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re: The Auditors

A China Fraud Dissected: Part 3 AgFeed's Trusted Advisors Protiviti and Latham & Watkins

By [Francine](#) • Mar 7th, 2014 • Category: [Latest](#), [Pure Content](#), [The Big 4 And Globalization](#)



This is Part 3 of a series about the fraud at AgFeed, a Chinese company with a US listing via a reverse merger. [Part 1 Milton Webster, AgFeed Audit Committee Member and Whistleblower](#) discussed the unique occurrence of an audit committee member as a fraud whistleblower. [A China Fraud Dissected: Part 2 AgFeed's Auditors](#) discusses the role of the two public accounting firms that acted as AgFeed's auditors.

An excellent [long read](#) by Dune Lawrence of Bloomberg in December 2013 describes how the AgFeed fraud was discovered and why the company eventually delisted its own common stock from NASDAQ to avoid a mandatory delisting by the exchange. In [July of 2013](#), the company filed for [Chapter 11 bankruptcy](#). Lawrence's story provides more background to help you appreciate what I'm going to talk about next.

Company executives and directors like to believe they can purchase a posse of "trusted advisors". Instead, they've often only bought a gaggle of self-interested auditors, lawyers, and consultants. But to whom does each of those vendors owe loyalty?

Not everyone can be Fred Rittreiser. (From [the deposition](#) of Milton Webster, former AgFeed Audit Committee member and whistleblower. Van Gothner was Chairman and Chief Executive Officer of AgFeed and Webster's personal friend who had recruited him to the board.)

Question from plaintiffs' attorney Joshua Silverman: Do you have an understanding of Mr. Rittreiser's role as an advisor to the Board?

Answer from Webster: As it was from the point in time that I became a director, yes.

Question from plaintiffs' attorney Joshua Silverman: And what was that role?

Answer from Webster: He advised the Board with regard to strategic and financial planning issues and was informal counsel to Van Gothner.

Question from plaintiff's attorney Joshua Silverman Are you using "counsel" in the legal sense?

Answer from Webster: Consigliere.

Question from plaintiff's attorney Joshua Silverman: The Godfather sense of the word?

Answer from Webster: Yes.

Agfeed's executives and the AgFeed board bought and paid for the usual "trusted advisor" suspects: [Public accounting firms Goldman and McGladrey as auditors](#), law firm Stevens & Lee's [Sunjeet Gill](#) as outside counsel, consulting firm Protiviti, law firm Latham & Watkins (Latham) and consulting firm [FTI](#), supporting Latham in the forensic investigation of the fraud allegations.

[Protiviti](#) was formed in May 2002 by many of the former partners and staff of Arthur Andersen's internal audit and business risk consulting practices. These professionals decided to join Robert Half Int'l, a global, publicly-listed staffing firm, rather than form a standalone firm such as [Huron Consulting](#). Protiviti provided support to AgFeed's executives and its board of directors from at least 2008, according to [the deposition of Milton Webster](#), audit committee member.

Question from plaintiffs' attorney [Joshua Silverman](#): Mr. Webster, I'm showing you what's been marked Deposition Exhibit 13. I'll represent to you that that I'm only going to be asking you questions with respect to one email in this stream, and that would be the March 3, 2011, email from Paul Vial [McGladrey audit engagement partner] to K.I.F. Gothner...I'd like to ask you regarding the bullet point that says "SOX/internal control impact" on the second page of the exhibit...Is the first email in this stream an email from Mr. Gothner to you forwarding the email from Mr. Vial on page 1?

Answer from Webster: Yes, uh-huh.

Question from plaintiffs' attorney Joshua Silverman: And then the questioning — the email that I've been asking you questions about follows below under the words "begin forwarded message," correct?

Answer from Webster: Yeah. I don't know exactly — I don't recall what this is referring to. The issues of SOX internal controls was an issue that ran through the whole audit and the lack of internal controls. There was a statement in the 10-K as to material weaknesses, and that's what it refers to, the material weaknesses in financial reporting and control.

