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Auditor Sued for Securities Fraud in Preparation of CSKI Financial Statements

A private investor has filed a lawsuit against the auditor of China Sky One Medical, Inc. (NASDAQ: CSKI), alleging "fraudulent misconduct" and violation of securities laws for failing to correct CSKI's "materially false" financial statements. [Click here](http://www.asensio.com/CSKI/complaint.pdf) for a copy of the complaint.

The complaint states, "...MSPC became aware of the fact that the CSKI Financial Statements were materially false and misleading and its unqualified opinion with respect to them was baseless. Despite becoming aware of these problems, and despite having a duty to correct the information that it knew to be false which had been disseminated into the market via the 10-K, MSPC failed to issue corrected statements or withdraw its support from the CSKI Financial Statements."

CSKI's auditor, Moore Stephens, P.C., has been the subject of [a previous asensio.com report](http://www.asensio.com/Reports/ReportView.aspx?ReportId=932&CompanyId=165&CompanyName=China+Sky+), which details the involvement of the firm in the First Jersey Securities scandal in the 1990's. The [SEC censured Moore Stephens](http://www.asensio.com/CSKI/sec_mspc.txt) and one of its current principals in 1999.

The complaint against Moore Stephens provides evidence of material inaccuracies in CSKI's audited financial statements, specifically concerning patent claims. CSKI's 2008 10-K claims that CSKI holds seven patents. The 10-K's audited financial statements show CSKI's patents having a value of \$15,093,718 at December 31, 2008. A year earlier, on December 31, 2007, the patents' value was only \$1,599,814, according to the 10-K. The list of patents provided in the 10-K entail items such as "bag design patent," "box design patent," and "Endothelin-1 patent relating to anti-tumor technology."

An investigation by a Chinese law firm found that there was only one valid patent registered for CSKI or any of its subsidiaries, according to a report prepared by the firm dated February 10, 2010 and attached to the complaint. The patent is for a box design and belongs to Heilongjiang Tianlong Pharmaceutical ("Tianlong"), a company which CSKI acquired on April 3, 2008, according to CSKI's 10-K. The application date for the Tianlong patent is April 2, 2008, which was the day before the reported closing date on CSKI's acquisition of Tianlong, and the application was not granted until April 2009.

The report notes that there is a record of a patent application made by Harbin Tian Di Ren Medical Science and Technology Co., CSKI's main operating subsidiary. The application was made in 2004, but has not been approved. The report states, "[W]e expect this application is abandoned or is still pending."

The complaint concludes, "...the CSKI Financial Statements were inaccurate in several material respects, including the fact that they reported that CSKI or its subsidiaries owned seven patents in China supposedly worth \$15,093,718, when in fact it did not own any patents. As a result of this material misstatement, the assets of CSKI were substantially overstated in the 10-K."

According to the complaint, the plaintiff in the case sent a copy of the Chinese law firm's investigation report to Moore Stephens and asked the firm to revise its unqualified opinion in CSKI's 2008 10-K. The complaint states, "To date, MSPC has not responded to this request, either privately or publicly, nor has it taken any action to inform the public of its flawed opinion and of the fact that the CSKI Financial Statements are materially false and misleading."