

II.

In anticipation of institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondents have each submitted an Offer of Settlement ("Offers") that the Board has determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the Board's jurisdiction over Respondents and the subject matter of these proceedings, which is admitted, Respondents consent to entry of this Order Instituting Disciplinary Proceedings, Making Findings and Imposing Sanctions ("Order") as set forth below.

III.

On the basis of Respondents' Offers and information obtained by the Board in this matter, the Board finds^{2/} that:

A. Respondents

1. Clancy and Co., P.L.L.C. is a public accounting firm located in Phoenix, Arizona. At all relevant times, Clancy and Co. was licensed under the laws of the state of Arizona to engage in the practice of public accounting (Firm Registration No. 01098-L). Clancy and Co.'s Arizona firm registration was placed on probation by the Arizona State Board of Accountancy ("Arizona Board") for a period of two years, commencing on May 27, 2008.^{3/} Clancy and Co. is registered with the Board pursuant to Section 102 of the Act and PCAOB rules.

^{2/} The findings herein are made pursuant to the Respondents' Offers and are not binding on any other person or entity in this or any other proceeding. The sanctions that the Board is imposing in this Order may be imposed only if a respondent's conduct meets one of the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5). The Board finds that Respondents' conduct described in this Order meets the condition set out in Section 105(c)(5), which provides that such sanctions may be imposed in the event of (A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

^{3/} See *In the Matter of Certified Public Accountant Certificate No. 10871-R Issued to: Jennifer C. Nipp, and Certified Public Accounting Firm Registration No. 1098-L Issued to: Clancy and Co., P.L.L.C.*, ASBA File Nos. 2007.075, 2007.110 (May 27, 2008 Decision & Order (By Consent)). The Arizona Board disciplined the Firm and Nipp for failures to comply with PCAOB and other professional standards in the audits



2. Jennifer C. Nipp, 42, of Draper, Utah, is a certified public accountant who is licensed under the laws of the State of Arizona (License No. 10871-R), the Commonwealth of Kentucky (License No. 5942), and the State of California (License No. 78106). Nipp's Arizona license was placed on probation by the Arizona State Board of Accountancy for a period of two years, commencing on May 27, 2008.^{4/} At all relevant times, she was a partner in the Firm and an associated person of a registered public accounting firm as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i).

3. Judith J. Clancy, 66, of Phoenix, Arizona, is a certified public accountant who is licensed under the laws of the State of Arizona (License No. 8221-R) and the Commonwealth of Kentucky (License No. 5398). At all relevant times, she was the Managing Member of the Firm and an associated person of a registered public accounting firm as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i).

B. Summary

4. This matter involves violations of PCAOB auditing standards by Respondents in the audits of the 2003, 2004, and 2005 financial statements of PacificNet, Inc. ("PNET"). Nipp and the Firm violated PCAOB auditing standards by failing to adopt appropriate measures to assure coordination with another accounting firm and using work of the other accounting firm without following up on indications that the work may have been inappropriate for use by the Firm. Nipp and the Firm also violated PCAOB auditing standards by failing to: a) perform sufficient audit procedures relating to PNET's accounting for certain business acquisitions in 2003, 2004, and 2005; b) identify and appropriately address departures from Generally Accepted Accounting Principles ("GAAP") concerning PNET's 2004 statement of cash flows; and c) perform sufficient audit procedures relating to the adequacy of PNET's disclosure concerning a related party receivable in its 2005 financial statements. Respondents violated PCAOB standards by failing to take appropriate steps in a timely manner after learning of possible errors in PNET's accounting for stock options in 2003, 2004, and 2005. Finally, Clancy failed to exercise due care in her role as concurring partner reviewer in the audits of the 2003, 2004, and 2005 PNET financial statements.

of two issuers, which, according to the Decision & Order, constitute violations of Arizona Board rules.

^{4/} See id.

C. Respondents Violated PCAOB Auditing Standards in Connection with the Audits of PNET's 2003, 2004, and 2005 Financial Statements

5. In connection with the preparation or issuance of an audit report, PCAOB rules require that a registered public accounting firm and its associated persons comply with the Board's auditing and related professional practice standards.^{5/} An auditor may express an unqualified opinion on an issuer's financial statements only when the auditor has formed such an opinion on the basis of an audit performed in accordance with PCAOB standards.^{6/} Among other things, those standards require that an auditor exercise due professional care, exercise professional skepticism, and obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements.^{7/} As detailed below, Respondents failed to meet these standards in connection with the audits of the financial statements of PNET for 2003, 2004, and 2005.

