
2018 Inspection MaloneBailey, LLP

(Headquartered in Houston, Texas)

August 5, 2020

PCAOB
Public Company Accounting Oversight Board

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

PCAOB RELEASE NO. 104-2020-015A
(Includes portions of Part II of the full report that were not included in PCAOB Release No. 104-2020-015)

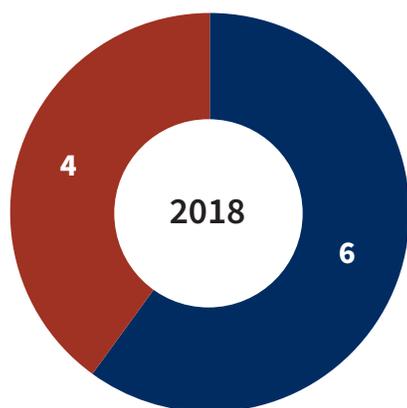
Executive Summary

Our 2018 inspection report on MaloneBailey, LLP provides information on our inspection to assess the firm’s compliance with Public Company Accounting Oversight Board (“PCAOB”) standards and rules and other applicable regulatory and professional requirements. This executive summary offers a high-level overview of: (1) Part I.A of the report, which discusses deficiencies (“Part I.A deficiencies”) in certain issuer audits that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer’s financial statements and/or internal control over financial reporting (“ICFR”), and (2) Part I.B of the report, which discusses deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.

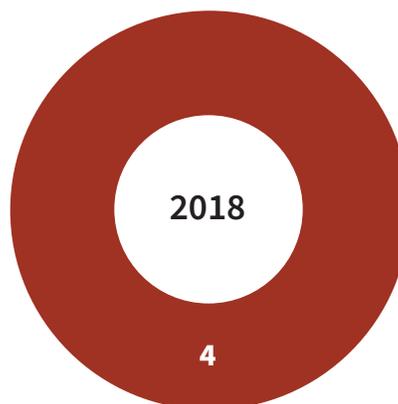
The fact that we have included a deficiency in this report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — does not necessarily mean that the issuer’s financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist. If a deficiency is included in Part I.A or Part I.B of this report, it does not necessarily mean that the firm has not addressed the deficiency.

Overview of the 2018 Deficiencies Included in Part I

Four of the 10 issuer audits we reviewed in 2018 are included in Part I.A of this report due to the significance of the deficiencies identified. The identified deficiencies primarily related to the firm’s substantive testing of inventory, revenue and related accounts, and business combinations.



■ Audits without Part I.A deficiencies
■ Audits with Part I.A deficiencies



■ Deficiencies in both financial statement and ICFR audits
■ Deficiencies in the financial statement audit only
■ Deficiencies in the ICFR audit only

The Part I.A deficiencies in 2018 related to evaluating significant assumptions or data that the issuer used in developing an estimate and testing the accuracy and completeness of data or reports used in substantive testing.

Other deficiencies identified during the 2018 inspection that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s), which appear in Part I.B, related to audit committee communications.

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2018 Inspection

During the PCAOB's 2018 inspection of MaloneBailey, LLP, we assessed the firm's compliance with laws, rules, and professional standards applicable to the audits of public companies.

We selected for review 10 audits of issuers with fiscal years generally ending in 2017. For each issuer audit selected, we reviewed a portion of the audit. We also evaluated elements of the firm's system of quality control.

What's Included in this Inspection Report

This report includes the following sections:

- **Overview of the 2018 Inspection and Historical Data by Inspection Year:** Information on our inspection, historical data, and common deficiencies.
- **Part I – Inspection Observations:**
 - o **Part I.A:** Deficiencies that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR.
 - o **Part I.B:** Deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.
- **Part II – Observations Related to Quality Control:** Criticisms of, or potential defects in, the firm's system of quality control. Section 104(g)(2) of the Sarbanes-Oxley Act ("the Act") restricts us from publicly disclosing Part II deficiencies unless the firm does not address the criticisms or potential defects to the Board's satisfaction no later than 12 months after the issuance of this report.
- **Appendix A – Firm's Response to the Draft Inspection Report:** The firm's response to a draft of this report, excluding any portion granted confidential treatment.

2018 Inspection Approach

In selecting issuer audits for review, we use a risk-based method of selection. We make selections based on (1) our internal evaluation of audits we believe have a heightened risk of material misstatement, including those with challenging audit areas, and (2) other risk-based characteristics, including issuer and firm considerations.

