1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8433
www.pcaobus.org

Report on

2014 Inspection of Pattillo, Brown & Hill, LLP
(Headquartered in Waco, Texas)

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

PCAOB RELEASE NO. 104-2015-066

PCAOB Release No. 104-2015-066

2014 INSPECTION OF PATTILLO, BROWN & HILL, LLP

Preface

In 2014, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Pattillo, Brown & Hill, LLP ("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 the PCAOB inspections generally). Overall, the inspection process included a review of portions of an issuer audit completed by the Firm. This review was intended to identify whether deficiencies existed in those portions of the inspected audit, 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[1]

Number of offices	5 (Albuquerque, New Mexico; and Brownsville, Hillsboro, Temple, and Waco, Texas)
Ownership structure	Limited liability partnership
Number of partners	14
Number of professional staff[2]	73
Number of issuer audit clients	None at the outset of the inspection; however, the Firm had issued at least one audit report with respect to an issuer since the preceding inspection

[1] 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.

[2] 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 May 12, 2014 to May 19, 2014.[3]

A. Review of Audit Engagement

The inspection procedures included a review of portions of one issuer audit 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, a reference to a specific paragraph of the auditing standard that relates to that deficiency. The text of that paragraph is set forth in Appendix A to this report. The reference in this sub-Part include only the standard that primarily relates to the deficiency; it does 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 the 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

[3] For this purpose, "primary procedures" includes 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 does not include (1) inspection planning, which is generally performed prior to primary procedures, and (2) inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which generally extend beyond the primary procedures.

sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with applicable 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.[4]

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

Issuer A

> the Firm's failure to identify, or to address appropriately, a departure from Generally Accepted Accounting Principles ("GAAP") that related to a potentially material misstatement in the audited financial statements concerning the accounting for convertible debt with a beneficial conversion feature (AS No. 14, paragraph 30).

---

[4] 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.

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 standard that is 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.

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 set 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. 14, *Evaluating Audit Results*	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,[5] as well as a

---

[5] 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,

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 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.[6]

---

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.

[6] 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

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 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* ("QC 20"), 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.[7] If identified deficiencies, when accumulated and

---

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.

[7] Not every audit deficiency suggests a defect or potential defect in a firm's quality control system.

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;[8] related firm methodology, guidance, and practices; and possible root causes.

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

[8] 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.

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] 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.

PB&H
PATTILLO, BROWN & HILL, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS ■ BUSINESS CONSULTANTS

October 20, 2014

Public Company Accounting Oversight Board
c/o Helen A. Munter, Director, Division of Registration and Inspections
1666 K Street, N.W.
Washington, DC 20006

Re: Public Response to Report on 2014 Inspection

Dear Ms. Munter:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board (PCAOB) with regard to the 2014 Inspection of Pattillo, Brown & Hill, L.L.P. It is our desire that this transmittal letter in its entirety be public and accompanies the final version of the report submitted.

The following is our response to the Report on 2014 Inspection of Pattillo, Brown & Hill, L.L.P. We believe our conclusion that no beneficial conversion feature existed is correct with regards to the 3/31/2011 audit of Issuer A and disagree with the Board's comments in the draft report. The following outlines our responses to each section of the Board's report.

Timing of Inspection

We would like to point out that our 3/31/2011 audit of the Issuer was completed before the 3/31/2010 PCAOB examination concluded on the same Issuer. In this prior year PCAOB report, the PCAOB requested that we update our programs and partner rotation documentation surrounding convertible debt. These items were completed and sent to the PCAOB with our response to the prior year Inspection Report. Please refer to our prior response for corrective actions undertaken subsequent to the audit reviewed.

Inspection Procedures and Certain Observations – Firm Responses

Review of Audit Engagement

We do not believe there was an audit deficiency with regards to Issuer A as noted by the Board. We disagree with the Board's conclusion that there is a possibility that the financial statements could be materially misstated. The Board cites that there was a beneficial conversion feature that existed at 3/31/2011; however as noted below, we stand by our conclusion that there was no beneficial conversion feature and therefore disagree with the Board.