6. PNET is a Delaware corporation based in Beijing, China. Its common stock is registered with the United States Securities and Exchange Commission ("Commission") under Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and is quoted on the OTC Bulletin Board. PNET's public filings disclose that it is a holding company with primary interests in the telecommunications industry. At all relevant times, PNET was an issuer as that term is defined by Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

7. The Firm was engaged as PNET's auditor from March 2002 to January 2007. During that time, Respondents audited PNET's 2003, 2004, and 2005 financial statements. Respondents issued audit reports dated March 30, 2004 (included in PNET's Form 10-KSB filed April 2, 2004), April 15, 2005 (included in PNET's Form 10-KSB filed April 19, 2005), April 25, 2006 (included in PNET's Form 10-KSB filed April 28, 2006), and October 25, 2006 (a dual-dated reissue of the April 25, 2006 report, included in PNET's Form 10-KSB/A filed November 3, 2006^{8/}), each of which were filed with the Commission. Each report stated that the audit was conducted in accordance

^{5/} See PCAOB Rules 3100, 3200T.

^{6/} See AU § 508.07, *Reports on Audited Financial Statements*.

^{7/} See AU § 150.02, *Generally Accepted Auditing Standards*; AU § 230, *Due Professional Care in the Performance of Work*; and AU § 326, *Evidential Matter*.

^{8/} The report is dated October 25, 2006 as to the matters discussed in Note 1 of the financial statements, concerning the correction of an error in accounting for business combinations, and is otherwise dated April 25, 2006.

with PCAOB standards, except for the March 30, 2004 report, which stated that the audit was conducted in accordance with generally accepted auditing standards ("GAAS").^{9/} In each of those audit reports, the Firm expressed an unqualified audit opinion and stated that, in the Firm's opinion, PNET's financial statements presented fairly, in all material respects, PNET's financial position, results of operations, and cash flows in conformity with U.S. GAAP. For each of the audits, Nipp was the engagement partner who had final responsibility for the audit, and Clancy served as the concurring review partner.

8. In auditing PNET's 2003, 2004, and 2005 financial statements, Nipp and the Firm performed various audit procedures but also used a significant amount of audit work that was performed by a Hong Kong accounting firm that had been separately engaged by PNET. Nipp and the Firm determined that the nature and extent of their work was sufficient to enable the Firm to serve as principal auditor with respect to financial statements that PNET filed with the Commission,^{10/} and the Firm assumed responsibility for the Hong Kong firm's work that it used.^{11/}

^{9/} Respondents were required to conduct the audit of the 2003 financial statements in accordance with the PCAOB's interim auditing standards pursuant to PCAOB Rule 3200T, which took effect on April 25, 2003. However, at the time Respondents performed the audit, the PCAOB's interim auditing standards were the same as GAAS as it existed on April 16, 2003, and, until PCAOB Auditing Standard No. 1 took effect on May 24, 2004, it remained appropriate for auditors to refer to GAAS in their audit reports. Accordingly, although the reference to GAAS in the March 30, 2004 audit report was appropriate at the time, the standards pursuant to which the audit was required to be performed were PCAOB standards, and that is how they are referred to in this Order.

^{10/} AU § 543, *Part of Audit Performed by Other Independent Auditors*, describes factors relevant to an auditor's consideration of whether the nature and extent of the auditor's own participation in audit work is sufficient to enable the auditor to serve as the principal auditor and to report as such on the financial statements. See AU § 543.02.

^{11/} Under AU § 543, a principal auditor who uses another auditor's work chooses between assuming responsibility for that work (in which case the principal auditor's report makes no reference to the other auditor's work or report) and not assuming such responsibility (in which case the principal auditor's report should make reference to the other auditor and clearly indicate the division of responsibility between the two auditors). See AU § 543.03.

9. As described below, in some instances, Nipp and the Firm failed to follow up on indications that the Hong Kong firm's work used by the Firm may not have been performed in accordance with PCAOB standards and may not have provided sufficient competent evidential matter relating to whether the financial statements comported with U.S. GAAP. In other instances, Nipp and the Firm failed to perform sufficient procedures in their own audit work.

