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# 2021 Inspection

# MaloneBailey, LLP

(Headquartered in Houston, Texas)

November 7, 2022

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

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## 2021 INSPECTION

In the 2021 inspection of MaloneBailey, LLP, the Public Company Accounting Oversight Board (PCAOB) assessed the firm's compliance with laws, rules, and professional standards applicable to the audits of public companies.

We selected for review seven audits of issuers with fiscal years generally ending in 2020. For each issuer audit selected, we reviewed a portion of the audit. We also evaluated elements of the firm's system of quality control.

### 2021 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. In certain situations, we may select all of the firm's issuer audits for review.

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 necessarily 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 2021 INSPECTION AND HISTORICAL DATA BY INSPECTION YEAR

The following information provides an overview of our 2021 inspection as well as data from the previous inspection. We use a risk-based method to select audits for review and to identify areas on which we focus our review. Because our inspection process evolves over time, it can, and often does, focus on a different mix of audits and audit areas from inspection to inspection and firm to firm. Further, a firm's business, the applicable auditing standards, or other factors can change from the time of one inspection to the next. As a result of these variations, we caution that our inspection results are not necessarily comparable over time or among firms.

## Firm Data and Audits Selected for Review

	2021	2019
<b>Firm data</b>		
<b>Total issuer audit clients for which the firm was the principal auditor at the outset of the inspection procedures</b>	72	113
<b>Total engagement partners on issuer audit work<sup>1</sup></b>	5	5
<b>Audits reviewed</b>		
<b>Total audits reviewed<sup>2</sup></b>	7	12
<b>Audits in which the firm was the principal auditor</b>	7	12
<b>Integrated audits of financial statements and internal control over financial reporting (ICFR)</b>	1	1
<b>Audits with Part I.A deficiencies</b>	6	4

If we include a deficiency 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 deficiency 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.

<sup>1</sup> The number of engagement partners on issuer audit work represents the total number of firm personnel (not necessarily limited to personnel with an ownership interest) who had primary responsibility for an issuer audit (as defined in AS 1201, *Supervision of the Audit Engagement*) during the twelve-month period preceding the outset of the inspection.

<sup>2</sup> The population of issuer audits from which audits are selected for review may differ from the issuer audits at the outset of the inspection procedures due to variations such as new issuer audit clients for which the firm has not yet issued an audit report or issuer audit clients lost prior to the outset of the inspection.

Our inspection may include 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 the current 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.

If we include a deficiency in our report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — it 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.

Our 2021 inspection procedures involved one audit for which the issuer, unrelated to our review, restated its financial statements to correct a misstatement and the firm revised and reissued its report on the financial statements.

## Audit Areas Most Frequently Reviewed

This table reflects the audit areas we have selected most frequently for review in the 2021 inspection and the previous inspection. 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.

2021		2019	
Audit area	Audits reviewed	Audit area	Audits reviewed
Revenue and related accounts	5	Revenue and related accounts	11
Cash and cash equivalents	5	Cash and cash equivalents	4
Business combinations	2	Debt	3
Equity and equity-related transactions	2	Accruals and other liabilities	3
Other investments	1	Derivatives	2

# PART I: INSPECTION OBSERVATIONS

Part I.A of our report discusses deficiencies, if any, 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, if any, 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 Sarbanes-Oxley Act ("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. We discuss any such criticisms or potential defects in Part II. Further, you should not infer from any Part I deficiency, or combination of deficiencies, that we identified a quality control finding in Part II. Section 104(g)(2) of 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.

## 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 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 a 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 a 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 revised its report, on ICFR. This classification does not include instances where, unrelated to our review, an issuer restated its financial statements and/or an issuer's ICFR was determined to be ineffective. We include any deficiencies identified in connection with our reviews of these audits in the audits with multiple deficiencies or audits with a single deficiency classification below.

### 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.

## 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). 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.

We present issuer audits 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 – Special Purpose Acquisition Companies

##### Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement audit related to **Warrants** and **Equity**.

##### Description of the deficiencies identified

With respect to **Warrants**:

During the audit, the firm did not identify, and appropriately address, that the issuer's accounting for warrants as equity was not in conformity with FASB ASC Topic 815, *Derivatives and Hedging*. (AS 2810.30)

Unrelated to our review, the issuer reevaluated its accounting for these warrants and concluded that a material misstatement existed that had not been previously identified. The issuer subsequently corrected this misstatement in a restatement of its financial statements, and the firm revised and reissued its report on the financial statements.

