SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Rel. No. 8555 / March 18, 2005

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 51393 / March 18, 2005

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 2214 / March 18, 2005

Admin. Proc. File No. 3-11194

In the Matter of

PHILIP L. PASCALE, CPA

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Causing Violations of Reporting and Recordkeeping Provisions

RULE 102(e) PROCEEDING

Grounds for Remedial Action

Improper Professional Conduct

Auditor caused company's violations of Section 15(d) of the Securities Exchange Act of 1934 and Exchange Act Rules 15d-1 and 15d-13 by auditing or reviewing financial statements included in company's annual reports, several quarterly reports, and registration statements filed with the Commission, which financial statements misrepresented the financial condition and results of operations of company by materially overstating assets and equity and understating losses. Auditor also failed to maintain an attitude of professional skepticism; obtain sufficient competent evidential matter; render an accurate audit report; and exercise due professional care. Held, it is in the public interest to order that auditor cease and desist from causing any violations or future

violations of Section 15(d) of the Exchange Act and Exchange Act Rules 15d-1 and 15d-13.

APPEARANCES:

Robert F. Van der Waag, of Van der Waag and Gray, for Philip L. Pascale.

Thomas M. Melton and Karen L. Martinez, for the Division of Enforcement.

Appeal filed: June 9, 2004
Last brief received: September 7, 2004

I.

The Division of Enforcement and the Office of the Chief Accountant (collectively, the "Division") appeal from the decision of an administrative law judge dismissing this proceeding. The law judge found that Philip L. Pascale did not willfully violate Section 17(a) of the Securities Act of 1933, 1/ Section 10(b) of the Securities Exchange Act of 1934, 2/ or Exchange Act Rule 10b-5. 3/ The law judge further found that Pascale did not willfully aid and abet or cause violations of Exchange Act Section 15(d) 4/ and Exchange Act Rules 15d-1 and 15d-13. 5/ Because the law judge found that Pascale did not willfully commit or aid and abet the alleged violations, the law judge found that Pascale was not subject to discipline under Rule 102(e)(1)(iii) of the Commission's Rules of Practice. 6/ The law judge further concluded that Pascale did not engage in improper professional conduct within the meaning of Rule 102(e)(1)(ii)

1/ 15 U.S.C. § 77q(a).

2/ 15 U.S.C. § 78j(b).

3/ 17 C.F.R. § 240.10b-5.

4/ 15 U.S.C. § 78o(d).

5/ 17 C.F.R. §§ 240.15d-1 and 15d-13, respectively.

6/ 17 C.F.R. § 201.102(e)(1)(iii). Rule 102(e)(iii) permits the Commission to censure or deny, permanently or temporarily, the privilege of appearing or practicing before it to persons found to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws or the rules and regulations thereunder.

of the Commission's Rules of Practice. 7/ We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

Background

Pascale has been a certified public accountant since 1980. He is licensed to practice in New York. His firm, Pascale, Razzino, Alexanderson & Company ("the Firm"), concentrates in auditing not-for-profit entities, 401(k) pensions, and certain private companies. Before founding the Firm in 1999, Pascale worked for several years at major accounting firms and was also the chief financial officer and senior vice president of a real estate development firm.

The allegations against Pascale arose in connection with audits of the financial statements of Composite Holdings, Inc. ("New Composite" or the "Company") for the fiscal years ending June 30, 1999, through December 31, 2001. The financial statements were included in annual reports filed by the Company on Forms 10-KSB and incorporated by reference into several registration statements on Forms S-8. Pascale also reviewed quarterly financial statements

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7/ 17 C.F.R. § 201.102(e)(1)(ii). Rule 102(e)(1)(ii) permits the Commission to censure or deny, permanently or temporarily, the privilege of appearing or practicing before it to persons found to have engaged in improper professional conduct. As applied to accountants, "improper professional conduct" includes, in relevant part,

> (A) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or
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> (B) . . . negligent conduct [consisting of]:
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>> (1) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.
>>
>> (2) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

17 C.F.R. § 201.102(e)(1)(iv).

included in the Company's quarterly reports on Forms 10-QSB for the quarters ending September 30, 2000, through December 31, 2001. 8/

III.

The Valuation of the Merger

A. New Composite was created from the April 1999 merger of Composite Industries, Inc. ("Old Composite"), a Nevada corporation, into Affordable Homes of America, Inc. ("Affordable"), a Nevada corporation. 9/ Pascale served as the engagement partner for the Firm's audits of the financial statements of Affordable for the year ending December 31, 1998, and of Old Composite from its inception (June 12, 1997) through June 30, 1998.

Merle Ferguson founded Old Composite in 1997. Old Composite acquired patent rights to a construction material called Z-Mix from Z-Mix's inventor, Joseph Zawada. In filings with the Commission, the Company described Z-Mix as a "cementitious product that combines diatomaceous earth and used tires to create a lightweight building material that reduces the time and the cost for constructing a house." At Old Composite's 1997 organizational meeting, Old Composite issued its founders 10,000,000 shares of common stock. Zawada received 6,370,000 of these shares (the "Zawada shares") in exchange for the Z-Mix patent rights. 10/ All 6,370,000 of the Zawada shares were to carry a voting legend, specified and required by the Old Composite organizational minutes. The restriction vested the voting rights for the Zawada shares with Old Composite's board of directors for a period of five years.

Ferguson founded Affordable in February 1997. Affordable engaged in no business activities until November 1998, when it received an initial capital infusion of $100,000. In March 1999, Kowtow, Inc., a public shell corporation, merged with Affordable. Kowtow's 1998 Annual Report, filed with the Commission on Form 10-K on March 19, 1999, states, "The Company has had no operational history and has yet to engage in business of any kind." In the merger, Kowtow issued Affordable's sole shareholder, a corporation owned entirely by Ferguson, 4,000,000 shares of Kowtow common stock, which represented approximately 80% of Kowtow's

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8/ After the 2001 audit, the Firm ceased performing audit work for New Composite because New Composite owed the Firm fees.

