

14th ANNUAL ALI-ABA COURSE OF STUDY – ACCOUNTANTS’ LIABILITY  
SCOTTSDALE (PHOENIX), ARIZONA  
DOUBLETREE LA POSADA RESORT  
JANUARY 24-25, 2002

**SEC ENFORCEMENT PROCEEDINGS AGAINST OUTSIDE ACCOUNTANTS  
1999-November 2001**

© December 2001 Christian J. Mixer<sup>1</sup>

*This outline is devoted to recent SEC enforcement matters against outside accountants that focus on violations other than lack of independence.<sup>2</sup> Sections I-III below discuss notable rulings during 1999-November 2001 in cases involving outside accountants. Section IV below summarizes the cases that settled during that period, and Section V lists the cases that were brought during that period and are still pending.*

I. Decisions by the Federal Courts

- A. *Marrie v. SEC*, unpublished order, No. CIV 99-1565-PHX-EHC (D. Ariz. Feb. 22, 2000) (dismissing suit by the respondents in III(A) below to enjoin the Rule 102(e) proceeding against them)
  - 1. The court reaffirmed that judicial review of SEC administrative proceedings lies only in the courts of appeals.

---

<sup>1</sup>Partner, Morgan, Lewis & Bockius LLP, Washington, D.C. Until September 2000, Mr. Mixer was Chief Litigation Counsel in the SEC’s Division of Enforcement. Portions of this outline have been used in prior presentations.

<sup>2</sup>On independence, see the independence rules, Rel. Nos. 33-7919, 34-43602, 35-27279, IC-24744, IA-1911, 2000 SEC LEXIS 2717 (Nov. 21, 2000); for enforcement proceedings regarding auditor independence, see *In the Matter of Peat Marwick LLP*, Rel. No. 34-43862, AAER No. 1360, 2001 SEC LEXIS 98 (Jan. 19, 2001), *reconsideration denied*, Rel. No. 34-44050, AAER No. 1374, 2001 SEC LEXIS 422 (Mar. 8, 2001), *appeal docketed*, No. 01-1131 (D.C. Cir. Mar. 16, 2001); the *Moore Stephens* cases (*In the Matter of Moore Stephens, P.C., et al.*, Rel. No. 34-41425, AAER No. 1135 (May 19, 1999); *In the Matter of Charles E. Falk, CPA*, Rel. No. 34-41424, AAER No. 1134 (May 19, 1999); and the currently-stayed *In the Matter of Dennis M. Gaito, CPA*, A.P. File No. 3-9904, Rel. No. 34-41426, AAER No. 1136, 1999 SEC LEXIS 1014 (Order Instituting Proceedings May 19, 1999)); and *In the Matter of PricewaterhouseCoopers LLP*, Rel. No. 34-40905, AAER No. 1098 (Jan. 14, 1999). See also *In the Matter of Swart, Baumruk & Co., LLP, et al.*, Rel. No. 34-43883, AAER No. 1363 (Jan. 25, 2001).

*In the Matter of Russell Ponce* (see II(A) below), *In the Matter of J. Allen Seymour* (see IV(G) below), *SEC v. Richard P. Smyth, et al.* (see V(B) below), and *In the Matter of Horton & Company, et al.* (see V(D) below) all contain independence allegations, but in none of those cases was lack of independence the top charge.

2. The court also ruled that the commencement of an A.P. against respondents was not a sufficient irreparable injury to relieve respondents of the requirement that they exhaust their administrative remedies by litigating the A.P.

## II. Decisions by the SEC

A. *In the Matter of Russell Ponce*, Rel. No. 34-43235, AAER No. 1297, 2000 SEC LEXIS 1814 (Aug. 31, 2000), *appeal docketed*, No. 00-71398 (9th Cir. Nov. 1, 2000)

1. This long-running A.P., instituted in February 1996, concerned Ponce's 1989-1991 audits of a NASDAQ-listed company called American Aircraft Corporation ("AAC"), which claimed to have roughly \$9 million in assets. At issue were the \$4.6 million recorded as the combined value of a license to manufacture certain aircraft and certain other intangible assets, tools and molds carried at \$1,222,896, and \$562,847 shown as the value of a prototype helicopter. Also at issue were the implications for Ponce's independence of the fact that AAC, at the time of each audit, owed Ponce fees for prior services rendered in amounts that grew from \$17,769 to \$65,000.
2. Reversing ALJ McEwen (who had dismissed the case essentially on the ground that any shortcomings in the AAC audits fell within the realm of Ponce's professional "judgment"), the SEC ruled that Ponce ignored the fact that the \$4.6 million value for the license and other intangibles was based on the overvalued AAC stock given in exchange for them, failed to investigate management representations regarding whether certain designs had progressed beyond r&d, capitalized items that should have been expensed, improperly acquiesced in management's treatment of other items, and was not independent because of the unpaid fees.
3. Sanction: The Commission found that Ponce willfully violated Section 10(b)/Rule 10b-5, aided and abetted and caused AAC's violations of the reporting and books and records provisions, and also engaged in improper professional conduct. The SEC issued a cease and desist order and a Rule 102(e) bar against Ponce with a right to reapply in five years. The Commission did not use the 1998 amendment to Rule 102(e) as the rule of decision, finding Ponce to have acted recklessly and concluding that reckless conduct was sanctionable under old Rule 102(e).
4. Statute of Limitations: Interestingly, even though Ponce never raised the applicability of the five-year statute of limitations contained in 28 U.S.C. § 2462 to 102(e) proceedings, the SEC did

bring up the age of the violations and did a full § 2462 analysis, concluding that Ponce had waived limitations as a defense and that since some of Ponce's conduct fell within five years of the institution of the proceeding, his older actions could in any event be considered in evaluating his motive, intent and the like.

