

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10039 / February 11, 2016

SECURITIES EXCHANGE ACT OF 1934
Release No. 77114 / February 11, 2016

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3742 / February 11, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-17112

In the Matter of

**FRAZER FROST, LLP; SUSAN WOO,
CPA; and MIRANDA SUEN, CPA,**

Respondents

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE AND CEASE-
AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF
THE SECURITIES ACT OF 1933 AND
SECTION 4C AND 21C OF THE
SECURITIES EXCHANGE ACT OF
1934 AND RULE 102(e) OF THE
COMMISSION'S RULES OF
PRACTICE**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Frazer Frost LLP, Susan Woo, and Miranda Suen pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), Sections 4C¹ and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), and Rule 102(e)(1)(ii)² and (iii)³ of the Commission’s Rules of Practice.

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: “The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.”

II.

After an investigation, the Division of Enforcement and the Office of Chief Accountant allege that:

SUMMARY

Frazer Frost, LLP (“Frazer”), an audit firm, and two of its accountants, engagement partner Susan Woo (“Woo”) and manager Miranda Suen (“Suen”), (together, “Respondents”), engaged in multiple instances of improper professional conduct during their third quarter 2010 review of interim financial information and their 2011 year-end audit of China Valves Technology, Inc. (“CVVT”). In 2010, CVVT misled investors about its acquisition of Watts Valve (Changsha) Co., Ltd (“Changsha Valve”) and, in 2011, materially overstated income and understated liabilities incurred by subsidiary Shanghai Pudong Hanwei Valve Co., Ltd. (“Hanwei Valve”) in its financial statements. Respondents failed to conduct the review and audit during the time in which these misstatements occurred in accordance with PCAOB auditing standards. As a result, Respondents engaged in improper professional conduct as defined in Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice. Additionally, Respondents willfully⁴ violated and/or caused violations of Rules 2-02 and 2-06 of Regulation S-X.

During Respondents’ review of CVVT’s third quarter 2010 financial statements included in Form 10-Q but before the third quarter 2010 Form 10-Q was filed, Respondents received an email from CVVT’s CEO admitting that certain material information concerning the acquisition of Changsha Valve was misstated or not included in the notes to the financial statements for the first and second quarter 2010 Forms 10-Q. The misstated or omitted information included: (i) the identity of the seller; (ii) the role of an undisclosed related party in the transaction; (iii) the price of the acquisition; (iv) the structure of the acquisition; and (v) the allocation of assets and liabilities. After receiving the email, Respondents performed procedures that confirmed that information in the first and second quarter 2010 financial statements filed in Forms 10-Q was materially incorrect. Respondents documented proposed changes to the notes to the financial statements in their work papers. Respondents, however, failed to take appropriate steps to communicate the inaccuracies and proposed changes to CVVT’s management or its audit committee and the third quarter 2010 Form 10-Q was issued without correction and repeated the known, material misstatements.

Respondents’ professional misconduct continued during the ensuing 2011 year-end audit of CVVT’s financial statements. Respondents correctly recognized the need to exercise heightened professional skepticism during that audit. In fact, they found CVVT’s internal controls to be ineffective and identified critical areas of the audit as high risk that merited extended audit procedures, including testing value-added-tax (“VAT”) payments made by CVVT’s subsidiaries. However, Respondents failed to follow their own audit plan for the

³ Rule 102(e)(1)(iii) provides, in pertinent part, that: “The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.”

⁴ “Willfully” as used in this Order means knowingly committing the act which constitutes the violation. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

Hanwei Valve subsidiary and did not perform extended procedures to test \$1.7 million in VAT payments purportedly made to a local tax bureau by Hanwei Valve.⁵ 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 CVVT and, in doing so, failed to obtain sufficient audit evidence. As a result, Respondents did not learn—unlike CVVT’s two subsequent auditors—that Hanwei Valve had not made the \$1.7 million in VAT payments as recorded in CVVT’s books and records and reported in the 2011 financial statements included in Form 10-K. Respondents’ improper professional conduct resulted in their improper issuance of an audit report containing an unqualified opinion as to CVVT’s 2011 financial statements, when in actuality the financial statements materially overstated net income by 6.22% and materially understated tax liabilities by 22.5%.

