I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Patrizio & Zhao LLC (“P&Z”) and Xinggeng (John) Zhao, CPA (“Respondents”) pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.2

1  Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2  Rule 102(e)(1)(ii) provides, in pertinent part, that:
II.

In anticipation of the institution of these proceedings, Respondents have each submitted an Offer of Settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondents’ Offers, the Commission finds\(^3\) that:

A. SUMMARY

1. This matter involves improper professional conduct under Rule 102(e) of the Commission’s Rules of Practice and related violations by Patrizio & Zhao LLC (“P&Z”) partner Xinggeng (John) Zhao. P&Z served as auditor to Keyuan Petrochemicals, Inc. (“Keyuan”), a China-based issuer, and Zhao was the engagement partner.

2. On February 28, 2013, the Commission filed a complaint against Keyuan alleging that between May 2010 and January 2011, in what was its first year as a U.S. public company, Keyuan systematically failed to disclose in its SEC filings numerous material related party transactions, including transactions between Keyuan and its CEO and controlling shareholders as well as entities controlled by or affiliated with those persons.\(^4\) The Commission further alleged that the related party transactions took the form of loan guarantees, purchases of raw materials, sales of products, and short term cash transfers for financing purposes.

3. P&Z conducted audits and interim reviews of the periods in which Keyuan failed to disclose the material related party transactions. P&Z audited Keyuan’s December 31, 2008 (“2008”) and December 31, 2009 (“2009”) financial statements (the “Keyuan Audits”). P&Z also conducted interim reviews of Keyuan’s financial statements for the first, second, and third quarters of 2010 (the “Keyuan Interim Reviews”).

\(^3\) The findings herein are made pursuant to Respondents’ Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

4. In conducting the Keyuan Audits and Keyuan Interim Reviews, Zhao failed to comply with Public Company Accounting Oversight Board ("PCAOB") standards. P&Z workpapers and other documents reflect many of the same types of related party transactions that Keyuan failed to disclose. Zhao, who determined that related party transactions were an audit risk area, reviewed documentation reflecting that Keyuan was engaged in such transactions. Nonetheless, he approved the issuance of unqualified audit opinions as well as interim review reports on Keyuan’s financial statements that failed to disclose the material related party transactions, in violation of U.S. generally accepted accounting principles ("GAAP").

5. By failing to conduct the Keyuan Audits and Keyuan Interim Reviews in accordance with PCAOB standards, P&Z and Zhao engaged in improper professional conduct. P&Z and Zhao also caused the primary disclosure and reporting violations that were the subject of the Commission’s civil action against Keyuan.

B. RESPONDENTS

6. Xinggeng (John) Zhao, age 48, is a Chinese citizen and resident of Montville, New Jersey. Zhao is a founding partner of P&Z and head of the firm’s China practice. Zhao is a Certified Public Accountant ("CPA") licensed in New Jersey. Zhao served as the engagement partner on the Keyuan Audits and Keyuan Interim Reviews.

7. Patrizio & Zhao LLC is an accounting and auditing firm registered with the PCAOB and based in Parsippany, New Jersey. The firm audits public companies, provides tax preparation services and performs a limited number of non-public company audits.

C. OTHER RELEVANT PARTY

8. Keyuan Petrochemicals, Inc., is a Nevada corporation whose common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act. It is headquartered in Ningbo, Zhejiang Province, China. NASDAQ suspended trading in Keyuan’s shares on October 7, 2011 and delisted the shares on April 23, 2012. Currently, its shares are quoted on OTC Link (formerly “Pink Sheets”) operated by OTC Markets Group Inc. under the symbol “KEYP.”

D. FACTS

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5 Citations to PCAOB standards refer to standards in effect at the time of the conduct discussed herein.

6 GAAP provides that an issuer has a duty to disclose material related party transactions. In particular, Financial Accounting Standards Board Accounting Standards Codification Topic 850 ("ASC 850"), formerly known as Statement of Financial Accounting Standards No. 57, provides that financial statements shall include disclosures of material related party transactions. ASC 850 specifically enumerates purchases, borrowings, lendings, and guarantees as “[e]xamples of common [related party] transactions.”
9. Keyuan, a China-based corporation, engages in the petrochemical business through its wholly-owned subsidiary, Ningbo Keyuan Plastics Co., Ltd. (“Ningbo Keyuan Plastics”). Chunfeng Tao, the CEO and Chairman of Keyuan, founded Ningbo Keyuan Plastics in 2007, along with Keyuan’s controlling shareholders, Jicun Wang and Peijun Chen. In April 2010, Ningbo Keyuan Plastics consummated a reverse merger with a dormant Nevada shell corporation, which was renamed as Keyuan Petrochemicals.

