, THE QUARTERLY AND YEAR END STATEMENTS FOR THOSE YEARS ARE BEING REPORTED ON A GOING CONCERN BASIS RATHER THAN AS DISCONTINUED OPERATIONS. THEY WILL, HOWEVER, BE REPORTED AS DISCONTINUED OPERATIONS COMMENCING WITH THE FISCAL 2010 FILINGS.

NEW MANAGEMENT HAS SUBSEQUENTLY INFUSED SUFFICIENT WORKING CAPITAL TO BRING THE 1934 ACT FILINGS CURRENT. ADDITIONALLY, A NEW LINE OF BUSINESS HAS ALSO COMMENCED WHICH WILL BE REPORTED ON IN THE FISCAL 2011 AND 2012 FILINGS.

ACCORDINGLY, THESE FINANCIAL STATEMENTS ARE BEING SUBMITTED ONLY TO COMPLY WITH SEC RULES AND REGULATIONS AND SHOULD NOT BE RELIED UPON FOR YOUR INVESTMENT DECISIONS. THE OPERATIONS REPORTED ON IN THESE FINANCIAL STATEMENTS HAVE BEEN DISCONTINUED AS OF FEBRUARY 4, 2010. NEW MANAGEMENT ENCOURAGES THE READERS OF THESE FINANCIAL STATEMENTS TO SUSPEND ANY INVESTMENT DECISIONS PERTAINING TO THE STOCK OF THIS COMPANY UNTIL ALL REQUIRED 1934 ACT FILINGS ARE BROUGHT CURRENT."

The process under which current management came to control the issuer was complex. We established an extensive timeline of events beginning with development of the software by the controlled entities, through the first arms-length sale of the software to third party public companies, through the subsequent rescission of the sale due to a dispute with management of those companies, through the subsequent expansion of the operating platform of the software, through the arms-length LOI entered into with former management of the issuer, through



subsequent issuer Board of Directors actions in accordance with the arms-length LOI which enabled current management to control the issuer, and finally through issuance of issuer stock to acquire the software.

- We substantively reviewed the various documents pertaining to the third party software sale to the public companies. We substantively determined that current issuer management did not control those public companies at the time of the sale and it was truly arms-length. We substantively determined that the fair value of the sale was \$1,000,000 based on the market price of the stock at the time of the sale and the number of shares issued
- We reviewed the various documents pertaining to the subsequent rescission of the sale. We determined that the rescission culminated from disagreements with former management which did not pertain to the fair value of the software'
- We substantively reviewed the arms-length letter(s) of intent with the issuer in the context of who was controlling the issuer at the time the LOI(s) were entered into and who was controlling the issuer at the time the purchase was culminated. We substantively obtained an extensive letter from counsel regarding the appropriateness and permissibility of the Board of Director actions and resulting stock issuances that enabled new management to obtain control of the issuer.
- We substantively determined that current management did not control the issuer either at the time the LOI was initially entered into or when it was subsequently revised and was in fact an arms-length transaction. We substantively determined that as a result of BOD actions authorized by the revised arms-length LOI, current management controlled the issuer at the time the transaction was culminated. If it was an arms-length transaction the fair value standard should be used, whereby the software would be valued based on the trading price of the stock at the date of the transaction. If the transaction was not arms-length the developers cost basis should be used.

On the issuer's assumption that the fair value standard applied, the issuer had initially capitalized the transaction based on over \$3,295,000 of costs incurred throughout the development stage of the software, believing that was representative of the fair value. At our urging, the issuer engaged a well-respected and highly competent valuation expert to determine the fair value of the software at that time. The valuation substantially exceeded the capitalized costs. Our own internal valuation expert, Steven E. Clark, a Certified Valuation Analyst, substantively reviewed the independent expert's valuation and related assumptions upon which it was based, and determined that the methods used, particularly the royalty method, were conservatively applied in the valuation.

Since there was some ambiguity about whether the fair value standard, or cost standard should be applied to the transaction, we encouraged issuer management to consult with the Office of Chief Accountant (OCA) at the SEC. After the SEC had a team of five individuals review the transaction over a period spanning about four months they rendered an informal opinion that "more likely than not" the cost basis should apply since current management controlled the issuer at the time the transaction was culminated. We believe that due to the complex circumstances involved with the transaction that even the OCA staff had difficulty determining which standard should apply.

