

Report on
2016 Inspection of MaloneBailey, LLP
(Headquartered in Houston, Texas)

Issued by the
Public Company Accounting Oversight Board
July 27, 2017

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SECTIONS 104(g)(2) AND 105(b)(5)(A)
OF THE SARBANES-OXLEY ACT OF 2002



2016 INSPECTION OF MALONEBAILEY, LLP

Preface

In 2016, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm MaloneBailey, LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. For a description of the procedures the Board's inspectors may perform to fulfill this responsibility, see Part I.D of this report (which also contains additional information concerning PCAOB inspections generally). The inspection included reviews of portions of selected issuer audits. These reviews were intended to identify whether deficiencies existed in the reviewed work, and whether such deficiencies indicated defects or potential defects in the Firm's system of quality control over audits. In addition, the inspection included a review of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

The Board is issuing this report in accordance with the requirements of the Act. The Board is releasing to the public Part I of the report, portions of Appendix A and Appendix B. Appendix A consists of the Firm's comments, if any, on a draft of the report. If the nonpublic portions of the report discuss criticisms of or potential defects in the Firm's system of quality control, those discussions also could eventually be made public, but only to the extent the Firm fails to address the criticisms to the Board's satisfaction within 12 months of the issuance of the report. Appendix B presents the text of the paragraphs of the auditing standards that are referenced in Part I.A in relation to the description of auditing deficiencies there.

Note on this report's citations to auditing standards: On March 31, 2015, the PCAOB adopted a reorganization of its auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). The reorganization became effective as of December 31, 2016. Citations in this report reference the reorganized PCAOB auditing standards.

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EXECUTIVE SUMMARY

This summary sets out certain key information from the 2016 inspection of MaloneBailey, LLP ("the Firm"). The inspection procedures included reviews of portions of 12 issuer audits performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. In six audits, certain of the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in conformity with the applicable financial reporting framework. These deficiencies are described in Part I.A of the report.

Effects on Audit Opinions

Of the six issuer audits that appear in Part I.A, deficiencies in all six audits relate to the substantive testing performed for purposes of the opinion on the financial statements only.

Most Frequently Identified Audit Deficiencies

The types of deficiencies that are included most frequently in Part I.A of this report relate to the Firm's failure, in four audits,¹ to sufficiently evaluate significant assumptions or test data that the issuer used in developing an estimate. The description of each deficiency in Part I.A contains more specific information about the individual deficiencies.

Areas in which Audit Deficiencies Were Most Frequently Identified

The financial statement accounts or auditing areas in which the deficiencies that are included in Part I.A of this report most frequently occurred relate to the allowance for doubtful accounts in two audits.²

¹ Issuers B, C, E, and F.

² Issuers E and F.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures³ for the inspection from September 19, 2016 to September 30, 2016. The inspection team performed field work at the Firm's headquarters in Houston, Texas.

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 12 issuer audits performed by the Firm.

The descriptions of the deficiencies in Part I.A of this report include, at the end of the description of each deficiency, references to specific paragraphs of the auditing standards that relate to those deficiencies. The text of those paragraphs is set forth in Appendix B to this report. The references in this sub-Part include only standards that primarily relate to the deficiencies; they do not present a comprehensive list of every auditing standard that applies to the deficiencies. Further, certain broadly applicable aspects of the auditing standards that may be relevant to a deficiency, such as provisions requiring due professional care, including the exercise of professional skepticism; the accumulation of sufficient appropriate audit evidence; and the performance of procedures that address risks, are not included in the references to the auditing standards in this sub-Part, unless the lack of compliance with these standards is the primary reason for the deficiency. These broadly applicable provisions are described in Part I.B of this report.

Certain deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained

³ For this purpose, the time span for "primary procedures" includes field work, other review of audit work papers, and the evaluation of the Firm's quality control policies and procedures through review of documentation and interviews of Firm personnel. The time span does not include (1) inspection planning, which may commence months before the primary procedures, and (2) inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which generally extend beyond the primary procedures.

sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in conformity with the applicable financial reporting framework. In other words, in these audits, the auditor issued an opinion without satisfying its fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement.

The fact that one or more deficiencies in an audit reach this level of significance does not necessarily indicate that the financial statements are misstated. It is often not possible for the inspection team, based only on the information available from the auditor, to reach a conclusion on those points.

Whether or not associated with a disclosed financial reporting misstatement, an auditor's failure to obtain the reasonable assurance that the auditor is required to obtain is a serious matter. It is a failure to accomplish the essential purpose of the audit, and it means that, based on the audit work performed, the audit opinion should not have been issued.⁴

The audit deficiencies that reached this level of significance are described in Parts I.A.1 through I.A.6, below.

