PCAOB
Public Company Accounting Oversight Board

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ORDER INSTITUTING DISCIPLINARY PROCEEDINGS, MAKING FINDINGS, AND IMPOSING SANCTIONS

In the Matter of Michael F. Albanese, *CPA and Michael F. Albanese, CPA*,

Respondents.

PCAOB Release No. 105-2016-018

June 14, 2016

By this Order, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") is censuring Michael F. Albanese, CPA (the "Firm"), revoking the Firm's registration and imposing a civil money penalty in the amount of $10,000 upon the Firm;[1] and censuring Michael F. Albanese ("Albanese") and barring him from being an associated person of a registered public accounting firm.[2] The Board is imposing these sanctions on the basis of its findings that the Firm and Albanese (collectively, "Respondents") violated PCAOB rules and standards in connection with two audits of one issuer client.

I.

The Board deems it necessary and appropriate, for the protection of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports, that disciplinary proceedings be, and hereby are, instituted pursuant to Section 105(c) of the Sarbanes-Oxley Act of 2002, as amended (the "Act"), and PCAOB Rule 5200(a)(1) against Respondents.

II.

In anticipation of institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondents have each submitted an Offer of Settlement (the "Offers") that the Board has determined to accept. Solely for purposes of these proceedings and any

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1 The Firm may reapply for registration after two (2) years from the date of this Order.

2 Albanese may file a petition for Board consent to associate with a registered public accounting firm after two (2) years from the date of this Order.

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other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the facts contained in paragraphs 15 through 18 and the Board's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to entry of this Order Instituting Disciplinary Proceedings, Making Findings and Imposing Sanctions ("Order") as set forth below.[3]

III.

On the basis of this Order and Respondents' Offers, the Board finds that:[4]

A. <u>Respondents</u>

1. Michael F. Albanese, CPA is, and at all relevant times was, a proprietorship organized under the laws of the state of New Jersey, with an office in Parsippany, New Jersey. The Firm registered with the Board on August 3, 2004, pursuant to Section 102 of the Act and PCAOB rules. The Firm is licensed to practice public accountancy by the New Jersey Department of Business & Professional Regulation (License No. 20CB00418800). At all relevant times the Firm was the external auditor for the issuer identified below.

2. Michael F. Albanese, CPA, 62, of Parsippany, New Jersey, is a certified public accountant licensed by the state of New Jersey (License No. 20CC01888000). At all relevant times, Albanese was the managing partner and sole owner of the Firm, and served as the engagement partner on the audit discussed below. Albanese is an associated person of a registered public accounting firm as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i).

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[3] The findings herein are made pursuant to Respondents' Offers and are not binding on any other persons or entities in this or any other proceeding.

[4] The Board finds that Respondents' conduct described in this Order meets the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5), which provides that certain sanctions may be imposed in the event of (1) intentional or knowing conduct, including reckless conduct, that results in a violation of the applicable statutory, regulatory, or professional standard; or (2) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

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B. Summary

3. This matter concerns Respondents' violations of PCAOB rules and standards in connection with the issuance of audit reports on the financial statements of ColorStars Group ("ColorStars") over a two year period. As detailed below, Respondents failed to obtain sufficient appropriate audit evidence and exercise due professional care and professional skepticism in connection with the audits of the December 31, 2012 and December 31, 2013 financial statements of ColorStars (the "2012 audit" and "2013 audit"), respectively.

4. This matter also concerns the Firm's failure to comply with Auditing Standard No. 7, *Engagement Quality Review* ("AS 7"). In the Firm's audits of ColorStars' 2012 and 2013 year-end financial statements, the Firm failed to obtain an engagement quality review of the audits even though an engagement quality review was required under AS 7.

5. Additionally, Albanese took or omitted to take actions knowing, or recklessly not knowing, that his acts and omissions would directly and substantially contribute to the Firm's violations of AS 7.

C. Respondents Violated PCAOB Rules and Auditing Standards

6. In connection with the preparation or issuance of any audit report, PCAOB rules and standards require that a registered public accounting firm and its associated persons comply with the Board's auditing and related professional practice standards.[5] An auditor may express an unqualified opinion on an issuer's financial statements only when the auditor has formed such an opinion on the basis of an audit performed in accordance with PCAOB standards.[6] Those standards require among other things, that an auditor plan and perform the audit to obtain appropriate audit evidence that is sufficient to support the opinion expressed in the auditor's report.[7] PCAOB standards further require that an auditor exercise due professional care and professional

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[5] See PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*.