When we review an audit, we do not review every aspect of the audit. Rather, we generally focus our attention on audit areas we believe to be of greater complexity, areas of greater significance or with a heightened risk of material misstatement to the issuer's financial statements, and areas of recurring deficiencies. We may also select some audit areas for review in a manner designed to incorporate unpredictability.

Our selection of audits for review does not constitute a representative sample of the firm's total population of issuer audits. Additionally, our inspection findings are specific to the particular portions of the issuer audits reviewed. They are not an assessment of all of the firm's audit work nor of all of the audit procedures performed for the audits reviewed.

View the details on the [scope of our inspections and our inspections procedures](#).

Overview of the 2018 Inspection and Historical Data by Inspection Year

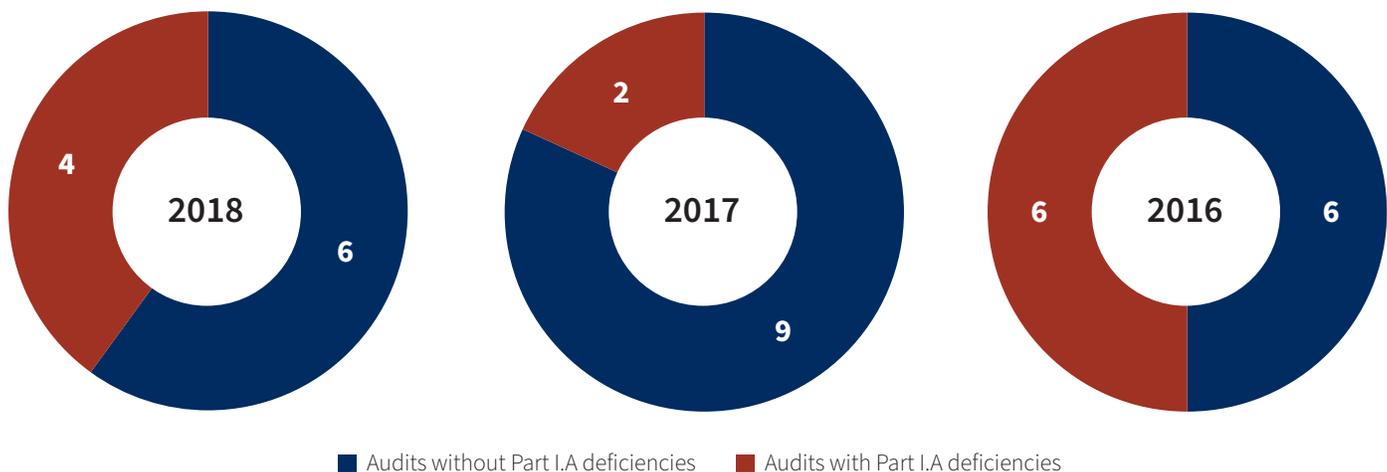
The following information provides an overview of our inspections in 2018 of the firm’s issuer audits as well as data from the previous two inspections. We use a risk-based method to select audits for review and to identify areas on which we focus our inspection. Because our inspection process evolves over time, it can, and often does, focus on a different mix of audits and focus areas from year to year and firm to firm. As a result of this variation, we caution that our inspection results are not necessarily comparable over time or among firms.

Audits Reviewed

	2018	2017	2016
Total audits reviewed	10	11	12
Audits in which the firm was the principal auditor	10	11	12
Integrated audits of financial statements and ICFR	3	1	2
Risk-based selections	10	11	12