10. P&Z was retained in September 2009 prior to the reverse merger and served as Keyuan’s independent auditor in connection with the company’s initial public filings with the Commission. Zhao served as the engagement partner for the Keyuan Audits and Keyuan Interim Reviews. Accordingly, he had the final responsibility for the Keyuan Audits and Keyuan Interim Reviews, including all accounting and auditing judgments made in connection with those engagements. In connection with the Keyuan Audits, P&Z issued audit reports with an unqualified opinion for 2008 and 2009. In connection with the Keyuan Interim Reviews, P&Z issued interim review reports for the first, second and third quarters of 2010.

11. Between May 2010 and January 2011, Keyuan filed two registration statements on Form S-1. During this period, Keyuan further filed quarterly reports for the second and third quarters of 2010 on Form 10-Q. P&Z’s audit opinions for 2008 and 2009 were included in Keyuan’s registration statements. P&Z’s interim review reports for the second and third quarters of 2010 were included in the relevant 10-Qs filed by Keyuan.

12. In January 2011, Keyuan replaced P&Z with a new accounting firm to audit the company’s December 31, 2010 (“2010”) financial statements. As part of its 2010 audit, in early 2011, the new accounting firm, among other things, identified previously-undisclosed related party transactions involving Keyuan and its officers, directors, and controlling shareholders.

13. In October 2011, Keyuan filed its 10-K for 2010. The following month, in November 2011, Keyuan filed restated 10-Qs for the second and third quarters of 2010. In the 2010 10-K and the restated 10-Qs, Keyuan disclosed for the first time numerous material related party transactions that occurred in 2009 and the first three quarters of 2010, periods that were the subject of the audit and interim reviews by P&Z. The related party transactions—which included loan guarantees, purchases of raw materials, sales of products, and short term cash transfers for financing purposes—included transactions between the company and its CEO and controlling shareholders as well as entities controlled by or affiliated with those persons.

Related Party Transactions were a Significant Risk Area in the Keyuan Audits

14. From the outset, Zhao had reason to view the Keyuan engagement as high risk. Zhao was aware that Keyuan was a new company with a limited operating history that was seeking to obtain a U.S exchange listing. He was further aware that Keyuan did not have any employees knowledgeable about U.S. accounting requirements and was reliant on an outside
consultant to prepare its U.S. GAAP financial statements. More generally, Zhao considered the firm’s Chinese audit clients to be high risk, and he further had a general understanding at the time that it was common for Chinese companies to engage in related party transactions. Notably, audit planning documents that Zhao reviewed and prepared specifically identified the company’s lack of U.S. GAAP experience and related party transactions as audit risk areas.

15. During the course of the Keyuan Audits, Zhao encountered red flags that Keyuan had not properly identified and disclosed related parties and related party transactions. For instance, during the audit planning, Zhao requested Keyuan’s Vice President of Accounting to provide a list of Keyuan’s related parties and related party transactions. The Vice President of Accounting informed Zhao that there were none. Moreover, the initial draft financial statements prepared by the outside consultant and provided to P&Z did not identify any related parties or disclose any related party transactions.

16. Thereafter, however, P&Z audit staff obtained a list of related parties from Keyuan and further identified related party transactions involving Keyuan, thus contradicting Keyuan’s initial representations that there were no related parties or related party transactions. For instance, audit workpapers and planning documents reflect the existence of related party transactions in the form of loan guarantees, sales, other payables, and notes payables. Several documents specifically noted the existence of related party transactions, while others indicated that “further procedures and disclosures [of related party transactions] were necessary.”

17. Zhao encountered yet additional red flags. The list of related parties provided by Keyuan’s management did not include several entities identified as related parties in either audit planning documents or audit workpapers prepared by P&Z audit staff. In addition, P&Z audit workpapers indicate that audit staff identified transactions with entities identified as related parties or members of Keyuan’s management that did not have proper approval. Finally, P&Z was provided a management representation letter at the conclusion of the audit, signed by the CEO, that stated that material related party transactions, including sales, payables, and guarantees, had been properly recorded or disclosed in the financial statements; however, there were no such disclosures anywhere in the financial statements.