RESPONDENTS

1. **Frazer Frost, LLP** is a PCAOB-registered accounting firm that maintains two offices in California. Frazer currently has thirteen partners who provide auditing, consulting and tax services. Frazer has not issued an audit report for a public company since 2012.⁶ In 2011, Frazer issued only one audit report: the report containing an unqualified opinion as to CVVT’s 2011 financial statements. Most of Frazer’s audit clients are companies with operations in the People’s Republic of China (“China”). Such audits were handled by Frazer’s Asia Services Group, which had two audit partners: Kerry Dean Yamagata (“Yamagata”) and Respondent Woo. In December 2010, the Commission issued a cease-and-desist order that found that Yamagata and Frazer’s predecessor-entity, Moore Stephens Wurth Frazer & Torbet, LLP, engaged in improper professional conduct in connection with its audits and quarterly reviews of another China-based U.S. issuer, China Energy Saving Technology, Inc. (“China Energy”).⁷ Respondent Woo acted as manager for the China Energy audits.

2. **Susan Woo**, age 53, is a certified public accountant and an engagement partner at Frazer. Woo has worked at Frazer since 1994, and became the Director of its Asia Services Group in 2002 and a partner in 2006. She was the engagement partner responsible for the 2010 interim review and 2011 audit of CVVT at issue in this matter. Woo supervised the Frazer audit staff, reviewed and signed-off on the majority of relevant work papers, was ultimately responsible for the work conducted, and approved the issuance of the 2011 CVVT audit report containing an unqualified opinion on CVVT’s financial statements.

3. **Miranda Suen**, age 42, is a certified public accountant and has worked at Frazer since 2006. She became a manager in 2009. She was the engagement manager responsible for the 2010 interim review and 2011 audit of CVVT at issue in this matter. Suen was responsible for the day-to-day work conducted for the 2010 interim review and 2011 audit, supervised other

⁵ The relevant tax bureau is the Shanghai Pudong Third Tax Office. For ease of reference, this order will refer to it as the Hanwei tax bureau.

⁶ Frazer also does business under the name Frazer LLP. Frazer LLP is not separately registered with the PCAOB, and audit opinions are issued by the firm under the name Frazer Frost, LLP.

⁷ The Commission censured the firm pursuant to Section 8A of the Securities Act and Section 4C of the Exchange Act and sanctioned Yamagata under Rule 102(e). *See In re Moore Stephens Wurth Frazer & Torbet LLP and K. Dean Yamagata, CPA*, Ex. Act. Rel. No. 9166 (Dec. 20, 2010).

staff working on each engagement with Woo, and reviewed and signed off on the relevant work papers.

RELATED PARTIES

4. **China Valves Technology, Inc.** is a Nevada corporation with operations solely in China. CVVT develops and manufactures water flow management products. CVVT became a U.S. issuer in December 2007 through a reverse merger with Intercontinental Resources, Inc., a Nevada shell corporation. CVVT's common stock was listed on the Nasdaq Global Market (NASDAQ) under the symbol "CVVT." On September 21, 2012, CVVT filed a Form 25 voluntarily withdrawing its securities from listing and registration on NASDAQ. The Commission revoked the registration of CVVT's securities on March 4, 2015 pursuant to Section 12(j) for failing to file periodic reports. On September 29, 2014, the Commission filed an action alleging fraud and other related misconduct against CVVT and three of its officers related to the disclosures concerning the Changsha Valve acquisition and the mischaracterization of \$1.7 million in VAT payments. The company and two of the three officers charged settled that action in May 2015.⁸

FACTS

Respondents Failed to Conduct the 2010 Third Quarter Review of CVVT's Interim Financial Statements in Accordance with PCAOB Standards

A. CVVT Misstates the Changsha Valve Acquisition

5. In January 2010, CVVT purchased Changsha Valve from Watts Water Technologies, Inc. ("Watts"). CVVT purchased the subsidiary from Watts through Able Delight, a related-party entity created by CVVT solely to facilitate its purchase of Changsha Valve.

6. On February 8, 2010, CVVT filed a Form 8-K announcing that it had purchased the assets of Changsha Valve from Able Delight "for a cash price of approximately \$15 million."

7. CVVT's first, second, and third quarter 2010 Forms 10-Q similarly stated that CVVT acquired "100% of the assets of Able Delight [(Changsha) Valve Co. Ltd] for a total cash consideration of \$15.0 million. The acquisition was accounted as a business combination in accordance to the terms of the purchase agreement." The Forms 10-Q also disclosed that the acquisition included \$4,944,755 in inventory, \$10,113,703 in buildings and equipment, and zero liabilities.

8. As described below, the Form 8-K and the 2010 Forms 10-Q fundamentally misstated the Changsha Valve transaction concerning: (i) the identity of the seller; (ii) the true role of Able Delight, an undisclosed related party, in the transaction; (iii) the price of the acquisition; (iv) the structure of the acquisition; and (v) the allocation of assets and liabilities.

⁸ See Litigation Release No. 23266 (May 20, 2015).