⁴ Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and an inspection may include a review of the adequacy of a firm's compliance with these requirements, either with respect to previously identified deficiencies or deficiencies identified during that inspection. Failure by a firm to take appropriate actions, or a firm's misrepresentations in responding to an inspection report about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

Audit Deficiencies

A.1. Issuer A

Related to the issuer's accounting for an intangible asset, the Firm identified a misstatement that the Firm, because of the misstatement's quantitative effect, considered could be material. The Firm proposed a related adjustment that the issuer did not make. The Firm then concluded that the misstatement was not material, taking into account, in addition to quantitative considerations, qualitative considerations, including that the misstatement was not pervasive, did not reverse a downward trend of earnings, did not change a net loss into net income, did not concern a significant segment or business activity, did not affect loan covenants or other contractual or regulatory requirements, and had no effect on management compensation.

The Firm failed to evaluate sufficiently whether the misstatement was material. Specifically, the Firm failed to identify as relevant to the materiality evaluation, and take into account among the qualitative considerations, (1) that the misstatement resulted in the issuer reporting a loss from operations rather than income from operations, (2) management's motivation with respect to the misstatement, and (3) the effect of certain erroneous disclosures in the notes to the audited financial statements. (AS 2810.04, .17, and .B2)

A.2. Issuer B

In this audit, the Firm failed to perform sufficient procedures to test the valuation of inventory. The Firm's procedures to test whether the raw material component of inventory was recorded at the lower of cost or net realizable value included performing a physical count of the inventory and performing certain publicly accessible commercial internet searches. In addition, the Firm used the work of a company-engaged valuation specialist. In connection with using the work of the valuation specialist, the Firm evaluated the objectivity and qualifications of the valuation specialist. The Firm also read the valuation report dated approximately three years prior to the year under audit, noting that the appraised unit price at that time exceeded the issuer's recorded unit cost as of the end of the year under audit. In evaluating whether the appraisal report continued to provide a reliable estimate of fair value, the Firm documented that the raw materials were a scarce resource and their fair value would likely increase over time. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed procedures to evaluate whether the significant assumptions used by the valuation specialist in determining the fair value of the raw materials

continued to be reasonable as of the end of the year under audit, including evaluating the relevance and reliability of the sources used from its internet search. (AS 1210.12; AS 2502.26 and. 28)

A.3. Issuer C

In this audit, the Firm failed to perform sufficient procedures to test capitalized software development costs for impairment. The Firm's procedures included obtaining and inspecting the issuer's cash flow projections, which included significant assumptions related to revenue and gross margins. The Firm's procedures related to these significant assumptions were limited to inquiries of the issuer's management. The Firm failed to perform procedures, beyond inquiries of management, to evaluate the reasonableness of these significant assumptions used in the issuer's cash flow projections. (AS 2501.11)

A.4. Issuer D

In this audit, the Firm failed to perform sufficient procedures to evaluate whether there was substantial doubt about the issuer's ability to continue as a going concern and, accordingly, the Firm's evaluation of the issuer's related disclosures was insufficient. The Firm identified conditions and events that caused it to believe there was substantial doubt concerning the issuer's ability to continue as a going concern for a reasonable period of time. In evaluating management's plans to alleviate that substantial doubt, the Firm performed procedures to evaluate the issuer's cash flow projections for the 12 months after the end of the year under audit. Those projections assumed proceeds would be received from the issuance of preferred equity instruments that would enable the issuer to satisfy a debt repayment due during the 12 month period after the end of the year under audit. In its evaluation, the Firm noted that the issuer had raised capital through the issuance of common shares in the year prior to and during the year under audit through a stock purchase agreement that expired at the end of the year under audit. There was no evidence in the audit documentation, and no persuasive other evidence, that in evaluating the issuer's ability to achieve its expected cash flow projections, the Firm had considered the issuer's current operating environment, its ability to issue preferred shares for cash, and the effect, if any, of the expiration of the stock purchase agreement on the issuer's ability to raise capital to meet its debt obligation for the one year period after the balance sheet date. As a result, the Firm had no basis on which to evaluate whether the absence of related disclosures in the issuer's financial statements was appropriate. (AS 2415.03, .08, and .11)

A.5. Issuer E

In this audit, the Firm failed to perform sufficient procedures to test the valuation of advances to employees. To test the issuer's allowance for doubtful advances to employees, the Firm developed an independent expectation of the allowance based on the methodology, aging categories, and loss factors used by the issuer for its trade receivables. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed procedures to support the reasonableness of using the same aging categories and the same loss factors as the issuer used in its allowance for doubtful trade receivables calculation in its independent expectation of the allowance for doubtful advances to employees. In addition, the Firm failed to test the accuracy of the amounts in the aging categories of the advances to employees. (AS 2501.12)