Zhao Failed to Conduct the Keyuan Audits in Accordance with PCAOB Standards

Failure to exercise due professional care

18. PCAOB standards require auditors to exercise due professional care when conducting an audit and preparing a report. (AU § 230.01) Under this standard, auditors must maintain an attitude of professional skepticism, which includes “a questioning mind and a critical assessment of audit evidence.” (AU § 230.07) An auditor should view related party transactions within the framework of existing accounting pronouncements, placing primary emphasis on the adequacy of disclosure. (AU § 334.02)

19. Zhao failed to exercise the requisite level of care and professional skepticism. He prepared and reviewed 12/31/08 and 12/31/09 audit planning documents that reflected related
parties and material related party transactions and further reviewed numerous 12/31/08 and
12/31/09 audit schedules that reflected the existence of material related party transactions. These
transactions took the form of loan guarantees, sales, other payables/financings, and notes
payables. However, Zhao failed to perform a critical assessment of the audit evidence and ensure
that P&Z issued the appropriate audit opinion since no related party disclosures were included in
Keyuan’s financial statements, as required by U.S. GAAP, and otherwise failed to design or
perform procedures to determine the extent of the related party transactions and why Keyuan had
not disclosed such transactions.

Improper reliance on representations by management

20. PCAOB standards provide that representations from management are part of the
audit evidence the auditor obtains to complement other audit procedures. (AU § 333.03) If a
management representation is contradicted by other audit evidence, the auditor should
investigate the circumstances of the contradiction and consider the reliability of those
representations. (AU § 333.04)

21. The primary related party audit procedure relied on by P&Z involved the use of a
list of related parties provided by Keyuan’s management. That list was purportedly used to
identify related party transactions during the Keyuan Audits.

22. However, Zhao and members of the audit team came across audit evidence that
cast substantial doubts on the reliability of the management-provided list. For instance, P&Z
audit staff identified several additional related parties that were not included on the list provided
by management. Moreover, P&Z identified numerous transactions with related parties, including
transactions with persons and entities on the list provided by management. These subsequent
findings by P&Z, which were reviewed by Zhao, contradicted the initial management
representations to P&Z that Keyuan was not engaged in related party transactions.

23. In these circumstances, PCAOB standards required Zhao to investigate the
circumstances behind the conflict between management’s representations regarding related
parties and related party transactions and the other audit evidence gathered by P&Z audit staff.
Zhao, however, did not direct the performance of any such procedures. Because Zhao failed to
further investigate these contradictions, he failed to comply with PCAOB standards and lacked a
basis to rely on the representations made by management.

Failure to obtain sufficient competent evidential matter and properly audit related
party transactions

24. PCAOB standards require an auditor to obtain sufficient competent evidential
matter to afford a reasonable basis for an opinion regarding the financial statements under audit.
(AU § 326.01) In selecting particular substantive tests to achieve the audit objectives, an auditor
considers, among other things, the risk of material misstatement of the financial statements. (AU
§ 326.11) With respect to related party transactions, PCAOB standards require that after an
auditor identifies related party transactions, he or she should apply the procedures considered
necessary to obtain satisfaction concerning their purpose, nature, and extent and their effect on
the financial statements. (AU § 334.09) For each related party transaction for which disclosure
is required, PCAOB standards require that the auditor satisfy himself that the transaction is
adequately disclosed in the financial statements. (AU § 334.11) The higher the auditor’s
assessment of risk regarding related party transactions, the more extensive or effective the audit
tests should be. (AU § 9334.19)

25. Zhao failed to obtain sufficient audit evidence to support an unqualified audit
opinion on Keyuan’s 2008 and 2009 financial statements. In particular, Zhao failed to obtain
audit evidence justifying why the material related party transactions reflected in the audit
documentation he reviewed (i.e., loan guarantees, sales, other payables/financings, and notes
payables) were not disclosed by Keyuan. Zhao also failed to perform adequate procedures to
determine the extent of Keyuan’s related party transactions and obtain sufficient evidence to
support the lack of related party disclosures by Keyuan in its 2008 and 2009 financial statements.

