

**Inspection of
Michael T. Studer, C.P.A., P.C.
(Headquartered in Freeport, New York)**

**Issued by the
Public Company Accounting Oversight Board
May 21, 2009**

**THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT
PORTIONS OF THE COMPLETE REPORT ARE OMITTED
FROM THIS DOCUMENT IN ORDER TO COMPLY WITH
SECTIONS 104(g)(2) AND 105(b)(5)(A)
OF THE SARBANES-OXLEY ACT OF 2002**



Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.
2. Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.
3. Board inspections encompass, among other things, whether the firm has failed to identify departures from U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.



INSPECTION OF MICHAEL T. STUDER, C.P.A., P.C.

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") has conducted an inspection of the registered public accounting firm Michael T. Studer, C.P.A., P.C. ("the Firm"). The Board is issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report and portions of Part IV of the report. Part IV of the report consists of the Firm's comments, if any, on a draft of the report.^{1/}

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.^{2/} A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

^{1/} The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

^{2/} See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from July 9, 2007 to July 13, 2007. These procedures were tailored to the nature of the Firm, certain aspects of which the inspection team understood at the outset of the inspection to be as follows:

Number of offices	1 (Freeport, New York)
Ownership structure	Professional corporation
Number of partners	1
Number of professional staff ^{3/}	2
Number of issuer audit clients ^{4/}	30

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.^{5/} To achieve that goal, Board

^{3/} "Professional staff" includes all personnel of the Firm, except partners or shareholders and administrative support personnel. The number of partners and professional staff is provided here as an indication of the size of the Firm, and does not necessarily represent the number of the Firm's professionals who participate in audits of issuers or are "associated persons" (as defined in the Act) of the Firm.

^{4/} The number of issuer audit clients shown here is based on the Firm's self-reporting and the inspection team's review of certain information for inspection planning purposes. It does not reflect any Board determination concerning which, or how many, of the Firm's audit clients are "issuers" as defined in the Act. In some circumstances, a Board inspection may include a review of a firm's audit of financial statements of an issuer that ceased to be an audit client before the inspection, and any such former clients are not included in the number shown here.

^{5/} This focus necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools.

inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.^{6/} It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements, are free of any deficiencies not specifically described in an inspection report.

A. Review of Audit Engagements

The inspection procedures included a review of aspects of the Firm's auditing of financial statements of four issuers. The scope of this review was determined according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the scope.

The inspection team identified what it considered to be audit deficiencies.^{7/} The deficiencies identified in two of the audits reviewed included deficiencies of such significance that it appeared to the inspection team that the Firm did not obtain sufficient

^{6/} When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with GAAP, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

^{7/} PCAOB standards require a firm to take appropriate actions to assess the importance of audit deficiencies identified after the date of the audit report to the firm's present ability to support its previously expressed opinions. See AU 390, *Consideration of Omitted Procedures After the Report Date*, and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T). Failure to comply with these PCAOB standards could be a basis for Board disciplinary sanctions.

competent evidential matter to support its opinion on the issuer's financial statements.^{8/} Those deficiencies were the failure, in two cases, to perform audits, instead issuing audit reports on the basis of procedures performed by a separate consulting firm pursuant to a contractual arrangement, without the Firm having planned, performed, supervised, or meaningfully reviewed the work.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance, training, compliance with independence standards, client acceptance and retention, and the establishment of policies and procedures. As described above, any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

^{8/} In some cases, an inspection team's observation that a firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if a firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3"), provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28. For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.



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PORTIONS OF THE REST OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED
FROM THIS PUBLIC DOCUMENT

PART II

* * * *

B. Issues Related to Quality Controls

The inspection of the Firm included consideration of aspects of the Firm's system of quality control. Assessment of a firm's quality control system rests both on review of a firm's stated quality control policies and procedures and on inferences that can be drawn from respects in which a firm's system has failed to assure quality in the actual performance of engagements.^{9/} On the basis of the information reported by the inspection team, the Board has the following concerns about aspects of the Firm's system of quality control.