### III. Decisions by SEC Administrative Law Judges

A. *In the Matter of Michael J. Marrie, CPA, and Brian L. Berry, CPA*, Init. Dec. Rel. No. 191, 2001 SEC LEXIS 1923 (Sept. 21, 2001), *petition for review filed*, A.P. File No. 3-9966

1. Marrie was the engagement partner, and Berry the engagement manager, for Coopers & Lybrand's 1994 audit of Cal Micro. The Division/OCA alleged that respondents recklessly failed to conduct a GAAS audit of Cal Micro's 1994 financial statements in the areas of accounts receivable, inventory, and property. Specifically, they were charged with having ignored "red flags" including Cal Micro's writeoff of 33% of its accounts receivable, and also with having failed to follow applicable auditing standards in the areas of inventory obsolescence and property and equipment. As noted in I(A) above, Marrie and Berry's effort to enjoin the the Rule 102(e) proceeding against them was unsuccessful, but on September 21, 2001, ALJ Kelly dismissed it on the merits. Judge Kelly used the same analytical framework in this "old Rule" decision as he did in the *Barry C. Scuttillo* and *Carroll Wallace* matters below, but concluded that Marrie and Berry, unlike Scuttillo and Wallace, had not acted recklessly and therefore had not violated Rule 102(e) as it existed at the time of their conduct.

B. *In the Matter of Barry C. Scuttillo, CPA, and Mark F. Jensen, CPA*, Init. Dec. Rel. No. 183, 2001 SEC LEXIS 844 (May 3, 2001), *petition for review filed*, A.P. File No. 3-9863

1. Like the accountant in IV(T) below, Scuttillo and Jensen were auditors for Sky Scientific. Scuttillo was the engagement partner; Jensen (the same Jensen as in IV(I) below) was the concurring partner. The charges were that respondents failed to plan or perform appropriate audit procedures to audit Sky Scientific's Russian CDs and its mineral properties; failed to maintain control over the confirmation process for the CDs; failed to obtain sufficient competent evidential matter for the valuation of the CDs, the mineral properties, or Sky's Form S-8 stock; and failed to assure that Sky's financial statements complied with GAAP on those items.
2. On May 3, 2001, ALJ Kelly barred Scuttillo from practicing before the Commission for three years based on his failure to expand his audit scope to meet the high risk that Sky presented, the economic irrationality of the purported Russian CD transactions, his failure to keep thorough work

papers despite a prior peer review criticizing him on this score, his surrender of his professional judgment to the demands of his client in crediting a doubtful confirmation, and his failure to audit Sky for unrecorded expenses. On May 4, 2001, Jensen settled this case as well as IV(I) below by consenting to an order barring him from practicing before the Commission, with a right to reapply in three years, see Rel. Nos. 34-44264, AAER No. 1389.

C. *In the Matter of Kevin E. Orton, CPA, et al.*, Rel. No. 34-44072, AAER No. 1377 (March 14, 2001)

1. Orton and his accounting firm, Orton & Co., audited the 1994 consolidated financial statements of PanWorld Minerals International, Inc. According to the Division/OCA, PanWorld reported mining assets at substantially inflated book values that were based on the arbitrary par values assigned to the unregistered stock that PanWorld had used to pay for those assets. Respondents were charged with failing to obtain sufficient competent evidential matter, failure to exercise due professional care and appropriate professional skepticism, and failure to adequately plan the audit. On March 14, 2001, after Orton's sentencing in a criminal matter, Orton and Orton & Co. were permanently barred from practicing before the Commission based on Orton's default.

D. *In the Matter of Carroll A. Wallace, CPA*, Init. Dec. Rel. No. 178, 2000 SEC LEXIS 2798 (Dec. 18, 2000), *petition for review filed*, A.P. File No. 3-9862

1. In a proceeding filed on April 1, 1999, respondent Wallace, a partner in KPMG's Denver office, was charged with improper professional conduct under Rule 102(e) in connection with the audits of the annual financial reports for 1994 and 1995 filed by The Rockies Fund, Inc., a closed-end investment company. Wallace was the engagement partner for both audits. The issue in the case was the Fund's treatment of restricted securities in a company called "Premier," which the Fund carried as "unrestricted" and valued accordingly. In the two years in question, those securities amounted to 28%/12% of the Fund's total assets, and 40%/19% of the Fund's securities portfolio.
2. ALJ Kelly found that the Fund's valuation of the Premier shares departed from its previously-disclosed valuation methods and was incorrect. The ALJ further ruled that the audit team had not responded appropriately to "red flags" in the forms of deficiency letters issued by the SEC after its examinations of the Fund, and the Fund's inconsistent valuations of Premier in its quarterly reports. The ALJ also faulted the auditors for taking insufficient steps to test management's representation that the Premier shares were unrestricted, and failing to test the valuation accorded those shares in the Fund's description of its assets and securities portfolio,

as well as for ignoring year-end transactions in both 1994 and 1995 that pointed to problems with the Fund's valuations.

3. The ALJ determined that the Division of Enforcement was using amended Rule 102(e) against Wallace, but noted that the Division was limiting itself to allegations of reckless conduct and was not attempting to use one of the new scienter standards allowed by amended Rule 102(e). The ALJ approved this on the strength of *Ponce* and *In the Matter of Albert Glenn Yesner, CPA*, Rel. No. 34-42030, AAER No. 1193, 1999 SEC LEXIS 2229 (Oct. 19, 1999), but also ruled that “the type of recklessness that is actionable against an outside auditor must approximate an actual intent to aid in the fraud being perpetrated by the company,” *id.* at \*110, and that “the Division cannot bootstrap its way to victory in an auditing recklessness case by stringing together separate acts of auditing negligence,” *id.* at \*119. The law judge found that Wallace's conduct rose to the level of recklessness when he ignored the fact that the Fund had different and inconsistent valuation policies, failed to investigate whether the Premier shares were restricted, and paid insufficient attention to the above-mentioned “red flags” confronted during the 1994 and 1995 audits.
4. The ALJ rejected the Division's call for a Rule 102(e) bar with a right to reapply in three years, and decided instead that the appropriate sanction was a one-year suspension.