Failure to ensure adequate audit documentation

26. PCAOB Auditing Standard No. 3 requires, in part, that audit documentation
contain sufficient information to enable an experienced auditor, having no previous connection
with the engagement, to understand the procedures performed, the evidence obtained, and the
conclusions reached; who performed and reviewed the work; and the dates such work was
completed and reviewed. (AS 3.06) Zhao failed to comply with, and failed to ensure audit staff
under his supervision complied with, the applicable audit documentation standards.

27. As an initial matter, P&Z’s audit documentation does not reflect several key
procedures purportedly employed by the engagement team to audit related party transactions: for
instance, there is no documentation reflecting that P&Z made an inquiry of Keyuan for an
identification of related parties and related party transactions (or management’s response that
there were no such transactions); that management provided a list of related parties; or that P&Z
audit staff used such a list to identify and test related party transactions.

28. Audit documentation also does not reflect P&Z’s conclusions and findings on the
issue of related party transactions. For instance, audit documentation does not reflect why the
material related party transactions reflected in P&Z’s workpapers were not disclosed by Keyuan.
In addition, there is no explanation for how or why certain entities—although not on the
management-provided list—were identified by P&Z audit staff as related parties, or why
transactions with these entities were ultimately not disclosed as related party transactions in
Keyuan’s financial statements. Moreover, audit documentation does not reflect sufficient
information to explain and reconcile otherwise conflicting information regarding certain entities
identified as related parties. In addition, although related party transactions were identified as a
risk area for the Keyuan Audits, P&Z did not document what procedures were performed with
respect to the presentation and disclosure of related party transactions.

29. Zhao also failed to fully document his review of audit workpapers and ensure
audit staff under his supervision properly documented their review of workpapers. None of the
2008 and 2009 audit testing workpapers bear any evidence of review by Zhao, the audit manager or the audit senior. However, in the relevant audit documentation checklists, Zhao checked “yes” to indicate that he had signed off and dated workpapers he had reviewed. Moreover, Zhao reviewed audit documentation checklists which reflected that the audit senior had checked “yes” to indicate that workpapers contained reviewer signatures when, in fact, none of the testing workpapers contained any such evidence of review.

30. Moreover, P&Z did not prepare an engagement completion document for the Keyuan Audits that documented significant findings or issues, including, as it relates to related party transactions. Zhao, however, checked “yes” in audit documentation checklists indicating that he had prepared and/or reviewed the engagement completion document.7

Other violations of PCAOB standards

31. Zhao violated additional PCAOB standards based on the conduct described above. First, Zhao did not adequately plan the audit—he failed to design procedures to identify related parties beyond those identified by management as well as to identify all material transactions with those parties.8 Zhao also failed to design procedures to investigate, as noted above, the conflict between management representations and certain other audit evidence gathered by P&Z audit staff.

32. Zhao also failed to develop audit procedures that were tailored to the risk presented by the company’s related party transactions. In particular, audit planning documents indicate that a risk assessment was conducted, and that related party transactions were specifically identified as a risk area. However, there is no indication that Zhao designed any heightened procedures for auditing this risk area.

33. Zhao further improperly issued an unqualified audit opinion on Keyuan’s 2008 and 2009 financial statements, which failed to include required disclosures under GAAP of material related party transactions.9

Zhao Failed to Conduct the Keyuan Interim Reviews in Accordance with PCAOB Standards

7 PCAOB Auditing Standard No. 3.13 states: “The auditor must identify all significant findings or issues in an engagement completion document.”

8 When planning the audit, the auditor should consider conditions that may require extension or modification of audit tests, such as the existence of related party transactions. (AU § 311.03g) Additionally, an audit of financial statements is a cumulative process and the audit evidence obtained may cause the auditor to modify the planned procedures. (AU § 312.33)

9 An auditor should express a qualified or an adverse opinion on financial statements that fail to include required disclosures under GAAP. (AU § 431.03)
34. In connection with an interim review, PCAOB standards provide that an auditor should exercise due professional care and professional skepticism (AU § 722.01); should obtain a basis for communicating whether he is aware of any material modifications that should be made to the interim financial information for it to conform with GAAP (AU § 722.07); and should follow general documentation standards (AS 3, AU § 722.51-.52).