Part I.A Deficiencies in Audits Reviewed

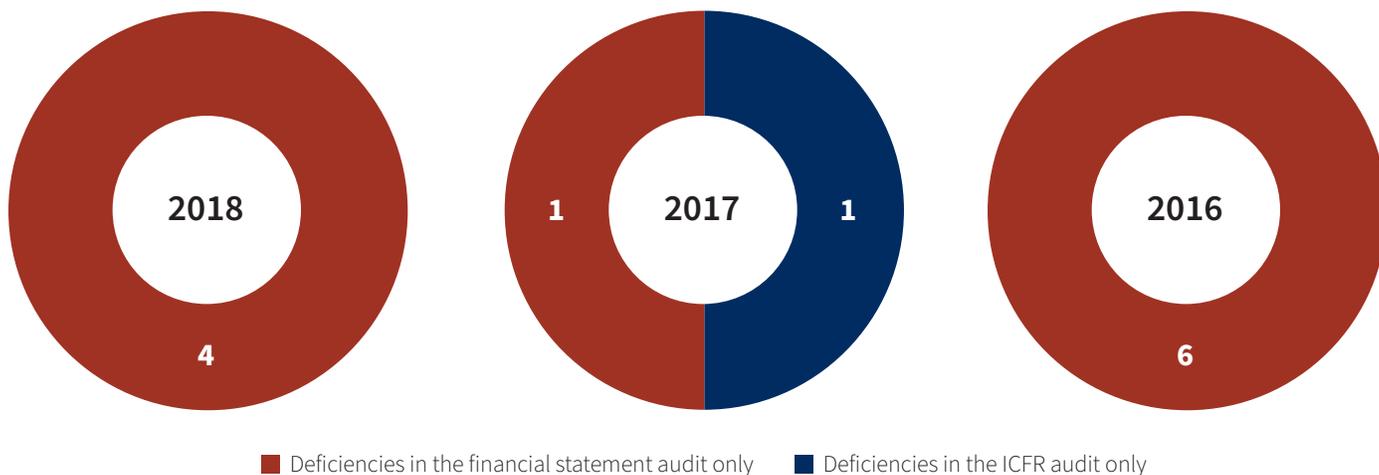
All audits appearing in Part I.A in 2018, 2017, and 2016 were selected for review using risk-based criteria.



If a deficiency is included in Part I.A of our report, it does not necessarily mean that the firm has not addressed the deficiency. In many cases, the firm has performed remedial actions after the issue was identified. Depending on the circumstances, remedial actions may include performing additional audit procedures, informing management of the issuer of the need for changes to the financial statements or reporting on ICFR, or taking steps to prevent reliance on prior audit reports. Our inspection normally includes a review, on a sample basis, of the adequacy of a firm's remedial actions, either with respect to previously identified deficiencies or deficiencies identified during that inspection. If a firm does not take appropriate actions to address deficiencies, we may criticize its system of quality control or pursue a disciplinary action.

The fact that we have included a deficiency in our report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — does not necessarily mean that the issuer’s financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist. It is often not possible for us to reach a conclusion on those points based on our inspection procedures and related findings because, for example, we have only the information that the auditor retained and the issuer’s public disclosures. We do not have direct access to the issuer’s management, underlying books and records, and other information.

Audits Affected by the Deficiencies Identified in Part I.A



The following tables and graphs summarize inspection-related information, by inspection year, for 2018 and the previous two inspections. We caution any comparison of the data provided without reading the descriptions of the underlying deficiencies in each respective inspection report.

Most Frequently Identified Part I.A Deficiencies

Deficiencies in audits of financial statements	Audits with Part I.A deficiencies		
	2018	2017	2016
Did not sufficiently evaluate significant assumptions or data that the issuer used in developing an estimate	3	0	4
Did not perform sufficient testing of the accuracy and completeness of data and reports used in the firm's substantive testing	1	1	0

Deficiencies in ICFR audits	Audits with Part I.A deficiencies		
	2018	2017	2016
Did not identify and test any controls related to a significant account or relevant assertion	0	1	0

Audit Areas Most Frequently Reviewed

This table reflects the five focus areas we have selected most frequently for review in each inspection year (and the related Part I.A deficiencies). For the issuer audits selected for review, we selected these areas because they were generally significant to the issuer's financial statements, may have included complex issues for auditors, and/or involved complex judgments in (1) estimating and auditing the reported value of related accounts and disclosures and (2) implementing and auditing the related controls.

2018			2017			2016		
Audit area	Audits reviewed	Audits with Part I.A deficiencies	Audit area	Audits reviewed	Audits with Part I.A deficiencies	Audit area	Audits reviewed	Audits with Part I.A deficiencies
Revenue and related accounts	9	1	Revenue and related accounts	10	1	Revenue and related accounts	10	2
Cash and cash equivalents	5	0	Cash and cash equivalents	3	0	Goodwill and intangible assets	3	2
Inventory	3	2	Long-lived assets	2	0	Long-lived assets	3	0
Income taxes	2	0	Debt	2	0	Cash and cash equivalents	3	0
Equity and equity-related transactions	2	0	Business combinations	2	0	Equity and equity-related transactions	3	0

Audit Areas with Frequent Part I.A Deficiencies

This table reflects the focus areas with the most frequently identified Part I.A deficiencies in each inspection year with the corresponding results for the other two years presented.