B. Respondents Learn that CVVT's Disclosures Materially Misstate the Changsha Valve Acquisition

9. On October 7, 2010, more than a month before CVVT filed its third quarter 2010 Form 10-Q, Respondent Woo received an email from CVVT's CEO Jianbao Wang ("Wang") to an industry analyst (the "Wang Email").

10. The Wang Email disclosed a number of material facts about the Changsha Valve transaction that were inconsistent with, or had not been included in, CVVT's prior disclosures.

11. Among other things, the Wang Email stated that:

- a. "CVVT Changsha subsidiary was previously a subsidiary of WATTS Water. CVVT made the acquisition through an intermediary Able Delight"
- b. "But the CVVT principles [sic] insisted to be appointed as principles [sic] of Able Delight (Changsha), a subsidiary of Able Delight (Hong Kong) to secure the risk during the transaction";
- c. "Able Delight paid WATTS Regulator 6.11 [million] USD, WATTS Shanghai 8 [million] RMB. and WATTS Tianjin 8 [million] RMB respectively. Able Delight has also paid 44691304.28 RMB to clean up the remained debts [sic] and costs such as lawyer cost, 350 employees working years complete 'bought off' and suspended sales commission etc. The total cost is 15 [million] USD"; and
- d. "This transaction has form of equity transaction"

12. Respondent Woo forwarded the Wang Email to Respondent Suen and other audit staff shortly after she received it and instructed them to "verify and confirm all the legal documents including the payments made to various entities according to the statements [made by Wang]."

13. Respondents should have exercised heightened professional skepticism after receiving the Wang Email.

14. In its work papers for the third quarter 2010 interim review, Respondents documented that they performed procedures that confirmed the statements in the Wang Email. Accordingly, they concluded in their work papers that:

- a. Watts was the true seller of Changsha Valve and "because Able Delight is a related party, [Frazer] will ensure that this related party is disclosed in FN" to the 2010 third quarter 10-Q;
- b. "Based on the procedures [documented in the work papers], Frazer Frost verified that the Company had paid out \$15 [million] to third parties, \$6.07 million as acquisition of Changsha, while \$8.4 million as payments to settle Changsha's previous liabilities and \$.6 million as legal and due diligent [sic] fees";

- c. The transaction was an equity, not an asset, purchase; and
- d. Proposed corrections should be made concerning net assets and liabilities.

C. Respondents Fail to Take Corrective Action and CVVT's Third Quarter Form 10-Q Repeats the Material Misstatements and Does Not Conform with GAAP

15. Although Respondents verified during their 2010 third quarter review that the information in the Wang Email was correct and that CVVT's 2010 financial statements included in Forms 10-Q misstated the acquisition, Respondents failed to act in accordance with PCAOB interim review standards and recommend modifications to CVVT's management or audit committee to make the Form 10-Q conform to Generally Accepted Accounting Principles ("GAAP").

16. Respondents' work papers contain no documentation of discussions with CVVT's management or audit committee concerning the need for modifications to make the Form 10-Q conform to GAAP or any steps taken to address the needed modifications.

17. Respondents Woo and Suen signed off on their review of the notes to the third quarter financial statements, and CVVT's third quarter Form 10-Q was issued on November 15, 2010.

18. Despite the auditors' awareness of the inaccuracies, CVVT's third quarter 2010 financial statements included in its Form 10-Q repeated the material misstatements from the two previous quarters and did not conform with GAAP.⁹

D. Respondents Failed to Act in Accordance with Interim Review Obligations (AU § 722) or Exercise Due Care (AU § 230)

19. PCAOB standards "require"¹⁰ that auditors exercise due professional care in performing reviews of interim financial information. (AU §§ 722.01 and 230.01.) Due care requires that the auditor exercise professional skepticism, "an attitude that includes a questioning mind and a critical assessment of audit evidence." (AU § 230.07.) When an auditor discovers information that causes it to question the accuracy of prior information in the financials, the

⁹ See ASC 805-10-50, which provides that: "the acquirer shall disclose the following information for each business combination that occurs during the reporting period: a. the name and description of the acquiree; b. the acquisition date; c. the percentage voting equity interests acquired; and d. the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree. Additionally, ASC 805-20-50 states the acquirer shall disclose "the amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed."