Question from plaintiffs' attorney Joshua Silverman: Okay. Well, let me ask you about the last sentence in that same bullet point. There is a reference to "...management's (via Protiviti) and the auditor SOX reports." Do you have an understanding of what the reference to via Protiviti means?

Answer from Webster: Protiviti had been hired going back several years to deal with Sarbanes-Oxley compliance. And they had generated much documentation concerning weaknesses in controls in China.

In June of 2011 Protiviti signed a master services agreement with AgFeed CFO Ed Pazdro, and worked with AgFeed until its bankruptcy. (Detail regarding these contracts, the services covered and the fees owed Protiviti were obtained from [Protiviti's claim](#) filed as a creditor of AgFeed after the bankruptcy.)

In June of 2011, Protiviti was engaged via a work order by CFO Pazdro and Controller Porter to support AgFeed Corporate and its Global Project Management Office (PMO) for AgFeed's 2011 Global Sarbanes-Oxley effort. Also in June of 2011, Protiviti's Shanghai office was engaged to support the Sarbanes-Oxley work to be done on behalf of management in China. An "internal controls manager", Lu Xin, was listed along with Pazdro and Porter as AgFeed leads.

In March of 2012, Protiviti was engaged by the interim CEO Gothner and new CFO Clay Marshall to "provide documentation requested in accordance with subpoena from the SEC dated March 20, 2012." Protiviti requested a \$30,000 retainer, advance payment for these services.

In spite of all of its history with AgFeed and its involvement in 2012 with the ongoing SEC investigation and response to the subpoena, Protiviti signed at least two more work orders in January 2013 to become the company's internal audit service provider. (An additional work order for China is mentioned but that document was not included to substantiate the claim for unpaid fees in bankruptcy. Either the work was never done or they already got paid.)

AgFeed filed for bankruptcy on July 15, 2013. On August 29, 2013 AgFeed filed [an 8-K](#) disclosing that the SEC had issued a "Wells notice" recommending that the full Commission file an enforcement action against the Company. The allegations? From the 8-K:

"the Company violated the antifraud, reporting, books and records and internal controls provisions of the federal securities laws. "

AgFeed had previously disclosed an SEC investigation "into issues arising out of accounting errors and irregularities in the Company's feed mill and legacy farms businesses in China, which resulted in errors and misstatements in the Company's financial statements from 2007 through the second quarter of 2011. AgFeed also disclosed that "certain current or former officers of the Company have also received Wells notices in the same investigation."

When Protiviti signed on to be the internal audit function for the company, it had not yet been paid for its work on the 2011 Sarbanes-Oxley management assessment support or its work related to the SEC investigation and subpoena. As a result, Protiviti is an AgFeed creditor in bankruptcy, owed \$193,416.87 by the AgFeed estate according to its filing.

The Protiviti master services agreement does not commit the firm to performing any of its consulting work under any recognized industry standards.

- 4. Authoritative Standards.** Client acknowledges that there is no authoritative standard against which risk management practices can be directly compared. In practice, methodologies and approaches to measuring, managing and controlling risk vary considerably. New and refined practices continue to evolve and the characterization of policies, procedures or models as sound, "industry standard" or "best" practices is judgmental and subjective.

When Protiviti signed up for the internal audit services work in January of 2013, it did not expand on this no-standards statement. (Protiviti's consulting work would not be governed by the AICPA standards for consulting since it is not a public accounting firm.)

I doubt the engagement letter that Crowe Horwath LLP signed as the [internal audit services vendor to bankrupt, fraud-ridden Colonial Bank](#) included a clause committing it to perform under anything other than the good-old AICPA standards for consulting engagements by audit firms. That approach provides the most flexibility for a public accounting firm and I doubt Colonial was a sophisticated enough client to insist contractually on a higher standard.

But that didn't stop the FDIC from arguing that [the standards and code of ethics of the Institute of Internal Auditors](#), a global education and advocacy organization for internal audit professionals, are the ones reasonable investors would expect a third-party vendor of internal audit services to meet.