9/ The combined entity originally kept Affordable's name after the Affordable-Old Composite merger. It changed its name to World Homes, Inc. in October 2000. World Homes, Inc. then changed its name to Composite Holdings, Inc. in August 2001. For purposes of this opinion, "New Composite" refers to the entity, regardless of its name at any point in time, that resulted from the merger of Old Composite into Affordable.

10/ Zawada allocated the Zawada shares among various persons, many of whom appear to have been members of his family.

issued and outstanding shares. Two days after the completion of the merger, on March 19, 1999, Kowtow changed its name to Affordable. 11/ On April 13, 1999, Affordable common stock began to trade on the Over-the-Counter Bulletin Board.

Old Composite merged into Affordable on April 28, 1999, 12/ forming New Composite. Affordable exchanged approximately 6,514,000 shares of its common stock for all of the approximately 13,028,000 shares of Old Composite's common stock then issued and outstanding. As a result of the merger, New Composite owned the patent rights to Z-Mix.

During the 1999 audit, Ferguson suggested to Pascale that the Z-Mix patent was worth $6,500,000, or approximately the equivalent of $1.00 per share. Pascale testified that Ferguson stated that he would obtain an appraisal of the patent. However, Pascale never saw an appraisal.

Instead of accepting the patent value Ferguson provided him, Pascale, on behalf of the Firm, certified New Composite's 1999 financial statements, in which the Company valued Affordable's acquisition of Old Composite's assets at historical cost. 13/ The Company recorded the value of the Z-Mix patent at $394,313, reflecting the amount Old Composite spent to acquire the patent, plus other related costs. Quarterly reports filed by the Company with the Commission in the remainder of 1999 and early 2000 reflect this historical cost accounting treatment. The Company's 1999 Commission filings and the financial statements of Old Composite and Affordable certified by Pascale referred to the two companies as "entities under common control." 14/

11/ Ferguson became the merged Affordable's president, chief executive officer, and chairman of the board. Susan Donohue was the only other member of Affordable's board.

12/ As of November 1998, Ferguson was chairman of the board of directors of Old Composite. The parties dispute whether Ferguson was an officer or director of Old Composite at the time of the Old Composite/ Affordable merger.

13/ If companies that are parties to a business combination are under common control, the assets of the acquired company should be recorded at historical cost. AICPA Accounting Interpretation of Accounting Principles Board ("APB") Opinion No. 16, "Business Combinations," Question No. 39, Paragraph 5.

14/ An example of that common control is set forth in Note 11 to Old Composite's June 30, 1998 financial statement. According to the note, under an "Entire Output Agreement," Old Composite agreed to sell its entire output of Z-Mix to Affordable (which had no then-current operations) for a ten-year period. In fact, the note itself referred to Affordable as a "company under common control." The sale was to be made at Old Composite's cost of production, thus producing no profit for Old Composite. These

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At the hearing, Pascale testified that he had based his determination to value the patent at its historical cost on his understanding that Affordable and Old Composite were under common control at the time of the merger. Asked how he came to this conclusion, Pascale stated that he based his determination on "discussions with management, understanding that they were both giving me answers having to do with both companies . . . ." Moreover, both companies used the same mailing address in Las Vegas, Nevada.

During Pascale's 2000 audit of the Company, Schulman, the Company's chief financial officer beginning in June 2000, requested that Pascale reconsider the historical cost treatment of the merger in the 1999 audit. According to Pascale, Schulman asserted that Old Composite and Affordable were not under common control at the time of the merger because Ferguson did not own a majority of Old Composite's voting stock. Pascale testified that, in addition to Schulman's representations with respect to Ferguson's ownership, Pascale received a letter from Old Composite's outside counsel, Donald J. Stoecklein, confirming this assertion. 15/

Under Generally Accepted Accounting Principles ("GAAP") in effect at the time of the merger transaction, if Old Composite and Affordable were not under common control, a proper accounting treatment for the merger was purchase accounting, which would result in valuing the transaction at fair value, rather than at its historical cost. 16/ The acquisition cost is to be assigned to the assets acquired, and this would result in stepping up the value of the Z-Mix patent rights. Based on Schulman's assertions that Old Composite and Affordable were not under common control at the time of the merger, Pascale determined that it was appropriate to restate the 1999 financial statements in connection with the 2000 audit. 17/

14/(...continued)
financial statements were incorporated into New Composite's Form 8-K announcing the merger transaction.

15/ Pascale testified that he understood that Ferguson owned 16 % of Old Composite's stock at the time of the merger. He now claims that he subsequently discovered that Ferguson owned only 3.5% of Old Composite's stock at that time. The only evidence of this reduction in Ferguson's holdings is testimony by Pascale's expert witness, who stated that he spoke to Ferguson. The expert was unable to obtain access to Old Composite's stock records to confirm Ferguson's assertions. The documentary evidence in the record places Ferguson's holdings at 16% of Old Composite's issued and outstanding stock.

16/ APB 16, paragraph 8 provided that a business combination of entities not under common control could be accounted for as a purchase or, if several criteria were met, as a "pooling of interests." APB 16 has been superseded by Statement of Financial Accounting Standards ("FAS") No. 141. FAS 141 no longer permits pooling.

17/ In this proceeding, Pascale asserts that this determination that Affordable and Old Composite were not under common control was based on his determination that Ferguson

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Pascale acquiesced in Schulman's request that the transaction should be recorded as a purchase and that the value of the transaction, including the patent, should be stepped up. Pascale valued the Affordable shares used to purchase Old Composite at approximately $18,000,000, of which Pascale's audit assigned $17,198,099 as the cost to acquire the patent. The Company's quarterly reports for the remainder of 2000 and early 2001 reflected this restated valuation of the patent.

Under Accounting Principles Board Opinion 16 ("APB 16"), paragraph 67, when assets are acquired in a business combination in exchange for consideration other than cash, including stock, the transaction is to be valued at the fair value of the consideration given or the property acquired, whichever of the two is more evident. That value must be assigned to the assets acquired. The Firm's analysis of the valuation of the transaction attempted to address the value both of the Affordable stock used to purchase Old Composite and also of the Z-Mix patent rights.