Based on the informal opinion of the SEC, we substantively reviewed the costs that aggregated the costs that had been capitalized in the transaction. Using substantive analytical review, we substantively determined that over \$2,000,000 of capitalized costs were not eligible for capitalization under either ASC 350 or 985 and had the issuer restate the transaction to exclude those costs. We further substantively determined that as of the date of the original arms-length sale to the public companies that costs eligible for capitalization under either ASC 350 or 985 slightly exceeded the \$1,000,000 sales price and had the issuer further impair those costs to the \$1,000,000 amount representing the fair value of the software at that time. We believe that since the original sale transaction was entered into on an arms-length basis and was recorded at the fair value standard, that the \$1,000,000 demonstrated the reasonableness of those costs and effectively became the new "cost basis" for costs incurred through that date.

Approximately \$200,000 of additional costs were subsequently incurred (to expand the operating platform of the software), from the date of the rescission of the original arms-length sale through the date of the LOI with the issuer. We substantively determined, through examination of a representative software development contract which exceeded that amount, that the \$200,000 of additional eligible capitalized costs were also reasonable.

We respectfully disagree with the assertion that we failed to examine sufficient supporting documentation related to those costs. Documentation includes both primary documentation and secondary documentation. Primary documentation includes vendor invoices, cancelled checks, etc. Secondary documentation includes bank statements, trial balances, etc. that result from processing the transactions pertaining to the primary documentation. Due to the substantial lapse of time during the accumulation of those costs by the related companies and the substantial lapse of time over which the issuer had not reported, there was admittedly a lack of existing primary documentation. Sufficient secondary documentation existed, however, to allow us to substantively analytically review the composition of the capitalized costs to determine if those costs were eligible for capitalization in accordance with GAAP and if those costs were reasonable.

This is where seasoned audit judgment comes in. If there is a lack of primary documentation to support an assertion, but the auditor is able to satisfy himself/herself as to the reasonableness of the assertion through alternative procedures, we believe the auditor has sufficiently complied with professional standards.

We are seasoned auditors of issuers whose stock is speculatively traded and have a good grasp of what is material to such investors. (See our prior response to our 2008 inspection.) Note 11 to the issuer's financial statements included a thorough disclosure of the facts and timeline discussed above along with a disclosure of the \$4,296,000 fair value of the transaction as determined by the independent valuation experts. The inspectors found that the procedures performed by us to determine the reasonableness of that valuation were sufficient. Without regard to whether the standard of value for the transaction should be cost or fair value basis, we believe the reasonable investor is more concerned about the fair value of the software than the developer's historic cost of the software. Logically, when buying a house, the buyer is more concerned about the fair market value of the house than he/she is in the seller's cost basis. In our judgment, it was reasonable and prudent to focus our procedures on determining the reasonableness of the developers historic costs rather than pursue a costly and delaying effort to recreate the primary documentation pertaining to those costs, which would have caused significant additional delay of the 34 Act filings to the market.

Furthermore, our judgments documented in our workpapers were reviewed by our independent quality reviewer who found them sufficient. Additionally, the auditors who succeeded us on the engagement reviewed our workpapers and judgments discussed in the various memos pertaining to this issue and found our work was sufficient without having to expand their procedures on the beginning balances. In short, other qualified independent PCAOB registered professionals believe our work pertaining to this matter was sufficient.

In the context of this transaction, in the context of this engagement, in the context of this issuer, in the context of the speculative market, we believe our work was sufficient to enable us to express our opinion as to the fair statement of the financial statements.

If the PCAOB staff continues to assert in the final report that "we issued an opinion without satisfying our fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement" we respectfully request that this response be included in the public record to allow the public to assess the reasonableness of our judgments pertaining to this assertion in the financial statements.

Respectfully,



Steven E. Clark, CPA\CFF, CVA  
Managing Shareholder  
SEClark & Company, PC

## **APPENDIX A**

### **AUDITING STANDARDS REFERENCED IN PART I**

This Appendix provides the text of the auditing standard paragraphs that are referenced in Part I.A of this report. Footnotes that are included in this Appendix, and any other Notes, are from the original auditing standards that are referenced. While this Appendix contains the specific portions of the relevant standards cited with respect to the deficiency in Part I.A of this report, other portions of the standards (including those described in Part I.B of this report) may provide additional context, descriptions, related requirements, or explanations; the complete standards are available on the PCAOB's website at <http://pcaobus.org/STANDARDS/Pages/default.aspx>.