A source close to the AgFeed bankruptcy proceedings tells me Protiviti could still be named as an additional defendant by the debtor and equity committee. That claim could be similar to the one the FDIC brought against Crowe Horwath LLP as an internal audit services provider for Colonial Bank. The additional allegations against Protiviti could be based on the firm's apparent failure to see the various alleged AgFeed frauds and report all of them to the Audit Committee on a timely and complete basis.

From [the deposition of Milton Webster](#), audit committee member:

Question from plaintiffs' attorney Joshua Silverman: Mr. Webster, I'm showing you what's been marked [Exhibit 15](#). Could you identify this document for the record, please?

Answer from Webster: This is an email sent by Van Gothner to the Chinese director Zhang and myself with a copy to John Stadler, who was at that time the time chairman and CEO of the company.

Question from plaintiffs' attorney Joshua Silverman: I'd like to ask you about the second paragraph in this email, which begins "We discussed our shared concern regarding the material weakness found during the audit process and the fact that while flagged by Protiviti back in 2008 how was it that management could brush the issue aside without it appearing in Protiviti's reports or being brought to the Audit Committee's attention on a recurring basis until resolved." Do you have an understanding about which particular concerns were flagged by Protiviti back in 2008?

Answer from Webster: No.

Question from plaintiffs' attorney Joshua Silverman: I'd like to move on to the following paragraph, which reads "I have asked Nancy to review their historic files for anything else that she thinks we should be aware of, but which may not have been communicated to us by previous management." To your knowledge, was there any further issues flagged by Protiviti?

Answer from Webster: My files contain a stack of documents from Protiviti acquired over time, some of them going back to those previous periods. There were a number of issues that they raised. They raised the issue of asset valuations, which they said that they could not comment on, and there was a need for the company to get people on the ground to really assess what was there. And this was in response to Glenn McClelland's very aggressively expressed concerns. They had found evidence of violations of the Foreign Corrupt Practices Act that they were very concerned about. They found evidence that the company had failed to pay approximately \$2 million of social service related taxes to the Chinese government, which created a serious potential political problem for the company. They found that there were instances of preferential pricing or payments being made to possibly and likely related parties in China.

The plaintiffs in the AgFeed class action lawsuit will likely not see any value in adding Protiviti as a defendant, but they could use Protiviti's performance as leverage against auditors McGladrey and Goldman, which are already defendants. Protiviti, maybe, did not do all they could have done or did not do well or completely what they did do. That's the premise for some of the FDIC's allegations against auditor PwC in the Colonial Bank case. The FDIC, as receiver of bankrupt Colonial Bank, is suing auditor PwC as well as internal audit services provider Crowe Horwath LLP. The FDIC claims PwC did not, as an external auditor, do everything it should have done to make up for what it said in its own workpapers was insufficient and substandard work by Crowe related to Crowe's Sarbanes-Oxley 404 documentation and testing of internal controls on behalf of Colonial Bank management.

Let me give you one example when McGladrey apparently did not follow up and perform additional investigation or testing to support its audit opinion, including its opinion on internal controls over financial reporting, even though Protiviti said it did not do enough and did not have the skills required.

On August 1, 2011, three months after signing the work order for its engagement to support the 2011 Sarbanes-Oxley assessment by management, according to the [second amended complaint](#) Protiviti circulated a report to Defendants Gothner, Stadler, Pazdro and Marshall, among others, entitled "Protiviti Global Update." In it Protiviti acknowledged that it had been informed by AgFeed management that "during Q2 a whistleblower reported allegations that included references to 'off books records' and overstated assets."

Protiviti also documented that AgFeed had no evidence to support its valuation of significant Chinese assets, and that Protiviti itself was unable to verify the claimed value of assets.

From [the Milton Webster deposition](#):

Question from plaintiffs' attorney Joshua Silverman: Did Mr. Vial indicate whether McGladrey had tested whether the hogs or farms existed?