Neither Pascale nor the Company obtained an appraisal to serve as the basis for the valuation assigned to the Affordable shares. Nor did the Company provide a valuation for the

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owned a minority of the shares of Old Composite at the time of the merger, thus requiring that he restate the Company's 1999 financial statements to record the merger transaction at fair value. In Note 2 to the restatement, the Company explained the basis for the restatement differently.

The note to the restatement states, "During the fiscal year ended June 30, 1999, Affordable originally recorded the patent at the accumulated out-of-pocket costs incurred by [Old] Composite to secure the patent ($394,313). That cost basis was subsequently deemed to be incorrect as there was crucial information about the legal form of the transaction that was not presented until the current year and which mandated a different accounting treatment. Specifically, it was originally reported that Composite Industries merged into Affordable and the transaction was recorded similar to a pooling of interests. In fact, Affordable acquired [Old] Composite by issuing 6,514,720 shares of its stock to acquire all of the shares of Composite Industries and then merged. The resultant fair market value assigned to the patent was $17,198,099 and a corresponding deferred tax liability of $5,713,287 was recorded. Management believes that in light of the new information and the resultant accounting ramifications that a correction is required to the financial statements for the year ended June 30, 1999."

The Division asserts that Pascale erred when, in 2000, he changed his 1999 opinion that Old Composite and Affordable were under common control at the time of their merger. In light of Pascale's other violations discussed below, we do not address the Division's charge with respect to Pascale's common control determination in this opinion.

shares. Instead, although neither Pascale nor his partners had expertise in the valuation of restricted stock, Pascale, in consultation with one of his partners at the Firm, attempted to establish the value of the Affordable shares used to purchase Old Composite after examining the average price at which Affordable's stock traded on April 26, 1999, and May 3, 1999, dates that bracketed the merger.

Prior to the April 28, 1999 merger, Affordable was closely held. Ferguson's corporation and the former Kowtow shareholders held approximately 96% of the outstanding shares of Affordable prior to the merger. Affordable's shares began trading on the Over-the-Counter Bulletin Board on April 13, 1999, less than three weeks before the merger date. The average daily volume of trading in Affordable's shares during the weeks surrounding the merger was approximately 12,500 shares, although Affordable's shares did not trade every day during this period. On April 26, 1999, the shares traded at $3.75 per share, and on May 3, 1999, the shares traded at $3.438 per share, for an average stock price of $3.59 per share. The Firm's calculation excluded, as an "anomaly," trades of approximately 200 shares between these two dates at a closing price of $2.125 per share. Pascale's work papers do not discuss why the trades were deemed to be anomalous.

Pascale, after consultations with "several people," including his partners and Robert Cheskes, whom he asked to function as a third-party reviewer, 18/ determined to discount the $3.59 average share price by 24% (12% because transfer of the shares used in the merger transaction was restricted and 12% because Affordable's shares were relatively thinly traded). Pascale's work papers in the record include a single, handwritten reference to the restriction as a "144 restriction," presumably referring to Rule 144 under the Securities Act, 19/ but there is nothing else in the record that indicates that Pascale inquired further into the nature of the restrictions imposed on the Affordable shares transferred in the merger. 20/ With the 24% discount, Pascale and the Firm determined that the fair value of Affordable's stock at the time of the merger was $2.73 per share. Pascale then multiplied this $2.73 share price by the approximately 6,514,000 Affordable shares used to purchase Old Composite to arrive at a value

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18/ Cheskes was not a member of the Firm. He previously had performed a peer review of the Firm. Cheskes testified before the law judge.

Pascale also testified that he spoke to Art Kappel at the American Institute of Certified Public Accountants. According to Pascale, Kappel confirmed that a discount was appropriate. Kappel did not testify.

19/ 17 C.F.R. § 230.144 (permitting public sale in ordinary trading transactions of limited amounts of securities by affiliates of the issuer and by persons who have acquired restricted securities from the issuer).

20/ For example, Pascale did not inquire whether the shares of Affordable issued to the holders of the Zawada shares were restricted as to voting rights.

of nearly $18,000,000. After costs were assigned to other Old Composite assets acquired in the merger, Pascale determined that the patent's value was $17,198,099. Pascale acknowledges that this was a material change to the value of the patent. The cost of acquiring the patent represented more than eighty percent of Affordable's assets in 2000.

Around the time of the merger, the Company also issued stock for services by vendors and consultants. The Company's June 30, 1999 annual report on Form 10-K describes these transactions as "arm's length" transactions. On May 24, 1999, the Company issued 550,000 shares of Common Stock for services rendered valued at approximately $39,000, or approximately $0.0545 per share. On June 23, 1999, according to the 1999 Form 10-K, the Company issued 19,149 shares of Common Stock for consulting services rendered to the Company valued at $9,575, or approximately $0.50 per share. 21/ Pascale ignored these issuances. Moreover, when the Company restated its 2000 financial statements, he certified the Company's increase in the value of these issuances. Note 13 to the Company's 2000 financial statements states, "Further, 569,149 shares of common stock that was issued for services rendered has been increased by $1,300,000 consistent with the value of the stock issued." 22/

B. Under Generally Accepted Auditing Standards ("GAAS"), as specified in Statement of Auditing Standards ("SAS") 150.02 and 230.01, an auditor is required to exercise due professional care in the conduct of audits. In exercising due professional care, an auditor is required to maintain "professional skepticism," defined in SAS 230.07 as "an attitude that includes a questioning mind and a critical assessment of audit evidence." Under SAS 150.02 and 326.01, an auditor is required to obtain sufficient evidential matter through inspection, observation, inquiries, and confirmation to afford a reasonable basis for his opinion regarding financial statements. 23/ SAS 333.02 provides that management's representations are part of the evidential matter an auditor must consider, but are not a substitute for the application of the auditing procedures necessary to provide the auditor with a reasonable basis for its opinion.