#### IV. Settled Cases

##### A. *In the Matter of Charles K. Springer, CPA, Robert S. Haugen, CPA, Haugen, Springer & Co., PC*, Rel. No. 34-44858, AAER No. 1456 (Sept. 27, 2001)

1. Springer was the partner in charge of the 1996-1999 audits of Vari-L Co. The SEC alleged that during those years Vari-L engaged in a financial reporting fraud that involved improperly recognizing revenue before shipment or simply holding the books open at quarter and year-ends, recognizing false revenue, improperly capitalizing internal labor and overhead costs, overstating revenue, improperly deferring costs. The combined effect of these improprieties was a \$39 million, or 132%, overstatement of the company's balance sheet and a cumulative overstatement of income that disguised a \$14.4 million loss as \$17.1 million in income for 1996-March 31, 2000.
2. Haugen, Springer & Co. had issued unqualified audit reports on Vari-L's 1996-1999 financial statements. The SEC charged that the auditors failed to obtain sufficient competent evidential matter and did not act with due professional care or exercise professional skepticism. Springer also was

charged with a violation of Section 10A(b)(1) of the Exchange Act<sup>3</sup> for failing to inform Vari-L's audit committee that Vari-L had or may have improperly recognized \$1.3 million in 1997 revenues while knowing, or being reckless in not knowing, that that misstatement was material. Finally, Springer was found to have caused and aided and abetted Vari-L's antifraud and books and records violations.

3. Springer consented to a cease and desist order and to a bar from practice before the Commission with a right to reapply in ten years. Haugen and Haugen, Springer & Co. were also barred, with the right to reapply in three years.

B. *In the Matter of Harlan & Boettger, LLP, William C. Boettger, CPA and P. Robert Wilkinson, CPA, Rel. No. 34-44817, AAER No. 1452 (Sept. 19, 2001)*

1. Boettger was the partner responsible for the 1996, 1997, and 1998 audits of Madera International, Inc., and the 1996 and 1997 audits of EMB Corporation. Wilkinson (who joined Harlan & Boettger in 1995), was primarily responsible for the 1994 and 1995 audits of Madera, and was the reviewing partner for the 1996 audits of Madera and the 1996 and 1997 audits of EMB.
2. In 1994 and 1995 Madera purported to purchase four interests in Latin American timber properties in exchange for convertible notes and Madera stock. In one instance Madera wrote up the investment from \$5 million to \$12 million by means of a fiscal year-end journal entry based upon "a study made of the property be an authority in Nicaragua" and the [subsequent] trading value of the Madera stock into which the purchase note was converted. In each instance, the timber investment proved to be worthless, but Madera management continued too long to carry the timber interests at the stated value. Madera also failed to record as related party transactions various consulting agreements with its officers, directors, and companies controlled by them.
3. EMB's audited financials contained two alleged GAAP failings: (a) \$3.9 million in "land held for sale" (representing 94% of the company's total 1996 assets) based on an appraisal report that incorrectly assumed EMB would develop the property and sell its water reserves; (b) a \$1,137,500 asset (68% of stockholder's equity in 1997) described as a "joint venture" to establish and operate a Dutch company, where no joint venture

---

<sup>3</sup>Section 10A, added to the Exchange Act in 1995, requires auditors to report illegal acts that they find in the course of their audits to the client's audit committee and, in some circumstances, the the SEC. See Paul Huey-Burns and Liza M. Ray, "The SEC's Enforcement Program and Section 10A," 29 Sec. Reg. L.J. 199 (Summer 2001); Thomas L. Riesenber, "Trying to Hear the Whistle Blowing: The Widely Misunderstood 'Illegal Act' Reporting Requirements of Exchange Act Section 10A," 56 Bus. Law. 1417 (Aug. 2001).

agreement had been drafted and no Dutch company formed at year-end. Even though Boettger had written management a letter the day before his audit report questioning the valuation of the joint venture, he released his unqualified report to EMB.

4. Boettger, Wilkinson, and the firm were charged with inadequate planning, supervision, and review of the audits, failing to obtain evidence of the ownership; and valuation of the timber properties, failing to ensure that the RPTs were disclosed despite having identified them as such, and failing to exercise due professional care and obtain sufficient competent evidential matter for the EMB transactions. All three consented to permanent Rule 102(e) bars.

C. *In the Matter of Ralph Sanchez, CPA*, Rel. No. 34-44816, AAER No. 1451 (Sept. 19, 2001)

1. Sanchez was the engagement partner for the fiscal 1999 audit of Madera (see IV(B) above). The company's major asset (72% of total assets) reported in 1999 was \$27 million in Brazilian timber properties. The SEC alleged that Madera had no credible evidence of clear title to the properties and no basis for the \$27 million valuation.
2. Sanchez was charged with failing to exercise due professional care, failing to obtain sufficient competent evidential matter, failing to review the timber properties for impairment in view of the absence of any revenue from them, and improperly relying on management representations. The SEC observed that Sanchez was on notice that Madera's management reps were not reliable because Madera had presented Sanchez with fraudulent sales invoices, shipping documents, and cash receipts records. Sanchez made sure that these entries were reversed, but obtained no adequate explanation for the false documents.
3. Sanchez consented to a bar from practice before the Commission with a right to reapply in one year.

D. *United States of America and SEC v. KPMG Siddharta Siddharta & Harsono and Sonny Harsono*, Lit. Rel. No. 17127, AAER No. 1446 (Sept. 12, 2001)

1. In what was described as a "first-ever joint civil action" by DOJ and the SEC under the Foreign Corrupt Practices Act, KPMG-SSH (an Indonesian accounting firm affiliate of KPMG International) and one of its partners, Harsono, were charged with bribing an Indonesian tax official \$75,000 on behalf of a KPMG-SSH client that was beneficially owned by Baker Hughes Incorporated. The bribe, which reduced the subsidiary's tax liability from \$3.2 million to \$270,000, was rolled into KPMG-SSH's bill for its professional fees.