Answer from Webster: No. It came out, however, that Protiviti, I believe, had sampled the farms. They did a random sample. They, however, came back and they said you need to get professionals in there to do a serious asset valuation. It really wasn't until it was Latham & Watkins and FTI got involved where they actually went around to each and every alleged asset and got hands on if they, in fact, existed.

But at this point in time — I mean, the analysis was, you know, it really gave meaning to the expression liars figure and figures lie in that it was very, very convoluted. He lost a lot of the people in the meeting trying to justify asset values. And McClelland, who is a very good agricultural, you know, accountant said fine and good, but the pigs don't fly, they don't exist.

At this time, Protiviti was not yet an internal audit services provider but simply providing staffing support for management's assessment of Sarbanes-Oxley internal controls. McGladrey might have over-relied on Protiviti's presence and whatever work its professionals did, ostensibly because [Protiviti](#) "retains the intellectual capital used and developed by its professionals over the past decade" and during their tenure at Arthur Andersen.

Chairman and CEO Van Gothner had worked previously with Protiviti Managing Director Nancy Pechloff when she was still at Arthur Andersen, according to Exhibit 15, mentioned above.

(Strange but true, most former Arthur Andersen professionals survive and thrive, buoyed by the belief of many—including thousands of AA alumni in CFO and industry regulatory positions worldwide—that AA was unfairly scapegoated based on one bad client, Enron. Alumni enjoy an industry reputation, at least, for superior professionalism and technical knowledge. That reputation is such that in the overall accounting/audit services vendor pecking order, Protiviti professionals, as progeny of Andersen, enjoy a stronger reputation for technical expertise than professionals at "next tier" firm McGladrey. Protiviti's professional and technical credibility dwarfs that of a 20th tier mini firm like Goldman.)

Unfortunately, McGladrey's and Goldman's possible over-reliance on Protiviti's reputation rather than its actual work, may have caused it to violate PCAOB [Auditing Standard 5](#), Using the Work of Others.

16. The auditor should evaluate the extent to which he or she will use the work of others to reduce the work the auditor might otherwise perform himself or herself....

Note: The auditor should not use the work of persons who have a low degree of objectivity, regardless of their level of competence. Likewise, the auditor should not use the work of persons who have a low level of competence regardless of their degree of objectivity. Personnel whose core function is to serve as a testing or compliance authority at the company, such as internal auditors, normally are expected to have greater competence and objectivity in performing the type of work that will be useful to the auditor.

19. The extent to which the auditor may use the work of others in an audit of internal control also depends on the risk associated with the control being tested. As the risk associated with a control increases, the need for the auditor to perform his or her own work on the control increases.

Protiviti had already admitted to executives it lacked competence in the valuation of the hog farm assets. Protiviti was also, possibly, not as objective as it could have been given its close relationship with the company and its awareness of serious issues management did not seem to be addressing.

Protiviti, through a spokesman, declined to comment on its AgFeed engagements citing client confidentiality.

The year 2011 marked the beginning of the end for AgFeed. The [second amended complaint](#) sets it up:

AgFeed's expansion was fueled in large part by fraud. To raise funds from Wall Street investors and to sustain its stock price, AgFeed engaged in a strategy known internally as "enlarging by faking." It created the illusion of rapid growth by overstating asset values in the Chinese hog farms it purchased, by overstating accounts receivable in its animal feed division, and by slashing its allowance for doubtful accounts even as it realized its customers would be less likely to pay. As a result, throughout the Class Period, AgFeed's financial statements: (a) materially overstated accounts receivable; (b) materially underreserved the allowance for doubtful accounts; and (c) as a result of (a) and (b), materially overstated operating results, net income and assets.

AgFeed also misrepresented in its financial statements the value of equipment, inventory and cost of goods sold in its legacy hog business during the Class Period. In particular: (a) nonexistent assets were recorded; and (b) even where they existed, hogs were not properly recorded at the lower value of cost or market ("LCM"). As a result, the Company materially overstated its net assets (and thus its shareholder equity) in periodic reports and filings throughout the Class Period.