¹⁰ PCAOB Rule 3101 discusses the meaning of certain terms used in the PCAOB standards. The rule provides the degree of responsibility the PCAOB standards impose on auditors. The rule states that the words "must," "shall," and "is required" indicate unconditional responsibilities. The word "should" indicates responsibilities that are presumptively mandatory. The phrase "PCAOB standards require" is used herein when discussing both unconditional responsibilities and presumptively mandatory responsibilities. This is appropriate because under Rule 3101(a)(2) the "[f]ailure to discharge a presumptively mandatory responsibility is a violation of the relevant standard and Rule 3100 unless the auditor demonstrates that, in the circumstances, compliance with the specified responsibility was not necessary to achieve the objectives of the standard."

auditor should consider what steps should be taken, including discussing the information with the client and preventing reliance on the financials. (AU §§ 722.46 and 561.04.) When an accountant becomes aware of misstatements, the accountant should evaluate the information to determine whether material modifications should be made to the interim financial information for it to conform with GAAP, and, where the accountant determines that a material modification should be made, “the accountant should communicate the matter(s) to the appropriate level of management as soon as practicable.” (AU §§ 722.22, 722.26 and 722.29.) If management does not respond appropriately within a reasonable period of time, the auditor should communicate the matter to the audit committee (or others with equivalent authority) and, if the audit committee does not appropriately respond, should consider whether to resign. (AU §§ 722.30 and 722.31.) The communication to the audit committee can be oral or in writing, but, if oral, should be documented. (AU § 722.30.) Finally, PCAOB standards require accountants to document any significant findings or issues, such as procedures that indicate that the interim financial statements could be materially misstated, and actions taken to address those findings. (AU § 722.52.)

20. Respondents received information directly from CVVT management that made it clear that the company’s disclosures concerning the Changsha Valve acquisition in its first and second quarter 2010 Forms 10-Q were false. Respondents failed to exercise due professional care and an appropriate level of professional skepticism in evaluating this new information and in considering whether actions were needed to correct the disclosures and prevent future reliance on the inaccurate Forms 10-Q for the first two quarters of 2010.

21. Respondents knew that CVVT’s notes to the third quarter 2010 financial statements materially misstated the Changsha Valve acquisition before they were filed with the Commission. In fact, Respondents repeatedly noted in the work papers that corrections were needed. Nevertheless, Respondents failed to raise the inaccuracies with CVVT management or CVVT’s audit committee as required by PCAOB standards.

22. Respondents further failed to document, as required by AU §§ 722.30 and 722.52, communications with the audit committee, if any, and what actions, if any, were taken to address their findings that the notes to the 2010 third quarter financial statements were inaccurate or why they deemed it unnecessary to recommend the corrections noted in their work papers. As a result of these failures, CVVT’s third quarter 2010 Form 10-Q repeated the material misstatements from the two previous quarters about the Changsha Valve acquisition and did not conform to GAAP.

Respondents Failed to Conduct the 2011 CVVT Audit in Accordance with PCAOB Standards and Regulation S-X

A. CVVT’s 2011 Form 10-K Misstated the Hanwei Valve VAT Payments

23. Frazer was the independent auditor for the 2011 audit of CVVT’s financial statements for the fiscal year ended September 30, 2011. On November 18, 2011, Frazer issued an audit report containing an unqualified opinion as to CVVT’s 2011 financial statements.

24. In a November 3, 2011 Form 8-K, CVVT announced that Frazer’s service as CVVT’s independent auditor would terminate at the completion of the 2011 audit. In that same

filing, CVVT announced that it had retained a China-based accounting firm (Successor Auditor A) to serve as the company's independent auditor starting with the first quarter ended December 31, 2011.

25. In a February 14, 2012 Form 8-K, CVVT disclosed that during the interim review of financial statements for the quarter ended December 31, 2011, Successor Auditor A discovered that the VAT return for CVVT's Hanwei subsidiary "could not be reconciled to the Company's financial statements for the fiscal year ended September 30, 2011." CVVT further disclosed that, as a result of an initial investigation, management had determined that a restatement was necessary and "that the Company's unaudited financial statements for the quarters ended March 31, 2011 and June 30, 2011 as well as its audited financial statements for the year ended September 30, 2011, should no longer be relied upon."

26. In an August 12, 2013 Form 8-K/A, CVVT announced that:

After internal auditing and investigation, management found that Hanwei purchased certain equipment from a third party to perform reverse engineering and improve its products. Since the third party did not provide Hanwei with an invoice or any other written record of the sale and, because Hanwei was concerned that its purchase of the equipment might cause it to become the subject of a challenge with respect to intellectual property rights associated with the equipment, Hanwei's management made the determination to account for this purchase transaction as VAT and supplementary tax payments against the VAT payable and paid the third party as such.

CVVT further disclosed that, as a result, approximately \$1.7 million in VAT had not been paid in fiscal year 2011 and was misstated in the 2011 Form 10-K.

B. Respondents Identified VAT Payments as High Risk Yet Failed to Perform Planned Extended Procedures Designed to Test Hanwei's VAT Payments

27. In its 2010 and 2011 audit reports, Frazer concluded that CVVT's internal controls over financial reporting were ineffective and identified material weaknesses and significant deficiencies in critical areas, including CVVT's control environment and the U.S. GAAP expertise of CVVT accounting staff.

