

INITIAL DECISION RELEASE NO. 65

ADMINISTRATIVE PROCEEDING FILE NO. 3-8330

**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**

In the Matter of

GEORGE CRAIG STAYNER, CPA

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INITIAL DECISION
May 8, 1995

Appearances:

Susan Ferris Wyderko, Esq.
Assistant Chief, Litigation Counsel
Securities and Exchange Commission

Paul Moxley, Gayanne K. Shmid
Attorneys for Respondent

Before:

Glenn R. Lawrence, Administrative Law Judge.

These public proceedings were instituted by an order of the Commission dated April 6, 1994 (Order) issued pursuant to 17 C.F.R. § 201.2 (e) (1) of the Commission's Rules of Practice to determine whether allegations of misconduct made by the Office of the Chief Accountant (OCA) against George Craig Stayner, CPA (Stayner) are true and what, if any, remedial action would be appropriate in the public interest.

In substance, the Chief Accountant alleged that Stayner, a certified public accountant, licensed by the states of Utah and California during the 1980's, audited financial statements of at least eight public companies. It was alleged that, of these public companies, trading in the securities of Capital Investment Services and Omni Corporation was suspended. The suspension was a result of questions raised as to the adequacy of publicly disseminated information concerning, among other things, the corporate histories and financial conditions of the companies and the claims for exemptions from the registration provisions of the Securities Act of 1933.

It is further alleged that Stayner engaged in improper conduct when he audited the financial statements of Pros International (Pros), a public company, for the years ending December 31, 1984, December 31 1985, and the eleven month period ending November 30, 1986. Such conduct violated Generally Accepted Auditing Standards (GAAS) in that he:

- (a) lacked the necessary knowledge to conduct the Pros audits;
- (b) failed to obtain sufficient competent audit evidence to support his audit opinion;
- (c) failed to conduct the requisite level of due professional care in his conduct of the audit; and
- (d) failed to plan or perform appropriate audit procedures required by GAAS to audit Pros' assets.

The Order instituting public proceedings notes that around December 1986, Pros caused AAA Capital and Securities Corp., a Salt Lake City broker dealer registered with the SEC, to file with the National Quotation Bureau ("NQB") an application to publish quotations on a daily basis of the prices for Pros. The disclosure statement, filed pursuant to Rule 15(c)2-11, showed \$2.6 million in assets consisting of a copyright and licensing rights based on a previous earning history of the copyright and test marketing results of the licensing rights. The 2.6 million figure materially overstated the value of Pros assets under GAAP. A statement by the respondent that Pros financial statements fairly presented the financial position of Pros was contained within the NGB application. Additionally, an audit report dated December 6, 1986 stated that Stayner audited in accordance with GAAP. In actuality, according to the OCA, Stayner did not audit the values of Pros assets but rather relied on Pros management's valuation of its assets. Further, OCA asserts that the only work papers prepared were those Stayner put together one year after the audit and after he received a subpoena from the SEC. Additionally, OCA contends that Stayner made no real effort to verify the Pros financial statements before he signed his audit opinion.

An injunctive action was brought by the Securities and Exchange Commission (SEC) on August 26, 1995, in the U.S. District Court, District of Utah, Central Division, Civil No. 87-C-0751S. The court denied the action noting omissions in the accounting procedures.^{1/} On appeal, the Tenth Circuit Court of Appeals affirmed the District Court's denial of the injunction but held that "Stayner's actions were clearly negligent and probably reckless..." and that Stayner's "errors in the audit report resulted

^{1/} However, it held that Stayner was negligent, lacked the expertise to conduct the audit but did not act with the requisite scienter and reasonably would not commit future violations.

from gross negligence and inexperience." S.E.C. v. Pros International, 994 F.2d 767 at 769-770 (10th Cir. 1993).

The Order further requested a determination as to whether the allegations are true and whether Stayner should be censured, or permanently or temporarily disqualified to practice before the SEC.

Stayner filed an answer stating, in summary, that he neither denied nor admitted allegations relating to the suspension of trading in Capital, Omni, and Pros and that he admitted auditing the statements for those concerns. Stayner further answered that he was without knowledge as to Pros filings with NQS and as to the values of appraised property set out in the financial statement.

Stayner admits that he signed the audits in the NQS, that he represented that he audited according to GAAS, and that he was uncomfortable about the Pros valuation of assets while performing the audit. He denies his report was materially false and misleading, that he failed to verify the assets, and that he prepared work papers a year after the SEC had commenced this proceeding.

Affirmatively, Stayner pleads, without factual allegations, the defenses of: failure to state a claim, res judicata, lack of scienter, lack of proximate cause and cause in fact, lack of reliance and injury, waiver, estoppel, unclean hands, good faith, statute of limitations and lack of legal authority.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon my observation of the various witnesses that testified at the hearing that was held in Salt Lake City, Utah, from October 20, 1994 to October 21, 1994 and also on November 29, 1994, as well as the

briefs, arguments and proposals of facts and law of the parties and the relevant statutes and regulations.

Findings of Fact and Conclusions of Law.

Except as noted, the parties have indicated their agreement to the following findings in their filings of proposed findings of fact and I so find:

Ad-Print, the predecessor to Pros International, was a shell corporation which, as Stayner knew, was revived by attorney Richard C. Landerman. OCA Ex. 10 at p. 94, lines 3-17 (Stayner).^{2/} Landerman approached David Lamoreaux and told him he had some public companies available. Tr. 365 (Lamoreaux). Scott and David Lamoreaux actually purchased the dormant shell from a company owned by Landerman's wife Janet, First Berkeley. Tr. 386 (Lamoreaux). The purchase price of the dormant shell was \$60,000, of which \$10,000 was paid to Landerman's trust account. Tr. 387-88 (Lamoreaux). Stayner knew, during the audit, that Landerman was paid \$10,000 down with more money to be paid later. OCA Ex. 10 at p. 96, lines 17-23 (Stayner). In December 1986, OCA Exhibits 1 through 5 (the "Rule 15(c)2-11 material") were submitted to the National Quotation Bureau (NQB) as part of an application to publish quotations for the common stock of Pros International. (Stipulation of the parties dated October 4, 1994).