A.6. Issuer F

In this audit, the Firm failed to perform sufficient procedures to test the allowance for doubtful accounts. The Firm's approach to testing the allowance involved a combination of testing the issuer's process for determining the allowance and developing an independent expectation of the allowance. The Firm's procedures to test the issuer's process were limited to recalculating the issuer's allowance calculation, and the Firm failed to perform procedures to evaluate the reasonableness of the issuer's loss factors, including the reasonableness of the issuer's conclusion that no loss factor was necessary for accounts receivable less than 180 days past due. In addition, in developing its independent expectation of the allowance, the Firm used a loss factor that was the average of the ratios of (1) uncollected accounts receivable balances at year end that were more than one, two, and three years old to (2) the corresponding total accounts receivable balances as of those year ends. Because that ratio does not represent an estimated loss percentage for the respective aging categories, it was not reasonable to use it as a loss factor. (AS 2501.11-.12)

B. Auditing Standards

Each deficiency described in Part I.A above could relate to several provisions of the standards that govern the conduct of audits. The paragraphs of the standards that are cited for each deficiency are those that most directly relate to the deficiency. The deficiencies also may relate, however, to other paragraphs of those standards and to other auditing standards, including those concerning due professional care, responses to risk assessments, and audit evidence.

Many audit deficiencies involve a lack of due professional care. Paragraphs .02, .05, and .06 of AS 1015, *Due Professional Care in the Performance of Work*, require the independent auditor to plan and perform his or her work with due professional care and set forth aspects of that requirement. AS 1015.07-.09 and paragraph .07 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, specify that due professional care requires the exercise of professional skepticism. These standards state that professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS 2301.03, .05, and .08 require the auditor to design and implement audit responses that address the risks of material misstatement. Paragraph .04 of AS 1105, *Audit Evidence*, requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement (in the audit of financial statements) or the risk associated with the control (in the audit of internal control over financial reporting ("ICFR")) and the quality of the audit evidence obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in providing support for the related conclusions.

The paragraphs of the standards that are described immediately above are not cited in Part I.A, unless those paragraphs are the most directly related to the relevant deficiency.

B.1. List of Specific Auditing Standards Referenced in Part I.A

The table below lists the specific auditing standards that are referenced in Part I.A of this report, cross-referenced to the issuer audits for which each standard is cited. For each auditing standard, the table also provides the number of distinct deficiencies for which the standard is cited for each of the relevant issuer audits. This information identifies only the number of times that the standard is referenced, regardless of whether the reference includes multiple paragraphs or relates to multiple financial statement accounts.

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
AS 1210, <i>Using the Work of a Specialist</i>	Issuer B	1
AS 2415, <i>Consideration of an Entity's Ability to Continue as a Going Concern</i>	Issuer D	1
AS 2501, <i>Auditing Accounting Estimates</i>	Issuer C Issuer E Issuer F	1 1 1
AS 2502, <i>Auditing Fair Value Measurements and Disclosures</i>	Issuer B	1
AS 2810, <i>Evaluating Audit Results</i>	Issuer A	1

B.2. Financial Statement Accounts or Auditing Areas Related to Identified Audit Deficiencies

The table below lists the financial statement accounts or auditing areas related to the deficiencies included in Part I.A of this report and identifies the audits described in Part I.A where deficiencies relating to the respective areas were observed.

	AS 1210	AS 2415	AS 2501	AS 2502	AS 2810
Allowance for doubtful accounts			E, F		
Going concern		D			
Goodwill and other intangible assets					A
Impairment of goodwill and intangible assets			C		
Inventory and related reserves	B			B	

B.3. Audit Deficiencies by Industry

The table below lists the industries⁵ of the issuers for which audit deficiencies were discussed in Part I.A of this report and cross references the issuers to the specific auditing standards related to the deficiencies.⁶

	AS 1210	AS 2415	AS 2501	AS 2502	AS 2810
Consumer Discretionary			F		
Consumer Staples	B			B	
Energy		D			
Industrials			E		
Information Technology			C		
Real Estate					A

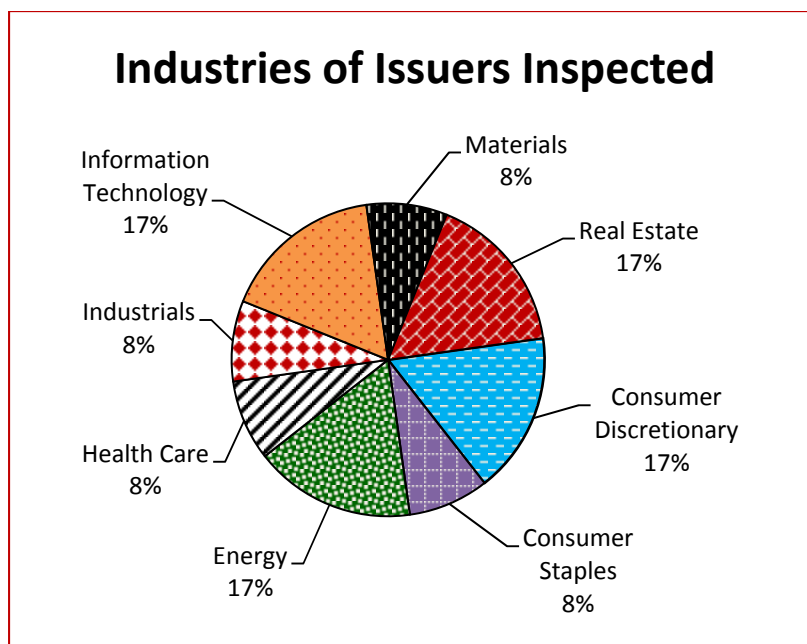
⁵ The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

⁶ Where identifying the industry of the issuer may enhance the understanding of the description of a deficiency in Part I.A, industry information is also provided there, unless doing so would have the effect of making the issuer identifiable.