Nipp's and the Firm's Failure to Adequately Coordinate with Another Auditor Whose Work They Used

10. PCAOB standards require a principal auditor to perform certain procedures when using the work of another auditor and assuming responsibility for that work.^{12/} Those procedures include adopting appropriate measures to assure the coordination of the auditor's activities with those of the other auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements.^{13/}

11. In using the Hong Kong firm's work in the audits of PNET's 2003, 2004, and 2005 financial statements, Nipp and the Firm failed to adopt appropriate measures to assure coordination with the Hong Kong firm. Nipp and the Firm never obtained representations from the Hong Kong firm that the Hong Kong firm's work that the Firm used on the 2003, 2004 and 2005 audits had been performed in accordance with PCAOB standards or had been done with the objective of assessing whether the financial statements were presented fairly in conformity with U.S. GAAP. With respect to the 2003 audit, Nipp and the Firm actually understood that the Hong Kong firm's work that the Firm used on the audit was performed in accordance with standards other than PCAOB standards and that the purpose of the Hong Kong firm's audit work was to assess the financial statements' compliance with accounting principles other than U.S. GAAP.

^{12/} AU § 543.10 (principal auditor should "make inquiries concerning the professional reputation and independence of the other auditor" and "adopt appropriate measures to assure the coordination of his activities with those of the other auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements," including, considering procedures such as ascertaining through communication with the other auditor that the other auditor is familiar with relevant accounting principles, auditing standards, and financial reporting requirements and will conduct his or her audit and will report in accordance therewith); AU § 543.12 (describing certain information that the principal auditor must obtain, review, and retain).

^{13/} AU § 543.10.

Deficiencies in the Audit Procedures Performed by Nipp and the Firm

12. Nipp's and the Firm's PNET audits were deficient in other respects as well. In some cases, Nipp and the Firm failed to audit significant aspects of the financial statements even in cases where they understood that the Hong Kong firm had not done so. In other cases, Nipp and the Firm failed to perform procedures adequately or failed to identify and properly address GAAP departures in PNET's financial statements. In particular:

- (a) In the audits of the 2003, 2004 and 2005 financial statements, Nipp and the Firm understood that PNET had relied upon an accounting standard other than U.S. GAAP to prepare its financial statements and then converted those financial statements into U.S. GAAP financial statements. Nipp and the Firm failed to evaluate whether PNET's purported conversions were appropriate.
- (b) GAAP requires acquiring entities to "allocate the cost of an acquired entity to the assets acquired and liabilities assumed based on their estimated fair values at date of acquisition."^{14/} Nipp understood during the audits of the 2003, 2004, and 2005 financial statements that PNET was recording the assets acquired and the liabilities assumed based on the acquirees' book value, which PNET claimed reasonably approximated fair value. Nipp and the Firm, however, failed to test management's assertion that the acquirees' book value reasonably approximated the estimated fair value.^{15/}
- (c) In assessing the appropriateness of PNET's 2004 statement of cash flows, Nipp and the Firm failed to appropriately address an error concerning PNET's reported reconciliation of net earnings to net cash used in operating activities. Specifically, the minority interest amount included on the reconciliation did not agree to the minority interest amount reported on PNET's 2004 Income

^{14/} Statement of Financial Accounting Standard ("SFAS") No. 141, *Business Combinations*, ¶ 35. (This cite to SFAS No. 141 refers to the version in effect at the time of Respondents' PNET audits and not to the revised version issued in 2007.)

^{15/} During 2003, PNET wrote off \$1,186,000 of its acquired assets within weeks of their acquisition. Nipp and the Firm knew of these write-offs during the 2003 audit, but performed no audit procedures on them. In an S-1/A filed on November 13, 2006, PNET restated its 2003 Summary Consolidated Financial Data to reduce its 2003 losses before income tax, minority interest and discontinued operations by \$1,186,000. The restatement showed that PNET had overstated its 2003 selling, general and administrative expenses by 75 percent and its 2003 net loss by 46 percent.