Audit area	2018		2017		2016	
	Audits with Part I.A deficiencies	Audits reviewed	Audits with Part I.A deficiencies	Audits reviewed	Audits with Part I.A deficiencies	Audits reviewed
Inventory	2	3	1	1	1	2
Revenue and related accounts	1	9	1	10	2	10
Business combinations	1	1	0	2	0	0
Goodwill and intangible assets	0	0	0	0	2	3

Inventory: The deficiencies in 2018 and the deficiency in 2016 related to substantive testing of assumptions used in the valuation of inventory. The deficiency in 2017 related to testing the accuracy and completeness of data and reports used in substantive testing.

Revenue and related accounts: The deficiency in 2018 related to testing the accuracy and completeness of data and reports used in substantive testing. The deficiency in 2017 related to identifying and testing controls over revenue. The deficiencies in 2016 related to substantive testing of the valuation of accounts receivable.

Business combinations: The deficiency in 2018 related to substantive testing of assumptions that the issuer used to value assets acquired and liabilities assumed.

Goodwill and intangible assets: The deficiencies in 2016 related to testing the assumptions used to evaluate an intangible asset for impairment and the evaluation of a misstatement.

Auditing Standards Associated with Identified Part I.A Deficiencies

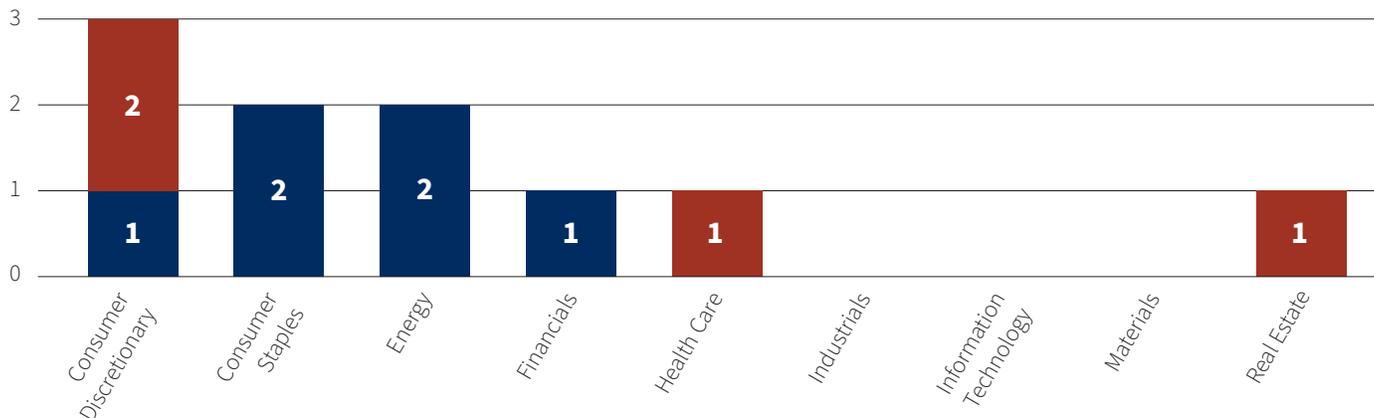
The following lists the auditing standards referenced in Part I.A of the 2018 and the previous two inspection reports and the number of times that the standard is cited in Part I.A.

PCAOB Auditing Standards	2018	2017	2016
<i>AS 1105, Audit Evidence</i>	1	1	0
<i>AS 1210, Using the Work of a Specialist</i>	0	0	1
<i>AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>	0	2	0
<i>AS 2415, Consideration of an Entity's Ability to Continue as a Going Concern</i>	0	0	1
<i>AS 2501, Auditing Accounting Estimates</i>	2	0	3
<i>AS 2502, Auditing Fair Value Measurements and Disclosures</i>	1	0	1
<i>AS 2810, Evaluating Audit Results</i>	0	0	1