C. Data Related to the Issuer Audits Selected for Inspection

C.1. Industries of Issuers Inspected

The chart below categorizes the 12 issuers whose audits were inspected in 2016, based on the issuer's industry.⁷

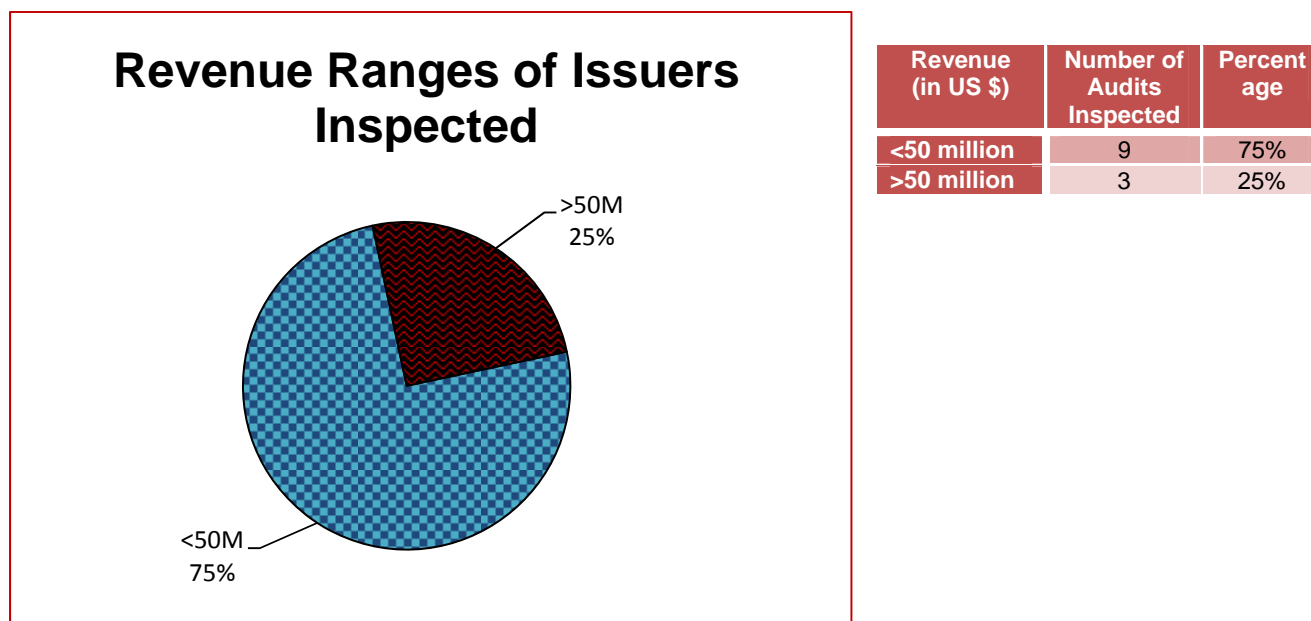


Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	2	17%
Consumer Staples	1	8%
Energy	2	17%
Health Care	1	8%
Industrials	1	8%
Information Technology	2	17%
Materials	1	8%
Real Estate	2	17%

⁷ See Footnote 5 for additional information on how industry sectors were classified.

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 12 issuers whose audits were inspected in 2016.⁸ This presentation of revenue data is intended to provide information about the size of issuer audits that were inspected and is not indicative of whether the inspection included a review of the Firm's auditing of revenue in the issuer audits selected for review.



D. Information Concerning PCAOB Inspections that is Generally Applicable to Annually Inspected Firms

Board inspections include reviews of certain portions of selected audit work performed by the inspected firm and reviews of certain aspects of the firm's quality control system. The inspections are designed to identify deficiencies in audit work and defects or potential defects in the firm's system of quality control related to the firm's audits. The focus on deficiencies, defects, and potential defects necessarily carries

⁸ The revenue amounts reflected in the chart are for the issuer's fiscal year end that corresponds to the audit inspected by the PCAOB. The revenue amounts were obtained from S&P and reflect a standardized approach to presenting revenue amounts.

through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools. Further, the inclusion in an inspection report of certain deficiencies, defects, and potential defects should not be construed as an indication that the Board has made any determination about other aspects of the inspected firm's systems, policies, procedures, practices, or conduct not included within the report.