35. Zhao served as engagement partner for P&Z’s interim reviews of Keyuan’s financial statements for the first, second, and third quarters of 2010. Several violations of PCAOB standards similar to some of those described above also occurred during the Keyuan Interim Reviews. As an initial matter, workpapers for each of the interim review periods, which Zhao reviewed, reflect numerous related party loan guarantees; none of these loan guarantees, however, were disclosed by Keyuan in its financial statements as related party transactions.  

36. P&Z also failed to perform required analytical procedures in connection with the quarterly reviews. In particular, PCAOB standards provide that an auditor, as part of an interim review, should apply analytical procedures to the interim financial information, which should include comparing current period and prior period information as well as comparing current period amounts against the auditor’s expectations that were based on plausible relationships. (AU § 722.16) P&Z did not perform the required analytical procedures for the first and second quarter 2010 interim reviews. With respect to the analytical procedures for the third quarter 2010 review, although procedures were performed, P&Z failed to perform procedures that were consistent with the requirements of PCAOB standards, as they failed to include a comparison of the current interim information to an auditor’s expectations that were based on plausible relationships.

37. Zhao also failed to ensure that appropriate documentation was prepared in connection with the 2010 interim reviews. Numerous workpapers contain no preparer and/or reviewer sign-offs by Zhao (or by other audit staff), even though Zhao indicated in interim review checklists that he had signed off and dated all workpapers he had reviewed. Zhao also failed to ensure preparation of engagement completion documents for the interim reviews, even though review programs that Zhao reviewed and signed-off on indicated that such a document had been prepared.

Zhao Failed to Investigate Subsequent Discovery of Facts

38. PCAOB standards provide that when an auditor becomes aware of information which relates to the financial statements previously reported on by him, but which was not known to him at the date of his report, and which is of such a nature from such a source that he would have investigated it had it come to his attention during the course of the audit, he should, as soon as practicable, undertake to determine whether the information is reliable, and whether

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10 The accountant performing a review of interim financial information should make additional inquiries or perform other procedures when he or she becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with GAAP in all material respects. (AU § 722.22) Additionally, the accountant should modify their report if information the accountant believes is necessary for adequate disclosure in conformity with GAAP is not included in the interim financial information. (AU § 722.43)
the facts existed at the date of his report. (AU § 561.04; see also AU § 722.46) This undertaking 
must be performed even when the auditor has resigned or been discharged. (AU § 9561.02)

39. Zhao failed to investigate subsequently discovered facts existing as of the date of the 
P&Z audit reports that may have affected the firm’s opinions on Keyuan’s 2008 and 2009 
financial statements and review reports on the financial statements for the 2010 quarterly 
periods. In particular, in early 2011, several months after P&Z had been replaced as Keyuan’s 
auditor, Zhao was informed by Keyuan’s senior management that the successor audit firm had 
refused to sign off on the 2010 audit report because, in part, it had identified an off-balance sheet 
cash account as well as undisclosed related party transactions (some of which involved entities 
that had not been previously identified by P&Z as related parties).

40. Zhao’s response to the serious revelations being made by Keyuan’s management 
was inadequate. Zhao did not take steps to determine whether the information learned regarding 
potentially new undisclosed related party transactions and the off-balance sheet account was 
reliable and whether the facts existed as of the dates of P&Z’s 2008 and 2009 audit opinions and 
the interim review reports for 2010. For instance, Zhao made no inquiry to determine the 
identities of the undisclosed related parties; what undisclosed related party transactions had been 
noted by the successor audit firm; or the periods in which the undisclosed related party 
transactions occurred. Zhao also made no inquiry regarding the off-balance sheet cash account, 
including the dates when the account was in use and the amount of the transactions conducted 
through the account. Zhao failed to inquire further as required by AU § 561 notwithstanding the 
fact that, based on the information provided to him by Keyuan’s management, he had developed 
substantial concerns around this time as to the audit opinions his firm had previously issued.

E. VIOLATIONS

Rule 102(e) and Section 4C of the Exchange Act

41. As a result of the conduct described above, Respondents engaged in improper 
professional conduct within the meaning of Section 4C of the Exchange Act and Rule 
102(e)(1)(ii) of the Commission’s Rules of Practice. Section 4C of the Exchange Act and Rule 
102(e)(1)(ii) provide, in pertinent part, that the Commission may censure or deny, temporarily or 
permanently, the privilege of appearing or practicing before the Commission to any person who 
is found by the Commission to have engaged in improper professional conduct. Section 4C(b) 
and Rule 102(e)(1)(iv) define improper professional conduct with respect to persons licensed to 
practice as accountants.