21/ On June 28, 1999, the Company issued 215,983 shares of "restricted Common Stock" valued at $2.43 per share to acquire Big Mountain Construction Company, Inc.

22/ The market price of Affordable stock began to decline after the merger. During June 1999, Affordable's shares traded at prices generally between $2.00 and $3.00 per share. After June 1999, the shares never again traded over $2.00 per share. From the end of August 1999 through February 2000, Affordable shares traded at prices under $1.00 per share, and, less than a year after the date of the merger, in March and April of 2000, the Affordable shares were trading at around $1.00 per share.

23/ AICPA, Codification of Statements on Auditing Standards, AU ("AICPA, AU") § 326.01 requires that "[sufficient] competent evidential matter . . . be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements."

As an initial matter, an auditor should review financial statements prepared by a company's management, not make those determinations for management. Pascale's own expert witness and Pascale himself recognized that the Firm's determination of the value of Affordable's shares, and its subsequent audit of its own work, deviated significantly from GAAS. When an auditor finds itself in the position of reviewing its own valuation determination, it is extremely difficult for the auditor to have obtained the "sufficient competent evidential matter" or for it to exercise the due professional skepticism required for it to issue a reasonably based opinion. 24/

Pascale admits that he had no expertise in valuation. SAS 326.21 states that evidence from independent sources outside the entity being audited provides greater assurance of reliability. Pascale asserts correctly that APB 16 does not require the use of an appraiser or outside expert to value stock transferred in a business combination. However, the Third Standard of Field Work under GAAS requires an auditor to obtain "[s]ufficient competent evidential matter . . . to afford a reasonable basis for an opinion regarding the financial statements under audit." GAAS cautions that an auditor is not expected to have the expertise of a person qualified in another profession, such as valuation. Under SAS 336.06 and 336.07, when the auditor faces issues that require expertise to be able to make a competent valuation, the auditor may use a specialist to obtain competent evidential matter for such purposes.

APB 16, paragraph 67 provides that an asset acquired by issuing stock should be recorded at "cost." APB 16, paragraph 67 further provides that "cost may be determined either by the fair value of the consideration given or by the fair value of the property acquired, whichever is the more clearly evident." While, under APB 16, paragraph 67, "the quoted market price" may be used "to approximate the fair value of the company," APB 16, paragraph 23 warns that the fair value of stock "is not always objectively determinable." The quoted market price may not be a reliable indicator of fair value "because the number of shares issued is relatively large, the market for the security is thin, the stock price is volatile, or other uncertainties influence the quoted price." 25/ Where the quoted market price is not reliable, under APB 16, paragraph 75, "independent appraisals may be used as an aid in determining the fair value of the securities issued."

Although Pascale claims that his analysis was reasonable, he did not comply with APB 16. He used an average of selected prices. He approved his partner's exclusion as "anomalous" of two trades at $2.125 per share from this average, although there is nothing in the work papers explaining that conclusion. Pascale failed to consider evidence that this "average" price per share was questionable.

24/ Pascale was not charged in the OIP with violations of the independence rules under GAAS.

25/ APB 16, paragraph 23.

Pascale also failed to weigh factors indicating that the contemporaneous trades of Affordable shares were not indicative of its fair value. Affordable was closely held prior to the merger. The market for Affordable shares was very thin, and it did not trade every day during the period immediately before the merger. Only a small percentage of the total shares of Affordable were freely tradeable during April 1999, and Pascale should have considered that the price was very likely to drop appreciably as ownership of the shares became more diffuse and existing restrictions on resale were lifted.

Under APB 16, paragraphs 74 and 75, Pascale and the Firm needed to investigate thoroughly and understand the nature of the restrictions that served as the basis for half of the discount they applied to the Affordable share price. Pascale noted that the Affordable shares issued to acquire Old Composite bore a "144 restriction" on resale, but there is little evidence in the record to establish that Pascale attempted to understand the nature of the restriction, or whether the shares bore other restrictions, such as the voting restriction on the Old Composite Zawada shares.

We are particularly troubled by Pascale's disregard of issuances of restricted New Composite stock around the time of the merger from $0.05 per share to $2.43 per share. In 2000, the Company, in financial statements certified by Pascale, restated the issuances at $0.05 and $0.50 per share to $2.43 per share. Because these issuances were for services rendered and the dollar amount of these services had been set in 1999, there was no basis to revisit their value. The significant increase in the value of these issuances – in one instance from approximately $39,000 to $1,300,000 – as a result of the restatement should have caused Pascale to review the valuation of the Affordable shares exchanged in the merger with considerable professional skepticism. Pascale also failed to consider that, beginning shortly after the merger, the market price for New Composite shares began to fall. By the time Pascale was preparing the restatement, the price of New Composite's shares had fallen to $1.00 or below.

Pascale notes that Cheskes approved the 24% discount the Firm applied to the Affordable "average" share price. We recognize that Cheskes was aware of the discount and told Pascale that "some" discount was appropriate. At the hearing, Cheskes testified that he eventually agreed that the discount was a "fair discount." As Pascale was aware, Cheskes did not review Pascale's 2000 work papers. Moreover, Cheskes acknowledged that he personally had no expertise in the valuation of restricted stock.

Pascale's own expert witness conceded that the discount did not comply with GAAP. Pascale acknowledges that the valuation methodology that the Firm employed (averaging Affordable's price on the Over-the-Counter Bulletin Board on selected days and applying a

discount to this figure) was the invention of one of Pascale's partners and that the 24% discount to the average share price of Affordable around the merger was not supported by GAAP. 26/

IV.