28. Respondents determined that they would exercise heightened skepticism for the 2011 audit of CVVT.

29. On October 3, 2011, the PCAOB issued *Staff Audit Practice Alert No. 8, Audit Risks in Certain Emerging Markets*, which advised auditors of the increased risks of auditing companies in emerging market such as China, including the risk of wrongdoing by company management and the need to independently authenticate management representations ("PCAOB

Alert No. 8”).

30. In response to PCAOB Alert No. 8, Respondents’ designed an extended audit approach for the area covering VAT payments.

31. The 2011 fiscal year VAT payable for Hanwei Valve exceeded the \$1.1 million materiality threshold assessed by Respondents for the audit.

32. Respondents did not conduct internal controls testing for the area covering VAT taxes, and therefore assessed control risk as high for all assertions.

33. Accordingly, Respondents’ designed the extended procedure of “go[ing] to the tax authority directly and confirm[ing] amount paid” in order to independently verify VAT tax paid (the “Tax Authority Procedure”).

34. Respondents determined it was necessary and planned to perform the Tax Authority Procedure in addition to standard tracing procedures that relied solely on information and documents provided to them by CVVT.

35. In addition to the Tax Authority Procedure, Respondent Woo instructed her staff to “observe the VAT and income tax return online using the Company’s IC card,” which could be placed into a computer system residing at the subsidiary to independently observe VAT amounts directly through the tax bureau system, including the amount of VAT paid (the “IC Card Procedure”).

i. Respondents Failed to Conduct the Tax Authority Procedure or Adequate Alternative Extended Procedures

36. Respondents failed to perform the Tax Authority Procedure or adequate alternative extended procedures to meet the audit objective of independently verifying the VAT paid by Hanwei Valve.

37. Respondents’ work papers contain no documentation that Respondents performed or attempted to perform the Tax Authority Procedure or adequate alternative extended procedures to meet the audit objective of independently verifying the VAT paid by Hanwei Valve.

38. A Skype exchange between two Frazer audit staff states: “we didn’t go [to the tax authorities] apparently . . . [and] per [a Frazer independent contractor conducting the work], the VAT tax return she saw was the one w/out tax bureau stamp . . . [and] apparently we didn’t trace all the tax payments when we did the audit . . . I’m getting this from Susan [Woo]. . .”

39. Respondents’ work papers do not document the basis for their conclusions and opinions regarding why they did not perform the Tax Authority Procedure and what, if any, alternative extended procedures were considered.

40. Respondents performed the Tax Authority Procedure for two other CVVT subsidiaries, Henan Kaifeng High Pressure Valve Co. (“Kaifeng”) and Zhengzhou City ZD

Valve Co. Ltd. (“ZD”). The work papers for Kaifeng and ZD state that Frazer staff went to the tax authorities and “the tax bureau personnel reconciled the numbers on VAT tax filing and the system. All numbers agreed and then stamped. [Frazer] observed beginning balance of OCT agreed to the Sep ending balance per VAT tax filing, and the stamp was the same as the stamp [provided by the company].”

41. In its review of CVVT’s interim financial statements for the quarter ended December 31, 2011, Successor Auditor A discovered that Hanwei Valve’s VAT tax return did not reconcile to CVVT’s financial statements. After that discovery, Successor Auditor A visited the Hanwei tax bureau and verified the correct VAT tax return.

42. In a July 23, 2012 Form 8-K, CVVT announced the resignation of Successor Auditor A as its independent auditor. In a June 3, 2013 Form 8-K, CVVT announced that it had engaged a U.S.-based accounting firm (“Successor Auditor B”) as the company’s independent auditor.

43. In August 2013, Successor Auditor B also visited the Hanwei tax bureau and verified that Hanwei Valve had paid approximately \$44,000, and not \$1.7 million, in VAT during fiscal year 2011. Thus, Successor Auditor B was able to determine the correct amount of VAT paid by Hanwei Valve by performing—in substance—the Tax Authority Procedure outlined in Respondents’ audit plan.

ii. Respondents Failed to Conduct the IC Card Procedure or Adequate Alternative Extended Procedures

44. Respondents failed to perform the IC Card Procedure or adequate alternative extended procedures to meet the audit objective of independently verifying the VAT paid by Hanwei Valve.

45. Respondents’ work papers do not document the basis for their conclusions and opinions regarding why they did not perform the IC Card Procedure for Hanwei Valve and what, if any, alternative extended procedures they considered.