2. KPMG-SSH and Harsono consented to the entry of injunctions forbidding violations, or aiding and abetting violations, of the FCPA or the books and records provisions of the Exchange Act.
- E. *In the Matter of Pat A. Rossetti and Jeffrey M. Yonkers*, Rel. No. 34-44606, AAER No. 1428 (July 27, 2001); Rel. No. 34-4427, AAER No. 1388 (May 2, 2001)
1. In this proceeding, commenced on October 31, 2000, the Division/OCA alleged that the respondents, while serving as independent auditors for Detour Magazine, Inc., learned that their client was using simple fractions of numbers from existing financial statements, rather than actual results of the company's operations, in preparing its quarterlies. The Division/OCA claimed that despite their discovery of these illegal acts, respondents failed to notify the company's management, the board of directors, or the Commission, and that the client continued to use the "fractional" approach in its quarterly financial statements throughout 1997 and 1998. Respondents were also charged with failing to record or require the client to record the expense associated with certain options that the company issued to consultants. In addition to the 10A charges, the auditors were alleged to have aided and abetted their client's violations of Exchange Act Section 13(a) and Rules 13a-1 and 13a-13.
  - b. On May 2, 2001, Respondent Rossetti settled the case against him by consenting to a c&d against further violations of Section 10A, and to a Rule 102(e) bar with a right to reapply in three years, see Rel. No. 34-4427, AAER No. 1388. On July 27, 2001, Respondent Yonkers settled the case by consenting to a c&d against further violations of Section 10A, and to a Rule 102(e) bar with a right to reapply after one year, see Rel. No. 34-44606, AAER No. 1428.
- F. *In the Matter of YourBankOnline.com, et al., and William L. Butcher*, Rel. No. 34-44511, AAER No. 1421 (July 3, 2001) (settling case as to respondent Butcher); see also Rel. No. 34-43359, AAER No. 1315 (Order Instituting Proceedings, Sept. 27, 2000)
1. YourBankOnline was a company with \$200 in cash that claimed to have purchased -- in exchange for \$10 million in cash and stock -- the rights to an Internet banking software program. (The same software had been purchased for \$400,000 a few months earlier.) After the "\$10 million" transaction was announced, YourBankOnline's stock leapt from \$1 to \$32 per share. The software was reflected as an asset -- essentially, the only asset -- on financial statements filed with the SEC in August 1999. Butcher, who audited those financials, was charged under Rule 102(e) with failing to take reasonable steps to determine the true value of the

software, thus violating GAAS and falsely representing that the company's financials comported with GAAP.

2. On July 3, 2001, Respondent Butcher settled the case against him by agreeing to be barred from practice before the SEC, with a right to reapply in one year, see Rel. No. 34-44511, AAER No. 1421.

G. *In the Matter of J. Allen Seymour, CPA*, Rel. No. 34-44461, AAER No. 1413 (June 21, 2001); see also *In the Matter of Michael J. Becker*, Rel. No. 34-44460, AAER No. 1412 (June 21, 2001); *SEC v. Richard P. Smyth, et al.*, Lit. Rel. No. 17175, AAER No. 1466 (Oct. 5, 2001); *SEC v. Richard P. Smyth, et al.*, Lit. Rel. No. 17211, AAER No. 1474 ((Oct. 30, 2001).

1. Becker was the VP-Finance and Administration of Vista 2000, Inc. In its September 1995 Form 10-QSB (which Becker helped prepare but refused to sign), Vista: prematurely consolidated the results of two acquired company with its own results, booked sales that had not been shipped, and recorded an unsubstantiated amount of COGS without comparing its estimate to actual costs. These GAAP violations resulted in Vista's EPS being overstated by 154%. Becker, who also was charged with failing to file stock ownership reports on Forms 3, 4, or 5, consented to the entry of cease and desist orders against further violations of the antifraud, periodic reporting, books and records, and stock ownership reporting provisions. In separate settlements of an SEC injunctive case also brought on June 21, 2001 (see V(B) below), (a) Becker consented to an injunction against further violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 (Lit. Rel. No. 17211), and (b) Smyth, Vista's CEO and Chairman, consented to be enjoined from the antifraud, periodic reporting, books and records, and beneficial ownership reporting provisions, and to take an officer and director bar (Lit. Rel. No. 17175).
2. Seymour was Vista's auditor. He was charged with lacking independence in his conduct of Vista's 1994 audit because his partner owned 23,333 shares of Vista common stock, failing to communicate properly with his predecessor auditor, acquiescing in Vista booking \$1.2 million in income from a transaction in which Vista purportedly sold the marketing rights for certain as-yet-unmanufactured products to a company in exchange for a promissory note whose collectibility was contingent on the successful sale of the products, and failing to conduct meaningful audit procedures into \$635,000 of fictitious sales. Seymour consented to the entry of a cease and desist order against further violations of Section 13(a) of the Exchange Act and Rule 13a-1, and to disgorge his audit fees.<sup>4</sup>

---

<sup>4</sup> The absence from this case of any bar or suspension from practice under Rule 102(e) is striking, as it was in the cases brought against W.R. Grace & Co.'s auditors, see IV(R) below.

H. *SEC v. Arthur Andersen LLP, Robert E. Allgyer, Walter Cercavski, and Edward G. Maier*, Lit. Rel. No. 17039, AAER No. 1410 (June 19, 2001); *In the Matter of Arthur Andersen LLP*, Rel. No. 34-44444, AAER No. 1405 (June 19, 2001); *In the Matter of Robert E. Allgyer, CPA*, Rel. No. 33-7986, Rel. No. 34-44445, AAER No. 1406 (June 19, 2001); *In the Matter of Edward G. Maier, CPA*, Rel. No. 33-7987, Rel. No. 34-44446, AAER No. 1407 (June 19, 2001); *In the Matter of Walter Cercavski, CPA*, Rel. No. 33-7988, Rel. No. 34-44447, AAER No. 1408 (June 19, 2001); *In the Matter of Robert G. Kutsenda*, Rel. No. 34-44448, AAER No. 1409 (June 19, 2001).