Impairment of Carrying Value of the Z-Mix Patent

A. APB 16, paragraph 67 requires that the cost of a transaction be assigned in proportion to the assets acquired in a purchase transaction. Pascale, not New Composite, assigned the majority of the value of the Affordable shares used to purchase Old Composite to the Z-Mix patent rights, which were valued at $17,198,099. Pascale failed to consider that Ferguson had told Pascale that the value of the patent rights was $6,500,000 only a year earlier in connection with the 1999 audit. Instead, Pascale stepped up the patent's value from $394,313 to over $17,000,000 without any question, even though the Company lacked any operating history, governmental approvals for the use of its patent, or contracts for the use, sale, or manufacture of the key product.

Statement of Financial Accounting Standards No. 121 ("FAS 121") required New Composite to review long-lived, non-cash assets, such as the patent rights. If the auditor determines that the carrying amount is unrecoverable, under FAS 121 the expected future cash flows expected to be generated from the asset (in this case, the Z-Mix patent rights) must be compared to the carrying value of the asset. The difference between these two figures is to be recorded as an impairment. In considering whether an impairment exists, under FAS 121, paragraph 5(e), the auditor should determine whether the company in question has experienced "a current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an asset used for the purpose of producing revenue."

In reviewing the patent values in both 2000 and 2001, Pascale was required to consider whether the carrying amount assigned to the patent was recoverable. At the end of New Composite's 2000 fiscal year, Z-Mix had not been used commercially. New Composite had no machinery for the production of Z-Mix, nor did it have a facility in which the manufacture could occur. Z-Mix had received no governmental or regulatory approval for use in construction of buildings in any jurisdiction, domestic or international. Pascale testified that the Company needed approval from Underwriters' Laboratory in order for the product to be used in the United States, but Pascale understood that the Company had not obtained that approval.

For the 2000 audit, Pascale determined not to require an impairment to the patent's value, based on revenue projections related to the patent that Pascale received from Schulman. On a

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26/ The parties debate whether Ferguson's 16% interest in Old Composite should have been stepped up or should have been recorded at historical cost. Given our conclusion that the overall valuation of the Affordable stock was flawed, we do not reach this issue.

single page, Schulman forecast revenue streams from two joint ventures the Company had entered with Tristar USA, Inc. ("Tristar") and AL NASR Trading & Industrial Corporation, LLC ("AL NASR") for the use of Z-Mix in construction of low-cost housing in countries outside the United States. The projections anticipated gross sales over the lives of the agreements (five years in one case and three years in another) totaling approximately $550,000,000. During the 2000 audit year, the projections expected that the company would earn profits of approximately $14,000,000. However, the projections included no basis for these conclusions, such as a detailed business plan, a budget, or evidence of cost of goods, operations, and expenses. Pascale relied exclusively on his conversations with Schulman and the projections provided by Schulman.

Schulman also gave Pascale copies of the joint venture agreements. However, Pascale did not review the agreements or contact representatives of Tristar or AL NASR. The joint venture agreement with AL NASR required the Company to engage in a private placement to pay the costs of the joint venture itself. These joint venture agreements were contingent on factors including the receipt of financing, government approvals for the use of Z-Mix, the establishment of relationships with buyers of Z-Mix, and the establishment of a facility for the production of Z-Mix. The joint venturers had not agreed to purchase Z-Mix from the company or to use the product in construction projects. Neither joint venturer had any contracts to construct houses using Z-Mix. Pascale relied on the projections as the basis for supporting the carrying value of the patent without an impairment. 27/

In the Company's 2001 audit, Pascale once again included no impairment to the Z-Mix patent. At the time of Pascale's 2001 audit, the Company still had no contracts for the sale or manufacture of Z-Mix. Z-Mix had received no domestic or foreign governmental or regulatory approvals for its use in construction. New Composite had met none of its 2000 projections. William Morris, who replaced Schulman as New Composite's chief financial officer, provided Pascale with a new set of projections for revenue derived from the patent rights through the joint ventures with Tristar and AL NASR. These projections anticipated total gross profits from the joint ventures of over $15,000,000; they were based on the assumption that the joint venture projects would be operational and that home construction would have begun during the 2001 fiscal year. These projections were premised on the Company's obtaining governmental approvals for the use of Z-Mix and on the Company obtaining financing. Because the Company had failed to achieve the joint venture revenue and profit projections from 2000, in connection with the 2001 audit Pascale requested additional information to verify the projections.

Pascale asked for the names of contact persons at the offices of the joint venturers. Pascale spoke to the president of Tristar, Rodney Whitney, and John Switzer, an official at AL

27/ In notes accompanying his 2000 review, Cheskes raised the issue of whether an impairment to the patent value was appropriate. The response to his inquiry is not recorded.

NASR. While Tristar was in the home construction business, Pascale discovered that AL NASR was engaged solely in the packaging of financing for others to purchase or construct homes. Although Whitney and Switzer expressed slight concerns about the strength and capability of the business, both ultimately told Pascale that their companies desired to go forward with their joint ventures with New Composite and that they were generally optimistic about the Company's prospects. After these conversations with the parties to the Company's joint ventures, and although the joint ventures had not resulted in contracts to sell Z-Mix, Pascale calculated his own projections, which differed from those provided to him by the Company. Pascale's own projections expected gross sales of $92,000,000 from the Tristar joint venture (projection of the sale of 4,000 units at an average price of $23,000 per unit) and $1,200,000,000 from the AL NASR joint venture (100,000 units sold at an average price of $12,000 per unit). Pascale did not review detailed business plans or budgets in connection with his review of the joint ventures and his preparation of the revenue projections. Pascale determined that it was appropriate to maintain the carrying value of the patent without impairment. 28/

Because of the lack of evidence to support the likelihood of the revenue projections, Pascale expressed some concern to Ferguson about the ability of the Company to continue as a going concern. Pascale requested, and received from Ferguson, a letter saying that Ferguson personally would supply sufficient working capital to allow the Company to continue to operate, if such a move became necessary. Pascale reviewed no corroborating evidence, such as tax returns or financial statements, from Ferguson that would have substantiated his actual ability to make such payments. 29/ Pascale testified that he believed that the Company could be run "on a shoestring" if necessary, because of its lack of operations. Despite all of these concerns, Pascale gave an unqualified certification of the Company's two sets of financial statements in 2000 and 2001, each of which projected annual revenues from the patent rights in the tens of millions of dollars.