<b>AS No. 12, <i>Identifying and Assessing Risks of Material Misstatement</i></b>		
<b>PERFORMING RISK ASSESSMENT PROCEDURES</b>		
AS No. 12.4	The auditor should perform risk assessment procedures that are sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement, whether due to error or fraud, <sup>3</sup> and designing further audit procedures. <sup>4</sup>	Issuer A
<p><u>Footnotes to AS No. 12.4</u></p> <p><sup>3</sup> AU sec. 316, <i>Consideration of Fraud in a Financial Statement Audit</i>, discusses fraud, its characteristics, and the types of misstatements due to fraud that are relevant to the audit, i.e., misstatements arising from fraudulent financial reporting and misstatements arising from asset misappropriation. Also, Auditing Standard No. 18, <i>Related Parties</i>, requires the auditor to perform procedures to obtain an understanding of the company's relationships and transactions with its related parties that might reasonably be expected to affect the risks of material misstatement of the financial statements.</p> <p><sup>4</sup> Auditing Standard No. 15, <i>Audit Evidence</i>, describes further audit procedures as consisting of tests of controls and substantive procedures.</p>		
<b>IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT</b>		
AS No. 12.59	The auditor should identify and assess the risks of material misstatement at the financial statement level and the assertion level. In identifying and assessing risks of material misstatement, the auditor should: <ul style="list-style-type: none"> <li>a. Identify risks of misstatement using information obtained from performing risk assessment procedures (as discussed in paragraphs 4–58) and considering the characteristics of the accounts and disclosures in the financial</li> </ul>	Issuer A

	<p>statements.</p> <p>Note: Factors relevant to identifying fraud risks are discussed in paragraphs 65–69 of this standard.</p> <p>b. Evaluate whether the identified risks relate pervasively to the financial statements as a whole and potentially affect many assertions.</p> <p>c. Evaluate the types of potential misstatements that could result from the identified risks and the accounts, disclosures, and assertions that could be affected.</p> <p>Note: In identifying and assessing risks at the assertion level, the auditor should evaluate how risks at the financial statement level could affect risks of misstatement at the assertion level.</p> <p>d. Assess the likelihood of misstatement, including the possibility of multiple misstatements, and the magnitude of potential misstatement to assess the possibility that the risk could result in material misstatement of the financial statements.</p> <p>Note: In assessing the likelihood and magnitude of potential misstatement, the auditor may take into account the planned degree of reliance on controls selected to test.<sup>32</sup></p> <p>e. Identify significant accounts and disclosures<sup>33</sup> and their relevant assertions<sup>34</sup> (paragraphs 60–64 of this standard).</p> <p>Note: The determination of whether an account or disclosure is significant or whether an assertion is a relevant assertion is based on inherent risk,</p>	
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	without regard to the effect of controls. f. Determine whether any of the identified and assessed risks of material misstatement are significant risks (paragraphs 70–71 of this standard).	
<u>Footnotes to AS No. 12.59</u>		
32	Paragraphs 16–35 of Auditing Standard No. 13.	
33	Paragraph A10 of Auditing Standard No. 5 states:  An account or disclosure is a significant account or disclosure if there is a reasonable possibility that the account or disclosure could contain a misstatement that, individually or when aggregated with others, has a material effect on the financial statements, considering the risks of both overstatement and understatement. The determination of whether an account or disclosure is significant is based on inherent risk, without regard to the effect of controls.	
34	Paragraph A9 of Auditing Standard No. 5 states:  A relevant assertion is a financial statement assertion that has a reasonable possibility of containing a misstatement or misstatements that would cause the financial statements to be materially misstated. The determination of whether an assertion is a relevant assertion is based on inherent risk, without regard to the effect of controls.	
<b>AS No. 13, <i>The Auditor's Responses to the Risks of Material Misstatement</i></b>		
<b>RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES</b>		
AS No. 13.8	The auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure.	Issuer A