David M. Lamoreaux personally delivered the Rule 15(c)2-11 material to the broker so that the stock could be listed for sale to the public. Tr. 372 (Lamoreaux). He told the broker there were people who were interested in buying the stock when it

^{2/} Respondent does not agree, but the record supports this finding.

became available through the market. Tr. 375 (Lamoreaux). The Rule 15(c)2-11 material shows a company called Metro Communications owned over 3 million shares. Resp. Ex. 39 at p. 259. Metro was a corporation that Landerman had created. Tr. 392 (Lamoreaux). He knew that Richard Landerman gave David Lamoreaux's brother-in-law, Stanford Larsen, stock in Pros. Tr. 393 (Lamoreaux). However, as Lamoreaux understood, when Larsen sold the stock he was listed as owning, he had to give the money to Landerman. Tr. 394 (Lamoreaux). Lamoreaux personally arranged for Larsen's stock to be listed with the market maker and sold. Tr. 393-394 (Lamoreaux). Lamoreaux was only aware of one sale to the public of Pros stock, that of Stanford Larsen, which Lamoreaux personally arranged. Tr. 362, 394 (Lamoreaux). One of his employees, Greg Snyder, also received shares in Pros from Landerman under the same arrangement as Stanford Larsen. Tr. 395 (Lamoreaux).

Generally accepted auditing standards (GAAS) require work papers to be prepared to document the work done. OCA Ex. 30, AU 339; Tr. 167 (Moulin). Auditing standards require audit work papers to be prepared contemporaneously with the audit. Tr. 276 (Moulin). It is not acceptable under GAAS to prepare work papers after signing the audit opinion. Tr. 174 (Moulin). It is "dishonest" to prepare work papers after the fact; they "would have been fabricated." Tr. 551 (Bowen).

Stayner signed his unqualified audit report on Pros International on December 8, 1986. Tr. 75 (Stayner). Stayner's first subpoena for his Ad-Print and Pros work papers is dated January 20, 1987. OCA Ex. 12. In January 1987, Stayner learned from an SEC investigator that the SEC was interested in the valuation of the intangible assets. Tr. 82 (Stayner). After receiving his first subpoena, Stayner sat down and drafted what

is now marked as OCA Ex. 6 and 8. He then produced these documents to the staff. OCA Ex. 11 at p. 64 (Stayner). 3/

In 1988, the Commission sent Stayner a second subpoena calling for production of Pros and Ad-Print work papers. OCA Ex. 14. In November 1988, the Commission deposed Stayner and, in preparation for the deposition, asked for copies of documents in Stayner's possession regarding OMNI Capital Corp, Capital Investment Services, and Zeus Energy, three entities which Stayner had audited. Attachment 3 to OCA Ex. 10 (Stayner). In an Order dated September 19, 1994, this Office ordered the parties to exchange copies of documentary exhibits no later than two weeks before the hearing. Two days before the hearing in this proceeding, on October 18, 1994, the OCA received copies of 318 pages of documents pre-marked as Respondent's Exhibits 37-39, described as work papers relating to the Pros and Ad-Print audits. The day before the hearing began, respondent produced another set of work papers, originally marked for identification as Respondent's Exhibit 42, now in evidence as OCA Exhibit 32. See, Tr. 67-68. 4/ OCA Ex. 32 includes a second set of audit documentation for the Pros audit,

3/ Respondent argues, in substance, that he put together the work papers on the intangibles at the time of the investigation in response to a request by the Division and by implication these papers were a substitute for mislaid work papers that were in existence at the time of the original audit.

4/ There was extensive argument on the record by OCA (Tr. 1-43), that such a late submission was inherently unfair to OCA as well as violative of my order. The trial was delayed a day, as a concession to OCA to review the late filings. I disagree with the OCA argument, as will be discussed later, indicating that these papers were undoubtedly fabrications. Rather, it appears to me as proof of the respondent's ineptness and unprofessional conduct. The many contradictions by Stayner as to the work papers reflect that he had lost control of an essential part of his accounting business to his own and the public's detriment.

as well as audit documentation relating to OMNI and Capital Investment. OCA Ex. 32 p. 278-355 (Pros); p. 368-388 (OMNI); p. 388-424 (Capital Investment Services, Inc.).

In a pre-hearing conference held the day the OCA first received copies of Respondent's Exhibits 37-39, respondent's counsel termed Exhibits 37-39 "newly discovered documents." Transcript of hearing on Oct. 18, 1994 at p. 3, line 23-24; see also p. 5, line 8 "newly discovered evidence." 5/ The first day of the hearing this Office ordered Mr. Stayner to confer with his lawyer and make a representation as to when Resp. Ex. 37-39 and OCA Ex. 6, 8 and 32 were prepared. After conferring with Stayner, respondent's counsel represented that the hand written documents in Resp. Ex. 37-39 were prepared before Stayner signed the audit opinion. Tr. 34. Respondent's counsel also represented that OCA Ex. 6 and 8 and the bulk of OCA 32 were drafted prior to the audit report being signed. Tr. 33-35.

The OCA then read into the record Stayner's prior sworn testimony in which he specifically admitted preparing OCA Ex. 6 and 8 only after receiving his SEC subpoena. Tr. 36-37. (The originals of these documents are now within Resp. Ex. 37 at p. 37 and 41-45). The following day Stayner conceded that he had prepared OCA Ex. 6 and 8 and Resp. Ex. 37 at p. 37 and p. 41-45 after he received the Commission's subpoena. Tr. 80-81. See footnote 2.

Sometime around 1988 Stayner changed counsel. Tr. 8. The file now labeled OCA Ex. 32 "was found by then," and in 1988 Stayner gave his counsel those documents. Tr. 83-84, 86 (Stayner). Resp. Ex. 37 appeared after OCA Ex. 32, Stayner testified that in 1989 he wanted to give "a copy of the work file to Mr. Bowen and at

5/ Respondent argues this is not a statement of fact since it is a statement of counsel.

that time, we went through the office again and found what was the work file." Tr. 84 (Stayner). Stayner gave Robert Bowen, Stayner's expert, Resp. Ex. 37-39 sometime after April 15, 1990 and before May 2, 1990. Tr. 481 (Bowen). Stayner did not give Bowen OCA Ex. 32, and Bowen only became aware of its existence shortly before this proceeding began. Tr. 80 (Stayner); 479 (Bowen).