In the third quarter of New Composite's 2002 fiscal year, Pascale requested that New Composite provide evidence that the revenues it projected for Z-Mix would be realized or, in the alternative, that Ferguson could infuse the Company with adequate cash to allow it to continue as a going concern. Pascale received no such assurance. Ultimately, the Company determined in 2002 to write off the entire value of the Z-Mix patent rights, and Pascale resigned the New Composite account shortly thereafter. 30/

28/ Cheskes reviewed the financial statements and some of Pascale's work papers in 2001 and concurred with Pascale's efforts in patent valuation in 2001.

29/ In 2000, Ferguson wrote to Pascale, stating that the Company intended to make a private placement pursuant to Regulation D or Regulation S. Pascale testified that he did not know whether that private placement occurred.

30/ In a separate proceeding, the Company and Ferguson were permanently enjoined from
(continued...)

B. Pascale failed to exercise due care or professional skepticism or to obtain sufficient, competent evidential material to support the conclusion that the carrying value of the Z-Mix patent was not impaired. During each of his audits, New Composite remained a development stage company. It had no operations or revenues from operations. Z-Mix was never approved for use in construction anywhere. The Company neither had contracts to sell Z-Mix nor the ability to manufacture it.

Pascale asserts that his determination that the value of the Z-Mix patent was not impaired was reasonable based on the Company's projections. Given the Company's situation, those projections were unreasonable on their face. The 2000 projections consisted of a single page, with no back-up for the revenue and profit assumptions. Although Pascale received the joint venture agreements, he did not read them, and he did not attempt to contact New Composite's joint venturers. Had he reviewed them, Pascale would have discovered the various contingencies and the fact that New Composite was to pay the costs of the AL NASR joint venture.

During the 2001 audit, Pascale learned that the Company had made no progress on its 2000 projections. It still had neither operations nor contracts to sell Z-Mix. Pascale's 2001 contacts with the principals of the joint ventures were insufficient to provide back-up for either the Company's projections or Pascale's re-computed projections. The principals expressed enthusiasm for Z-Mix, but the joint ventures had not resulted in contracts for the Company to sell Z-Mix or even contracts to construct houses that might use Z-Mix. Moreover, we note that Pascale concluded his audit after the first quarter of the succeeding fiscal year (i.e., after the first quarter of the 2001 fiscal year for the 2000 fiscal audit). Yet, in the case of each audit, the Company had made no progress on its projections for the then-current year. For example, the Company had made no sales of Z-Mix in the first quarter of 2001, which was inconsistent with the projections that Schulman had given Pascale in connection with the 2000 audit.

Pascale appears not to have considered the nature of the construction industry in which New Composite intended to operate. Because construction projects are typically long-range in

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30/(...continued)

future violations of the securities registration provisions of Section 5 of the Securities Act, 15 U.S.C. § 77e, and the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5. Ferguson was also ordered to pay a civil money penalty in the amount of $120,000. The complaint alleged that the Company and Ferguson had distributed false press releases about the Company's progress in manufacturing Z-Mix, obtaining financing for the Company, and generating contracts for the use of Z-Mix, and that these false press releases resulted in an increase in the price of the Company's common stock and an increase in the volume of the Company's shares traded on the Over-the-Counter Bulletin Board. SEC v. World Homes, Inc., Merle Ferguson, and Susan Donohue, Litigation Rel. No. 17328 (Jan. 22, 2002), 76 SEC Docket 2364.

nature, Pascale should have exercised considerable professional skepticism at management projections that were based on the production of a nearly immediate flow of revenues from the joint ventures. In addition, Pascale accepted the revenue projections from Schulman in the first quarter of New Composite's 2001 fiscal year. Although a portion of the time covered by the projections had run, New Composite still had no contracts for the use or production of Z-Mix. Professional skepticism should have pushed Pascale to question the projections rather than simply to accept them at that time.

Pascale recognized that there was a legitimate issue as to whether the Company could continue as a going concern. Pascale claimed that he received assurances from Ferguson that Ferguson would supply the shortfall to make up for any lack of working capital. Pascale obtained no evidential material to support that assertion until well into the 2002 fiscal year. Pascale testified that he was not concerned because he concluded that Ferguson could operate the Company from his home on a "shoestring." However, that conclusion further undercuts Pascale's reliance on the projections. Pascale had to know that the Company could not generate the projected levels of revenue from a "shoestring" operation.

Pascale notes that his expert witness testified that it "would have been extraordinarily unusual" to step up the value of an asset and then write it down in the same period. 31/ This testimony has no implication for Pascale's failure to assess an impairment in 2001. In any event, FAS 121 clearly dictates that companies are required to assess assets such as the patent rights for impairment when events indicate that the carrying value is likely not to be recoverable. Pascale failed to do so in both his 2000 and 2001 audits.

In basing his analysis on the projections, Pascale did not exercise adequate professional skepticism and did not exhibit the proper degree of professional care. The acceptance of the projections served as the basis for Pascale's determination that no impairment to the patent rights needed to be recorded in the Company's financial statements.

31/ Pascale's expert witness characterized a statement by a member of the Commission staff that the staff would not "expect to see write-downs in the year after acquisition," warning practitioners to "[g]et your accounting right." Pascale concedes that his expert "did not state that GAAP precludes taking an impairment loss in the year of a restatement."

As shown above, Pascale did not "get the accounting right" on the patent's value. The record and the Division's expert witness demonstrated that the 2000 valuation of the 1999 acquisition of the patent lacked competent evidential matter to support it. The evidence here of impairment also indicates that the restatement had substantially inflated the patent's value. The Division's expert witness further corroborated that the revenue projections without any back-up were not sufficient to support a determination that the patent's value was unimpaired.

V.

