

April 17, 2009

Are China Sky's Financials Believable?

China Sky One Medical, Inc.'s (NASDAQ: CSKI) shares have traded as high as 63% above the low set two days ago. On the surface, the market action seems a response to the company filing its 2008 Form 10-K, which had been delayed since March 31. Yet CSKI had already announced its revenue and net income in a [press release](http://www.asensio.com/CSKI_Release.pdf) on April 7. Beneath the surface, there seem to be good reason to question not just the stock's irregular trading, but China Sky's audited results as well.

China Sky had to restate its 2006 earnings twice, reducing net income from \$4.3 million to \$600,000. The company had three auditors at different times in 2007 alone, and has had four auditors in the last three years. More alarming is that all four of CSKI's auditors have been the subject of controversies concerning auditing improprieties. Also concerning is the number of penny stocks audited by its 2007 auditor.

Investors should also be aware that China Sky is the product of a reverse-merger with an immaterial shell. China Sky's shell had only \$40,000 in equity immediately prior to the reverse-merger. Investors should carefully examine the history of China Sky's backers and other involved parties, including American Eastern Securities, Global Hunter Securities, Guerrilla Capital, Pope Asset Management, and Halter Financial.

CSKI's current auditor is MSPC. Since May 2006, CSKI's other auditors have been Sherb & Co. LLP, Murrell Hall McIntosh & Co., PLLP, and e-Fang Accountancy Corp.

MSPC was formerly known as Moore Stephens, P.C. The firm was at the center of a scandal in the 1990's involving Robert Brennan and First Jersey Securities. Moore Stephens was [sanctioned by the SEC](http://www.sec.gov/litigation/admin/34-41425.txt) in 1999 for its involvement with Brennan. There are only two people on the [Moore Stephens website](http://www.moore-cpa.com) listed having experience with China. One of them is Angelo Coppolino. Mr. Coppolino is one of the Moore Stephens employees named specifically in the SEC sanction from 1999.

Sherb & Co., based in Boca Raton, Florida, has had its own problems. A sampling of Sherb & Co.'s other clients include Proguard Acquisition Corp. (OTC BB: PGRD \$1.05), Neuro-Hitech, Inc. (OTC BB: NHPI \$0.06), Lotus Pharmaceutical, Inc. (OTC BB: LTUS \$0.28), and Electronic Sensor Technology, Inc. (OTC BB: ESNR \$0.04).

The Public Company Accounting Oversight Board (PCAOB) issued an [inspection report](http://www.asensio.com/CSKI/PCAOB_Sherb.pdf) on Sherb & Co. in June 2007, stating that it had found deficiencies in Sherb's audits, including "a deficiency of such significance that it appeared to the inspection team that the Firm did not obtain sufficient competent evidential matter to support its opinion on the Issuer's financial statements."

Murrell, Hall, McIntosh & Co., PLLP was the subject of an [informal investigation](http://www.asensio.com/CSKI/Murrell_hall.pdf) by the SEC's Enforcement

Division. The SEC raised concerns about Murrell Hall's audit of American Dairy, Inc., another US-listed Chinese reverse-merger. CSKI dismissed Murrell Hall after news of the SEC investigation came out.

e-Fang Accountancy was sanctioned in 2008 by the California Board of Accountancy. The sanction stated that e-Fang "admitted to committing gross negligence, violating professional standards, and failing to issue a report in accordance with professional standards in performing an audit."

China Sky management stated in its earnings conference call yesterday that the company is trying to improve its corporate governance and transparency. If that were the case, surely they could have found a better auditor than Moore Stephens.

CSKI's devotion to corporate governance seems more doubtful considering the recent election to its board of directors of a 25-year-old graduate student, to serve on the audit committee as a "financial expert."