In testifying during this proceeding, Bowen assumed that the memo Stayner created after receiving his first subpoena, Resp. Ex. 37 at p. 41-45, was created prior to when the audit report was signed. Tr. 482 (Bowen). He further assumed that Stayner's audit work "revalued intangible assets based on the value of stock which had been given up based on a prior transaction." Quote from Bowen affidavit, attached to Resp. Ex. 5, at ¶ 6(a); same thought at Tr. 443 (Bowen). Bowen based this assumption on Stayner's note added to Resp. Ex. 37 at p. 45. Tr. 486 (Bowen).

Generally accepted auditing standards (GAAS), promulgated through "Statements on Auditing Standards," or SAS, are the criteria, established by the accounting profession, by which audits must be conducted. Tr. 156 (Moulin). These auditing standards "set the minimum level of quality that auditors are expected, by their clients and the public, to achieve." Sullivan, Gnospelius, DeFliese and Jaenicke, Montgomery's Auditing Tenth Edition, 1985 at p. 49.

Stayner issued an unqualified audit report upon Pros International. Tr. 159 (Moulin) An unqualified report means that the auditor has performed his audit in accordance with GAAS. Tr. 158 (Moulin). Financial statements are the responsibility of management. Tr. 157 (Moulin) The auditor must perform tests to determine whether they are fairly stated in accordance with generally accepted accounting principles (GAAP). Tr. 159 (Moulin). Obtaining sufficient competent audit evidence is the basis

of an audit. Tr. 166 (Moulin); Montgomery's Auditing Tenth Edition at p. 33 ("The purpose of any audit is to enable an auditor to understand the subject matter to the extent and in the particular terms necessary to express an informed opinion on it.") GAAS requires that audit reports be written in a standardized manner. Tr. 160 (Moulin). The Pros audit report was not written in accordance with GAAS. Tr. 161 (Moulin); 554 (Bowen).

As the experts agreed, the intangible assets should have been valued at historical cost. Tr. 233-237 (Moulin); 434 (Bowen). Stayner did not use historical cost. Tr. 237 (Moulin). Audit step 3 on page 305 of OCA Ex. 32 requires: "Obtain assurance the company has legitimate right and claim to intangible assets." This would have been an appropriate audit step, Tr. 237, 242 (Moulin), but it was not performed. If Pros had legitimately purchased intangible assets, it would be reasonable and normal to expect to see contracts evidencing the terms of that sale. Tr. 521 (Bowen). There is no evidence Stayner obtained any contracts evidencing Pros' alleged purchase of the intangible assets.

Pros allegedly obtained the marketing rights from David Lamoreaux's brother Scott. Resp. Ex. 37 at p. 19; OCA Ex. 42 at p. 354. Scott Lamoreaux was elected president and director of Pros on November 24, 1986, the same day Pros allegedly issued stock to acquire the intangible assets. Resp. Ex. 37 at p. 38. Scott Lamoreaux also owned Pros Marketing, the entity to which Pros had loaned money during 1986. OCA Ex. 11 at p. 30 (Stayner). Stayner knew that Scott Lamoreaux and Pros Marketing were both related parties to Pros International. Id. The fact that the bulk of the transactions recorded in the Pros financial statements were with related parties "heightens the skepticism the auditor would have." Tr. 185 (Moulin).6/

6/Respondent contends this was normal accountant's skepticism.

At the time he signed the audit report, Stayner was "uncomfortable" with the valuation of the intangible assets (OCA Ex. 10 at p. 31, line 20) because "it was so high." OCA Ex. 10 at p. 33, line 22. Stayner felt the valuation was "high" because it was based on projections of being able to place the marketing system in so many newspapers during a one-year period that it "seemed awfully ambitious to me." OCA Ex. 10 at p. 36, lines 15-16.

The asset labeled "licensing rights", on the Pros financial statements, was not a "license" and not a "right." Tr. 210 (Moulin). (accord, OCA Ex. 34 at p. 85, line 23-24 (Lamoreaux), not a "formal licensing right."). This is clear from reading the description in OCA Ex. 2, a document reproduced in Resp. Ex. 39 beginning at p. 264. Tr. 210 (Moulin). If the valuation approach Pros used had been appropriate under GAAP, to audit the intangible assets, Stayner had to obtain sufficient competent evidence corroborating the assumptions Pros management made. Tr. 221 (Moulin); 483 (Bowen). Stayner did not obtain such corroboration. Tr. 222 (Moulin); 483, 485 (Bowen).

Stayner did not obtain any independent evidence corroborating the value of the licensing program. Tr. 229 (Moulin); 483, 485-86 (Bowen); OCA Ex. 10 at p. 35 (Stayner). Auditing "by conversation," simply by discussing matters with David Lamoreaux, "is not auditing" because an auditor must obtain competent evidential matter beyond talking to management of the company. Tr. 225 (Moulin). The calculation Lamoreaux provided was premised on an assumption Pros was generating 200 new subscriptions per week, at a net profit of \$7 per subscription. Resp. Ex. 37 at p. 45.1. Stayner did not obtain evidence that any revenue was being generated by the marketing program. Tr. 493 (Bowen). Obtaining contracts is a usual and normal audit procedure, designed to confirm whether the client actually has the contracts represented. Tr. 494

(Bowen). Stayner did not obtain any contracts between Pros and any newspapers. Tr. 499 (Bowen). Instead, all the contracts in the work papers are between other companies. There is no evidence that Pros assumed those contracts or had any rights to them. Tr. 542 (Bowen). The Rule 15(c)2-11 material, used to sell the stock to the public, lists "current customers" of Pros International. Resp. Ex. 37 at p. 257. Stayner had no audit evidence at all that these entities had contracts with Pros International. Tr. 499 (Bowen). Lamoreaux had seen no documents indicating whether Pros Marketing had ever earned any income. Tr. 401 (Lamoreaux).