46. A China-based accounting firm subsequently hired by CVVT used the IC Card system to determine that Hanwei Valve paid approximately \$44,000, and not \$1.7 million, in VAT payments to the Hanwei tax bureau during the 2011 fiscal year.

C. Respondents Failed to Exercise Due Care (AU § 230), Obtain a Reasonable Basis for Believing that the Financial Statements were Accurate (AU §§ 230 and 316 and AS Nos. 8 and 13), Obtain Sufficient Evidential Matter (AS No. 15 and AU § 150), and Instead Placed Undue Weight on Management Representations (AU § 333)

47. 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.) “The auditor neither assumes that management is dishonest nor assumes unquestioning honesty.” (AU § 230.09.) “The exercise of due professional care allows the auditor to obtain reasonable assurance about whether the financial

statements are free of material misstatement, whether caused by error or fraud . . . Although not absolute assurance, reasonable assurance is a high level of assurance.” (AU § 230.10.)

48. Auditors must design and perform audit procedures to obtain reasonable assurance that the financial statements are free of material misstatement due to error or fraud. (AS Nos. 8.3 and 13.3.) “The necessary extent of a substantive audit procedure depends on the materiality of the account or disclosure, the assessed risk of material misstatement, and the necessary degree of assurance from the procedure.” (AS No. 13.42.) “The auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion.” (AS No. 15.4.) The higher the assessed risk of material misstatement, the more persuasive audit evidence the auditor should obtain from substantive audit procedures. (A.S. Nos. 13.37, 13.9, and 15.5.) In determining the amount of audit evidence needed, the auditor should consider the risk associated with the relevant internal control and the quality (i.e. the relevance and reliability) of the evidence obtained. (AS Nos. 15.5 and 15.6.) Among other things, “[e]vidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources.” (AS No. 15.8.) When audit evidence is provided by the company, the auditor should evaluate the sufficiency and appropriateness of the evidence by “performing procedures to: [t]est the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and [e]valuate whether the information is sufficiently precise and detailed for purposes of the audit.” (AS No. 15.10.)

49. Auditing standards require that “[s]ufficient appropriate evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.” (AU § 150.02.) Management’s representations should not act as a substitute for auditing procedures necessary to obtain a reasonable basis about the financial statements. (AU § 333.02.) Rather, auditors must plan and perform procedures to address the fraud risks and obtain reasonable assurance that the financial statements do not contain material misstatements. (AU §§ 316.01 and 316.52.) In doing so, the auditor “should not be satisfied with less-than-persuasive evidence because of a belief that management is honest.” (AU § 333.03.)

50. Respondents failed to exercise due care and professional skepticism in performing the 2011 year-end audit of Hanwei Valve. Respondents specifically designed the extended Tax Authority Procedure and IC Card Procedure to account for the risk of material misstatement. Nonetheless, Respondents failed to ensure that the planned procedures were actually performed for Hanwei Valve.

51. Respondents failed to ensure that alternative extended procedures to the Tax Authority Procedure or IC Card Procedure were performed to independently verify the VAT payments recorded by Hanwei Valve and obtain a reasonable basis for concluding that the financial statements were free of material misstatements. Accordingly, Respondents violated the standards of due care and professional skepticism, failed to ensure that appropriate procedures were performed to address the risk of material misstatement, and failed to obtain sufficient audit evidence.

52. Respondents placed undue weight on management’s representations by relying solely on documentation and information provided by CVVT instead of performing the

specifically designed extended procedures or adequate alternative extended procedures designed to meet the audit objective of independently verifying the VAT paid by Hanwei Valve.

D. Respondents Failed to Document Procedures or Retain Documents (AS No. 3) and, by doing so, Frazer Violated and Woo and Suen Caused Frazer’s Violation of Rule 2-06 of Regulation S-X

53. PCAOB standards require that auditors document the procedures performed, the evidence obtained, and the conclusions reached. (AS No. 3.6.) Notably, “audit documentation must clearly demonstrate that the work was in fact performed,” regardless of whether the work was performed by the engagement team or specialists assisting the auditor. *Id.* Audit documentation must contain information sufficient to allow an auditor with no connection to the work to understand the procedures performed, evidence obtained and conclusions reached and to determine who performed the work, when the work was completed, the person who reviewed the work, and the date of the review. *Id.*

54. “Because audit documentation is the written record that provides the support for the representations in the auditor’s report, it should: a. Demonstrate that the engagement complied with the standards of the PCAOB, b. Support the basis for the auditor’s conclusions concerning every relevant financial statement assertion, and c. Demonstrate that the underlying accounting records agreed or reconciled with the financial statements.” (AS No. 3.5.) “The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached in connection with each engagement.” (A.S. No. 3.12). Significant findings or issues include “e. circumstances that cause difficulty in applying auditing procedures” and “f. significant changes in the auditor’s risk assessments, including risks that were not identified previously, and the modifications to audit procedures or additional audit procedures in response to those changes.” *Id.*