D.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of ICFR. The inspection team selects the audits, and the specific portions of those audits, that it will review, and the inspected firm is not allowed an opportunity to limit or influence the selections. For each specific portion of the audit that is selected, the inspection team reviews the engagement team's work papers and interviews engagement personnel regarding those portions. If the inspection team identifies a potential issue that it is unable to resolve through discussion with the firm and any review of additional work papers or other documentation, the inspection team ordinarily provides the firm with a written comment form on the matter and the firm is allowed the opportunity to provide a written response to the comment form. If the response does not resolve the inspection team's concerns, the matter is considered a deficiency and is evaluated for inclusion in the inspection report. Identified deficiencies in the audit work that exceed a significance threshold (which is described in Part I.A of the inspection report) are summarized in the public portion of the inspection report.⁹

Audit deficiencies that the inspection team may identify include a firm's failure to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,¹⁰ as well as a firm's failure to perform,

⁹ The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process. In addition, any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.

¹⁰ 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,

or to perform sufficiently, certain necessary test of controls and substantive audit procedures. An inspection of an annually inspected firm does not involve the review of all of the firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, a Board inspection report should not be understood to provide any assurance that a firm's audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In reaching its conclusions about whether a deficiency exists, an inspection team considers whether audit documentation or any other evidence that a firm might provide to the inspection team supports the firm's contention that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the firm claimed to have performed the procedure. AS 1215, *Audit Documentation*, 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. In the case of every matter cited in the public portion of a final inspection report, the inspection team has carefully considered any contention by the firm that it did so but just did not document its work, and the inspection team has concluded that the available evidence does not support the contention that the firm sufficiently performed the necessary work.

The Board cautions against extrapolating from the results presented in the public portion of a report to broader conclusions about the frequency of deficiencies throughout the firm's practice. Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among

results of operations, or cash flows of the issuer in conformity with the applicable financial reporting framework, the Board's practice is to report that information to the Securities and Exchange Commission ("SEC" or "the Commission"), which has jurisdiction to determine proper accounting in issuers' financial statements. Any description in this report of financial statement misstatements or failures to comply with SEC disclosure requirements should not be understood as an indication that the SEC has considered or made any determination regarding these issues unless otherwise expressly stated.

selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Thus, the audit work is generally selected for inspection based on factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

D.2. Review of a Firm's Quality Control System

QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, provides that an auditing firm has a responsibility to ensure that its personnel comply with the applicable professional standards. This standard specifies that a firm's system of quality control should encompass the following elements: (1) independence, integrity, and objectivity; (2) personnel management; (3) acceptance and continuance of issuer audit engagements; (4) engagement performance; and (5) monitoring.

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when aggregated, may indicate areas where a firm's system has failed to provide reasonable assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion may indicate a defect or potential defect in a firm's quality control system.¹¹ If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of deficiencies;¹² related firm methodology, guidance, and practices; and possible root causes.

¹¹ Not every audit deficiency suggests a defect or potential defect in a firm's quality control system, and this report does not discuss every audit deficiency the inspection team identified.

¹² An evaluation of the frequency of a type of deficiency may include consideration of how often the inspection team reviewed audit work that presented the opportunity for similar deficiencies to occur. In some cases, even a type of deficiency that is observed infrequently in a particular inspection may, because of some

Inspections also include a review of certain of the firm's practices, policies, and processes related to audit quality, which constitute a part of the firm's quality control system. The inspection team customizes the procedures it performs with respect to the firm's practices, policies, and processes related to audit quality, bearing in mind the firm's structure, procedures performed in prior inspections, past and current inspection observations, an assessment of risk related to each area, and other factors. The areas generally considered for review include (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining issuer audit engagements, including the application of the firm's risk-rating system; and (4) the firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to defects or potential defects in quality control. A description of the procedures generally applied to these areas is below.

D.2.a. Review of Management Structure and Processes, Including the Tone at the Top

Procedures in this area are designed to focus on (1) how management is structured and operates the firm's business, and the implications that the management structure and processes have on audit performance and (2) whether actions and communications by the firm's leadership – the tone at the top – demonstrate a commitment to audit quality. To assess this area, the inspection team may interview members of the firm's leadership and review significant management reports, communications, and documents, as well as information regarding financial metrics and other processes that the firm uses to plan and evaluate its business.

combination of its nature, its significance, and the frequency with which it has been observed in previous inspections of the firm, be cause for concern about a quality control defect or potential defect.

D.2.b. Review of Practices for Partner Management, Including Allocation of Partner Resources and Partner Evaluation, Compensation, Admission, and Disciplinary Actions

Procedures in this area are designed to focus on (1) whether the firm's processes related to partner evaluation, compensation, admission, termination, and disciplinary actions could be expected to encourage an appropriate emphasis on audit quality and technical competence, as distinct from marketing or other activities of the firm; (2) the firm's processes for allocating its partner resources; and (3) the accountability and responsibilities of the different levels of firm management with respect to partner management. The inspection team may interview members of the firm's management and review documentation related to certain of these topics. In addition, the inspection team's evaluation may include the results of interviews of audit partners regarding their responsibilities and allocation of time. Further, the inspection team may review a sample of partners' personnel files.