To audit the value of the copyright in accordance with GAAS, Stayner first had to determine if the copyright existed and if Pros owned it. Tr. 237 (Moulin); accord, OCA Ex. 28, AU 326.04. Tr. 237, 241-242 (Moulin); accord, OCA Ex. 28, AU 326.06.^{7/} Stayner obtained no evidence corroborating Pros' assertion that the copyright generated income. Tr. 239, 240, 242 (Moulin). Lamoreaux apparently told Stayner that the copyright had generated income either in 1983 (Resp. Ex. 37 at p. 45.1) or in 1981-1982 (Resp. Ex. 37 at p. 21). It is "highly unusual" to rely upon gross profit from the use of a copyright to begin with, but if the client is going back to 1981, 1982 or 1983, the auditor must ask what has been happening more recently with the asset. Tr. 239 (Moulin). There is no evidence Stayner asked this question. Id. It would be more appropriate to ask whether the copyright was currently producing a gross revenue, and what the gross revenue was. Tr. 239-240 (Moulin). People 'n Profile was "inactive" until Pros acquired it in December 1986. Tr. 400, 405 (Lamoreaux) 8/.

^{7/}There appears to be no evidence in this record that a copyright was issued. Stayner apparently confused an unfilled application with the grant of a copyright. Tr.151.

^{8/} Stayner did not agree. However the record supports this view.

Before relying upon this alleged transaction (discussing a prior sale of 80,000 shares of Pros stock for \$20,000) to value the intangible assets, GAAS required Stayner to obtain evidence whether it ever in fact occurred. Tr. 248 (Moulin), 487 (Bowen). Stayner obtained no evidence corroborating whether this sale occurred. Tr. 248 (Moulin); 487 (Bowen). Apart from the issue of how the intangible assets were to be valued, "the rest of the audit was pretty simple and straightforward." Tr. 443, line 13-14 (Bowen).

The loan receivable shown on the Pros balance sheet was allegedly from Pros Marketing, an affiliated company. Tr. 205 (Moulin). The notes to the financial statements indicate that this loan was "secured." OCA Ex. 5, note 5. The work papers do not show that this loan is secured. Tr. 522 (Bowen).^{9/}

Resp. Ex. 39 at p. 242 contains a minute of a Pros, International Board of Directors meeting on December 3, 1986. It states "discussed options for Pros Mktg. capitol [sic] problems -chapter II or extra funding from stock sales." Auditors "absolutely" routinely obtain and look at Board of Director Meeting minutes during an audit in order to gather information about existing, prior, pending or future matters. Tr. 508 (Bowen). This notation in the Pros Board of Director meeting minutes concerning possible bankruptcy proceedings for Pros Marketing would cause a reasonable auditor to question the collectability of the \$21,000 loan to Pros Marketing. Tr. 519 (Bowen). There is no evidence the notation caused Stayner to question collectability. Tr. 520 (Bowen). The "loan payable" shown on the Pros financial statements purports to be "secured by assets." OCA Ex. 5, Note 6. The loan was payable to David and Scott

^{9/} This contradiction should have been reconciled by Stayner.

Lamoreaux, who were related parties. GAAP required the related party nature of the transaction to be disclosed. Tr. 249 (Moulin). It was not. Tr. 250 (Moulin).

The Pros financial statements show zero gross profit and no revenues. OCA Ex. 5. The calculation Lamoreaux provided to justify the \$2 million valuation in the Pros financial statements was based on the assumption the program was generating 200 new subscriptions per week, with profit of \$7 per subscription, multiplied by 30 papers. Resp. Ex. 45.1 (Lamoreaux calculation); OCA Ex. 11 at p. 57-58 (Stayner). The work papers do not reflect that Stayner thought Pros had acquired a system that was generating income. Tr. 493 (Bowen). If Pros had in fact acquired viable assets that had been generating income, GAAS would have required Stayner to justify why revenues were not included in the financial statements. Tr. 252-53 (Moulin). There is no evidence that Stayner considered this issue. Tr. 252 (Moulin).

The Pros financial statements show an expense of \$10,000, labeled "consulting fees." OCA Ex. 5, Statement of Operations and Retained Deficit. The "consulting fees" description raises the issue as to what the nature and extent of the consulting work might be. Tr. 255 (Moulin). In fact, the \$10,000 payment to Landerman was the initial payment on the total \$60,000 fee for the Ad-Print shell. Tr. 387-88 (Lamoreaux).

The Pros financial statements reflect that Pros paid \$343 in 1986 for "rent." OCA Ex. 5, Statement of Operations and Retained Deficit. Stayner testified originally that he had simply examined the checks Pros wrote to verify the rent amount. OCA Ex. 11 at p. 38; Tr. 115 (Stayner). Page 352 of OCA Ex. 32 is a list of audit steps to audit the expenses, including rent. Tr. 109 (Stayner). Step two states, "Satisfy yourself that expenses are properly recorded," and Stayner wrote, "No exceptions noted." Tr. 110, 111 (Stayner). The check Pros purportedly wrote for "rent" went to Zion Bank, with

the notation that it was to pay off a loan. Resp. Ex. 37 at 33-34. In testimony, Stayner did not have an explanation for how he could have seen a notation upon a check stating "loan" and categorized it as rent. Tr. 113 (Stayner).

A standard bank confirmation is a letter, sent by the client to its bank and returned directly to the auditor, confirming the bank balance at a particular date. Tr. 187 (Moulin), 126 (Stayner), 518 (Bowen). There is no standard bank confirmation letter in the work papers. Tr. 518 (Bowen). Six weeks after the Pros audit, Stayner testified that he had not confirmed the cash balance with the bank. Ex. 11 at p. 46-47. However, Resp. Ex. 37 at p. 30 strongly implies that he did. Tr. 126 (Stayner).^{10/}

Within Resp. Ex. 37 at p. 21-23 and OCA Ex. 32 at p. 290-92, there is a management representation letter, signed by David Lamoreaux and dated December 5, 1986, and a work sheet David Lamoreaux prepared, explaining the calculation he used to arrive at the valuation of the intangible assets (the "Central Glass" memorandum). Tr. 403 (Lamoreaux); Resp. Ex. 37 at p. 45.1. The management representation letter within Resp. Ex. 37 states that the earnings upon which the copyright valuation was based occurred in 1981 and 1982. Resp. Ex. 37 at 23. This conflicts with the Central Glass memorandum (Id. at p. 45.1) which says that these earnings were in 1983. Tr. 238 (Moulin). It further states that the valuation of the copyright was \$450,000. Resp. Ex. 37 at p. 21. However, the Central Glass memorandum which David Lamoreaux prepared for Stayner (Id. at p. 45.1) gives the valuation of the copyright as \$440,000. The reason auditors obtain representation letters from management is to get a management representation that the information provided is complete and accurate. Tr.

