

Report on

**2010 Inspection of Patrizio & Zhao, LLC
(Headquartered in Parsippany, New Jersey)**

Issued by the

Public Company Accounting Oversight Board

February 2, 2012

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.

2010 INSPECTION OF PATRIZIO & ZHAO, LLC

In 2010, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Patrizio & Zhao, LLC ("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 October 4, 2010 to October 15, 2010. 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	2 (Parsippany, New Jersey and Shijiazhuang, People's Republic of China)
Ownership structure	Limited liability company
Number of partners	2
Number of professional staff ^{3/}	14
Number of issuer audit clients ^{4/}	12

^{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 and internal control over financial reporting ("ICFR") 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.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.^{5/} To achieve that goal, Board 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 or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

In addition, inclusion of a deficiency in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, when audit deficiencies are discovered after the date of the audit report, a firm must take appropriate action to assess the importance of the deficiencies to the firm's present ability to support its previously expressed audit opinions.^{7/} Depending upon the circumstances, compliance with these standards may

^{5/} This focus on weaknesses and deficiencies 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.

^{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/} 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), and PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over*

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 previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

A. Review of Audit Engagements

The inspection procedures included a review of aspects of the Firm's auditing of financial statements of three 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. Those deficiencies included failures by the Firm to identify or appropriately address errors in the issuer's application of GAAP, including, in some cases, errors that appeared likely to be material to the issuer's financial statements. In addition, the deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

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 and Appendix A to AS No. 3, paragraph A28. For purposes of the inspection, an observation that the Firm did not perform a

Financial Reporting That is Integrated with An Audit of Financial Statements ("AS No. 5"), ¶ 98.

procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

The deficiencies identified in all three audits reviewed included deficiencies 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 competent evidential matter to support its opinion on the issuer's financial statements. Those deficiencies were –

- (1) the Firm's failure to identify, or to address appropriately, a departure from GAAP that related to a potentially material misstatement in the audited financial statements concerning omitted disclosure of the issuer's business combination;
- (2) the failure to perform audit procedures to test a business combination;
- (3) the failure to perform sufficient audit procedures to evaluate whether goodwill was impaired;
- (4) the failure to perform audit procedures to test discontinued operations;
- (5) the failure to perform audit procedures to test related party transactions;
- (6) the failure to perform audit procedures to test the fair value of derivatives;
- (7) the failure, in two audits, to perform sufficient audit procedures related to revenue;
- (8) the failure to perform audit procedures to evaluate the accounting related to convertible securities; and
- (9) the failure to perform audit procedures related to the allowance for doubtful accounts.

One of the deficiencies described above related to auditing an aspect of an issuer's financial statements to which the issuer made substantial adjustments subsequent to the primary inspection procedures.^{8/}

^{8/} The Board inspection process did not include review of any additional audit work related to the adjustments.

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. 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

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

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.^{9/}

^{9/} 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.

Patrizio & Zhao, LLC

Certified Public Accountants and Consultants

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December 6, 2011

Ms. Helen A. Munter, Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006

Re: *Response to Part 1 of 2010 Draft Report on Inspection of Patrizio & Zhao, LLC*

Dear Ms. Munter:

Patrizio & Zhao, LLC ("the Firm") is pleased to provide its response to Part 1 of the 2010 draft report regarding the 2010 inspection performed by the staff of the Public Company Accounting Oversight Board ("PCAOB"). We recognize and appreciate the importance of the inspection process and we are committed to enhancing the Firm's audit and quality control policies and procedures based on the findings in the 2010 draft report.

We support the PCAOB's goal of improving audit quality and, consequently, the reliability of financial reporting. We acknowledge that considerable value is derived from the inspection process. Since an inherent part of our audit practice involves monitoring and continuous improvement, the PCAOB's inspections assist us in identifying areas where we can continue to improve audit quality. We recognize the importance and value of the inspection process and accordingly, undertook our best efforts to fully cooperate with the inspection team.

The inspection process is designed to identify deficiencies in the selected sample of audit engagements. However, based on the limited selection of audits inspected, the findings are not necessarily indicative or reflective of a Firm's overall professional practice in general. The PCAOB audit inspection process is one of hindsight and necessarily involves evaluation of professional judgments and may result in differing views on certain professional judgments made during the conduct of an audit. In addition, given the fact that all of the Firm's issuers are based and operate in China, the translation, interpretation and evaluation by the PCAOB inspection team of Chinese documents, contracts and other written supporting documentation may be translated, interpreted and evaluated differently than by the Firm's native born Chinese accountants who are very familiar with the culture, customs and business practices inherently performed in China. It is often difficult to reach a common understanding of what is sufficient documentation because of the variety of judgments involved in that analysis by professionals having different levels of knowledge of the issuers' businesses, language and culture at the time of the audit. This is particularly true as it relates to the extent of testing, assessing the proper application of accounting principles and determining what constitutes sufficient documentation. We believe that the nature and extent of our procedures during the audits inspected were appropriate and responsive to the engagement risk assessments.

Each of the specific matters noted in Part I of the 2010 draft report have been addressed by appropriate action, where in our professional judgment it was deemed required. We have also considered whether it was necessary to perform additional procedures or supplement our documentation in accordance with AU 390, *Consideration of Procedures After the Report Date*, and AU 561, *Subsequent Discovery of facts Existing At The date of The Auditor's Report*. No facts or circumstances have come to our attention in preparing this response to the 2010 draft report which caused us to change our conclusions or affect our previously issued audit reports.

In our view, the value of the results of the inspection of Issuer A's 2008 audit in a 2010 PCAOB inspection must be seriously questioned, since the performance of this engagement more closely falls into our previous 2008 initial inspection period. We note that the majority of the deficiencies in the 2010 draft report, as would be expected, relate to the 2008 audit of Issuer A's financial statements. In our view, these matters are not indicative of the Firm's current overall professional practice and audit quality and were already addressed by the Firm in our audits subsequent to the 2008 PCAOB inspection through our extensive efforts to implement significant changes to our overall internal quality control policies and procedures in response to the 2008 PCAOB inspection. Accordingly, we believe that the previous 2008 PCAOB inspection significantly assisted us in improving our overall Firm quality control practices, policies and procedures as evidenced by the results of the inspections of the more recent engagements selected during the 2010 inspection. These engagements are more indicative of the improvements in the Firm's current overall professional practice and audit quality.

We appreciate the opportunity to respond to the 2010 draft report and look forward to future inspections to improve our quality control policies, practices and procedures as part of the Firm's commitment to maintaining the highest level of audit quality.

Sincerely,

Patrizio & Zhao, LLC

Patrizio & Zhao, LLC