[6] See AU § 508.07, *Reports on Audited Financial Statements.*

[7] See Auditing Standard No. 15, *Audit Evidence* ("AS 15") at ¶4.

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skepticism in performing the audit.[8] In addition, PCAOB standards require the auditor's evaluation of audit results to include an evaluation of conditions identified during the audit that relate to the assessment of the risk of material misstatement due to fraud.[9]

7. As described below, Respondents failed to comply with PCAOB rules and standards in connection with the Firm's audits of ColorStars' 2012 and 2013 financial statements.

Audits of ColorStars' 2012 and 2013 Financial Statements

8. ColorStars Group ("ColorStars") is a Nevada corporation headquartered in Irvine, California. ColorStars' public filings disclose that, at all relevant times, it was in the light-emitting diode ("LED") lighting industry, and that its LED lighting application development activity ranged from lighting fixture design to special packaging methods designed for general lighting applications. At all relevant times, ColorStars' common stock was quoted on the OTC Bulletin Board. At all relevant times, ColorStars was an issuer as that term is defined by Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

9. Albanese, as engagement partner, authorized the Firm's issuance of audit reports, dated March 25, 2013, and March 28, 2014, respectively, expressing an unqualified audit opinion on ColorStars' financial statements for the years ended December 31, 2012 and December 31, 2013. The audit reports were included in ColorStars' Forms 10-K filed with the Commission on April 1, 2013 and April 11, 2014, respectively.

10. For the audits of ColorStars' financial statements for 2012 and 2013, a Taiwanese subsidiary's revenue and assets constituted approximately 92 percent and 80 percent of ColorStars' consolidated revenue and assets in 2012, and 93 percent and 84 percent of ColorStars' consolidated revenue and assets in 2013.

11. Respondents failed to comply with applicable professional standards in connection with the ColorStars' audits. They failed to establish an audit strategy and to develop an audit plan.[10] In addition, they failed to identify and assess the risks of

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[8] See AU § 150, *Generally Accepted Auditing Standards* and AU § 230, *Due Professional Care in the Performance of Work*.

[9] See Auditing Standard No. 14, *Evaluating Audit Results* ("AS 14") at ¶ 4.d.

[10] See Auditing Standard No. 9, *Audit Planning* ("AS 9") at ¶¶ 8-10.

material misstatements. For example, Respondents failed to identify revenue recognition as a fraud risk.[11]

12. In its 2012 and 2013 financial statements, ColorStars reported net sales from a subsidiary located in Taiwan of approximately $2,512,000 and $1,575,000, respectively. These amounts represented 92% and 93% of the total net sales for ColorStars through the end of each of the respective years. Respondents failed to perform sufficient appropriate procedures over net sales of the Taiwanese subsidiary. Other than obtaining management representations, inspecting a limited number of sales invoices, recalculating net sales schedules and tracing the net sales to the consolidated trial balance, Respondents failed to perform any other procedures regarding net sales of the Taiwanese subsidiary during the 2012 and 2013 audits. As a result, Respondents failed to sufficiently test whether net sales transactions actually took place and were recorded during the proper period, and whether amounts included in the financial statements were appropriately valued.[12]

13. In its 2012 and 2013 financial statements, ColorStars reported inventory from its Taiwanese subsidiary of approximately $591,000 and $596,000, respectively. These asset balances represented 26% and 39% of the total assets for ColorStars at the end of each of the respective years. Respondents failed to perform sufficient appropriate procedures over inventory balances of the Taiwanese. Other than obtaining management representations, visiting ColorStars' inventory facilities in Taiwan during the 2012 audit, inspecting a limited number of inventory purchase invoices, recalculating inventory schedules and tracing the inventory balance to the consolidated trial balance, Respondents failed to perform any other procedures over the inventory of the Taiwanese subsidiary during the 2012 and 2013 audits. As a result, Respondents failed to sufficiently test whether inventory existed, was owned by ColorStars, and was appropriately valued.[13]

14. In its 2012 and 2013 financial statements, ColorStars reported cash and equivalents from its Taiwanese subsidiary of approximately $289,000 and $112,000, respectively. These asset balances represented 13% and 7% of the total assets for

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[11] See Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement* at ¶ 68.