401 WEST HIGHWAY 6 ■ P. O. BOX 20725 ■ WACO, TX 76702-0725 ■ (254) 772-4901■ FAX: (254) 772-4920 ■ www.pbhcpa.com
AFFILIATE OFFICES: BROWNSVILLE, TX (956) 544-7778 ■ HILLSBORO, TX (254) 582-2583
TEMPLE, TX (254) 791-3460 ■ WHITNEY, TX (254) 694-4600 ■ ALBUQUERQUE, NM (505) 266-5904

The primary reasons we concluded that there was no beneficial conversion feature are that the market was thinly traded, the issuer had reoccurring losses, a working capital deficit, a stockholders' deficit and a very low volume of stock being traded. Assuming that a willing buyer for the stock could be found, conversion of the shares would have greatly reduced the overall share value. Therefore, there was no benefit to conversion.

There were 12,300 shares traded on the U.S. market on the commitment dates of the convertible notes. If the notes had been converted and 100% of the represented daily volume of trade was attributable to the converted shares, it would take over 538 days of trades to convert the shares to cash; this is also assuming that a willing buyer could be attracted and no other sellers desired to sell. The likelihood this would occur with the company's current level of equity, sales, assets and liabilities is remote at best.

It should be noted that the sufficiency of evidential matter required to support an audit opinion is determined through the exercise of an auditor's professional judgment, which involves many decisions that may be subject to various reasonable interpretations. The above analysis is the reason that we concluded there was no beneficial interest. We believe that to properly apply the accounting guidance, all characteristics of the subject company must be included within the scope of analysis. To consider only the characteristics of the convertible debt without regard to the ultimate effect of a hypothetical conversion inappropriately isolates the notes in question. Looking at accounting guidance and a company's financial profile in its entirety is required when analyzing a company as described above.

FASB ASC 820-10-35-41 states "a quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available." Under this definition "an active market for an asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis." By reviewing the stock transactions throughout the past few years, it is evident that there is a limited market for the issuer's stock. For example in March 2011, the stock was traded only 7 days throughout the month with a total volume of 28,900 shares. Market prices were considered as secondary reasoning to substantiate there was no beneficial conversion feature.

The Company had no sales for the year ended March 31, 2011 and there was an accumulated deficit of $6.3 million. The balance sheet reflects $8 thousand in cash and $1.4 million in current liabilities. There was emphasis of matter paragraph in the audit opinion with regards to going concern.

Auditing Standards

In the Board's Inspection report, it cites that AU 230 and AS 13 were not followed. However we disagree with the Board's comment. Each of the items noted above was referenced within our workpapers, as well as documented thoroughly in a memo. Our memo contained the accounting standards, our professional opinion, as well as the evidence documented above. There was no lack of risk assessment or development of auditing procedures. Our workpapers thoroughly documented our conclusion and we stand by that conclusion, even after discussions with the Board.

Reviews of Audit Work

We disagree with the Board's comments that our audit work did not contain appropriate evidence, nor reach the appropriate conclusion. After discussing these same reasons, the successor auditor in an email to us on July 9, 2012 agreed that no beneficial conversion feature existed. Therefore we disagree with the Board's comments and request that the facts noted above be reviewed again.

Review of a Firm's Quality Control System

We do not believe there is a breakdown in our Firm's quality control. Our audit documentation appropriately reflected our risk assessment, gathering of facts and testing, a review of accounting and auditing standards, economic circumstances and reached the appropriate conclusion. The appropriate conclusion is that no beneficial conversion feature existed at 3/31/2011 and this is why the successor auditor agreed with us.

After the 3/31/2010 PCAOB review referenced above, our Firm staff completed Continuing Professional Education on the accounting for stock options and other stock based compensation. After the completion of these CPE courses, we continued and will continue to stand by our conclusion that no beneficial conversion feature existed with regards to the Issuer.

Sincerely,

Pattillo, Brown & Hill, L.L.P.

Pattillo, Brown & Hill, L.L.P

APPENDIX A

AUDITING STANDARDS REFERENCED IN PART I

This Appendix provides the text of the auditing standard paragraph that is referenced in Part I.A of this report. Footnotes that are included in this Appendix, and any other Notes, are from the original auditing standard that is referenced. While this Appendix contains the specific portions of the relevant standard 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 standard is available on the PCAOB's website at http://pcaobus.org/STANDARDS/Pages/default.aspx.

AS No. 14, *Evaluating Audit Results*		
Evaluating the Presentation of the Financial Statements, Including the Disclosures		
AS No. 14.30	The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Note: AU sec. 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles,* establishes requirements for evaluating the presentation of the financial statements. Auditing Standard No. 6, *Evaluating Consistency of Financial Statements,* establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements. Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.	Issuer A