1. This series of proceedings focused on Andersen's 1992-1996 audits of Waste Management, Inc. Andersen and four of its partners were charged with issuing unqualified audit reports when it had failed to quantify all known and likely misstatements resulting from GAAP violations and concluded that the quantified misstatements were not material, and netted unrelated gains and losses. Andersen consented to the entry of an antifraud injunction against, to pay a \$7 million civil penalty, and to accept a censure in a Rule 102(e) administrative proceeding based on improper professional conduct. Three Andersen partners also consented to be enjoined from further violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5, to be barred from practicing before the SEC as accountants with the right to reapply in five, three, and three years respectively, and to pay civil penalties of \$50,000, \$40,000, and \$30,000 respectively. A fourth Andersen partner, Kutsenda, consented to be barred from practicing before the SEC with the right to reapply in one year.
2. The SEC conspicuously noted that its "investigation is continuing as to others."

I. *In the Matter of Robert G. Jones, CPA, and Mark F. Jensen, CPA*, Rel. No. 34-44265, AAER No. 1390 (May 4, 2001); Rel. No. 34-44264, AAER No. 1389 (May 4, 2001); see also Rel. No. 34-42828, AAER No. 1261 (Order Instituting Proceedings, May 25, 2000)

1. Jones was the engagement partner for the 1995 audit of Dynamic American Corp. Jensen was the concurring partner. 91% of the assets shown on Dynamic's 1995 financials were attributed to certain Bolivian mining properties as to which the purchase price -- Dynamic preferred stock, to be converted into restricted Dynamic common stock -- was not delivered until after the 1995 year-end. The restricted common was never delivered. The original grant of preferred also was improperly supplemented by Dynamic Class B preferred, whose arbitrary redemption value was then used to buttress the carrying value of the mining assets. Jones and Jensen were charged with failing to adequately plan the audit, failing to obtain sufficient competent evidential mater, failing to maintain an attitude of professional skepticism, failing to exercise due professional

care in the audit, failing to issue a proper audit report with respect to work performed by other auditors, and failing to test the balance sheet presentation of \$4.3 million in “ore concentrates.”

2. On May 4, 2001, Jones consented to the entry of an order barring him from practice before the Commission, with a right to reapply in three years, see Rel. No. 34-44265, AAER No. 1390. On the same day Jensen, to settle both this case and III(B) above, also consented to a Rule 102(e) bar with a right to reapply in three years, see Rel. No. 34-44264, AAER No. 1389.

J. *SEC v. Countryland Wellness Resorts, Inc., et al.; In the Matter of Luis R. Hidalgo, Jr., CPA*, Rel. No. 34-43531, AAER No. 1341 (Nov. 8, 2000); *see also* Lit. Rel. No. 16732, AAER No. 1327 (Sept. 27, 2000).

1. Countryland claimed to be engaged in the mining and electrical contracting businesses and to have plans to operate a longevity center at a “wellness resort and casino” in Las Vegas. Hidalgo was originally sued in the Commission’s injunctive action against Countryland and others, in which the company was charged with having reported non-existent assets including, at various times, \$19.5 million-\$27.3 million in “gold in storage,” \$1.2 billion-\$2.1 billion in “proven gold and silver reserves,” and \$400 million-\$1.1 billion in “Indonesian bank guarantees.” Hidalgo was charged with having rendered false audit reports for 1996, 1997, and 1998 when Hidalgo claimed that Countryland’s financial statements were presented in conformity with GAAP and that he had performed GAAS audits.
2. Hidalgo consented to an injunction against further violations of Securities Act Section 17(a) and Exchange Act Section 10(b)/Rule 10b-5, as well as a Rule 102 (e) bar with a right to reapply in five years.

K. *In the Matter of Schnitzer & Kondub, P.C., et al.*, Rel. No. 34-42979, AAER No. 1278 (June 23, 2000)

1. Schnitzer & Kondub, P.C., Schnitzer, and Kondub audited the 1995-1999 financial statements of DCI Telecommunications, Inc. The Order Instituting Proceedings (“OIP”) charged that DCI’s financial statements improperly accounted for six business combinations, misdescribed a purported \$15 million contract as an intangible asset, and overvalued a \$5 million promissory note. The GAAP violations resulted in overstatements of assets ranging from 40%-1,408% in the affected years, and revenue overstatements of 202% in 1996, 1009% in 1997, and 88% in 1998. Respondents’ GAAS violations included failure to exercise due professional

care, failure to acquire adequate evidentiary support, failure properly to qualify audit opinions, and failure to maintain an attitude of professional skepticism.

2. The respondents agreed to Rule 102 (e) bars with a right to reapply in five years.

L. *In the Matter of Charles E. Wessman*, Rel. No. 33-7854, 34-42709, AAER No. 1251 (April 21, 2000)

1. Wessman (whose accounting firm was not named in the SEC's order) compiled financial statements for Intercontinental Resources, NA, Inc. ("IRC"), and issued a compilation report for the period ended March 31, 1997, in which he stated that he had complied with the AICPA's Statements on Standards for Accounting and Review Services. IRC used the financial statements to sell stock. The OIP charged that Wessman knew or should have known that the compiled statements, among other things, carried assets at unverifiable values, did not properly depreciate certain property and equipment, improperly capitalized certain expenses, either understated or omitted liabilities, and falsely stated that IRC had revenues.
2. Wessman consented to a cease and desist order from further violations of Securities Act Section 17(a) and Exchange Act Section 10(b)/Rule 10b-5.