42. Under Section 4C(b) and Rule 102(e)(1)(iv)(B), the term “improper professional 
conduct” means one of two types of negligent conduct: (1) a single instance of highly 
unreasonable conduct in circumstances for which heightened scrutiny is warranted; or (2) 
repeated instances of unreasonable conduct that indicate a lack of competence.

43. Respondents’ failures to abide by PCAOB standards in the Keyuan Audits and the 
Keyuan Interim Reviews constitute repeated instances of unreasonable conduct, and also satisfy
the highly unreasonable conduct standard since the audit area of related party transactions warranted heightened scrutiny. Any one of Respondents’ auditing failures would have been highly problematic, but taken together the failures are deemed by the Commission to be egregious. In short, Respondents conducted the Keyuan Audits and Keyuan Interim Reviews in a manner that no other reasonable auditor would have done so under the circumstances with respect to related party transactions.

P&Z and Zhao were a Cause of Keyuan’s Violations of Sections 17(a)(2) and (a)(3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder

44. Under Section 21C of the Exchange Act, the Commission may enter a cease-and-desist order against any person who is or was a “cause” of another’s primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish “causing” liability under Section 21C of the Exchange Act when a person is alleged to have caused a primary violation that does not require scienter. See KPMG LLP v. SEC, 289 F.3d 109, 112 (D.C. Cir. 2002).

45. Keyuan violated Sections 17(a)(2) and (a)(3) of the Securities Act of 1933 (“Securities Act”) by failing to disclose material related party transactions in registration statements filed with the Commission between May 2010 and January 2011. Keyuan further violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder by failing to disclose material related party transactions in its 10-Qs for the second and third quarters of 2010, as required by GAAP. With respect to both the registration statements and the quarterly reports, the material related party loan guarantees, sales, other payables/financings, and notes payables reflected in P&Z’s workpapers should have been disclosed by Keyuan pursuant to GAAP and/or Commission regulations.

46. For each of the periods in which Keyuan failed to disclose material related party transactions, P&Z issued an audit report or an interim review report. In particular, for 2008 and 2009, P&Z issued audit reports containing an unqualified opinion stating that P&Z conducted an audit of Keyuan’s financial statements in accordance with PCAOB standards and that Keyuan’s financial statements were presented in conformity with GAAP. P&Z consented to the inclusion of these audit reports in Keyuan’s Form S-1 registration statements filed with the Commission between May 2010 and January 2011. For the second and third quarters of 2010, P&Z issued interim review reports stating that P&Z conducted reviews of Keyuan’s quarterly financial statements in accordance with PCAOB standards and that P&Z was not aware of any material modifications that should be made to Keyuan’s financial statements for them to conform with

As noted above, Zhao received conflicting information from management regarding the existence of related parties and related party transactions. Zhao also knew that Keyuan was a relatively new China-based company and that its accounting staff lacked U.S. GAAP experience. More generally, courts have found that related party transactions warrant heightened scrutiny and must be appropriately vetted and scrutinized by auditors to a greater degree because of the risk that they may not be conducted on an arms-length basis. See McCurdy v. SEC, 396 F.3d 1258, 1261 (D.C. Cir. 2005) (noting that related party transactions “are viewed with extreme skepticism in all areas of finance”); see also AU § 334 (recognizing the need for care in the examination of material related party transactions).
GAAP. P&Z consented to the inclusion of these interim review reports in Keyuan’s 10-Qs for the second and third quarters of 2010.

47. Neither P&Z’s audit reports or its interim review reports were accurate, however, because P&Z failed to conduct the Keyuan Audits and Keyuan Interim Reviews in accordance with PCAOB standards and because Keyuan’s financial statements were not prepared in conformity with GAAP. Zhao knew or should have known that as a consequence Keyuan filed financial statements with the Commission that failed to disclose material related party transactions as required by GAAP and Commission regulations. P&Z and Zhao were thus a cause of Keyuan’s failure to accurately disclose material related party transactions and Keyuan’s resulting violations of Sections 17(a)(2) and (a)(3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

P&Z and Zhao Violated Exchange Act § 10A(a)(2)

48. Section 10A(a)(2) of the Exchange Act requires each audit conducted of an issuer by a registered public accounting firm to include “procedures designed to identify related party transactions that are material to the financial statements or otherwise require disclosure therein.” No showing of scienter is necessary to establish a violation of Section 10A. See SEC v. Solucorp Indus., Ltd., 197 F. Supp. 2d. 4, 10-11 (S.D.N.Y. 2002).