D.2.c. Review of Policies and Procedures for Considering and Addressing the Risks Involved in Accepting and Retaining Issuer Audit Engagements, Including the Application of the Firm's Risk-Rating System

The inspection team may consider the firm's documented policies and procedures in this area. In addition, the inspection team may select certain issuer audits to (1) evaluate compliance with the firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the issuer audit engagements and (2) observe whether the audit procedures were responsive to the risks of material misstatement identified during the firm's process.

D.2.d. Review of a Firm's Processes for Monitoring Audit Performance, Including Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance, Independence Policies and Procedures, and Processes for Responding to Defects or Potential Defects in Quality Control

D.2.d.i. Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance

Procedures in this area are designed to identify and assess the monitoring processes that the firm uses to monitor audit quality for individual engagements and for

the firm as a whole. The inspection team may interview members of the firm's management and review documents relating to the firm's identification and evaluation of, and response to, possible indicators of deficiencies in audit performance. In addition, the inspection team may review documents related to the design, operation, and evaluation of findings of the firm's internal inspection program, and may compare the results of its review of audit work to those from the internal inspection's review of the same audit work.

D.2.d.ii. Review of Response to Defects or Potential Defects in Quality Control

The inspection team may review steps the firm has taken to address possible quality control deficiencies and assess the design and effectiveness of the underlying processes. In addition, the inspection team may inspect audits of issuers whose audits had been reviewed during previous PCAOB inspections of the firm to ascertain whether the audit procedures in areas with previous deficiencies have improved.

D.2.d.iii. Review of Certain Other Policies and Procedures Related to Monitoring Audit Quality

The inspection team may assess policies, procedures, and guidance related to aspects of independence requirements and the firm's consultation processes, as well as the firm's compliance with these requirements and processes. In addition, the inspection team may review documents, including certain newly issued policies and procedures, and interview firm management to consider the firm's methods for developing audit policies, procedures, and methodologies, including internal guidance and training materials.

END OF PART I

PARTS II AND III OF THIS REPORT ARE NONPUBLIC
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

APPENDIX A

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.¹³

¹³ 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 some cases, the result may be that none of a firm's response is made publicly available. 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.



June 12, 2017

Ms. Helen Munter
Director
Division of Registration and Inspections
1666 K Street NW, suite 800
Washington, DC 20006

Re: Response to Part I of the Draft Report on the 2016 Inspection of MaloneBailey LLP

Dear Ms. Munter:

We are pleased to provide our response to the Public Company Accounting Oversight Board's ("PCAOB") report on the 2016 inspection of MaloneBailey LLP dated May 11, 2017 (the "Draft Report"). We support the PCAOB inspection process to help us identify areas where we may improve our audit performance. We believe the inspection process is a fundamental mission of the PCAOB and intend to use the process to identify areas where we should improve and enhance our audit quality.

We have evaluated each of the matters described in Part I of the Draft Report. In that regard, we have considered whether it was necessary to perform additional procedures in accordance with 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* and, where appropriate, performed such procedures.

We remain committed to improving our audit performance and underlying quality control systems. We appreciate the opportunity to respond to the report and look forward to future constructive dialogue.

Sincerely,

Malone Bailey LLP

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APPENDIX B

AUDITING STANDARDS REFERENCED IN PART I.A

This appendix provides the text of the auditing standard paragraphs that are referenced in Part I.A of this report. Footnotes that are included in this appendix, and any other Notes, are from the original auditing standards that are referenced. While this appendix contains the specific portions of the relevant standards cited with respect to the deficiencies in Part I.A of this report, other portions of the standards (including those described in Part I.B of this report) may provide additional context, descriptions, related requirements, or explanations; the complete standards are available on the PCAOB's website at <http://pcaobus.org/STANDARDS/Pages/default.aspx>.

AS 1210, <i>Using the Work of a Specialist</i>		
USING THE FINDINGS OF THE SPECIALIST		
AS 1210.12	The appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist. The auditor should (a) obtain an understanding of the methods and assumptions used by the specialist, (b) make appropriate tests of data provided to the specialist, taking into account the auditor's assessment of control risk, and (c) evaluate whether the specialist's findings support the related assertions in the financial statements. Ordinarily, the auditor would use the work of the specialist unless the auditor's procedures lead him or her to believe the findings are unreasonable in the circumstances. If the auditor believes the findings are unreasonable, he or she should apply additional procedures, which may include obtaining the opinion of another specialist.	Issuer B

AS 2415, <i>Consideration of an Entity's Ability to Continue as a Going Concern</i>		
The Auditor's Responsibility		
AS 2415.03	The auditor should evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in the following manner:	Issuer D