Once the company's executives could no longer sustain the alleged fraud, the disclosures came in squirts, over a span of six months in 2011.

On **March 16, 2011** AgFeed filed an annual report on Form 10-K with the SEC revealing that, contrary to prior Class Period representations, AgFeed had material weaknesses in its financial controls.

AgFeed shares dropped from the prior day's closing price of \$2.01 to as low as \$1.52, but recovered to close the day at \$1.81 for a loss of \$.20, or 10%, on heavy volume. The impact may have been limited because there was more bad news, known but not yet disclosed, still to come.

The most serious deficiencies —those involving AgFeed's accounts receivable, allowance for doubtful accounts, and asset valuation of the legacy hog businesses — were disclosed on **August 2, 2011**, but were still a few pigs short of a drove. AgFeed wrote off \$9.2 million of outstanding accounts receivable in its animal nutrition business as uncollectible and took a charge of an additional \$5 million to increase its allowance for bad debt. Together, these charges caused a substantial loss for the quarter. AgFeed's stock price tanked to \$0.97, or nearly 50%, in five consecutive trading sessions, to close at \$1.02 on August 8, 2011.

According to the [second amended complaint](#), the Defendants were still concealing the most damaging information:

- Asset values had been falsified
- An internal report warned that the Chinese accounting had been fabricated
- A whistleblower report
- Repeated warnings from its Chief Operating Officer that legacy hog farm assets either were non-existent or overstated
- Approximately \$22 million in accounts receivable factored to parties reputedly associated with Chinese organized crime, for which AgFeed had received only a few hundred thousand dollars in cash and was unlikely to receive any further remuneration.

On **September 29, 2011**, after the market closed, AgFeed disclosed "for the first time that its accounting irregularities were so pervasive that not only the collectability, but also the validity, of its debts was in question, and that its asset values were likely misrepresented." The company announced the appointment of a special committee to investigate "the accounting relating to certain of the Company's Chinese farm assets (acquired during 2007 and 2008) used in its hog production business, as well as the validity and collectability of certain of the Company's accounts receivable relating to its animal nutrition business in China and any other issues that may arise during the course of the investigation."

Law firm [Latham & Watkins](#) pitched itself to represent the company, directors, and executives in the [securities and derivative litigation](#) that resulted from these disclosures. Latham continues to serve in that capacity (except the derivative which was wiped out by the bankruptcy) and also now serves as special counsel to the company in bankruptcy.

Latham & Watkins was also hired as counsel to the special investigative committee at the end of 2011 and hired consulting firm FTI to act as forensic accountants under its direction.

Protiviti's work was one area of focus of the special investigation. From [the Milton Webster deposition](#):

Question from plaintiffs' attorney Joshua Silverman: Mr. Bowen [attorney for defendant Gerard Daignault] has raised a number of objections regarding your expression of opinions regarding — about misconduct at AgFeed. And my question for you is did the company not put you in charge of investigating misconduct at AgFeed?

Answer from Webster: I guess the charter under the Special Committee was to investigate certain allegations of accounting impropriety in the China act — in the China operations, certain issues regarding Protiviti's fixed asset valuations, and other issues as they may have come to our attention.

On January 31, 2012, AgFeed announced that the special committee had completed its investigation. From the second amended complaint:

The investigation confirmed the lack of internal controls identified in the first partial disclosure on March 16, 2011, as well as the specific concerns identified in the two subsequent partial disclosures on August 2, 2011 and September 29, 2011. As AgFeed admitted, the investigation established accounting irregularities in the Company's legacy farm hog operations in China resulting in the misstatement of revenues, inventory, property and equipment, and cost of goods sold for the 2008 fiscal year and subsequent periods through the first two quarters of 2011. The Company also admitted that the special committee investigation uncovered facts confirming the unreliability of recorded accounts receivable in the animal feed division. The Company's interim chief executive officer and chief financial officer further concluded that the Company's audited financial statements for the year ended December 31, 2008 should no longer be relied upon. This was in addition to the 2009 and 2010 financial statements the Company previously conceded were unreliable.