55. Rule 2-06 of Regulation S-X imposes documentation and retention obligations on accountants. Rule 2-06 requires that accountants retain certain relevant audit records for a period of seven years, including work papers and other documents that contain conclusions, opinions, analyses, or financial data. Rule 2-06 also requires documentation of any significant matters considered during the audit. As noted in the adopting release, “[i]f such work is performed but not documented, the auditor generally would violate [generally accepted auditing standards] or new rule 2-06.”¹¹

56. Respondents failed to document the extended procedures, if any, performed to test Hanwei Valve’s VAT payments.

57. Respondents failed to ensure that Frazer staff documented the basis for their conclusions and opinions regarding why the designed extended procedures were not performed, why sufficient alternative extended procedures that achieved the same audit objective were not performed, and how reasonable assurances that the financial statements were free of material misstatements were obtained in the absence of these procedures.

58. Respondents failed to ensure adequate documentation of who performed and

¹¹ Final Rule: Retention of Records Relevant to Audits and Reviews, 17 CFR Part 210.

reviewed procedures concerning the Hanwei Valve VAT payments and when that work was performed.

59. Respondents also failed to ensure the documentation and retention of documents that contain conclusions, opinions, analyses, and financial data concerning the Hanwei audit as required under Rule 2-06 of Regulation S-X, including: tax bureau vouchers, bank account statements, monthly VAT returns, or any other financial data concerning the VAT purportedly paid by Hanwei.

E. Respondents Failed to Adequately Supervise Staff (AS No. 10).

60. PCAOB standards require auditors to supervise the audit engagement “so that the work is performed as directed and supports the conclusions reached.” (AS No. 10.2.) “[T]he engagement partner is responsible for proper supervision of the work of the engagement team members and for compliance with PCAOB standards.” (A.S. No. 10.3.) The engagement partner may obtain assistance from other team members in supervising the audit staff, and such team members are similarly responsible for complying with supervisory standards. (AS No. 10.4.) The engagement partner and other staff members assisting with supervision should inform staff members of their responsibilities, including, among other things: (1) the objectives of the procedures, (2) the nature, timing, and extent of the procedures to be performed, and (3) any relevant issues that could affect the performance of the procedures. (AS No. 10.5.) In determining the extent of supervision, the engagement partner and staff members assisting with supervision should take into account “the risk of material misstatement; and the knowledge, skill, and ability of each engagement team member.” (A.S. No. 10.6.) Additionally, the engagement partner and staff members assisting with supervision should review the work of their team members “to evaluate whether: (1) the work was performed and documented; (2) the objectives of the procedures were achieved; and (3) the results of the work support the conclusions reached.” (AS No. 10.5.)

61. Respondent Woo, as the engagement partner, was responsible for supervising her audit staff and for the conduct of the audit in accordance with PCAOB standards.

62. Respondent Suen, the audit manager, directed the fraud and audit planning discussions¹² and assisted in supervising the audit staff and reviewing the work performed.

63. Respondents Woo and Suen failed to adequately supervise staff in connection with the audit of Hanwei Valve.

64. Respondent Woo assigned a manager (“Assisting Manager”), who was not originally assigned to the CVVT engagement, to perform field work for Hanwei Valve. Respondents Woo and Suen reviewed the Assisting Manager’s work.

65. The Assisting Manager’s involvement in the CVVT engagement began after planning was completed and field work was underway; thus, she was not involved in the initial

¹² The engagement partner is responsible for planning the audit and may seek assistance from appropriate engagement team members in fulfilling these responsibilities. (A.S. No. 9.3.) Engagement team members who assist the engagement partner with audit planning must also comply with the relevant PCAOB standards governing planning. *Id.*

fraud discussion and audit planning. The Assisting Manager was not aware of and did not conduct the designed Tax Authority Procedure, IC Card Procedure, or adequate alternative extended procedures to independently verify the VAT paid by Hanwei Valve.

66. A China-based independent contractor assisted Respondents on the 2011 audit (“Independent Contractor”). The Independent Contractor purportedly performed standard tracing procedures to test Hanwei Valve’s VAT payments, but did not perform the designed Tax Authority Procedure, the IC Card Procedure, or adequate alternative extended procedures to independently verify the VAT paid by Hanwei Valve.

67. Respondents Woo and Suen failed to ensure that the Independent Contractor—who was not a licensed U.S. accountant and hired only to perform low-level administrative tasks—performed procedures that were commensurate with her qualifications.