^{10/}Stayner says that at the time he testified he had not located his files.

489 (Bowen). There is no evidence Stayner investigated or resolved the discrepancies between the representation letter and the Central Glass memorandum. Tr. 489 (Bowen).

The notes to the Pros financial statements state that "[o]n November 4, 1986, the stockholders approved the issuance of 12,000,000 shares of the company's restricted common stock for the acquisition of copyrights and licensing rights in the newspaper circulation and advertising industries." OCA Ex. 5, quoting Note 4. In the exercise of professional due care, Stayner should have confirmed whether that event took place on November 4. Tr. 507 (Bowen). The Board of Director minutes within Resp. Ex. 37 recite that on November 24, 1986, the stockholders took the action described in Note 4 of the financial statements. Resp. Ex. 37 at 38-40. There is no evidence in the work papers that Stayner investigated or resolved the discrepancy in the dates between the financial statements and the Board meeting minutes. (Tr. 508, Bowen does not recall any evidence.)

The Pros financial statements, upon which Stayner rendered an unqualified audit opinion, show Retained Earnings as of January 1, 1985 of (\$10,004). OCA Ex. 5, Exhibit D, Statement of Changes in Stockholders' Equity. The Ad-Print financial statements, upon which Stayner rendered an unqualified audit opinion, show Retained Earnings one day earlier, as of December 31, 1984 of (\$66,470). OCA Ex. 5, Ad-Print Statement of Changes in Stockholders' Equity. GAAS required Stayner to document a reconciliation of the retained deficit difference between Ad-Print on December 31 1984, and Pros on January 1, 1985. Tr. 259-61 (Moulin).

The address of Pros listed in the Rule 15(c)2-11 material and used to sell Pros stock to shareholders was in San Diego. Resp. Ex. 39 at 225. The address of Pros, as reflected in the Lamoreaux representation letter, was in Sandy, Utah. Resp. Ex. 37 at

23. The address of Pros in the Lamoreaux representation letter actually was the address of David Lamoreaux's CPA practice. Tr. 397 (Lamoreaux). Stayner knew where Lamoreaux's office was during 1986, as he went there shortly before testifying to look for documents in response to the Commission's first subpoena. OCA Ex. 11 at p. 6 (Stayner). There is no analysis or discussion of the conflicting addresses for Pros reflected in any of Stayner's documentation.

Resp. Ex. 39 at p. 232 shows that 884,000 shares of stock allegedly were exchanged for "People 'n Profile." Tr. 524 (Bowen). Since the financial statements valued People 'n Profile at \$440,000, that would indicate a value of 50 cents per share for the People 'n Profile stock. Tr. 525 (Bowen). The note Stayner added to p. 45 of Resp Ex. 37 before he gave the file to Bowen indicates there allegedly was a prior sale of stock for 25 cents per share, which Stayner allegedly used to value the intangible assets. Tr. 525 (Bowen). There is no analysis in any work papers of the discrepancy between 50 cents and 25 cents per share. Id.

On page 301 of OCA Ex. 32 Stayner noted that the amount listed in the financial statements as paid for "rent" actually had been paid to Zion bank. Stayner wrote, "Paid to bank at instruction of David and Scott Lamoreaux in lieu of rent." Id.; Tr. 114 (Stayner). Stayner did not give this document, or any document with similar information, to his expert Bowen. Id.;

During testimony in this proceeding Stayner had no explanation for how he could have seen a check to Zion Bank with the notation that it was to pay off a loan, and allowed it to be categorized as "rent" in the financial statements. Tr. 113 (Stayner)11/.

11/ Respondent claims that the work-papers show that Lamoreaux made the payment in lieu of rent.

Stayner's unqualified audit report on public company OMNI for the year end June 18, 1986 is dated June 19, 1986. OCA Ex. 10 at 90 (Stayner); report is attachment 16 to OCA Ex. 10. GAAS therefore required Stayner to do an audit of those financial statements, and Stayner's audit report recites that his "examination was made in accordance with generally accepted auditing standards. . . ." Attachment 10 to OCA Ex. 10. The financial statements for OMNI reflected an asset labeled "land," valued at \$198,000. Attachment 10 to OCA Ex. 10; Tr. 515 (Bowen). This was the most material asset in the financial statements. Tr. 510 (Bowen). Page 401 of OCA Ex. 32 contains the Audit Program for the OMNI audit for land. See, Tr. 513 (Bowen).

The first step under the asset category "land" states, "satisfy yourself as to adequacy of carrying value of land." OCA Ex. 32 at 401. That was an appropriate audit step. Tr. 514 (Bowen). Step 4 under the category "land" says, "satisfy yourself as to legal right to land." OCA Ex. 32 at 401. That was an appropriate audit step. Tr. 514 (Bowen). Stayner wrote, "Inspected photocopy of warranty deed date 6/4/86." OCA Ex. 32 at p. 401. GAAS required Stayner to obtain evidence corroborating the value of the land shown on the OMNI financial statements. Tr. 511 (Bowen).^{12/}

Stayner audited public company OMNI at the request of David Lamoreaux. OCA Ex. 10 at 87, lines 7-11 (Stayner); OCA Ex. 32 at 409 (audit planning memo says "OMNI Capital is a corporation with no business activity. David Lamoreaux, CPA, has approached us and requested that we perform an audit on the company.") Stayner audited a public company called Capital Investment Services Inc. at the request of David Lamoreaux. OCA Ex. 32 at 388 (audit planning memo says "We have been contacted

^{12/} The record does not reflect that Stayner obtained such evidence.

by David Lamoreaux, CPA, and asked to perform an audit on Capital Investment Services, Inc.").