As I discussed on [Part 1 of this series](#), AgFeed Audit Committee member Milton Webster will never see his day in court. He passed away unexpectedly last December. Before he died he gave documents and testimony to the SEC to aid its investigation of AgFeed and its executives and also gave [the deposition](#) in the class action lawsuit.

Question from plaintiffs' attorney Joshua Silverman: Mr. Webster, I'm showing you what's been marked Deposition Exhibit 35. Could you please identify this document for the record?

Answer from Webster: It looks like a letter I wrote to Chris Lueking at Latham & Watkins, Bruce Ginn, Michael Faris, Bill Baker, [Michele Rose](#) and Judah Rodgon all from Latham.

Question from plaintiffs' attorney Joshua Silverman: Is this a document you produced to the SEC?

Answer from Webster: Yes.

Milton Webster believed that AgFeed, its executives and their "trusted advisors" did not do everything they could have to be transparent.

Question from plaintiffs' attorney Joshua Silverman: At this time who was Latham & Watkins representing?

Answer from Webster: The Special Committee, the Special Committee and they may have at that time been engaged to represent the officers and directors of AgFeed Industries, who by that point were defendants in both the 10B5 and the derivative actions.

Question from plaintiffs' attorney Joshua Silverman: I'd like to ask you about your statement at the end of the first paragraph, which reads "...I believe it appropriate to insist on complete transparency as to Committee findings and conclusions." Can you explain what you meant by that?

Answer from Webster: It's my opinion that the findings and the conclusions of the Special Committee at the point in time it presented to the Board should be made public.

Question from plaintiffs' attorney Joshua Silverman: In a written report?

Answer from Webster: In a written report and released to the public via the PR news wire or rather, you know, or filed with the SEC, however, on EDGAR.

The investigation was performed under the cloak of attorney-client privilege that, even now, continues to obstruct full transparency. (A recent [New York Times story](#) explains how attorney-client privilege can be used effectively to shield details of an investigation even from regulators, in the Times' story case JPMorgan's investigation of its knowledge of Bernie Madoff's fraud.)

Question from plaintiffs' attorney Joshua Silverman: Did either Latham & Watkins or FTI provide the Special Committee with written reports of interviews?

Answer from Webster: They shared with us any information that we requested. They shared emails with us. They provided a written weekly summary of the investigation. Would you restate your question again?

Question from plaintiffs' attorney Joshua Silverman: Sure. I was wondering if Latham & Watkins or FTI provided the Special Committee with written reports describing their interviews with witnesses.

Answer from Webster: Yes. Yes, they did.

Question from plaintiffs' attorney Joshua Silverman: Was that in the form of emails or in a different written form?

Answer from Webster: No, they were emails.

AgFeed executives rejected Webster's suggestion to produce a written report and to make the report publicly available. From [the Milton Webster deposition](#):

Question from Bowen: Okay. Are you telling me, Mr. Webster, that this report was not reduced to writing at any point?

Answer from Webster: Well, there were many thousands of pages of documentation, but the final report, no, it was not reduced. The Board's report was not reduced to writing. It was a verbal report presented by Latham & Watkins, and I believe FTI was present, a representative was present, via teleconference and then in person both in Chicago and in New York.

As Webster testified in [his deposition](#):

At that point in time, I think Latham was somewhat conflicted in that they represented both the company and the company and — they represented the Special Committee, who's conducting the investigation, and also the company and officers and directors as defendants in actions that could, in theory, have been brought by the company against those officers and directors. So, you know, her concerns were that the Special Committee knew the truth that perhaps was not in the interest of the defendant to have out there if they were trying to protect themselves.