M. *In the Matter of Nanette Miller, CPA*, Rel. No. 34-42586, AAER No. 1241 (Mar. 29, 2000)

1. Miller was a partner in Chadbourne & Miller, a Washington, D.C. accounting firm that acted as outside auditor for Underwriters' Financial Group, whose 1994 income of \$521,192 was overstated by approximately \$5,687,000 due to falsification of the company's books and records and other fraudulent conduct. The OIP charged that Miller departed from GAAS by failing to obtain competent evidential matter, failing to exercise due professional care, failing to maintain an attitude of professional skepticism, and failing to maintain independence in mental attitude.
2. Miller agreed to, and was given, a permanent Rule 102(e) bar.

N. *In the Matter of William L. Clancy, CPA*, Rel. No. 34-42392, AAER No. 1220 (Feb. 7, 2000)

1. Clancy, a solo practitioner and later a partner in Clancy & Co., P.L.L.C., audited the 1996 and 1997 financial statements of C.E.C. Corporation. In a related injunctive action, the SEC charged CEC

with overvaluing in its financials certain paintings by an artist named Sky Jones, a parcel of coal and timber property in Tennessee, and stock in a company called Synfuels Technologies (which was carried as free-trading but was contractually restricted). In addition, CEC was alleged to have improperly recognized substantially all of its 1996 and 1997 revenues. The OIP against Clancy charged him with failing to conduct GAAS audits in that he did not exercise due professional care, did not apply appropriate professional skepticism, did not recognize the enhanced audit risks associated with CEC's accounts, and did not obtain sufficient competent evidential matter to support his opinion that CEC's financials were presented in conformity with GAAP.

2. Clancy received a Rule 102(e) bar with a right to reapply in three years.

O. *SEC v. Lynne K. Mercer*, Lit. Rel. No. 16409, AAER No. 1216 (Jan. 14, 2000)

1. Mercer, whose CPA license had been revoked in 1992, was sued in an SEC injunctive action for forging the signature of his former audit partner on audit opinions for the financial statements of Computerized Thermal Imaging, Inc., Son-Tech, Inc., and Technology Selection, Inc.
2. Mercer consented to an injunction against further violations of Exchange Act Section 10(b)/Rule 10b-5, to disgorge his "audit fees" of \$5,855, and to pay a \$5,855 penalty.

P. *In the Matter of Carl F. Ruzicka, CPA*, Rel. No. 34-41785, AAER No. 1155 (Aug. 24, 1999)

1. Ruzicka was a partner in Ruzicka & Associates. He audited the 1996 financial statements of Chicago Partnership Board. Because CPB matched buyers and sellers of public limited partnership interests, it was regulated as a broker-dealer, and Ruzicka also reported on CPB's net capital and reserve requirement computations. In 1996-1997, CPB's President diverted \$3.5 million in investor funds and attempted to "balance the books" by removing, and purporting to assume, \$3.4 million of CPB's liabilities to sellers, which in fact were non-assumable. Those dealings left CPB with insufficient reserves and net capital. Ruzicka was charged with recklessly failing to obtain the requisite training to audit a broker-dealer, failing adequately to plan his audits, failing to assess audit risk, failing to exercise due professional care, and failing to obtain sufficient competent evidential matter.

2. Ruzicka received a Rule 102(e) bar with a right to reapply in three years.
- Q. *In the Matter of Gerald R. Hinshaw, CPA*, Rel. No. 34-41680, AAER No. 1147 (Aug. 2, 1999)
1. Hinshaw delivered unqualified audit opinions on 1990-1993 financial statements of American Telephone+Data, Inc. Those financial statements listed as an asset the right to license certain patents that did not exist (and which AT+D had not paid for), as well as shares of preferred stock that AT+D did not own (and which, if owned, would not have been worth the value at which they were carried). Hinshaw was charged with failure adequately to plan his audits and failure to obtain sufficient competent evidential matter (and a correspondingly excessive reliance on management representations).
  2. Hinshaw consented to a permanent Rule 102(e) bar.
- R. The cases brought against W.R. Grace & Co.'s auditors -- *In the Matter of Thomas J. Scanlon, CPA*, Rel. No. 34-41581, AAER No. 1142 (June 30, 1999), and *In the Matter of Eugene F. Gaughan, CPA*, Rel. No. 34-41580, AAER No. 1141 (June 30, 1999).
1. Scanlon was the concurring partner for Price Waterhouse's 1991-1992 audits of Grace, and the engagement partner for the 1995 audit. Gaughan was the engagement partner for 1991-1994. The accounting issue was whether Grace improperly created large reserves in 1991-1992, and then improperly bled those reserves into revenues in subsequent periods. The amount of the reserves varied from \$7 million to over \$60 million. The audit teams were aware of the reserves and proposed to management adjustments that would have eliminated them, but management refused to make the adjustments, and the auditors acquiesced in that refusal on the ground that the amounts in questions were not material.
  2. Scanlon and Gaughan each consented to a cease and desist order against further violations of Exchange Act Sections 13(a)-13(b) and Rules 12b-20, 13a-1, and 13a-13.
- S. *In the Matter of Michael, Adest & Blumenkrantz, P.C., et al.*, Rel. No. 34-41284, AAER No. 1125 (April 14, 1999)
1. Michael, Adest and Blumenkrantz were outside auditors for Power Phone, Inc. 95% of Power Phone's total assets consisted of certain artwork and a software program. It turned out that Power Phone did not own either asset as of the date of the financials. Moreover, Power Phone lacked any basis for its valuations of these items. The respondent firm as well as Michael

and Adest were charged with failing to obtain sufficient competent evidential matter as to both the ownership and the valuation issues, failing to exercise due professional care, and failing to maintain a proper degree of professional skepticism as to those issues.