* * * *

2. Audit Performance

A firm's system of quality control should provide sufficient assurance that the work performed on an audit engagement will meet applicable professional standards and regulatory requirements. On the basis of the information reported by the inspection team, including the audit performance deficiencies described in Part II.A and any other deficiencies identified below, the Board has concerns that the Firm's system of quality control fails to provide such reasonable assurance in at least the following respects.

a. Planning, performance, supervision, and review

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will refrain from issuing audit reports in circumstances in which doing so is inappropriate because the Firm has not planned, performed, supervised, or meaningfully reviewed the audit work. As discussed above, the inspection team identified two cases in which the Firm inappropriately issued reports stating that the

^{9/} A firm's failure to comply with the requirements of PCAOB standards when performing an audit may be an indication of a potentially significant defect in a firm's quality control system even if that failure did not result in an insufficiently supported audit opinion.

Firm had performed an audit and that the Firm's audit provided it with a reasonable basis for an opinion even though the Firm and its personnel did not plan, did not perform, did not supervise, and did not meaningfully review the audit work performed in those engagements. This information provides cause for concern regarding the Firm's quality control policies and procedures related to the Firm's planning, supervision and review of issuer audit engagements. [Issuers A and B]

In addition, the Firm's system of quality control appears not to provide sufficient assurance that the Firm will properly execute an audit in accordance with the Firm's audit methodology. The Firm's audit methodology requires use of audit programs, forms, and checklists to document procedures performed that, if completed and reviewed, would have provided the engagement team specific steps to address the deficiencies noted above; however, the audit programs provided to individuals at the consulting firm were not completed or partially completed, even though the Firm's audit methodology requires their use. [Issuers A and B]

b. Fraud Procedures

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will perform all required procedures in accordance with the provisions of AU 316, *Consideration of Fraud in a Financial Statement Audit*. Specifically, the Firm did not perform any of the procedures required by AU 316. [Issuers C and D]

* * * *

d. Auditor Communications

The Firm's system of quality control appears not to provide sufficient assurance that the required auditor communications to the audit committee, or equivalent, occur and are appropriately documented, including required independence confirmations. [Issuers C and D]

e. Partner workload

The Firm's system of quality control appears not to provide sufficient assurance that the audit partner's workload realistically allows for sufficient time to supervise staff and review work papers with due care. The Firm's only audit engagement partner is responsible for servicing all of the Firm's issuer audit clients.

3. Monitoring and Addressing Identified Weaknesses

The Firm's system of quality control appears to lack a monitoring element sufficient to provide the firm with reasonable assurance that the Firm's policies and procedures for engagement performance are suitably designed and effectively applied. Appropriate monitoring includes meaningfully addressing identified weaknesses in the Firm's audit practice, which the Firm has failed to do in at least two respects. In a report dated March 9, 2006, which related to an inspection of the Firm conducted in 2005, the Board noted that the Firm's procedures appeared not to provide sufficient assurance that all required auditor communications to the audit committee occur and are appropriately documented or that appropriate procedures related to the identification of fraud risks were performed and appropriately documented. An appropriate approach to monitoring would have resulted in the Firm avoiding these deficiencies in audits performed after it was brought to the Firm's attention, yet the same deficiencies were noted in this inspection. This indicates that the Firm had not responded meaningfully to these deficiencies identified in its previous PCAOB inspection.

* * * *

PART IV

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.^{10/}

^{10/} In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.