Carson Block of [Muddy Waters Research](#) and a veteran of the Chinese fraud scene commented on Twitter on my post about Milton Webster, whistleblower:



MuddyWatersResearch
@muddywatersre

[@retheauditors](#) piece shows 1) MANAGEMENT narrowed the investigation's scope, 2) prestigious advisors Latham & FTI gave only oral report, and

2:26 AM - Feb 27, 2014

See MuddyWatersResearch's other Tweets



MuddyWatersResearch
@muddywatersre

3) Latham advised against (verbal) report being made public b/c it was unfavorable for company & management.

2:26 AM - Feb 27, 2014

See MuddyWatersResearch's other Tweets

Block recently published an interesting summary of sham Chinese fraud investigations as part of [a recent letter to the management of NQ Mobile](#), a company Block, a short seller, believes is also a fraud. In the letter, Block provides a long list of what he calls, "The Troubling History of China Companies' Independent Committees." In this section he talks about what he calls "numerous other examples of independent committee dysfunction –especially with China issuers".

Block also recently penned an OpEd for the Financial Times on the subject of the false security of "independent" investigations. I will end with an excerpt that should put all investors—and the professionals who theoretically work to protect them—on notice.

[Beware the false reassurance of corporate probes](#)

Time and again, investigators report that they have found no evidence to support claims of wrongdoing. The question that investors need to ask themselves is: how hard did these investigators look for clues that might have revealed something was amiss?

The firms hired to support the probe are often given a deliberately narrow brief. For example, there might be tight restrictions on the investigators' ability to investigate the sources of the company's cash balances.

Fraudsters have repeatedly duped independent committees and their advisers by showing that they control large cash balances. Often, they do this by borrowing the funds. If directors make it impossible to detect such ruses by limiting investigators' access to evidence, nobody knows; the entire process is shrouded by the cloak of attorney-client privilege.

Accounting firms are also rife with conflicts of interest. Their main line of work is auditing public companies. This makes them unwilling to heap embarrassment on management teams and boards. To do so would be bad for business.

Professional advisers are least likely to speak up when they detect a fraud that is an instance of systematic wrongdoing. An auditor confronted with evidence of wrongdoing in a China-based company has a strong incentive to keep it under wraps, lest the discovery of the fraud attract scrutiny to other clients in China.

The refusal of Chinese affiliates of the Big Four accountancies to turn over documents relating to their Chinese audit clients to the Securities and Exchange Commission in January prompted a US judge to prevent them from auditing companies listed in the US. This is a sign of how little faith we should put in the notion that auditors act in investors' interests.

The problem is not confined to emerging markets. In the US, numerous independent board investigations have issued clean bills of health, only to be proved wrong later on.



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4 Responses »

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I seem to have lost the plot.

2. [Francine](#) on [March 8th, 2014 at 8:41 am](#):

@Jack

What's tragic is that I have only scratched the surface in almost 15k words. There are several more stories here but I'm done.

3. [Chuck Sarahan](#) on [March 10th, 2014 at 9:42 am](#):

Anytime you are investing in a Chinese company – extra caution is warranted with the accounting. Caveat emptor really applies. Investing in a Chinese company that obtained a US listing via reverse merger is another warning flag that extra diligence is required. In my opinion, any company that obtains a US listing via reverse merger requires extra due diligence not just Chinese.

4. [The SEC's AgFeed Complaint: No Restatement Means No Sarbanes-Oxley Clawback](#) on [March 25th, 2014 at 2:22 pm](#):

[...] in the Chinese operations of AgFeed that allegedly occurred from 2008 until the end of June 2011. I wrote about Latham & Watkins, the firm that began representing AgFeed and its officers and directors shortly they disclosed the [...]

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• **About the author**

 Francine McKenna (@retheauditors) is the Transparency Reporter at MarketWatch.com, a Dow Jones publication, where her work is also featured frequently in the Wall Street Journal. McKenna had more than twenty-five years of experience in consulting and professional services including tenure at two Big 4 firms, both in the US and abroad before becoming a journalist. Look for her prior columns, "[Accounting Watchdog](#)" at Forbes.com and "[Accountable](#)" at American Banker. For more information, click "About" at the bottom of this page. For more information contact Francine McKenna, fmckenna@mckennapartners.com

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