In its restated financial statements, the issuer recorded these warrants as liabilities and engaged a specialist to determine the fair value for the warrants. The firm's approach for substantively testing the fair values of these warrants was to test the issuer's process. The firm did not evaluate the relevance and reliability of data the company's specialist obtained from an external source and used to develop a significant assumption. (AS 1105.A8a) In addition, the firm did not evaluate the reasonableness of this significant assumption, including whether it was consistent with relevant information. (AS 1105.A8b) The firm also did not evaluate the reasonableness of an assumption that was developed by the issuer and used by the company's specialist. (AS 2501.16)

With respect to **Equity**:

The firm did not identify, and appropriately address, that the issuer's accounting for certain redeemable shares as permanent equity was not in conformity with FASB ASC Topic 480, *Distinguishing Liabilities from Equity*. (AS 2810.30)

## Issuer B

### Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement audit related to a **Business Combination** and **Goodwill**.

### Description of the deficiencies identified

With respect to a **Business Combination**:

During the year, the issuer acquired a controlling interest in a business and engaged a specialist to estimate the fair value of both an acquired intangible asset and the acquired business. The firm's approach for substantively testing the fair value of each was to test the issuer's process. The following deficiencies were identified:

- Beyond comparing certain forecasted assumptions to actual results for the period subsequent to the acquisition, the firm did not evaluate the reasonableness of certain assumptions provided by the issuer and used by the company's specialist. (AS 2501.16)
- The firm did not evaluate the reasonableness of certain assumptions developed by the company's specialist, including the consistency of these assumptions with relevant information. (AS 1105.A8b)
- The firm did not sufficiently evaluate the relevance and reliability of certain data from sources external to the issuer that were used by the company's specialist in developing certain assumptions, because it limited its procedures to inquiry of the company's specialist and obtaining information from the company's specialist. (AS 1105.A8a)

With respect to **Goodwill**:

The issuer used the fair value of the acquired business at the acquisition date to record a goodwill impairment at year end. The following deficiencies were identified:

- The firm did not evaluate whether the impairment of goodwill was the result of an error in the initial valuation at the acquisition date. (AS 2810.30)
- The firm did not perform procedures to determine whether the fair value of the acquired business at the acquisition date was an appropriate or relevant measurement for use in the goodwill impairment analysis as of year end. (AS 2301.08)
- The firm did not identify, and appropriately address, a GAAP departure related to the issuer's omission of disclosures related to the facts and circumstances leading to the goodwill impairment as required by FASB ASC Topic 350, *Intangibles – Goodwill and Other*. (AS 2810.30 and .31)

## Issuer C – Consumer Discretionary

### Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Cash Equivalents** and **Long-Term Investments**.

### Description of the deficiencies identified

With respect to **Cash Equivalents**:

The firm selected for testing controls over the review of journal entries to record cash equivalents and the presentation and disclosure of cash equivalents. The firm did not evaluate the specific review procedures that the control owners performed to determine the completeness of cash equivalents and whether certain investments met the definition and requirements of cash equivalents. (AS 2201.42 and .44)

The firm did not sufficiently evaluate whether certain investments were appropriately presented as cash equivalents, because it did not obtain an understanding of, and evaluate, the nature of those investments, including the underlying investments and the associated risks. (AS 2301.08) In addition, the firm did not perform any substantive procedures to test whether the description of certain cash equivalents in the notes to the financial statements was appropriate. (AS 2301.08)

With respect to **Long-Term Investments**:

The issuer reported the valuation of certain investments based on investee financial results, including both audited and unaudited financial statements and financial statements that were prepared using different accounting principles. The following deficiencies were identified:

- The firm selected for testing a control over the valuation of these investments, including the review of an impairment analysis of these investments. The firm did not evaluate the review procedures that the control owners performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)
- The firm did not apply sufficient auditing procedures to the unaudited financial statements for certain investees, because it limited its procedures to a fluctuation analysis. (AS 1105.B3)
- The firm did not obtain sufficient appropriate audit evidence for an investee's financial statements prepared using different accounting principles, because it did not perform procedures to obtain evidence related to significant differences in accounting principles. (AS 1105.B1 and .B2)

