

Proceedings Instituted Against California-based Audit Firm and Two of Its Accountants For Alleged Improper Professional Conduct and Audit Failures

Feb. 11, 2016 – The Securities and Exchange Commission today announced the issuance of an Order Instituting Administrative and Cease-and-Desist Proceedings against California-based audit firm Frazer Frost LLP and two of its accountants, engagement partner Susan Woo and manager Miranda Suen (together, the “Auditors”), alleging multiple instances of improper professional conduct and audit failures during their third quarter 2010 review of interim financial information and their 2011 year-end audit of China Valves Technology, Inc.

The SEC’s Enforcement Division and Office of the Chief Accountant allege that, during Frazer Frost’s third quarter 2010 interim review:

- The Auditors learned from China Valves’ CEO that certain material information concerning China Valves’ January 2010 acquisition of Watts Valve (Changsha) Co., Ltd. was misstated or not included in the notes to the financial statements for the first and second quarter 2010 Forms 10-Q.
- The Auditors performed procedures which confirmed that the information in the prior Forms 10-Q was materially misstated and proposed corrections to the third quarter Form 10-Q in Frazer Frost’s workpapers.
- Despite proposing corrections, Frazer Frost’s workpapers did not document that the Auditors communicated the inaccuracies and proposed changes to China Valves’ management or its audit committee.
- Despite their awareness of the inaccuracies, Woo and Suen signed off on Frazer Frost’s third quarter 2010 review of China Valves’ interim financial information, and the company filed its Form 10-Q with the SEC that repeated the material misstatements from the two previous quarters concerning the acquisition.

The SEC’s Enforcement Division and Office of the Chief Accountant further allege that, during Frazer Frost’s 2011 year-end audit of China Valves:

- While recognizing the need to exercise heightened professional skepticism during the audit, the Auditors failed to follow their audit plan to perform extended procedures to test \$1.7 million in value-added-tax (“VAT”) payments purportedly made to a local tax bureau by China Valves’ Pudong Hanwei Valve Co., Ltd. subsidiary. They also failed to replace those procedures with adequate alternatives or to document why those procedures were no longer necessary.
- Instead, in contravention of the risks they had identified, Respondents relied solely on information provided by China Valves and, in doing so, failed to obtain sufficient audit evidence.
- As a result of this failure, the Auditors did not learn that Hanwei Valve had not made the \$1.7 million in VAT payments as recorded in China Valves’ books and records and reported in the 2011 financial statements included in Form 10-K.
- Frazer Frost subsequently issued an audit report containing an unqualified opinion as to China Valves’ 2011 financial statements, which materially misstated the company’s tax liabilities.

The Enforcement Division and the Office of the Chief Accountant allege that Frazer Frost engaged in improper professional conduct under Rule 102(e) of the Commission's Rules of Practice and willfully violated Rules 2-02 and 2-06 of Regulation S-X, that Woo and Suen engaged in improper professional conduct under Rule 102(e), that Woo caused Frazer Frost's violations of Rules 2-02 and 2-06 of Regulation S-X, and that Suen caused Frazer Frost's violations of Rules 2-06.

The matter will be scheduled for a public hearing before an administrative law judge for proceedings to adjudicate the Enforcement Division's and the Office of the Chief Accountant's allegations and determine what, if any, remedial actions are appropriate.

This action is the latest from the Cross-Border Working Group that focuses on companies with substantial foreign operations that are publicly traded in the U.S. The Working Group has enabled the SEC to file fraud cases against more than 120 foreign issuers or executives, at least another 25 non-fraud cases involving at least 40 other defendants and respondents, most of whom were auditors and other gatekeepers, and deregister the securities of more than 145 companies.

The SEC's investigation was conducted by Sarah Nilson, Patrick L. Feeney, and Janet Yang and supervised by Melissa Hodgman. The litigation will be led by Alfred Day.

See Order: <http://www.sec.gov/litigation/admin/2016/33-10039.pdf>