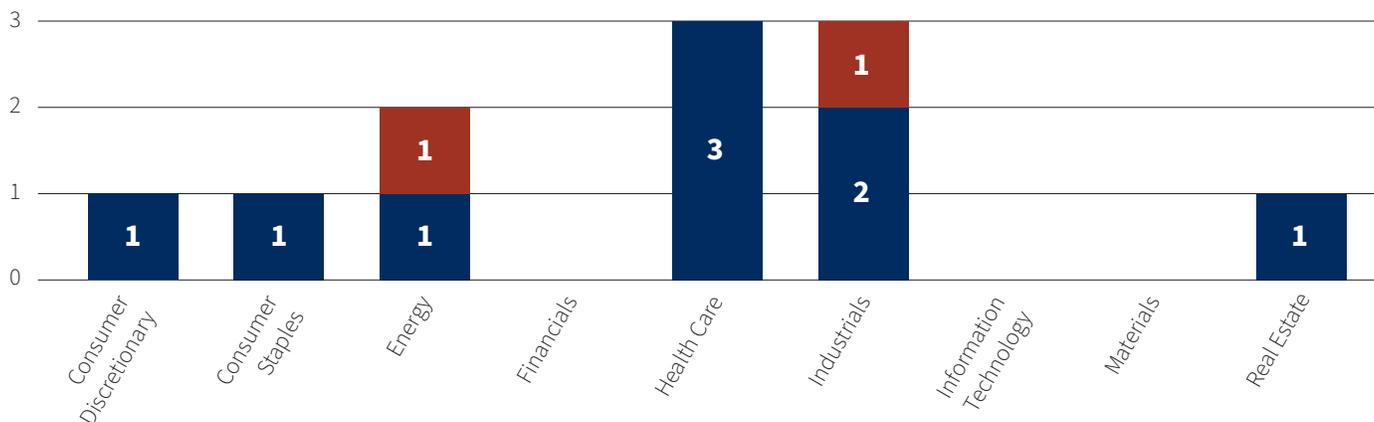
Inspection Results by Issuer Industry Sector

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 data for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