[12] See Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* at ¶¶ 8-15; see also AS 14 at ¶¶ 32-36; and AS 15 at ¶¶ 4-6.

[13] Id.

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ColorStars at the end of each of the respective years. Respondents failed to perform sufficient appropriate procedures over cash and cash equivalents balances of the Taiwanese subsidiary. Other than obtaining management representations, inspecting certain bank statements, recalculating cash and cash equivalent schedules and tracing the total cash balances from those schedules to the consolidated trial balance, Respondents failed to perform any other procedures related to cash and cash equivalents during the 2012 and 2013 audits. As a result, Respondents failed to sufficiently test whether cash and cash equivalents existed, were owned by ColorStars, and were appropriately valued.[14]

D. <u>The Firm Violated PCAOB Rules and Standards Relating to Engagement Quality Reviews</u>

15. For audits of financial statements for years beginning on or after December 15, 2009, AS 7 requires that an engagement quality review be performed on audits and interim reviews conducted pursuant to PCAOB standards.[15] AS 7 also provides that a firm may grant permission to a client to use the engagement report only after an engagement quality reviewer provides concurring approval of issuance.[16] In connection with the audits of ColorStars' financial statements for 2012 and 2013, the Firm failed to comply with these requirements.

16. For each of these audit engagements, the Firm improperly permitted the issuance of its audit reports which were included in ColorStars' 2012 and 2013 Forms 10-K filings with the Commission, without obtaining an engagement quality review and concurring approval of issuance as required by AS 7. As a result, the Firm violated AS 7.

E. <u>Albanese Contributed to the Firm's Violations of PCAOB Rules and Standards relating to Engagement Quality Reviews</u>

17. PCAOB Rule 3502 prohibits an associated person of a registered public accounting firm from "tak[ing] or omit[ting] to take an action knowing, or recklessly not knowing, that the act or omission would directly and substantially contribute to a violation by that registered public accounting firm of the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports

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[14] <u>Id.</u>

[15] <u>See</u> AS 7 at ¶ 1.

[16] <u>See</u> AS 7 at ¶ 13.

and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act, or professional standards."

18. Albanese, the sole owner of the Firm, was the engagement partner for the audits conducted by the Firm and was responsible for them. Accordingly, he had overall responsibility for ensuring that the Firm complied with PCAOB rules and standards. Albanese knew, or was reckless in not knowing, that his acts and omissions would directly and substantially contribute to the Firm's violations of AS 7, described above. As a result, Albanese violated PCAOB Rule 3502.

IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondents' Offers. Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), Michael F. Albanese, CPA, and Michael F. Albanese are hereby censured;

B. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Michael F. Albanese is barred from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i);[17]

C. After two (2) years from the date of this Order, Michael F. Albanese may file a petition, pursuant to PCAOB Rule 5302(b), for Board consent to associate with a registered public accounting firm;

D. Pursuant to Section 105(c)(4)(A) of the Act and PCAOB Rule 5300(a)(1), the registration of Michael F. Albanese, CPA is revoked;

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[17] As a consequence of the bar, the provisions of Section 105(c)(7)(B) of the Act will apply with respect to Albanese. Section 105(c)(7)(B) provides: "It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any issuer, broker, or dealer in an accountancy or a financial management capacity, and for any issuer, broker, or dealer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission."

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E. After two (2) years from the date of the Order, Michael F. Albanese, CPA may reapply for registration by filing an application pursuant to PCAOB Rule 2101; and

F. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of $10,000 is imposed upon Michael F. Albanese, CPA. All funds collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. Michael F. Albanese, CPA shall pay this civil money penalty within ten (10) days of the issuance of this Order by (1) wire transfer pursuant to instructions provided by Board staff; or (2) United States Postal Service money order, bank money order, certified check, or bank cashier's check (a) made payable to the Public Company Accounting Oversight Board, (b) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006, and (c) submitted under a cover letter which identifies Michael F. Albanese, CPA as a Respondent in these proceedings, sets forth the title and PCAOB release number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to the Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

June 14, 2016