## Issuer D – Information Technology

### Type of audit and related area affected

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

### Description of the deficiencies identified

The issuer entered into contracts with certain customers that required revenue to be recognized over time based on costs incurred to date relative to total estimated costs to complete these contracts. To substantively test revenue, the firm selected a sample of invoices and performed procedures. The following deficiencies were identified:

- With respect to invoices related to contracts for which all revenue was recognized by year end, the firm did not perform procedures to test if the issuer's performance obligations were satisfied before revenue was recognized, beyond obtaining issuer-prepared documents. (AS 2301.08)
- With respect to invoices related to contracts that were open at year end, the firm did not test the accuracy and completeness of certain aspects of schedules used by the issuer to determine the estimated cost for the project or the completeness of reports used to track total cost incurred for the project. (AS 1105.10)
- The firm did not perform sufficient procedures to test the estimated costs to complete for contracts open at year end, because the firm limited its procedures to comparing total actual costs for one contract that was completed subsequent to year end to estimated costs at year end. (AS 2501.07)
- With respect to testing revenue recognition, the firm drew its sample from the population of the issuer's invoices that were not necessarily representative of the revenue recorded during the year. (AS 2315.17)

## Audits with a Single Deficiency

### Issuer E – Special Purpose Acquisition Companies

#### Type of audit and related area affected

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

#### Description of the deficiency identified

The firm did not identify, and appropriately address, that the issuer's accounting for certain redeemable shares as permanent equity was not in conformity with FASB ASC Topic 480, *Distinguishing Liabilities from Equity*. (AS 2810.30)

### Issuer F – 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 issuer engaged a manufacturer to produce and distribute certain of its products. The firm did not perform sufficient procedures to evaluate whether the issuer was acting as a principal or as the agent for this revenue in conformity with FASB ASC Topic 606, *Revenue from Contracts with Customers*. Specifically, in its evaluation, the firm did not evaluate (1) the insurable risk of inventory, (2) the manufacturer's discretion to set minimum prices for inventory sold to the issuer's customers, and (3) the manufacturer's responsibility for honoring the limited warranty extended to the issuer's customers. (AS 2810.30)

## 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 areas below were not necessarily reviewed on every audit. In some cases, we assess the firm's compliance with specific PCAOB standards or rules on other audits that were not reviewed and include any instances of non-compliance below.

The deficiencies below are presented in numerical order based on the PCAOB standard or rule with which the firm did not comply. We identified the following deficiencies:

- In one of seven audits reviewed, the firm did not establish an understanding of the terms of the audit engagement with the audit committee, record such understanding in an engagement letter, and determine that the audit committee acknowledged and agreed to the terms of the engagement. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.
- In one of seven audits reviewed, the firm did not communicate to the issuer's audit committee all of the critical accounting estimates. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.
- In one of seven audits reviewed, the firm's audit report contained inaccurate information regarding the city and country from which the auditor's report had been issued. In this instance, the firm was non-compliant with AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.
- In two of seven audits reviewed, the engagement team performed procedures to determine whether or not matters were critical audit matters but did not include in those procedures certain matters that were communicated to the issuer's audit committee and that related to accounts or disclosures that were material to the financial statements. In these instances, the firm was non-compliant with AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. These instances of non-compliance do not necessarily mean that other critical audit matters should have been communicated in the auditor's report.

## 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.

We include deficiencies 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.

This report does not reflect changes or improvements to the firm's system of quality control that the firm may have made subsequent to the period covered by our inspection. The Board does consider such changes or improvements in assessing whether the firm has satisfactorily addressed the quality control criticisms or defects no later than 12 months after the issuance of this report.

When we issue our reports, we do not make public criticisms of, and potential defects in, the firm's system of quality control, to the extent any are identified. 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, we will make public any such deficiency.

## 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.



August 1, 2022

Mr. George Botic  
Director  
Division of Registration and Inspections  
1666 K Street NW, suite 800  
Washington, DC 20006

Re: Response to the Public Company Accounting Oversight Board's (PCAOB) Draft Report on the 2021 Inspection of MaloneBailey LLP

Dear Mr. Botic:

We are pleased to provide our response to the PCAOB's draft report on the 2021 inspection of MaloneBailey LLP dated June 29, 2022 (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 enhance our audit quality.

We have evaluated 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 PCAOB rules and auditing standards 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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