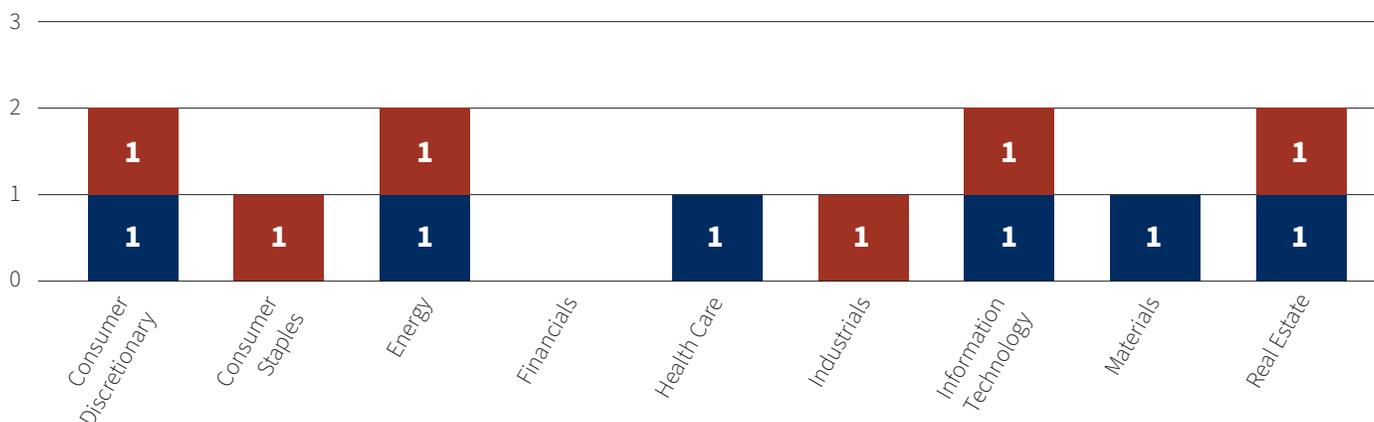
2018



2017



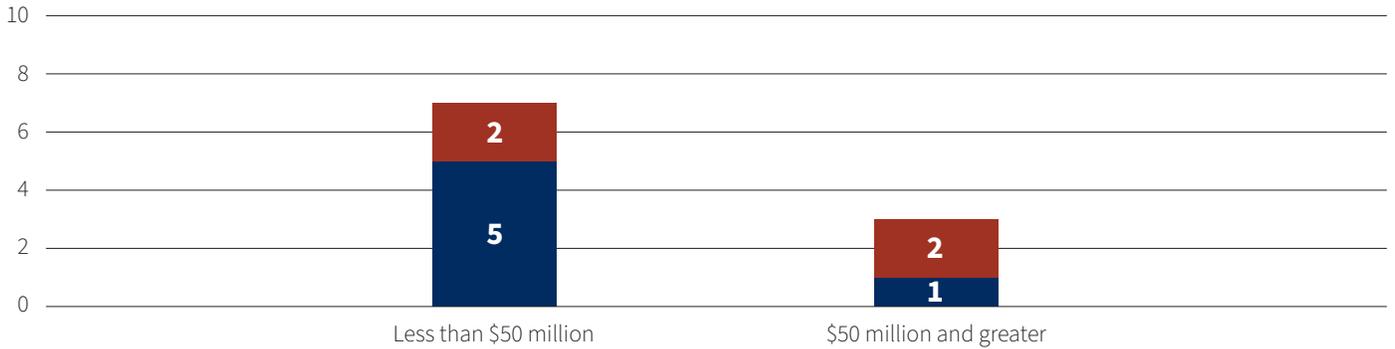
2016



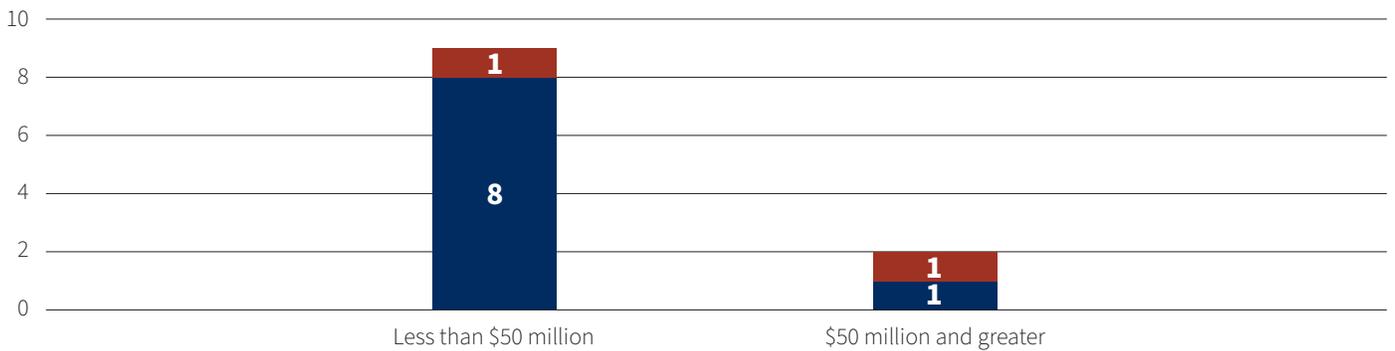
■ Audits without Part I.A deficiencies ■ Audits with Part I.A deficiencies

Inspection Results by Issuer Revenue Range

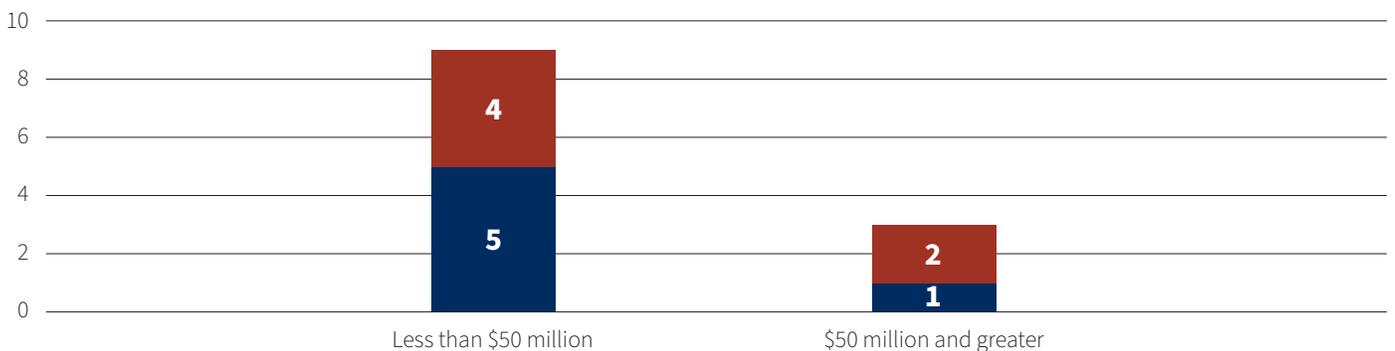
2018



2017



2016



■ Audits without Part I.A deficiencies ■ Audits with Part I.A deficiencies

Classification of Audits with Part I.A Deficiencies

Within Part I.A of this report, we classify each issuer audit in one of the categories discussed below based on the Part I.A deficiency or deficiencies identified in our review.

The sole purpose of this classification system is to group and present issuer audits by the number of Part I.A deficiencies we identified within the audit as well as to highlight audits with an incorrect opinion on the financial statements and/or ICFR.

Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

This classification includes instances where an audit deficiency was identified in connection with our inspection and, as a result, an issuer's financial statements were determined to be materially misstated, and the issuer restated its financial statements. It also includes instances where an audit deficiency was identified in connection with our inspection and, as a result, an issuer's ICFR was determined to be ineffective, or there were additional material weaknesses that the firm did not identify, and the firm withdrew its opinion, or modified its report, on ICFR.