2. The respondent firm and the individuals consented to permanent Rule 102(e) bars.

T. *In the Matter of Frederick R. Grant, CPA*, Rel. No. 34-41255, AAER No. 1123 (April 5, 1999)

1. Grant was a partner with Grant-Schwartz Associates, CPAs, and was the engagement partner for the audit for Sky Scientific's 1995 financial statements and a reaudit of the 1994 statements. The 1995 accounting issues were the accounting treatment given to the issuance of Form S-8 and restricted stock issued by Sky, the carrying value accorded to certain mineral properties, and the existence of certain other assets. The issue on the reaudit was whether Grant violated GAAS when he simply reused the work papers of the original auditor, who had resigned. The GAAS violations charged were failing to obtain sufficient competent evidential matter and failing to meet the requirements for reliance on a specialist with respect to certain artwork that the company was carrying on its books.
2. Grant consented to a permanent Rule 102(e) bar.

U. *In the Matter of Miguel A. Cabrera, Jr., CPA, et al.*, Rel. No. 34-41038, AAER No. 1107 (Feb. 10, 1999)

1. This case concerned Cabrera & Co.'s audits of Madison Group Associates, Ltd. for 1992 and 1993. Here too, the issue was the valuation of assets -- in this instance, media properties that were materially overvalued, and mortgage notes that Madison did not in fact own. Cabrera was faulted for failing to make reasonable inquiries of Madison's predecessor auditor (who had concluded that the appraisal used to value the media assets was inadequate, had questioned the ownership of the mortgage notes, and had refused to re-issue his 1991 audit report until he had performed additional audit steps), failing to conclude that there was a high degree of intrinsic audit risk and adjust the audit scope accordingly, failing to obtain sufficient competent evidential matter, and failing to qualify or disclaim an opinion in light of the firm's failure to perform a GAAS audit.
2. Cabrera & Co. and Miguel Cabrera were given Rule 102(e) bars with the right to reapply in three years.

V. *In the Matter of James Bogner, CPA*, Rel. No. 34-40987, AAER No. 1103 (Jan. 28, 1999)

1. Bogner & Co. and Bogner (its sole shareholder and employee) performed the 1991 and 1992 audits of Aqua Buoy Corp., later known as Chester Holdings. In 1991-1992 Aqua Buoy made a series of acquisitions, each paid for with a combination of its restricted stock, cash, and promissory notes. The company booked valuations of the acquired companies that were internally inconsistent and violated GAAP because the unregistered stock was given the same value as freely-tradable stock. The impact of these errors in 1992 was a 25% overstatement of assets and shareholders' equity. Bogner was charged with failing to obtain competent evidential matter (particularly from sources independent of management), failing to exercise due professional care, and failing to use appropriate professional skepticism.
2. Bogner received a Rule 102(e) bar with a right to reapply in three years.<sup>5</sup>

## V. Pending Cases

- A. *SEC v. William F. Buettner, Mark D. Kirstein, and Amy S. Frazier*, Lit. Rel. No. 17083, AAER No. 1431 (Aug. 1, 2001)
  1. The SEC has sued a Coopers & Lybrand audit partner and two managers in the United States District Court for the Eastern District of Pennsylvania, charging them with violating Section 10(b) and Rule 10b-5 for participating in an alleged scheme under which AHERF transferred \$99.6 million of reserves from a recently-acquired subsidiary and used them to increase its own reserves or to reduce expenses relating to written off accounts receivable.<sup>6</sup>
  2. AHERF and a number of associated persons had previously been charged in connection with the same activities. *See* Lit. Rel. No. 16534, AAER No. 1254 (May 2, 2000); Lit. Rel. No. 16885, AAER No. 1365 (Jan. 1, 2001); Rel. No. 34-42743 (May 2, 2000); Rel. No. 34-42742 (May 2, 2000); Rel. No. 34-42992 (June 30, 2000); Lit. Rel. No. 16885, AAER No. 1365 (Jan. 1, 2001).

---

<sup>5</sup>There were also three "follow-on" A.P.s brought and settled in 1999-2000 which, however, relate to enforcement actions that originated in federal district court in prior years. They were *In the Matter of Samuel L. White, CPA*, Rel. No. 34-42879, AAER No. 1263 (June 1, 2000) (permanent Rule 102(e) bar); *In the Matter of Michael J. Hooper, CPA*, Rel. No. 34-42157, AAER No. 1210 (Nov. 19, 1999) (Rule 102(e) bar with a right to reapply in five years); and *In the Matter of Herbert Woll, CPA*, Rel. No. 34-41894, AAER No. 1159 (Sept. 22, 1999) (permanent Rule 102(e) bar and a penny stock bar).

<sup>6</sup> The fact that these auditors were sued injunctively for fraud (with the implied threat of a Rule 102(e) proceeding to follow on the basis of any injunction that is entered) stands in marked contrast to the books-and-records-and-reporting-based cease and desist proceedings to which W.R. Grace & Co.'s auditors consented in a "cookie jar reserve" case (see IV(R) above).