Stayner audited a public company called "Wetherell" at the request of David Lamoreaux. OCA Ex. 10 at 89 (Stayner). Stayner audited a public company called "All Time High" for David Lamoreaux. Resp. Ex. 37 at 18 ("I have previously performed audits on All Time High for David."); Resp. Ex. 39 at 259 (Lamoreaux "has been president and director of All-Time High, Inc., a public company. . ."). Stayner did audit work for David Lamoreaux on a company called "Logan County Feeders". Resp. Ex. 37 at 18. Stayner did audit work for David Lamoreaux on a company called "RETEC". Resp. Ex. 37 at 18.

The fact that an audit client is a revived shell with all prior records lost "definitely would deserve some consideration in the approach and investigation. There's no question." Tr. 552 (Bowen). Bowen testified that in his experience, the prior management of a defunct corporation "generally is reachable" so that the auditor can get representations from them. Tr. 552 (Bowen). Bowen would expect a reasonable auditor to obtain audit evidence confirming that the circumstances surrounding the company were such that the retained deficit was appropriately stated. Tr. 516 (Bowen).

Bowen has never seen any audit work papers for Ad-Print. Tr. 504. There is no evidence Stayner investigated the retained deficit number in either the Ad-Print or Pros financial statements, and no information about where either of those numbers were derived. Tr. 259-60 (Moulin). (Bowen, Ad-Print).

The notes to the Pros financial statements recite that "during the years of inactivity, the company lost or misplaced all the financial records, thus no information is available for that period of time." OCA Ex. 5, Note 1. The SEC stopped trading in

the stock of Pros on January 16, 1987 "because of an apparent lack of current adequate and accurate public information concerning the company's business operations and financial condition." OCA Ex. 20. 13/

The notes to the OMNI financial statements Stayner audited also recite that all records have been lost or misplaced. Attachment 16 to OCA Ex. 10. Stayner's audit planning memo on OMNI states that OMNI "is a corporation with no business activity." OCA Ex. 32 at p. 409. The SEC stopped trading in OMNI on June 21, 1988 because of "questions that have been raised about the adequacy and accuracy of publicly disseminated information concerning the corporate histories and financial conditions of the companies, the identities of their shareholders and claims for exemption from the registration provisions of the Securities Act of 1933 made by these companies and pursuant to which their securities are trading." OCA Ex. 19.

The notes to the Capital Investment Services financial statements as of May 31, 1986 and December 31, 1985 also recite that all records have been lost or misplaced. Stayner's audit report is the second report in attachment 15 to OCA Ex. 10. Stayner's audit planning memo on Capital Investment Services, Inc. states that "The company has been dormant..." OCA Ex. 32 at p. 388, third paragraph. The SEC stopped trading in Capital Investment Services on June 21, 1988 because of "questions that have been raised about the adequacy and accuracy of publicly disseminated information concerning the corporate histories and financial conditions of the companies, the identities of their shareholders and claims for exemption from the registration provisions of the Securities Act of 1933 made by these companies and pursuant to which their securities are trading." OCA Ex. 19.

13/ Stayner failed to analyze the effect of the loss of documents.

Bowen thought Stayner had not performed audits on any public companies since his Pros difficulty with the SEC. Tr. 437, 461, 468 (Bowen). Stayner did not tell Bowen that he signed an audit report included within a 10-K filing for Ambra Corporation filed with the Commission in December 1987. Tr. 472 (Bowen); OCA Ex. 37. Bowen was not aware if Stayner was doing audits on other public companies when he performed his peer review for the year ended September 30, 1988. Tr. 474 (Bowen).^{14/}

David M. Lamoreaux was permanently suspended from practice before the SEC in a Rule 2(e) action. Tr. 370 (Lamoreaux); 52 SEC Docket 1908 (1992 WL 308053), AAER 429, October 14, 1992. This concludes areas of agreement between the parties.

Matters of dispute, for the most part, concern themselves with whether respondent fabricated work papers after signing the audit. They also concern Stayner's conduct as an accountant by suggesting recklessness or gross negligence. The respondent has also argued that collateral estoppel bars the Commission from bringing this proceeding.

The OCA asserts that Stayner fabricated, some time after signing the audit, the key work papers on intangible assets, adding additional text prior to sending the documents to his expert, Mr. Bowen. (OCA Ex.11 at p. 64). Respondent concedes the "after the fact" creation of the papers on intangibles, but argues that all of the work papers were in existence at one time and were mislaid. Shortly before this proceeding began, the respondent produced 500 pages in two discrete sets of what he claims is his contemporaneously prepared Pros audit documentation. Resp. Ex. 37 and OCA Ex. 32 including the papers on intangible assets. (Resp. Ex. 37 at. pp. 37, 41-45).

^{14/} Respondent says he was not required to notify Bowen that he was auditing public companies.

It is not clear from the record where the additional audit documentation came from. Tr. 85 (Stayner). Stayner testified that by 1989 "someone in the staff had found" the documents now in OCA Ex. 32, and thereafter he "was asked if [he] could provide a copy of the work file to Mr. Bowen." Tr. 83, 84. Stayner testified that he "became aware that somehow, someone in the office had located this other file." Tr. 85. He added "extra notation" to his work-paper pages, placed them in Resp. Ex. 37, and sent that file to Mr. Bowen. Tr. 85. Two sets of work papers as well as a separate segment supporting the intangible assets portion are in the record. Stayner explains that when he worked late and couldn't find papers he created another set to avoid having to look for them. (Tr. 104, Stayner). I find his story credible but reflecting negatively on his conduct as an accountant. Further, I find that OCA is estopped from raising the fabrication issue here since it has already been raised in the United States District Court and not credited there. Resp. EX. 14 ¶ 56. There should be some sort of a trail leading from his audit to his work papers. It appears that Stayner was creating a chaotic mess with little hope of reconstructing the work process, if every time Stayner mislaid a document he created a new one. Further, his failure to produce the papers when they were first subpoenaed by the OCA as well as the addition of notations to a second set furnished to his expert (Tr. 84-85, 89-91) is also very questionable.