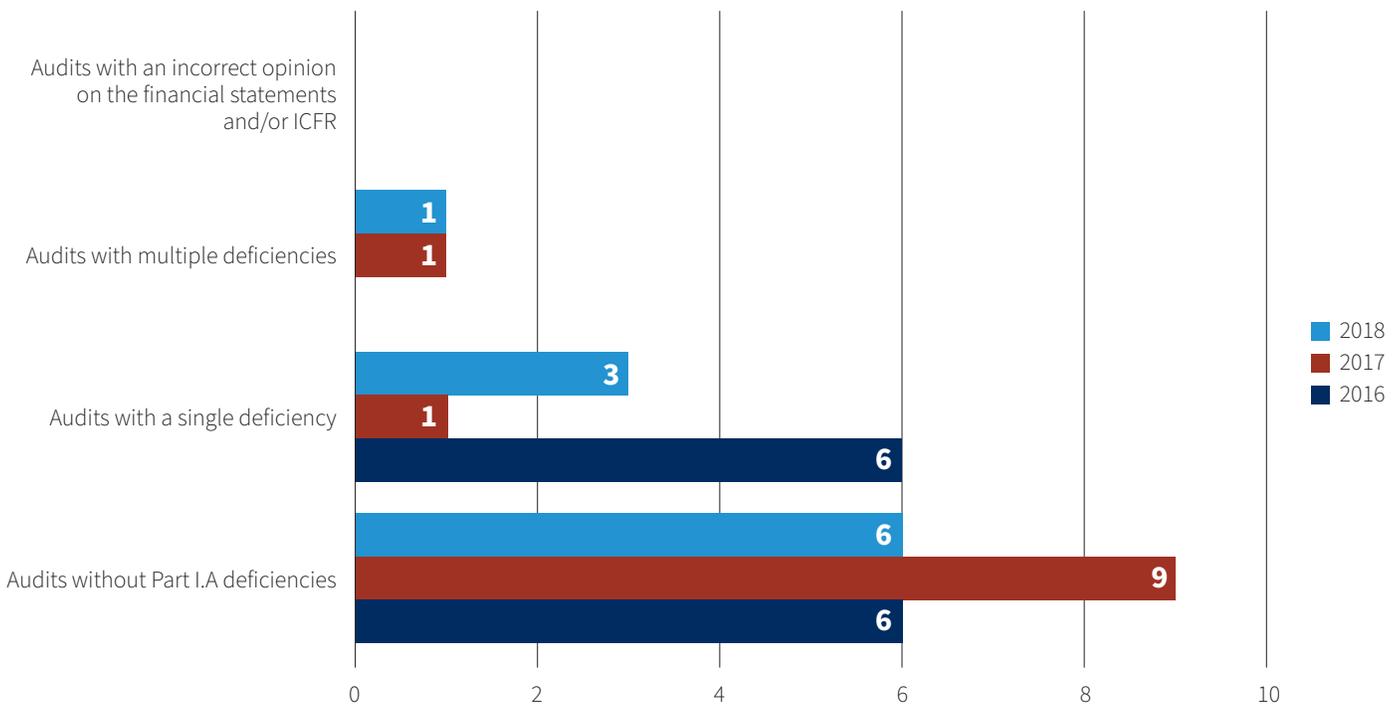
Audits with Multiple Deficiencies

This classification includes instances where multiple deficiencies were identified that related to a combination of one or more financial statement accounts, disclosures, and/or important controls in an ICFR audit.

Audits with a Single Deficiency

This classification includes instances where a single deficiency was identified that related to a financial statement account or disclosure or to an important control in an ICFR audit.

Number of Audits in Each Category



Part I: Inspection Observations

Part I.A of our report discusses deficiencies that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR. Part I.B discusses deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules. Consistent with the Act, it is the Board's assessment that nothing in Part I of this report deals with a criticism of or potential defect in the firm's quality control system. Any such criticisms or potential defects are discussed in Part II. Further, you should not infer from any Part I deficiency or combination of deficiencies that a quality control finding is identified in Part II.

Part I.A: Audits with Unsupported Opinions

This section of our report discusses the deficiencies identified, by specific issuer audit reviewed, in the audit work supporting the firm's opinion on the issuer's financial statements and/or ICFR.

We identify each issuer by a letter (e.g., Issuer A) and industry sector. Each deficiency could relate to several auditing standards, but we reference the PCAOB standard(s) that most directly relates to the requirement with which the firm did not comply.