- B. *SEC v. Richard P. Smyth, et al.*, Lit. Rel. No. 17044 (June 21, 2001)
1. This case is the litigated component of the Vista 2000 matter discussed in IV(G) above. The SEC filed an injunctive action in the U.S. District Court for the Northern District of Georgia charging three former Vista 2000 officers with fraud, periodic reporting, books and records, and insider selling violations stemming from misstatements in Vista's revenues, income, and assets, along with misreporting of the use of public offering proceeds and misappropriation of company funds. Two of those officers, Smyth and Becker, consented to injunctions and other remedies after the case was filed.
  2. Significantly for purposes of this outline, the fourth defendant in the SEC's injunctive action is Alan T. Davis, Vista 2000's outside auditor, who is charged with the company's false financial reporting for 1995 and 1996, insider trading and tipping, and failing to be independent and failing to conduct a GAAS audit of the company's 1994 financial statement. Davis, along with Vista director and president Arnold E. Johns, Jr., continues to litigate the case, which is pending before Judge Clarence Cooper.
- C. *SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip Harlow*, Lit. Rel. No. 17001, AAER No. 1395 (May 15, 2001); see also *In the Matter of Sunbeam Corporation*, Rel. No. 34-44305, AAER No. 1393 (May 15, 2001); *In the Matter of David C. Fannin*, Rel. No. 33-7977, AAER No. 1394 (May 15, 2001)
1. The Commission has named the Arthur Andersen audit partner for Sunbeam, Phillip Harlow, as a defendant in its injunctive action brought in the United States District Court for the Southern District of Florida against five former executives of Sunbeam Corporation. The SEC alleges that Dunlap and Kersh orchestrated a scheme to depress Sunbeam's results for 1996, and enhance the company's results for 1997 and early 1998, in order to create the impression that Dunlap and Kersh had conducted a successful "turnaround" at Sunbeam. The SEC claims that mechanics of the alleged scheme involved the creation of "cookie jar" reserves and "channel stuffing."
  2. Harlow is charged with having issued unqualified audit opinions on Sunbeam's 1996 and 1997 financial statements despite his alleged awareness of Sunbeam's "accounting improprieties and disclosure failures."
- D. *In the Matter of Horton & Company, et al.*, A.P. File No. 3-10355, Rel. No. 34-43498, AAER No. 1339 (Order Instituting Proceedings, Oct. 31, 2000)

1. The Division/OCA have charged Horton & Co. and Edward Horton with aiding and abetting Monarch Investment Properties, Inc.'s violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13, as well as with engaging in improper professional conduct, by failing to record or cause Monarch to record an expense related to options issued to consultants in 1997, rendering Monarch's 1997 and 1998 financial statements materially misstated. Respondents are also charged with lacking independence because the audit firm's staff accountant made all of Monarch's bookkeeping entries, and the firm then audited the resulting financial statements.
  2. This case is pending before ALJ Foelak.
- E. *SEC v. Solucorp Industries Ltd.*, Lit. Rel. No. 16785, AAER No. 1337 (announcing filing of amended complaint in the S.D.N.Y., Oct. 31, 2000)
1. The Commission amended its complaint in this previously-filed injunctive action to add as a defendant Glenn R. Ohlhauser, a chartered accountant with the Canadian firm MacKay & Partners. The amended complaint alleges that Ohlhauser failed to take appropriate action after he learned of possible illegal conduct by company management. Ohlhauser allegedly discovered, in the course of his audit of Solucorp's financial statements for the period ending December 31, 1997, that Solucorp officials had backdated a license agreement in order to justify Solucorp's recognition of \$500,000 in license fees during the quarter ended September 30, 1997. This amount represented 40% of Solucorp's revenues for that quarter. The SEC claims that Ohlhauser "reasonably concluded that the agreement appeared to have been backdated for improper accounting purposes," but nevertheless failed to comply with Section 10A.
  2. The case is pending before Judge Conner.
- F. *In the Matter of Scott E. Edwards, CPA*, A.P. File No. 3-10220, Rel. No. 34-42910, AAER No. 1271 (Order Instituting Proceedings, June 8, 2000)
1. Edwards is charged with having engaged in improper professional conduct by issuing an unqualified opinion on 1995 financial statements of Firstmark Corp., even though Edwards learned during the audit that Firstmark's investments in one of two start-up companies had become worthless, and that Firstmark had improperly recognized income on appreciation of its investment in the second such company by reclassifying the stock it owned from restricted to tradable.
  2. The proceeding is awaiting an initial decision by ALJ McEwen. The administrative hearing was concluded on October 12, 2000, and briefing was completed on January 22, 2001.

\* \* \*

A 1998 administrative proceeding, worth watching because it raises interesting questions regarding an auditor's obligations when he or she undertakes to provide advice on unaudited statements, is *In the Matter of Jeffrey M. Steinberg and John Geron*, A.P. File No. 3-9608, Rel. No. 34-40025, AAER No. 1038 (Order Instituting Proceedings, May 22, 1998), in which an Arthur Andersen audit partner and a regional practice director are charged with causing Spectrum Information Technologies, Inc.'s violations of Exchange Act Section 13(a) by advising Spectrum that its treatment of the licensing agreements was appropriate for purposes of Spectrum's unaudited quarterly report. The SEC alleges that Spectrum had made false statements to the press and improperly accounted for certain licensing agreements in quarterly filings, thereby misleading investors into thinking that Spectrum had earned millions of dollars in licensing fees and, as a result, had experienced its first two profitable quarters, whereas in fact Spectrum and the licensees had agreed to a "cash in/cash out" scheme under which most of the licensing fees would be offset by equal payments by Spectrum to the licensees under companion licensing agreements. The administrative hearing as to Steinberg and Geron was concluded on January 15, 1999, and briefing was completed on July 9, 1999. The case is awaiting decision by ALJ Mahony.

The SEC also brought an injunctive action against a number of other defendants in the Spectrum matter. In *SEC v. Peter C. Caserta, Salvatore Marino and Dana C. Verrill*, Lit. Rel. No. 17115, AAER No. 1436 (Sept. 5, 2001); *In the Matter of Salvatore T. Marino, CPA*, Rel. No. 34-44761, AAER No. 1435 (Sept. 5, 2001), the Commission announced that Caserta (Spectrum's former president) had consented to the entry of injunctions against further violations of Sections 5(a), 5(c), and 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1, and from aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) and Rules 13a-13 and 12b-20, to pay disgorgement, interest and penalties totalling \$772,638, and to be permanently barred from serving as an officer and director of a public company; that Marino (Spectrum's former CFO) had consented to the entry of injunctions against further violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1, and from aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) and Rules 13a-13 and 12b-20, to pay disgorgement, interest and penalties totalling \$301,792, to be barred from serving as an officer and director of a public company for five years, and to accept a permanent Rule 102(e) bar from practicing before the SEC as an accountant; and that Verrill (Spectrum's former Chairman) had consented to the entry of an injunction against further violations of Sections 5(a) and 5(c) of the Securities Act, and to pay a civil penalty of \$25,000.