Statement. Although Nipp and the Firm identified the inconsistency, they did not address it other than to ask management about it and accept management's explanation.^{16/}

- (d) Assets reported on PNET's 2005 financial statements included a \$1,215,000 loan receivable due from a related party. PNET's 2005 financial statements disclosed the amount of, counterparty to, purpose of, and collateral for the receivable, but did not disclose that, at December 31, 2005, approximately \$1 million of the receivable was past due. Nipp and the Firm understood that the receivable was past due but failed to assess the adequacy of the disclosure in light of the omission of that information.^{17/}

Inadequate Response to Subsequent Discovery of Possible Errors in PNET's Accounting for Stock Options

13. PNET's financial statements for 2003, 2004, and 2005, as originally reported, did not recognize certain expenses associated with the issuance of stock options to PNET executives and directors. In mid-December 2006, Respondents became aware of information suggesting that PNET's stock option expense accounting may have been inappropriate. Respondents recognized almost immediately that the information existed at the time of the Firm's audit reports and that had they been aware of it at the dates of those reports it might have affected the reports. As Respondents

^{16/} An auditor's opinion that an issuer's financial statements are presented in conformity with GAAP must be based on an audit performed in accordance with PCAOB standards. PCAOB standards require an auditor to perform audit procedures sufficient to evaluate the issuer's adherence to GAAP. This Order's description of audit failures relating to GAAP departures in an issuer's financial statements necessarily reflects the Board's judgment concerning the proper application of GAAP. Any such description of GAAP departures, however, should not be understood as an indication that the Commission has considered or made any determination concerning the issuer's compliance with GAAP. In 2006, however, PNET restated its 2004 financial statements to revise its Statement of Cash Flows. See PNET's Form 10-KSB, filed on April 28, 2006.

^{17/} AU § 431.02, *Adequacy of Disclosure in Financial Statements*, requires an auditor to consider the adequacy of an issuer's financial statement disclosures and to take certain steps if the financial statements omit information required by GAAP. In its financial statements for the year ended December 31, 2006, PNET recorded a \$993,000 provision relating to the receivable. See PNET's Form 10-K, filed on May 11, 2007, p. F-33.

realized, PCAOB standards required them to take action as soon as practicable to determine whether the information was reliable and, if so, whether steps were necessary to prevent future reliance on the Firm's audit reports.^{18/} Respondents, resigned from the engagement in mid-January 2007 without having taken any such action and then waited until February 2007 before contacting PNET to confirm the reliability of the information^{19/} and quantifying the potential error.^{20/}

Clancy's Concurring Reviews

14. An auditor who undertakes to perform a concurring review has "a duty to perform that task professionally,"^{21/} which includes a duty to perform the task with due care and professional skepticism.^{22/} In her role as the Firm's concurring partner reviewer for the audits of PNET's 2003, 2004, and 2005 financial statements, Clancy understood that PNET relied upon an accounting standard other than U.S. GAAP to prepare its financial statements. Clancy understood that PNET had converted those financial statements into U.S. GAAP financial statements and that neither the Hong Kong firm nor Nipp and the rest of the Firm's engagement team had performed audit procedures to evaluate whether PNET's purported conversion was appropriate. Clancy, understanding that no such audit procedures were performed, still concurred with the Firm's audit opinions for the 2003, 2004, and 2005 financial statements. In so doing, she failed to exercise due professional care in her concurring partner reviews.

^{18/} See AU § 561.04, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.

^{19/} AU § 561 requires the auditor to undertake to determine whether the information is reliable even when the auditor has resigned or been discharged. See AU § 9561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report: Auditing Interpretations of Section 561*.

^{20/} After Respondents notified PNET's management and audit committee of the possible errors in its accounting for stock options, PNET restated its compensation expense for 2003, 2004, and 2005. See PNET's Form 10-K, filed on May 11, 2007.

^{21/} See *Potts v. Securities and Exchange Comm'n*, 151 F.3d 810, 813 (8th Cir. 1998).

^{22/} See AU § 230.

IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondents' Offers. Accordingly, it is hereby ORDERED that:

- A. Pursuant to Section 105(c)(4)(A) of the Act and PCAOB Rule 5300(a)(1), the registration of Clancy and Co., P.L.L.C. is revoked;
- B. After one (1) year from the date of this Order, Clancy and Co., P.L.L.C. may reapply for registration by filing an application pursuant to PCAOB Rule 2101;
- C. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Jennifer C. Nipp is barred from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i);
- D. After two (2) years from the date of this Order, Nipp may file a petition, pursuant to PCAOB Rule 5302(b), for Board consent to associate with a registered public accounting firm, and any such petition shall be filed by submitting it to Office of the Secretary of the PCAOB; and
- E. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Judith J. Clancy is suspended for one (1) year from the date of this Order from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i).

ISSUED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Secretary

March 31, 2009