The Deferred Tax Asset

Under FAS 109, an entity may carry forward net operating losses as a deferred tax asset, as long as those losses are more likely than not (i.e. more than 50% likely) to be recovered in future periods. This determination is based on projections of future taxable income, derived from revenue projections. In the event that some portion of a deferred tax asset is not likely to be realized, that portion of the deferred tax asset should be reduced by a valuation allowance. FAS 109 also requires that a deferred tax asset be netted against any deferred tax liabilities.

New Composite recorded net operating losses as deferred tax assets of $496,638 in 1999, $2,260,000 in 2000, and $2,390,000 in 2001. At the time, New Composite had also recorded a deferred tax liability because the recorded carrying value of the Z-Mix patent rights was greater than its tax basis. The deferred tax liability should have offset the deferred tax asset and, because the deferred tax liability was always greater than the deferred tax asset, there should have been no deferred tax asset recorded for the Company. Pascale's expert witness testified, and Pascale concedes, that reporting the deferred tax asset was inconsistent with GAAP.

Moreover, even if a deferred tax asset had been proper, Pascale should have reduced the amount of the deferred tax asset by a valuation allowance. For the same reasons discussed in Section IV above, the projections of future revenues and profits on which Pascale relied were without basis, and there were substantial questions as to whether the Company could continue as a going concern. The Company was considerably more likely than not to fail to have taxable income from future operations that would allow it to use the deferred tax asset. By relying exclusively on projections of these revenues and very brief conversations with the joint venturers, Pascale failed to exercise due care or professional skepticism, and to acquire sufficient competent evidential material.

VI.

Reporting and Recordkeeping Requirements

Under Exchange Act Section 21C(a), we may order a person to cease and desist from certain conduct if the person "is violating, has violated, or is about to violate" any provision of the Exchange Act, or any rule or regulation thereunder. 32/ The section also authorizes us to order a person to cease and desist from certain conduct if the person "is, was or would be a cause of [a] violation [of the Exchange Act or the rules and regulations thereunder], due to an act or omission the person knew or should have known would contribute to such violation."

32/ 15 U.S.C. § 78u-3(a).

For the reasons discussed above, Pascale acted at least negligently, and his conduct resulted in his being a "cause" of the Company's violations of Section 15(d) of the Exchange Act and Exchange Act Rules 15d-1 and 15d-13. Rules 15d-1 and 15d-13 require that public companies file annual and quarterly reports with the Commission. The reporting mandates contain within them the requirement that the reports to be filed must be accurate. 33/ As established above, Pascale's audits were at least negligent, and this caused the Company to file materially misleading financial statements in numerous filings made on Forms 10-K, 10-KSB, and 10-QSB with the Commission. 34/ Both the audited financial statements certified by the Firm, with Pascale as engagement partner, and the quarterly financial statements reviewed by Pascale, which continued to apply the accounting principles approved in Pascale's audits, were materially false and misleading for the reasons discussed above. 35/

VII.

Rule 102(e)(1)(ii)

Improper professional conduct by an accountant includes a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the accountant knows, or should know, that heightened scrutiny is warranted. We have held that an accountant's conduct is highly unreasonable when he fails to

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33/ SEC v. Savoy Indus., 587 F.2d 1149, 1165 (D.C. Cir. 1978) ("The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports") (citing SEC v. IMC Int'l, Inc., 384 F.Supp. 889, 893 (N.D. Tex.), aff'd mem., 505 F.2d 733 (5th Cir. 1974), cert. denied sub nom. Evans v. SEC, 420 U.S. 930 (1975).

34/ See KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175-76 (2001) (finding that negligence may establish a determination that a respondent caused a violation of Exchange Act reporting requirements because the underlying primary violations are not scienter-based violations), petition denied, 289 F.3d 109 (D.C. Cir. 2002).

35/ The OIP also charged Pascale with violations of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, and Section 17(a) of the Securities Act. The OIP also charged Pascale with aiding and abetting the Company's reporting violations under Exchange Act Section 15(d) and Exchange Act Rules 15d-1 and 15d-13. As a result, the OIP also alleged that Pascale is subject to discipline under Commission Rule of Practice 102(e)(1)(iii). Based on our determinations set forth in this opinion, we do not address these issues.

employ heightened scrutiny with regard to matters that are "important or material, or when warning signals or other factors should alert an accountant" to a heightened risk. 36/

Pascale failed to employ heightened scrutiny in conducting the audits of New Composite in question in this matter. Pascale ignored numerous indicia that should have alerted him to the possibility that his audits would result in materially misleading financial statements. He signed audit opinions that improperly represented that the Company's financial statements were presented in accordance with GAAP and that he conducted his audits in accordance with GAAS.

Pascale's work papers indicate that he understood that the valuation of the Affordable shares exchanged in the merger transaction and the valuation of the patent rights were critical audit topics. The patent was the Company's chief asset. Nevertheless, despite his and his Firm's lack of expertise in valuation issues, Pascale and the Firm undertook both of these valuations on their own. Pascale did not consider the factors identified in APB 16, paragraphs 23, 74, and 75, in his valuation. He ignored ample evidence that the trading price of Affordable's shares around the time of the merger did not provide useful guidance as to their fair value. Pascale agreed to a 24% discount of that price that had no basis and, as he admits, was inconsistent with GAAP.

In 2000, Pascale accepted unsubstantiated management projections of the future revenues to be derived from the patent rights. In 2001, Pascale made his own projections after receiving a new set of unsubstantiated management projections that were provided by the Company's chief financial officer, but Pascale's own projections nonetheless appear to continue to rely significantly on the management projections provided at the time, although Pascale knew that the Company had no operating history, no governmental or regulatory approvals for use of Z-Mix, its key product, and no contracts for the use or manufacture of Z-Mix. This lack of an operational history of the Company should have led Pascale to realize that an impairment to the patent value was necessary. Furthermore, Pascale allowed the Company to record a deferred tax asset that was not netted against the deferred tax liability that arose from the step-up in the patent's value. Even if the deferred tax asset had been appropriate, Pascale did not require the Company to take a valuation allowance against the deferred tax asset, although it was not likely that the Company could generate sufficient revenues to use the deferred tax asset, for the same reasons cited above in connection with the impairment analysis. Pascale, as a result, is subject to discipline under Commission Rule of Practice 102(e)(1)(ii).