AS 2415, Consideration of an Entity's Ability to Continue as a Going Concern		
	<p>a. The auditor considers whether the results of his procedures performed in planning, gathering evidential matter relative to the various audit objectives, and completing the audit identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. It may be necessary to obtain additional information about such conditions and events, as well as the appropriate evidential matter to support information that mitigates the auditor's doubt.</p> <p>b. If the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, he should (1) obtain information about management's plans that are intended to mitigate the effect of such conditions or events, and (2) assess the likelihood that such plans can be effectively implemented.</p> <p>c. After the auditor has evaluated management's plans, he concludes whether he has substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. If the auditor concludes there is substantial doubt, he should (1) consider the adequacy of disclosure about the entity's possible inability to continue as a going concern for a reasonable period of time, and (2) include an explanatory paragraph (following the opinion paragraph) in his audit report to reflect his conclusion. If the auditor concludes that substantial doubt does not exist, he should consider the need for disclosure.</p>	
Consideration of Management's Plans		
AS 2415.08	When evaluating management's plans, the auditor should identify those elements that are particularly significant to overcoming the adverse effects of the conditions and events and should plan and perform auditing procedures to obtain evidential matter about them. For example, the auditor should consider the adequacy of	Issuer D

AS 2415, Consideration of an Entity's Ability to Continue as a Going Concern		
	support regarding the ability to obtain additional financing or the planned disposal of assets.	
Consideration of Financial Statement Effects		
AS 2415.11	When, primarily because of the auditor's consideration of management's plans, he concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time is alleviated, he should consider the need for disclosure of the principal conditions and events that initially caused him to believe there was substantial doubt. The auditor's consideration of disclosure should include the possible effects of such conditions and events, and any mitigating factors, including management's plans.	Issuer D

AS 2501, Auditing Accounting Estimates		
EVALUATING ACCOUNTING ESTIMATES		
Evaluating Reasonableness		
AS 2501.11	<p>Review and test management's process. In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach:</p> <ol style="list-style-type: none"> a. Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation. b. Identify the sources of data and factors that management used in forming the assumptions, and consider whether such data and factors are relevant, reliable, and sufficient for the purpose based on information gathered in other audit tests. c. Consider whether there are additional key factors or alternative assumptions about the factors. d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data. 	Issuers C and F

AS 2501, Auditing Accounting Estimates		
	<ul style="list-style-type: none"> e. Analyze historical data used in developing the assumptions to assess whether the data is comparable and consistent with data of the period under audit, and consider whether such data is sufficiently reliable for the purpose. f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions. g. Review available documentation of the assumptions used in developing the accounting estimates and inquire about any other plans, goals, and objectives of the entity, as well as consider their relationship to the assumptions. h. Consider using the work of a specialist regarding certain assumptions (AS 1210, <i>Using the Work of a Specialist</i>). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate. 	
AS 2501.12	<i>Develop an expectation.</i> Based on the auditor's understanding of the facts and circumstances, he may independently develop an expectation as to the estimate by using other key factors or alternative assumptions about those factors.	Issuers E and F

AS 2502, Auditing Fair Value Measurements and Disclosures		
TESTING THE ENTITY'S FAIR VALUE MEASUREMENTS AND DISCLOSURES		
Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data		
AS 2502.26	The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of audit procedures. When testing the entity's fair value measurements and disclosures, the auditor evaluates	Issuer B

AS 2502, Auditing Fair Value Measurements and Disclosures		
	<p>whether:</p> <ul style="list-style-type: none"> a. Management's assumptions are reasonable and reflect, or are not inconsistent with, market information (<u>see</u> paragraph .06). b. The fair value measurement was determined using an appropriate model, if applicable. c. Management used relevant information that was reasonably available at the time. 	
AS 2502.28	Where applicable, the auditor should evaluate whether the significant assumptions used by management in measuring fair value, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements.	Issuer B

AS 2810, Evaluating Audit Results		
EVALUATING THE RESULTS OF THE AUDIT OF FINANCIAL STATEMENTS		
AS 2810.04	<p>In the audit of financial statements,¹ the auditor's evaluation of audit results should include evaluation of the following:</p> <ul style="list-style-type: none"> a. The results of analytical procedures performed in the overall review of the financial statements ("overall review"); b. Misstatements accumulated during the audit, including, in particular, uncorrected misstatements;² c. The qualitative aspects of the company's accounting practices; d. Conditions identified during the audit that relate to the assessment of the risk of material misstatement due to fraud ("fraud risk"); e. The presentation of the financial statements, including the disclosures; and f. The sufficiency and appropriateness of the audit evidence obtained. 	Issuer A

AS 2810, Evaluating Audit Results

Footnotes to AS 2810.04

¹ For purposes of this standard, the term "audit of financial statements" refers to the financial statement portion of the integrated audit and to the audit of financial statements only.

² Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

Accumulating and Evaluating Identified Misstatements

AS 2810.17

Evaluation of the Effect of Uncorrected Misstatements. The auditor should evaluate whether uncorrected misstatements are material, individually or in combination with other misstatements. In making this evaluation, the auditor should evaluate the misstatements in relation to the specific accounts and disclosures involved and to the financial statements as a whole, taking into account relevant quantitative and qualitative factors.⁷ (See Appendix B.)

Note: In interpreting the federal securities laws, the Supreme Court of the United States has held that a fact is material if there is "a substantial likelihood that the ...fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."⁸ As the Supreme Court has noted, determinations of materiality require "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him"⁹

Note: As a result of the interaction of quantitative and qualitative considerations in materiality judgments, uncorrected misstatements of relatively small amounts could have a material effect on the financial statements. For example, an illegal payment of an otherwise immaterial amount could be material if there is a reasonable possibility¹⁰ that it could lead to a material contingent liability or a material loss of revenue.¹¹ Also, a misstatement made intentionally could be material for qualitative

Issuer A

AS 2810, Evaluating Audit Results

	<p>reasons, even if relatively small in amount.</p> <p>Note: If the reevaluation of the established materiality level or levels, as set forth in AS 2105,¹² results in a lower amount for the materiality level or levels, the auditor should take into account that lower materiality level or levels in the evaluation of uncorrected misstatements.</p>	
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Footnotes to AS 2810.17

⁷ If the financial statements contain material misstatements, AS 3101, *Reports on Audited Financial Statements*, indicates that the auditor should issue a qualified or an adverse opinion on the financial statements. AS 3101.35 discusses situations in which the financial statements are materially affected by a departure from the applicable financial reporting framework.

⁸ *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976). See also *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

⁹ *TSC Industries*, 426 U.S. at 450.

¹⁰ There is a reasonable possibility of an event, as used in this standard, when the likelihood of the event is either "reasonably possible" or "probable," as those terms are used in the FASB Accounting Standards Codification, Contingencies Topic, paragraph 450-20-25-1.

¹¹ AS 2405, *Illegal Acts by Clients*.

¹² AS 2105.11-.12.

AS 2810, Evaluating Audit Results		
Appendix B - Qualitative Factors Related to the Evaluation of the Materiality of Uncorrected Misstatements		
AS 2810.B2	<p>Qualitative factors to consider in the auditor's evaluation of the materiality of uncorrected misstatements, if relevant, include the following:</p> <ul style="list-style-type: none"> a. The potential effect of the misstatement on trends, especially trends in profitability. b. A misstatement that changes a loss into income or vice versa. c. The effect of the misstatement on segment information, for example, the significance of the matter to a particular segment important to the future profitability of the company, the pervasiveness of the matter on the segment information, and the impact of the matter on trends in segment information, all in relation to the financial statements taken as a whole. d. The potential effect of the misstatement on the company's compliance with loan covenants, other contractual agreements, and regulatory provisions. e. The existence of statutory or regulatory reporting requirements that affect materiality thresholds. f. A misstatement that has the effect of increasing management's compensation, for example, by satisfying the requirements for the award of bonuses or other forms of incentive compensation. g. The sensitivity of the circumstances surrounding the misstatement, for example, the implications of misstatements involving fraud and possible illegal acts, violations of contractual provisions, and conflicts of interest. h. The significance of the financial statement element affected by the misstatement, for example, a misstatement affecting recurring earnings as contrasted to one involving a non-recurring charge or credit, such as an extraordinary item. i. The effects of misclassifications, for example, misclassification between operating and non-operating income or recurring and non-recurring income items. 	Issuer A

AS 2810, Evaluating Audit Results

- j. The significance of the misstatement or disclosures relative to known user needs, for example:
 - The significance of earnings and earnings per share to public company investors.
 - The magnifying effects of a misstatement on the calculation of purchase price in a transfer of interests (buy/sell agreement).
 - The effect of misstatements of earnings when contrasted with expectations.
- k. The definitive character of the misstatement, for example, the precision of an error that is objectively determinable as contrasted with a misstatement that unavoidably involves a degree of subjectivity through estimation, allocation, or uncertainty.
- l. The motivation of management with respect to the misstatement, for example, (i) an indication of a possible pattern of bias by management when developing and accumulating accounting estimates or (ii) a misstatement precipitated by management's continued unwillingness to correct weaknesses in the financial reporting process.
- m. The existence of offsetting effects of individually significant but different misstatements.
- n. The likelihood that a misstatement that is currently immaterial may have a material effect in future periods because of a cumulative effect, for example, that builds over several periods.
- o. The cost of making the correction—it may not be cost-beneficial for the client to develop a system to calculate a basis to record the effect of an immaterial misstatement. On the other hand, if management appears to have developed a system to calculate an amount that represents an immaterial misstatement, it may reflect a motivation of management as noted in paragraph .B2I above.
- p. The risk that possible additional undetected misstatements would affect the auditor's evaluation.