MICHAEL T. STUDER CPA P.C. | Certified Public Accountant

18 East Sunrise Highway, Suite 311
Freeport, NY 11520
Tel 516.378.1000
Fax 516.546.6220

April 1, 2009

VIA TELECOPIER AND E-MAIL

Mr. George H. Diacont
Director
Public Company Accounting Oversight Board
Division of Registration and Inspections
1666 K Street, N.W.
Washington, D.C. 20006

Re: Public Response to Part I of Draft Report of Inspection

Dcar Mr. Diacont:

Introduction

Michael T. Studer, CPA, P.C. ("Firm") welcomes the opportunity to provide this public response to Part I of the PCAOB's ("Board's") Draft Report of Inspection ("Draft Report"), entitled "Inspection Procedures and Certain Observations." The Board's Draft Report was sent to the Firm under the February 27, 2009, covering letter of Mr. George H. Diacont, Director, Division of Registration and Inspection.

In this response, *inter alia*, the Firm indicates where it respectfully disagrees with portions of Part I of the Draft Report. By this response, as well as through separate inquiry of the Board, the Firm also asks for further guidance from the Board on certain matters.

Nature of the Firm

As to the Draft Report's description of the "nature of the firm," in the twenty-month period since the Board's routine on-site inspection of the Firm, a number of changes have occurred at the Firm that impact, both directly and indirectly, on the Board's observations and other aspects of its Draft Report. The number of professional staff of the Firm has increased, from three to five. These two additional staff members are accountants, under the Board's definition, and also read, write and speak Mandarin Chinese with native fluency. These professionals of the Firm have assisted -- and will continue to assist -- in conducting the audits of certain audit clients whose principal offices are in China ("Chinese Issuers"). Regrettably,

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another Chinese-fluent accountant, hired in January 2008, has not been successful in obtaining a United States visa renewal so as to be able to continue in the Firm's employ.

Review of Audit Engagements

As to the summary of the Board's "Review of Audit Engagements," the Firm respectfully, but strongly, disagrees with the assertion that in two instances (the audits of Issuers A and B), the Firm "did not obtain sufficient competent evidential matter to support its opinion." This statement is premised on the further assertion that the Firm failed to perform audits, merely issuing audit reports based upon the work of "a separate consulting firm," without the Firm having "planned, performed, supervised or meaningfully reviewed the work." The Firm also strongly disagrees with the latter assertion.

The Firm believes that the Board Rules very clearly permit the use by the Firm of independent contractors and agents to assist it in its audit work. Indeed, given the specific facts relating to certain of the Firm's audit clients, such a use seems eminently appropriate given the Chinese language barrier that would otherwise impede the Firm in providing audit services to its several audit clients based entirely in China. The Firm's use of an independent contractor (called a "consultant" in the Board's Draft Report) has provided it with the assistance of a number of Chinese-language accountants. In brief, by the Firm's use of such personnel through the independent contractor, or agent, of the Firm, these accountants are thus part of the Firm for purposes of the audit work. Accordingly, the Firm in fact complied with the requirement that an audit firm plan, perform, supervise and review the audit work. See generally AU 311. Moreover, even if such personnel were somehow not considered part of the Firm by the Board, it is the Firm's belief that they were supervised in all requisite respects for purposes of compliance with GAAS.¹

To the extent the Board is concerned that the Firm's employment of this independent contractor raises questions about the Firm's compliance with the Board's Standards, the Firm is currently endeavoring to obtain guidance and advice from the Board on this subject. To that end, the Firm has engaged counsel to research this issue -- viz. the use of an independent contractor to assist in the Firm's audit work for its Chinese Issuer audit clients -- and to request guidance from the Board on this subject.²

¹ In two instances, on March 23 and March 27, 2009, the Firm's counsel was advised by Board staff that there was no authoritative literature regarding the use of consultants in performing audit work, and referred counsel to the general guidance provided by AU 543 and AU 311.

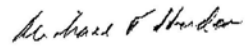
² The Firm's counsel, in discussions with Board staff, has recently been informed that there is no formal procedure by which a registrant may obtain an opinion on a technical area such as this.

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This concludes the Firm's public response to Part I of the Board's Draft Report of Inspection, entitled "Inspection Procedures and Certain Observations."

Very truly yours,



Michael T. Studer
President



MICHAEL T. STUDER CPA P.C. | Certified Public Accountant

18 East Sunrise Highway, Suite 311
Freeport, NY 11520
Tel 516.378.1000
Fax 516.546.6220

April 1, 2009

**CONFIDENTIAL AND PRIVILEGED
VIA TELECOPIER AND EMAIL**

Mr. George H. Diacont
Director
Public Company Accounting Oversight Board
Division of Registration and Inspections
1666 K Street, N.W.
Washington, D.C. 20006

Re: Non-public Response to Part II of Draft Report of Inspection

Dear Mr. Diacont:

Introduction

Michael T. Studer, CPA, P.C. ("Firm") welcomes the opportunity to provide this non-public response to Part II of the PCAOB's ("Board's") Draft Report of Inspection ("Draft Report"), entitled "Detailed Discussion of Inspection Reports." The Board's Draft Report was sent to the Firm under the February 27, 2009, covering letter of Mr. George H. Diacont, Director, Division of Registration and Inspection. The Firm is also providing a public response to Part I of the Draft Report by a separate letter of this date.

In this response, *inter alia*, the Firm indicates where it respectfully disagrees with portions of the Draft Report. Also by this response, as well as by a forthcoming separate inquiry of the Board, the Firm asks for further guidance from the Board on certain matters. The Firm also acknowledges its obligation to meet the challenge of remedying any quality control issues raised by the Board's Draft Report, as well as those that were the subject of the Board's "Determination" dated September 29, 2008.

For the sake of clarity, some of the text in the Firm's public response is repeated herein, to avoid the need for Board staff members to refer to both documents at the same time.

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Nature of the Firm

As to the Draft Report's description of the "nature of the firm," in the twenty-month period since the Board's routine on-site inspection of the Firm, a number of changes have occurred at the Firm that impact, both directly and indirectly, on the Board's observations and other aspects of its Draft Report. The number of professional staff of the Firm has increased, from three to five. These two additional staff members are accountants, under the Board's definition, and also read, write and speak Mandarin Chinese with native fluency.¹ These professionals of the Firm have assisted -- and will continue to assist -- in conducting the audits of certain audit clients whose principal offices are in China ("Chinese Issuers"). Regrettably, [REDACTED], another Chinese-fluent accountant, hired in January 2008, has not been successful in obtaining a United States visa renewal so as to be able to continue in the Firm's employ.

Review of Audit Engagements

As to the summary of the Board's "Review of Audit Engagements," the Firm respectfully, but strongly, disagrees with the assertion that in two instances (the audits of Issuers A and B), the Firm "did not obtain sufficient competent evidential matter to support its opinion." This statement is premised on the further assertion that the Firm failed to perform audits, merely issuing audit reports based upon the work of "a separate consulting firm," without the Firm having "planned, performed, supervised or meaningfully reviewed the work." The Firm also strongly disagrees with the latter assertion.

The Firm believes that the Board Rules very clearly permit the use by the Firm of independent contractors and agents to assist it in its audit work. Indeed, given the specific facts relating to certain of the Firm's audit clients, such a use seems eminently appropriate given the Chinese language barrier that would otherwise impede the Firm in providing audit services to its several audit clients based entirely in China. The Firm's use of an independent contractor (called a "consultant" in the Board's Draft Report) has provided it with the assistance of a number of Chinese-language accountants. In brief, by the Firm's use of such personnel through the independent contractor, or agent, of the Firm, these accountants are thus part of the Firm for purposes of the audit work. Accordingly, the Firm in fact complied with the requirement that an audit firm plan, perform, supervise and review the audit work. *See generally* AU 311. Moreover, even if such personnel were somehow not considered part of the Firm by the Board, it is the Firm's belief that they were supervised in all requisite respects for purposes of compliance

¹ Chun-Hao (Oliver) Wang (MBA in accounting from Hofstra University) and Jiaqi Wang (MS in financial mathematics from University of Chicago).

* As a matter of policy, the PCAOB makes reasonable efforts to redact from firms' responses to draft inspection reports personal identifying information about individuals not associated with the firm.

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with GAAS.²

To the extent the Board is concerned that the Firm's employment of this independent contractor raises questions about the Firm's compliance with the Board's Standards, the Firm will shortly endeavor to obtain guidance and advice from the Board on this subject. To that end, the Firm has engaged counsel to research this issue -- viz. the use of an independent contractor to assist in the Firm's audit work for its Chinese Issuer audit clients -- and to request guidance from the Board on this subject.³

I. Detailed Discussion of the Firm's Use of Yongfu as an Independent Contractor

A. Introduction

The Firm well appreciates the Board's concern about its use of the services of individual accountants provided through an independent contractor, Yongfu International Consultants, Ltd. ("Yongfu"), of Vancouver, Canada. Accordingly, the Firm has engaged counsel to assist it in reviewing, as much as reasonably possible, the literature, both authoritative and professional, on the issue of the use by an audit firm of independent contractors. Counsel focused particularly on the situation the Firm faces when it does audit work for the Chinese Issuers, with few or no officers or employees fluent in English.⁴ As a result of counsel's review, the Firm believes not only that the AICPA, S-X, GAAS and Board Rules and other guides, taken together or separately, do not prohibit such use of independent contractors, but also that, in fact, they actually *contemplate* such use, including the use of independent contractors in foreign countries.

This section reviews the Firm's basis for this position in some detail. We hope that this review may be as informative for the Board as it was for the Firm. Additionally, as mentioned above, given the somewhat "gray" area involved, the Firm is directing counsel to approach the Board for further guidance, advice and opinion on this subject.

At the outset, we ask the Board to appreciate the factual circumstances presented by the

² In two instances, on March 23 and March 27, 2009, the Firm's counsel was advised by Board staff that there was no authoritative literature regarding the use of consultants in performing audit work, and referred counsel to the general guidance provided by AU 543 and AU 311.

³ The Firm's counsel, in recent discussions with Board staff, has been informed that there is no formal procedure by which a registrant may obtain an opinion on a technical area such as this.

⁴ To avoid repetition, the Firm will use the word "fluent" to refer to the ability to speak, read and write the language in question.

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fact that a number of Chinese-headquartered companies have merged with public companies in the United States. Through these mergers, Chinese companies are able to access United States capital markets, which is generally thought to be advantageous to our country's overall standing in the financial world. However, despite the increasing use of English as the *lingua franca* of globalized businesses, many Chinese companies -- especially small ones -- do not have officers or employees who are fluent in English. Because United States auditors must interact with these issuers' officers and employees and review Chinese documents in order to provide audit services, the auditors' ability to contract with Chinese-fluent accountants for this purpose is imperative.

With that background, the Firm now turns to the literature which, though not extensive,⁵ clearly contemplates the use of independent contractors -- even in foreign countries -- to assist Board registrants with their audit work.

B. Board Rules

Yongfu has provided the Firm with assistance in conducting the audits of its Chinese Issuer clients located exclusively in China, with few or no officers or employees fluent in English.⁶ Yongfu, engaged by the Firm as an independent contractor, is plainly permitted by Board Rules to assist the Firm in the preparation and issuance of any audit report. Rule 1001(p)(i) states:

Person Associated With a Public Accounting Firm (and Related Terms)

The terms "person associated with a public accounting firm" (or with a "registered public accounting firm" or "applicant") and "associated person of a public accounting firm" (or of a "registered public accounting firm" or "applicant") mean any individual proprietor, partner, shareholder, principal, accountant, or professional employee of a public accounting firm, or any independent contractor that, in connection with the preparation or issuance of any audit report --

⁵ In a recent conversation with Board staff, the Firm's counsel asked what rules govern an auditor's use of "consultants" (the term used in the Draft Report). He was told that there were no rules specifically governing the use of such outsiders to help with audits. The staff members referred the Firm's counsel only to AU 543 and AU 311 for general guidance. AU 543, however, is clearly inapposite, as it deals with audit firms who engage *other audit firms* to provide opinions on a portion (*e.g.*, subsidiary or division) of an issuer. That is not the case presented in the Firm's current situation.

⁶ In most instances, the Issuers have engaged bilingual outside accountants to prepare the U.S. GAAP financial statements. The Firm, through its owner and President and other personnel, speaks and corresponds with these individuals regularly.

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- (1) shares in the profits of, or receives compensation in any other form from, that firm; or
(2) participates as agent on behalf of such accounting firm in any activity of that firm;

provided, however, that these terms do not include a person engaged only in clerical or ministerial tasks or a person whom the public accounting firm reasonably believes is a person primarily associated with another registered public accounting firm.

Board Rule 1001(p)(i), effective pursuant to SEC Release No. 34-48180, File No. PCAOB-2003-03 (July 16, 2003) (emphases added).

In the course of the comment period for this proposed rule, much was written about the burden of the requisite disclosures proposed by the Board for registrants to make about any such independent contractors. *Never*, however, was a question raised that the use of staff provided by independent contractors was in any way improper or other than normal.⁷ Ultimately, the Board did not require registrants to list non-accountant associated persons, including independent contractors, on their registration forms (Form 1).⁸

Notably, a “public accounting firm,” defined as engaging “in the practice of public accounting or preparing or issuing audit reports,” includes a “proprietorship.” Board Rule 1001(p)(iii). Hence, a small public accounting firm (even one with several accounting employees, as the Firm now has) would be expected to use an “independent contractor” to assist it, especially given the language barrier issue at hand.

⁷ See, e.g., Comments of Grant Thornton International LLP on PCAOB-2003-03, submitted to the U.S. Securities and Exchange Commission (“SEC”), available at <http://sec.gov/rules/pcaob/pcaob200303/grantthorn070203.htm>, at 3 (stating that “the staff of the [Board] staff has indicated informally that the ‘person associated’ . . . would not include individuals or staff of independent contractors” and that “where a U.S. firm requests an associated non-U.S. firm to perform audit services . . . , the individual staff . . . would not be considered to be an ‘associated person’”); Comments of Deloitte & Touche LLP on PCAOB-2003-03, available at <http://sec.gov/rules/pcaob/pcaob200303/deloitte070103.htm>, at 5 (requesting the SEC to “clarify that individuals at non-U.S. associated accounting firms will not be deemed “independent contractors” and therefore not “associate persons”). Further examples of the discussion of independent contractors include the comments to the SEC on PCAOB-2003-03 made by KPMG (available at <http://sec.gov/rules/pcaob/pcaob200303/kpmg070103.htm>) and BDO Seidman, LLP (available at <http://sec.gov/rules/pcaob/pcaob200303/bdos070203.htm>).

⁸ The Firm, at the time of its 2003 registration with the Board, was not conducting any audits. Moreover, the Chinese Issuers did not engage the Firm until approximately August 2006.

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Indeed, the Board, in its "Frequently Asked Questions" regarding registration (available at http://www.pcaobus.org/Registration/Registration_FAQ.pdf), unequivocally confirms that the use of independent contractors by a registrant on audit work is proper.

23. My firm uses an outside accounting firm as an independent contractor on certain audit engagements. Is the outside firm considered an associated person of my firm? What about the outside firm's employees?

Board rules define "person associated with a public accounting firm" to include independent contractors, so the outside firm you use on audits will be considered an associated person if it otherwise meets the definition in the rule.

PCAOB Release 2003-011C, *Frequently Asked Questions Regarding Registration with the Board* ("Registration FAQs"), at 8.⁹ And the Board Rules also clearly contemplate registrants using independent contractors in foreign countries. See Board Rule 5103, entitled "Demands for Production of Audit Workpapers and Other Documents from Registered Public Accounting Firms and Associated Persons":

(a) General

The Board, and the staff of the Board designated in an order of formal investigation, may issue an accounting board demand for the production of audit work papers or any other document or information in the possession of a registered public accounting firm or any associated person thereof, *wherever domiciled*, that the Board or its staff considers relevant or material to the investigation.

Board Rule 5103 (emphasis added).¹⁰

Likewise, the Board Rules also contemplate registrants using foreign accountants to help perform audit services:

25. If my firm employs an accountant *from another country* on a temporary basis, does it have to list that accountant as an associated person in Part VII of Form 1?

⁹ The Board also notes that the *personnel* of an independent contractor that is an associated person of the registrant would *not themselves* individually be considered associated persons of the registrant. *Id.*

¹⁰ To this end, as Yongfu is an "associated person" of the Firm, it has consented to comply with Board requests for such information, pursuant to Rule 2104.

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Yes, if the accountant meets the definition of a person associated with the firm and provided at least 10 hours of audit services for any issuer during the last calendar year. The fact that an accountant is from another country is irrelevant.

Registration FAQs at 9 (emphasis added).¹¹

Finally, so frequent is the use by an audit firm of independent contractors, that a model independent contractor engagement letter is even published in the CCH publication *CPA's Guide to Effective Engagement Letters*.

C. Quality of Personnel Provided by Yongfu

The Firm has previously provided information to the Board concerning Yongfu. When it first contracted with Yongfu, the Firm procured resumes and independence representations. Yongfu's employees are mostly Certified General Accountants with heavy SEC audit experience. While not necessarily the equivalent of "CPAs" in American practice, the Firm believes Yongfu's employees are as capable of assisting the Firm in performing audit work as if they were the direct employees of the Firm.

Conclusion

Had the Firm's own personnel, including Mr. Studer, gone to China with simultaneous interpreters and document translators, this would have been essentially the same as the way the Firm utilized Yongfu. That is, at all times, the Firm would have been dependent on the skills of such interpreters and translators. Instead, there was a higher quality of assistance here, in that experienced *accounting personnel* of Yongfu did what a direct employee of the Firm (with an interpreter or translator) would have done – but to better effect, given their experience in the accounting field *combined* with their fluency in Chinese.¹²

¹¹ Board staff members have informed counsel for the Firm that there is no provision in the Board Rules for amending a registrant's registration form. The Firm will nevertheless prepare and send an informal amended form shortly with an updated list of associated persons, including all its current employees and Yongfu. As noted above, foreign accountants who themselves are employees of an independent contractor, such as Yongfu, that is an associated person of a registrant, need not be separately disclosed in Form 1. See FAQ 23, discussed *supra*.

¹² Taken to an extreme, the Board's position could be interpreted to mean that for any issuer whose internal business records are in a foreign language in which an audit firm's employees are not fluent, the audit firm, in order to comply with Board Rules and Standards, would need to add to *its own professional staff*, accountants who were fluent in that language, as well as able to travel to the headquarters of the issuer. We do not believe that the Board would intend such a result, nor that it is required. Again, the Firm, through counsel, will seek guidance

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The Firm, as part of the corrections to its quality control system it has made and which will be included in its forthcoming Rule 4009 submissions to the Board, will address not only the various comments of the Board in its current Draft Report, but will *also* address the quality control concerns and determinations recited by the Board in its correspondence with the firm dated September 16 and September 29, 2008.

This concludes the Firm's non-public response to Part II of the Board's Draft Report of Inspection, entitled "Detailed Discussion of Inspection Reports."

Very truly yours,



Michael T. Studer
President

on this subject.