Additionally, it is noted that Stayner, notwithstanding the assurances of his counsel, failed to testify during his direct case. His appearance would have been of help in clearing up a number of areas of confusion. Had he testified, I assume his testimony would have been adverse and would have supported OCA's case that he was grossly negligent. See, e.g., N. Sims Organ & Co. v. S.E.C., 293 F.2d 78, 80-81 (2d Cir. 1961) (in affirming SEC order revoking broker-dealer registration, court observed that

respondent's failure to testify was "significant," and that "accepted rule is that failure to explain facts and circumstances warrants the inference that his testimony would have been adverse"); Koufakis v. Carvel, 425 F.2d 892, 902 (2d Cir. 1970); E. Cleary, McCormick on Evidence § 272 at 804-05 (3d ed. 1984).

The respondent essentially loaned out his name as a CPA to, in effect, certify the value of substantial corporate assets in Pros where little actually existed - all to facilitate the creation of a market in stock which realistically had only a very nominal worth. In accomplishing this end, he violated GAAS in that he:

- (a) lacked the necessary knowledge to conduct the Pros audits;
- (b) failed to obtain sufficient competent audit evidence to support his audit opinion;
- (c) failed to conduct the requisite level of due professional care in his conduct of the audit; and
- (d) failed to plan or perform appropriate audit procedures required by GAAS to audit Pros' assets.

Further as the Court of Appeals found here, Stayner "prepared a materially false and misleading audit report expressing an unqualified opinion on Pros International. The financial statements grossly overstated the value of Pros assets, giving a materially misleading description of Pros' financial condition. The audit report indicates that Mr. Stayner had prepared the report in accordance with generally accepted auditing standards when, in fact, Mr. Stayner performed no independent verification of assets and failed to discover management's misrepresentations." The Court acknowledged that Stayner's actions "were clearly negligent and probably reckless...." S.E.C. v. Pros International Inc., 994 F.2d 768 (10th Cir. 1993). Similarly, the District Court found that he

violated Sections 17(a)(2) and (3) of the Securities Act. OCA Ex. 15, Conclusions of Law 5, 7.

It is considered that Stayner's acceptance of an auditing engagement "demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust." U.S. v. Arthur Young & Co., 465 U.S. 805, 818 (1984). Admittedly, this element of independence was missing from Stayner's performance notwithstanding respondent's discomfort with the excess value placed on the intangible assets. OCA Ex.10 at p.31,33.

Recently the D.C. Circuit remanded to the Commission a case under 2 (e) (1) (ii) of the Rules of Practice. 17 C.F.R. 201.2(e) (1) (ii). Essentially, the Court requested that the Commission state which of the following standards is it using: (1) simple negligence, (2) gross negligence, (3) recklessness, or (4) wilfulness (bad faith). David D. Checkowsky v. S.E.C., 23 F.3rd 542, (D.C.Cir. 1994). Under the facts in the instant case, it appears that with the exception of the wilfulness or bad faith standard, the other three standards are applicable. The negligence standard clearly applies. As mentioned, the District Court, the Tenth Circuit and the respondent himself clearly indicate that Stayner's performance as an accountant was negligent. Negligence is "conduct which involves an unreasonably great risk of causing damage." Prosser and Keeton on Torts at 169 (5th ed. 1984) (citation omitted). Negligent conduct involves a failure to comply with the standard of conduct that "society demands generally of its members." Id. Whether or not conduct is negligent is determined by considering how a "reasonable person" would have behaved under the circumstances. Id. at 173-75. The experts both for the OCA and Stayner agree, and I so find, that Stayner's conduct, in

failing to verify the principle assets of a shell corporation, was negligent and violated GAAS.

GAAS "set the minimum level of quality that auditors are expected, by their clients and the public, to achieve." Jerry D. Sullivan, Montgomery's Auditing, at 49 (10th ed. 1985). Thus, the Ninth Circuit has observed that a failure to comply with generally accepted auditing standards constitutes improper professional conduct within the meaning of Rule 2(e). Davy v. S.E.C., 792 F. 2d 1418, 1422 (9th Cir. 1986). Such a breach constitutes improper professional conduct. "Breaches of professional responsibility jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors." Touche Ross v. S.E.C., 609 F.2d 570, 581 (2d Cir. 1979). In re Ernst & Ernst, ASR 248 [1937-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,270 (May 31, 1978), holds that where the audit was not performed in accordance with GAAS, the respondents failed to fulfill their responsibility of serving as independent accountants by relying on management's unsupported and questionable representations. It follows from these findings that respondents engaged in improper professional conduct within the meaning of Rule 2(e). Id., at 62,733. Stayner's gross negligence breathed life into a defunct corporation with a resultant substantial hazard to the investing public.

Stayner argues, by implication, that his negligence was an isolated case.^{15/} In re Morton I. Myers, ASR 92 [1937-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,114 (July 20, 1962), held that the accountant argued, in substance, that his conduct was an "isolated instance of negligence," and pointed to "adverse consequences he has

^{15/} However, It appears that Stayner was similarly negligent in audits of a number of other public corporations with the resulting risk to the investing public.

already sustained from publicity..." Nevertheless, the Commission suspended him from practice "unless and until he shall obtain our prior approval."

Mr. Stayner argues that In re Carter & Johnson, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,847 (Feb. 28, 1981), saves him because his expert testified that he only committed an error of judgment. Stayner contends that there must be "proof of willful or reckless disregard of a settled standard of conduct" for imposition of discipline. Id. However, Carter was not addressing 2 (e) (1) (ii) but rather Rule 2 (e) (1) (iii) for "willfully aiding and abetting" their client's violations. The Commission states in Carter that "the crucial inquiry . . . tends to focus on the awareness or the intent element of the offense of aiding and abetting." Id. at 84,167.

In the portion of its opinion in Carter (entitled "ETHICAL AND PROFESSIONAL RESPONSIBILITIES"), the Commission indicated that the respondents were subject to suspension under Rule 2 (e) (1) (ii) for "unethical or improper professional conduct." Id. at 84,172. The discussion proceeded from the premise that there is

no unfairness whatsoever in holding those professionals who practice before us to generally recognized norms of professional conduct, whether or not such norms ha[ve] previously been explicitly adopted or endorsed by the Commission. To do so upsets no justifiable expectations, since the professional is already subject to those norms.