36/ James Thomas McCurdy, Exchange Act Rel. No. 49182 (Feb. 4, 2004), 82 SEC Docket 271, 286, aff'd, McCurdy v. SEC, 396 F.3d 1258 (D.C. Cir. 2005). Heightened scrutiny was clearly warranted here. As the Court of Appeals for the District of Columbia Circuit observed in McCurdy, "[A]n auditor must exercise, not his 'inclination,' but his 'professional judgment' and that judgment must be 'guided by sound' auditing principles, among which are a 'thorough . . . search for evidential matter,' AU § 326.23, and an 'attitude that includes a questioning mind and a critical assessment of audit evidence,' AU § 230.07." McCurdy, 396 F.3d at 1263.

Pascale notes that he sought out Cheskes, who concurred in his audits. However, as Pascale was aware, Cheskes's involvement was limited. 37/ Cheskes testified that he spent approximately five hours on the 2000 audit and did not review the work papers. The record is unclear about whether Cheskes reviewed Pascale's methodology for valuing the Affordable stock exchanged in the merger beyond concurring in the discount applied by Pascale. It is also unclear what Cheskes knew about the basis for Pascale's determinations not to assess an impairment against the value of the Z-Mix patent or a valuation allowance against the deferred tax asset. As the engagement partner at the Firm, Pascale was responsible for the audit. He had ample evidence that the value of the Z-Mix patent was inflated and that the Company had not received the necessary regulatory approvals to develop the patent and had no contracts for the sale or manufacture of the product. As discussed in Section IV above, the Company's revenue projections did not provide an adequate basis for maintaining the carrying value of the patent.

We conclude that Pascale's failures to apply due care, to exercise professional skepticism, and to obtain sufficient competent evidential information to support his audits were highly unreasonable. His failures resulted in his improperly representing that his audits complied with GAAS and that the Company's financial statements comported with GAAP. His conduct further demonstrates repeated instances of unreasonable conduct, each a violation of applicable professional standards, indicating a lack of competence to practice before the Commission.

37/ It is unclear from the record what Cheskes or Pascale understood to be Cheskes's role. To the extent that Cheskes was supposed to act in a role similar to a "concurring partner" in an audit, we believe that Pascale should have known that Cheskes's efforts were inadequate. A concurring partner is obligated to make an objective review of significant accounting, auditing, or reporting considerations. That review includes review of selected working papers, as well as conversations with the engagement partner. He or she is to exercise due care and to bring professional skepticism to bear on that review. When a concurring partner identifies material errors or irregularities, the concurring partner should obtain sufficient competent evidential matter to determine their effect. Robert D. Potts, CPA, 53 S.E.C. 187, 195-97 (1997), aff'd, 151 F.3d 810 (8th Cir. 1998).

VIII.

We have determined to impose a cease-and-desist order. Pascale argues that his conduct of the audit, while not perfect, was reasonable. He asserts that his interpretation of the authority in the area of common control provided a reasonable basis for the restatement in 2000 of the 1999 audit. Pascale points to the approval granted by Cheskes, the Firm's independent reviewing accountant, as indicating that his certification of the New Composite financial statements had an adequate evidential basis and that his treatment of the impairment and the deferred tax asset were not unreasonable.

Pascale was a cause of violations of the reporting and recordkeeping requirements in Section 15(d) of the Exchange Act and Exchange Act Rules 15d-1 and 15d-13 by New Composite. Pascale's conduct of the New Composite audits had serious deficiencies. Highly unreasonable failures to comply with auditing standards, such as those of Pascale, "jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors." 38/ Pascale's audits did not comply with GAAS, and, contrary to his representations, the financial statements deviated from GAAP. Pascale's conduct continued over three years in the face of numerous indications that his step-up of the valuation of the Z-Mix patent rights transferred in the merger transaction (which Pascale concedes was material), his failure to record an impairment to the Z-Mix patent, and the treatment of the deferred tax asset were without basis. These failures resulted in materially misstated financial statements.

Pascale's conduct demonstrates a highly unreasonable disregard of his duties as an independent auditor. His failures adversely affected the Commission's processes. In addition to the factors discussed above, Pascale asserts that he has not engaged in another public company audit since ceasing his relationship with New Composite, but Pascale could return to public company audits in the future. In addition, Pascale appears not to recognize the seriousness of his failures that attended the determinations at issue here. The reliability and integrity of information provided in public financial statements is essential to the functioning of the markets, 39/ and

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38/ Touche Ross & Co. v. SEC, 609 F.2d 570, 581 (2d Cir. 1979).

39/ See, e.g. McCurdy, 396 F.3d at 1261 ("Investor confidence is bolstered by the knowledge that public financial statements have been subjected to the rigors of independent and objective investigation and analysis.").

Pascale's conduct calls his credibility in this area into question. Thus, there is a sufficiently high level of risk of future violations that would endanger the public to warrant a cease-and-desist order. A cease-and-desist order under Section 21C of the Exchange Act is therefore warranted to protect the public. 40/

An appropriate order will issue. 41/

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN, GOLDSCHMID and ATKINS); Commissioner CAMPOS not participating.

Jonathan G. Katz
Secretary

40/ In light of our issuance of a cease and desist order, under the particular circumstances of this case, we have determined not to sanction Pascale for his improper professional conduct under Rule 102(e)(1)(ii).

41/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No. 8555 / March 18, 2005

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 51393 / March 18, 2005

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 2214 / March 18, 2005

Admin. Proc. File No. 3-11194

In the Matter of

PHILIP L. PASCALE, CPA

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Philip L. Pascale cease and desist from causing any violation of the reporting provisions of Section 15(d) of the Securities Exchange Act of 1934 and Exchange Act Rules 15d-1 and 15d-13.

By the Commission.

Jonathan G. Katz
Secretary