49. P&Z and Zhao, in connection with the Keyuan Audits, violated Section 10A(a)(2) of the Exchange Act because they failed to include auditing procedures designed to identify material related party transactions. As noted above, P&Z audit workpapers reflected the existence of material related party transactions; the audit, however, lacked adequate procedures to ensure that those transactions were disclosed as such by Keyuan in financial statements that were the subject of the Keyuan Audits and Keyuan Interim Reviews. Moreover, P&Z and Zhao failed to appropriately design procedures to identify Keyuan’s related party transactions, including investigating the conflicting information provided by management regarding the identification of related parties and related party transactions.

F. FINDINGS

50. Based on the foregoing, the Commission finds that P&Z and Zhao engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice and Section 4C of the Exchange Act.

51. Additionally, the Commission finds that P&Z and Zhao were a cause of Keyuan’s violations of Sections 17(a)(2) and (a)(3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

52. Additionally, the Commission finds that P&Z and Zhao violated Section 10A(a)(2) of the Exchange Act.
IV.  

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents’ Offers.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. P&Z shall cease and desist from committing or causing any violations and any future violations of Section 10A(a)(2) of the Exchange Act and from causing any violations and any future violations of Sections 17(a)(2) and (a)(3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 promulgated thereunder.

B. P&Z is denied the privilege of appearing or practicing before the Commission as an accountant pursuant to Rule 102(e)(i)(ii) of the Commission’s Rules of Practice and Section 4C of the Exchange Act.

C. After three years from the date of this order, P&Z may request that the Commission consider its reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as an independent accountant. Such an application must satisfy the Commission that:

1. P&Z is registered with the PCAOB in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective. However, if registration with the PCAOB is dependent upon reinstatement by the Commission, the Commission will consider the application on its other merits;

2. P&Z has hired an independent CPA consultant (“consultant”), who is not unacceptable to the staff of the Commission and is affiliated with a public accounting firm registered with the Board, that has conducted a review of P&Z’s quality control system and submitted to the staff of the Commission a report that describes the review conducted and procedures performed, and represents that the review did not identify any criticisms of or potential defects in the firm’s quality control system that would indicate that any of P&Z’s employees will not receive appropriate supervision. P&Z agrees to require the consultant, if and when retained, to enter into an agreement that provides that for the period of review and for a period of two years from completion of the review, the consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with P&Z, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the consultant in performance of his/her duties under this Order shall not, without prior written consent of the staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with P&Z, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the review and for a period of two years after the review.
3. P&Z has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (other than reinstatement by the Commission); and

4. P&Z acknowledges its responsibility, as long as it appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. P&Z shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $30,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;12
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier’s check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying P&Z as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

E. Zhao shall cease and desist from committing or causing any violations and any future violations of Section 10A(a)(2) of the Exchange Act and from causing any violations and any future violations of Sections 17(a)(2) and (a)(3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 promulgated thereunder.

F. Zhao is denied the privilege of appearing or practicing before the Commission as an accountant pursuant to Rule 102(e)(i)(ii) of the Commission’s Rules of Practice and Section 4C of the Exchange Act.

12 The minimum threshold for transmission of payment electronically is $50,000.00 as of April 1, 2012. This threshold will be increased to $1,000,000 by December 31, 2012. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.
G. After three years from the date of this order, Zhao may request that the Commission consider its reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company’s financial statements that are filed with the Commission. Such an application must satisfy the Commission that Zhao’s work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

   (a) Zhao, or the public accounting firm with which he is associated, is registered with the PCAOB in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

   (b) Zhao, or the registered public accounting firm with which he is associated, has been inspected by the PCAOB and that inspection did not identify any criticisms of or potential defects in the Zhao’s or the firm’s quality control system that would indicate that Zhao will not receive appropriate supervision;

   (c) Zhao has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (other than reinstatement by the Commission); and

   (d) Zhao acknowledges his responsibility, as long as Zhao appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

H. The Commission will consider an application by Zhao to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission’s review may include consideration of, in addition to the matters referenced above, any other matters relating to Zhao’s character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary