

ORDER

and without admitting or denying the findings herein, except as to the Board's jurisdiction over them and the subject matter of these proceedings, which is admitted, Respondents consent to the entry of this Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions (the "Order") as set forth below.³

III.

On the basis of Respondents' Offers, the Board finds⁴ that:

A. Respondents

1. **Arshak Davtyan Inc.** is a professional corporation organized under the laws of the state of Utah and located in Salt Lake City, Utah. The Firm is registered with the Board pursuant to Section 102 of the Act and PCAOB Rules.⁵ The Firm is licensed to practice public accountancy by the Utah Division of Occupational and Professional Licensing (License No. 9173806-2603). At all relevant times, ADI was the external auditor of the issuer identified below.

2. **Arshak Davtyan**, 38, is a certified public accountant licensed by the state of Utah (License No. 5666700-2601). At all relevant times, Davtyan was the managing director and sole employee of the Firm, and served as the engagement partner on the audits discussed below. Davtyan is 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 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.

⁴ The Board finds that Respondents' conduct described in this Order meets the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5), which provides that certain sanctions may be imposed in the event of (1) intentional or knowing conduct, including reckless conduct, that results in a violation of the applicable statutory, regulatory, or professional standard; or (2) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

⁵ Initially, the Firm registered with the Board as Arshak Davtyan, a sole proprietorship. On October 14, 2014, the Firm filed a Form 4 indicating a change in its organization to a corporation under the laws of the state of Utah.



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B. Summary

3. This matter concerns Respondents' violations of PCAOB rules and standards in connection with the issuance of audit reports on the consolidated financial statements of China Pharma Holdings, Inc. ("CPHI" or the "Company") for the years ended December 31, 2013 and 2014. As detailed below, Respondents failed to exercise due professional care, including professional skepticism, and failed to obtain sufficient appropriate audit evidence in connection with the audits of CPHI's financial statements for the years ended December 31, 2013 and the December 31, 2014.

C. Respondents Violated PCAOB Rules and Standards

4. 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 all applicable Board auditing and related professional practice standards.⁶ 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.⁷ Those standards require, among other things, that an auditor plan and perform the audit to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's opinion.⁸ PCAOB standards further require that an auditor exercise due professional care and professional skepticism in performing the audit.⁹

5. In addition, PCAOB standards require the auditor to design and implement audit responses that address the risks of material misstatement¹⁰ and to evaluate whether the financial statements are presented fairly, in all material respects, in

⁶ See PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*. All references to PCAOB standards are to the versions of those standards in effect at the time of the audits.

⁷ See AU § 508.07, *Reports on Audited Financial Statements*.

⁸ See Auditing Standard No. 15, *Audit Evidence* ("AS 15") at ¶ 4.

⁹ See AU § 150.02, *Generally Accepted Auditing Standards*; AU § 230, *Due Professional Care in the Performance of Work*; Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS 13"), ¶ 7.

¹⁰ See AS 13 ¶¶ 3, 5 and 8.



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conformity with U.S. Generally Accepted Accounting Principles ("US GAAP") when evaluating audit results.¹¹

6. The auditor is also responsible for evaluating the reasonableness of management's accounting estimates.¹² In evaluating reasonableness, the auditor should obtain an understanding of how management developed the estimate.¹³ Based on that understanding the auditor should use one or a combination of the following approaches: (a) review and test the process used by management to develop the estimate; (b) develop an independent expectation of the estimate to corroborate the reasonableness of management's estimate and (c) review subsequent events or transactions occurring prior to the date of the auditor's report.¹⁴

7. As described below, Respondents failed to comply with PCAOB rules and standards in connection with the audits of CPHI's 2013 and 2014 financial statements (collectively the "Audits").

Audits of CPHI's 2013 and 2014 Financial Statements

8. CPHI is a Nevada corporation with its headquarters and primary operations in Haikou, Hainan Province, People's Republic of China. CPHI's public filings disclose that it is engaged in the development, manufacture and marketing of pharmaceutical products for a variety of high-incidence and high-mortality diseases and medical conditions in China. Its common stock is registered under Section 12(b) of the Exchange Act, and is listed on the NYSE Market. At all relevant times, CPHI was an "issuer" as that term is defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

9. Davtyan, as the engagement partner, authorized the Firm's issuance of audit reports, dated March 20, 2014 and March 30, 2015, respectively, each expressing an unqualified opinion on CPHI's financial statements for the years ended December 31, 2013 and December 31, 2014. The audit reports were included in CPHI's Forms 10-

¹¹ See Auditing Standard No. 14, *Evaluating Audit Results* ("AS 14"), ¶ 30; AU §§ 411.04, .06, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*.

¹² See AU § 342.04, *Auditing Accounting Estimates*.

¹³ See AU § 342.10.

¹⁴ See AU § 342.10 a. – c.



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K, filed with the U.S. Securities and Exchange Commission on March 20, 2014 and March 30, 2015, respectively.

10. In its 2013 and 2014 Forms 10-K, CPHI disclosed that it earned revenue from the sale of pharmaceutical and biochemical products it manufactured to hospitals, distributors and private retailers in China. CPHI reported revenue of \$32.8 million and \$24.9 million in its 2013 and 2014 financial statements, respectively.

11. Respondents knew that CPHI's accounts receivable aged over a year had increased rapidly in 2013 and 2014. As of December 31, 2012, CPHI had \$30.1 million of aged receivables or 43% of the total (gross) accounts receivable balance. By year-end 2013, aged receivables increased to \$35.8 million or 61% of the total (gross) receivable balance. By year-end 2014, CPHI had \$48.6 million of aged receivables representing 83% of its total (gross) accounts receivable, with \$17.3 million aged one-to-two years and \$31.3 million aged over two years.

12. As disclosed in its 2013 Form 10-K, in the fourth quarter of 2013, CPHI initiated a collection discount program to encourage its customers to pay long overdue balances by offering 15% to 37% discounts to those with receivables aged over one year. CPHI collected \$5.85 million under this program after giving \$2.1 million in discounts which was recorded as a bad debt expense. In addition, CPHI disclosed in its 2013 financial statements that its accounts receivable included \$23 million of sales that occurred more than a year ago which management believed were still collectible.

13. CPHI also disclosed in its 2014 Form 10-K that, in the third quarter of 2014, the Company offered customers a 30% discount on payments for aged accounts receivable even though the Company initially created the collection discount program as a unique event.

14. In its 2013 and 2014 Forms 10-K, CPHI disclosed that the company recognized revenue when it has persuasive evidence of an arrangement with the customer, delivery of the product has occurred, the sales price is fixed or determinable, and collectability is reasonably assured.¹⁵

15. During the Audits, Respondents identified significant risks related to revenue and accounts receivable, including a fraud risk related to revenue recognition. Nevertheless, other than obtaining management's representations regarding the Company's recognition of revenue, Respondents failed to perform procedures that were

¹⁵ See Financial Accounting Standards Board Accounting Standards Codification Topic 605-10-S99, *Revenue Recognition*.



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specifically responsive to the assessed fraud risk,¹⁶ and failed to evaluate whether the Company's revenue recognition was in conformity with US GAAP.¹⁷ Specifically, Respondents failed to evaluate whether collectability was reasonably assured in light of the customers with significantly past due receivables and CPHI's repeated use of the collection discount program.

16. CPHI's allowance for doubtful accounts also increased markedly from 2012 through 2014. As of December 31, 2012, the Company reported \$4.4 million in allowance for doubtful accounts or 6% of gross accounts receivable. By the end of the years 2013 and 2014, the allowance for doubtful accounts had grown to \$13.3 million, and \$33.3 million, representing 23% and 57% of gross accounts receivable, respectively.

17. CPHI disclosed in its 2013 and 2014 financial statements that its accounts receivable net of the allowance for doubtful accounts represented approximately 16% and 19% of total assets, respectively, at the end of each of those two years. In both 2013 and 2014, CPHI further disclosed that it reserved 3.5% of accounts receivable less than one year old, 10% for amounts past due between one and two years, and fully reserved for amounts past due over two years.

18. In both Audits, Respondents assessed the risk of material misstatement as high for the valuation assertion related to accounts receivable, net of allowance for doubtful accounts. During the 2013 Audit, to test the allowance for doubtful accounts, the Firm: (1) made inquiries of management about the Company's accounting policy regarding allowance for doubtful accounts; (2) for the accounts receivable aging balance, compared data used in the Company's allowance calculation to the Company's accounts receivable aging report and compared percentages for each aging category to prior year's amounts; (3) tested the mathematical accuracy of the Company's allowance calculation; and (4) tested amounts collected after year end which represented approximately 1% of accounts receivable. During the 2014 Audit, Respondents performed the same procedures as the previous year and inquired of management regarding the collectability of certain accounts aged over one year with no sales reported during the year under audit.

19. During the Audits, Respondents were also aware of the large increase in aged receivables, the Company's use of the collection discount program, and the significant increase in the Company's bad debt expense from \$10.8 million in 2013 to

¹⁶ See AS 13 ¶¶ 12-15.

¹⁷ See AS 14 ¶ 30; AU §§ 411.04, .06.



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\$20.6 million in 2014. However, Respondents failed to perform any procedures to evaluate the reasonableness of the allowance for doubtful accounts estimate and whether the allowance for doubtful accounts was properly valued. Specifically, Respondents, in testing the Company's allowance for doubtful accounts calculation, failed to perform any procedures to evaluate the reasonableness of reserve percentages used in the allowance calculation.¹⁸ Respondents also failed to test the accuracy and completeness of the accounts receivable aging categories in the accounts receivable aging schedule provided by management.¹⁹

20. In addition, during the Audits, Respondents failed to perform a retrospective review of management's allowance for doubtful accounts estimate reflected in the financial statements of the prior years to determine whether management's judgments and assumptions relating to the allowance for doubtful accounts estimate indicated a possible bias on the part of management.²⁰

CPHI Restated its 2014 Financial Statements

21. On December 11, 2015, CPHI disclosed in a Form 8-K that it was advised by the Respondents that during a PCAOB inspection of the Firm, the PCAOB issued comments that identified certain deficiencies in the audit of the financial statements filed in Form 10-K for the year ended December 31, 2014, and for the quarterly reports filed for the first three quarters of 2015. As a result of those comments, the Company concluded that its previously filed 2014 financial statements and 2015 quarterly filings should no longer be relied upon because the Company "had not properly evaluated whether collectability of revenue was reasonably assured for sales to customers with significantly aged receivable balances and, therefore, whether the revenue had been appropriately recognized; and the Company had not properly evaluated the reasonableness of the allowance for doubtful accounts."

22. On December 28, 2015, CPHI filed an amendment to its 2014 financial statements, restating its revenue, accounts receivable and bad debt expense. As restated, accounts receivable (net) decreased by 44%, revenue decreased by 11% and bad debt expenses increased by 52%, resulting in an increase in net loss of 52% or \$13.5 million.

¹⁸ See AU §§ 342.04, .09 - .14

¹⁹ See AS No. 15 ¶ 10.

²⁰ See AU § 316.64.

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IV.

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

- A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), Arshak Davtyan Inc. and Arshak Davtyan, CPA are hereby censured;
- B. Pursuant to Section 105(c)(4)(A) of the Act and PCAOB Rule 5300(a)(1), the registration of Arshak Davtyan Inc. is revoked;
- C. After two (2) years from the date of the Order, Arshak Davtyan Inc. may reapply for registration by filing an application pursuant to PCAOB Rule 2101;
- D. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Arshak Davtyan, CPA 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),²¹ and

²¹ As a consequence of the bar, the provisions of Section 105(c)(7)(B) of the Act will apply with respect to Arshak Davtyan, CPA. Section 105(c)(7)(B) of the Act provides that "[i]t shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any issuer, broker, or dealer in an accountancy or a financial management capacity, and for any issuer, broker, or dealer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission."

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- E. After two (2) years from the date of this Order, Arshak Davtyan, CPA may file a petition, pursuant to PCAOB Rule 5302(b), for Board consent to associate with a registered public accounting firm.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

December 20, 2016