Issuer audits are presented below within their respective deficiency classifications (as discussed previously). Within the classifications, we generally present the audits based on our assessment as to the relative significance of the identified deficiencies taking into account the significance of the financial statement accounts and/or disclosures affected, and/or the nature or extent of the deficiencies.

Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

None

Audits with Multiple Deficiencies

Issuer A – Real Estate

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement audit related to **Business Combinations**.

Description of the deficiencies identified

During the year, the issuer acquired multiple businesses and used an external specialist to determine the fair values of the assets acquired and the liabilities assumed. The firm's approach for testing these fair values was to review and test management's process. The firm did not evaluate the reasonableness of assumptions used by the specialist to determine the fair values of the assets acquired and the liabilities assumed. (AS 2502.26 and .28)

Audits with a Single Deficiency

Issuer B – Consumer Discretionary

Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to **Revenue**.

Description of the deficiency identified

The firm did not perform any procedures to test, or in the alternative, test any controls over, the accuracy and completeness of system-generated reports used in its substantive testing of certain revenue transactions. (AS 1105.10)

Issuer C – Health Care

Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to **Inventory**.

Description of the deficiency identified

The issuer's products had expiration dates and the issuer determined that a reserve for excess or obsolete inventory was not necessary. In its testing of the process, including assumptions, used by management to evaluate the need for an inventory reserve, the firm did not evaluate whether the issuer's products could be sold at or above cost prior to their expiration dates. (AS 2501.11)

Issuer D – Consumer Discretionary

Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to **Inventory**.

Description of the deficiency identified

The issuer's products consisted of various categories, and each category included numerous individual parts. The issuer determined that a reserve for excess or obsolete inventory was not necessary. In its testing of the process, including assumptions, used by management to evaluate the need for a reserve for excess and obsolete inventory, the firm only performed procedures at the product level and did not consider individual parts for excess quantities or obsolescence. (AS 2501.11)

Part I.B: Other Instances of Non-Compliance with PCAOB Standards or Rules

This section of our report discusses any deficiencies we identified that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules. When we review an audit, we do not review every aspect of the audit. As a result, the area below was not reviewed on every audit inspected.

We identified the following deficiency:

In six of 10 audits reviewed, the firm did not provide to the issuer's audit committee, or equivalent, the management representation letter. In these instances, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

Part II: Observations Related To Quality Control

Part II of our report discusses criticisms of, and potential defects in, the firm's system of quality control.

Deficiencies are included in Part II if an analysis of the inspection results, including the results of the reviews of individual audits, indicates that the firm's system of quality control does not provide reasonable assurance that firm personnel will comply with applicable professional standards and requirements. Generally, the report's description of quality control criticisms is based on observations from our inspection procedures.

Any changes or improvements to its system of quality control that the firm may have brought to the Board's attention may not be reflected in this report, but are taken into account during the Board's assessment of whether the firm has satisfactorily addressed the quality control criticisms or defects no later than 12 months after the issuance of this report.

Criticisms of, and potential defects in, the firm's system of quality control, to the extent any are identified, are nonpublic when the reports are issued. If a firm does not address to the Board's satisfaction any criticism of, or potential defect in, the firm's system of quality control within 12 months after the issuance of our report, any such deficiency will be made public.

Testing Estimates, Including Fair Value Measurements

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the work performed by the firm's personnel to test accounting estimates, including fair value measurements, will meet the requirements of AS 2501 and AS 2502. (QC 20.03 and .17)

In three audits,¹ all of which are included in Part I.A of this report, we identified deficiencies in the firm's procedures to test accounting estimates, including fair value measurements, related to assets acquired and liabilities assumed in business combinations and the valuation of inventory. Specifically, the firm did not evaluate certain assumptions used by the issuer in developing an estimate or fair value measurement.

* * * *

¹ Issuers A, C, and D

Appendix A: Firm's Response to the 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, excluding any portion granted confidential treatment, is attached hereto and made part of this final inspection report.

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. 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.



July 15, 2020

Mr. George Botic
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 2018 Inspection of MaloneBailey LLP

Dear Mr. Botic:

We are pleased to provide our response to the Public Company Accounting Oversight Board's ("PCAOB") report on the 2018 inspection of MaloneBailey LLP dated June 16, 2020 (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.A and 1.B of the Draft Report. In that regard, we have considered whether it was necessary to perform additional procedures in accordance with AS 2901, Consideration of Omitted Procedures After the Report Date, and AS 2905, 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,

MaloneBailey, LLP

Malone Bailey LLP

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