Id. at 84,170. See Dana and Dentinger v. S.E.C., No. C-93-4158 CW (N.D.Cal. February 8, 1994).

Further, it is considered that a negligence standard is in harmony with the sanctions of most state board of accountancy standards. Respondent contends that the Commission must adopt a recklessness standard for imposition of discipline because the District of Columbia and other state boards allow revocation of a license for

"[d]ishonesty, fraud, or gross negligence." D.C. Code § 2-115(3)(B). However, the D.C. Code, like Codes in most states, also allows license revocation or suspension for any "violation of a rule of professional conduct promulgated by the Board." D.C. Code § 2-115(3)(D). Similar to most states, and consistent with the Uniform Accountancy Act drafted by the American Institute of Certified Public Accountants and the National Association of State Boards of Accountancy, the District of Columbia has adopted a Code of Ethics requiring its licensed accountants to comply with generally accepted auditing standards. D.C. Municipal Regs §2511(8) ("all professional and technical standards that are generally recognized by the profession for the particular service."). The District of Columbia, consistent with the Accountancy Act, like many states, also allows revocation of an accountant's license for "[c]onduct discreditable to the public accounting profession." D.C. Code § 2-115(3)(J).

Mr. Stayner is licensed as a CPA in Utah. Under Utah law, an accountant's license may be revoked on a finding that the accountant has "committed an act or omission defined as unprofessional conduct," or has "acted in a manner discreditable to the profession." Utah Code Ann. § 58-26-15(1), (8) (Accountancy Law Reporter (CCH) ¶ 47,015 at 10,511). "Unprofessional conduct" in Utah includes: "committing an act or practice that fails to conform to accepted and recognized standards and ethics of the profession and that does or could jeopardize the public health, safety, or welfare." Id. at § 58-26-16(1). Utah requires auditors to comply with generally accepted auditing standards including Statements on Auditing Standards (SAS). Utah Admin. Code, R.153-26-11C(2). Accountancy Law Reporter (CCH) ¶ 47,504 at 10,551.¹⁶

¹⁶I agree with OCA that the states action is not relevant here. However, it can be reasonably argued that the respondent will fair in Utah, with respect to his state license, at least as well as David Lamoreaux, CPA. In 1992, the SEC permanently suspended

The argument mounted by the respondent with respect to collateral estoppel is disingenuous. As indicated, the SEC brought a proceeding in the United States District Court to enjoin the respondent and others from future violations of Securities laws. A motion for summary judgment was filed by the Government. Respondent filed a cross motion for summary judgment and filed an affidavit dated May 2, 1990. The affidavit alleges, among other things, that "[t]he SEC's counsel has notified Stayner that regardless of the outcome of this case, 2(e) proceedings will be initiated against him. Accordingly, the SEC has another remedy available to it to achieve their objective of policing professionals who practice security accounting." (emphasis added). Having prevailed in the Federal Courts on the injunction issue, respondent now does and about face, and argues that the Commission is collaterally estopped or barred to proceed against him. Mr. Stayner wishes to have his cake and eat it too.

The respondent argues that the Commission should be estopped from retrying the case. There is no effort to retry the injunctive suit here. I accept the proposition that some issues have already been concluded by the Court of Appeals and are precluded from being relitigated. For instance, in no way have I differed with the Tenth Circuit, who decide that the respondent was negligent, grossly negligent and perhaps reckless, but that he did not possess the requisite scienter for an injunction. Further, as discussed, it is considered that OCA is precluded from raising the issue of fabrication of work papers. Under Checkowsky, discussed supra, Stayner could be disciplined, and I find

David Lamoreaux from practice before the Commission. In re David M. Lamoreaux, AAER 429, 52 SEC Docket 1908, 1992 SEC LEXIS 2647, (Oct. 14, 1992). Thereafter, he was convicted of one felony count for fraud stemming out of his involvement with Pros. (OCA Ex. 35 at p. 16-17). David Lamoreaux is currently licensed as a CPA by the State of Utah. Tr. 370 (Lamoreaux).

he should be disciplined, under 3 of the 4 standards and it is not considered that scienter, wilfulness, or bad faith is required.

Stayner argues that this proceeding is barred by the five-year limitations period of 28 U.S.C. § 2462, which provides in relevant part:

Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued

This proceeding does not seek a "civil penalty." In re Howard F. Rubin, Sec. Exch. Rel. No. 35179, A.P. File No. 3-8293 (December 30, 1994), noted that it is "well-settled" that the Commission's administrative proceedings suspending or barring individuals are not punitive but remedial. Accordingly, I find that 28 U.S.C. is not applicable.

Under Rule 2(e) of The Commissions Rules of Practice, 17 C.F.R. 201.2 (e) the Commission may deny permanently or temporarily, the right of accountants, engaging in improper professional conduct, to appear or practice before it. Taking into account that the Tenth Circuit found a lack of scienter, I consider the OCA request for a permanent bar to be too severe. The respondent received a nominal sum, if any, for his audit work performed in this case. Further, he was totally unsophisticated in SEC accounting, notwithstanding the fact that he had large firm experience. His specialty is in small business tax, not SEC accounting. Additionally, this appears to be the first disciplinary proceeding that has been filed against the respondent, and he appears genuinely contrite.

Based on the foregoing and considering the need for the Commission to secure professional level accounting work to serve the investor public, and given that the


respondent's conduct was grossly negligent in violation of GAAS and other accounting standards, respondent's practice privilege before the SEC is permanently denied with the right to reapply after three years.

ORDER

Based on the findings and conclusions set out in this decision, I ORDER that George Craig Stayner be permanently denied the privilege of appearing or practicing before the Securities and Exchange Commission with a right to reapply after a period of three years. This order is imposed as necessary and appropriate in the public interest, for the protection of investors.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Rules of Practice. (17 CFR 201.17(f)).

Pursuant to this rule this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



Glenn Robert Lawrence
Administrative Law Judge

Washington, D.C.
May 8, 1995