68. Respondents Woo and Suen violated their obligations when they failed to adequately inform the Assisting Manager and Independent Contractor of the designed procedures, the extent and objectives of the procedures, and the risks involved in the audit. In particular, Respondents Woo and Suen failed to supervise the Assisting Manager and Independent Contractor when they failed to evaluate whether the designed procedure were performed, that the objectives of the procedures were achieved, and that the results of the work supported the conclusions reached.

69. Although the designed extended procedures or adequate alternative extended procedures to independently verify the VAT paid by Hanwei Valve were not performed, Respondents Woo and Suen reviewed and signed off on the relevant work papers and provided improper assurance on the 2011 financial statements, which materially misstated the amount of VAT paid.

70. On November 18, 2011, Frazer issued an audit report containing an unqualified opinion as to CVVT’s 2011 financial statements, which materially misstated the VAT payable.

F. Frazer Violated Rule 2-02(b)(1) of Regulation S-X and Woo Caused Frazer’s Violation by Issuing an Audit Report Falsely Stating that the Audit Complied with GAAS

71. Rule 2-02(b)(1) of Regulation S-X requires that an auditor’s report state, “whether the audit was made in accordance with generally accepted auditing standards [GAAS].”¹³ 17 C.F.R. 210.2-02(b)(1). An auditor violates Rule 2-02(b)(1) if it issues a report stating that it conducted its audit in accordance with PCAOB standards when it did not. Frazer’s 2011 audit report stated that the firm had conducted the audits in accordance with PCAOB standards. These representations were false, and thus Frazer willfully violated Rule 2-02(b)(1). Woo, as an engagement partner at Frazer, approved the signing of the firm’s name to the audit report and its issuance for inclusion in the filings with the Commission. As a result, Woo caused Frazer’s violation of Rule 2-02(b)(1).

¹³ These standards include the auditing standards adopted by the PCAOB following passage of the Sarbanes-Oxley Act of 2002.

VIOLATIONS

Rule 102(e)(1)(ii) and Section 4C(a)(2) of the Exchange Act

72. As a result of the conduct described above, Respondents engaged in improper professional conduct within the meaning of Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

73. Section 4C of the Exchange Act and Rule 102(e)(1)(ii) provide, in 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." In relevant part, Section 4C(b)(2) and Rule 102(e)(1)(iv)(B) define "improper professional conduct" as 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. As discussed above, Respondents' failures to conform to applicable professional standards in connection with the 2010 interim review and the 2011 audit of CVVT constitute both repeated instances of unreasonable conduct and single instances of highly unreasonable conduct under circumstances that warranted heightened scrutiny.

Rules 2-02 and 2-06 of Regulation S-X

74. An auditor violates Rule 2-02(b)(1) of Regulation S-X by issuing a report falsely stating that an audit was conducted in accordance with PCAOB standards. As a result of the conduct described above, Respondent Frazer willfully violated and Respondent Woo caused Frazer's violation of Rule 2-02(b)(1).

75. Rule 2-06 under Regulation S-X provides that for a period of seven years after an accountant concludes an audit or review of an issuer's financial statements, the accountant shall retain records relevant to the audit or review, including work papers and other documents that form the basis of the audit or review, and memoranda, correspondence, communications, other documents and records (including electronic records), which: "(1) Are created, sent or received in connection with the audit or review, and (2) Contain conclusions, opinions, analyses, or financial data related to the auditor or review." The rule also requires documentation of any significant matters considered during the audit. Frazer willfully violated Rule 2-06 as a result of its documentation and retention failures, and Woo and Suen caused Frazer's violation of Rule 2-06.

Rule 102(e)(1)(iii) and Section 4C(a)(3) of the Exchange Act

76. As a result of the conduct described above, Frazer willfully violated certain provisions of the federal securities laws or the rules and regulations thereunder pursuant to Section 4C(a)(3) of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

77. Section 4C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice provide that the Commission may deny the privilege of appearing or practicing before the Commission to any person found "[t]o have willfully violated, or willfully aided and

abetted the violation of, any provision of the Federal securities laws or the rules and regulations thereunder.” As a result of the conduct described above, Frazer willfully violated certain provisions of the federal securities laws or rules and regulations thereunder pursuant to Section 4C(a)(3) of the Exchange Act and Rule 102(e)(1)(iii) of the Commission’s Rules of Practice.

III.

In view of the allegations made by the Division of Enforcement and the Office of Chief Accountant, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

- A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;
- B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 4C of the Exchange Act and 102(e) of the Commission’s Rules of Practice.
- C. What, if any, remedial action is appropriate and in the public interest, pursuant Section 21B and 21C of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission’s Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission’s Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission’s Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission’s Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related

proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not “rule making” within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary