

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56470 / September 19, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2721 / September 19, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12811

In the Matter of

PRESS C. SOUTHWORTH, CPA

Respondent.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO RULE 102(e) OF THE
COMMISSION'S RULES OF PRACTICE,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative proceedings be, and hereby are, instituted against Press C. Southworth (“Southworth” or “Respondent”), pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.¹

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as

¹ Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds² that:

A. SUMMARY

1. These proceedings arise out of Press C. Southworth's improper professional conduct in connection with the audit of the 1998 consolidated financial statements ("1998 audit") of National Century Financial Enterprises, Inc. ("NCFE"). Located in Dublin, Ohio, NCFE was a private healthcare finance company that ultimately went bankrupt in November 2002. Southworth was the engagement partner for PricewaterhouseCoopers LLP's ("PwC") audits of NCFE for the years ended 1995 through 1998. Southworth commenced work on the 1998 audit in approximately the Fall of 1998 and completed the audit in August 1999.

2. NCFE created special purpose subsidiaries to operate separate investment "programs" under which asset-backed notes were issued to institutional investors in private offerings. NCFE represented to investors in the notes ("noteholders") issued by nearly all programs that the proceeds of those notes would be used exclusively for the purchase of patient-specific healthcare accounts receivable. Although NCFE used some noteholder funds to purchase such accounts receivable, NCFE used a substantial portion of the private placement proceeds to make unsecured loans or loans secured by collateral other than healthcare accounts receivable ("non-permitted loans"). These loans violated the requirements of the master trust indentures ("indentures") that governed NCFE's note offerings. The quality of the receivables that the programs purchased was material to noteholders because the pool of purchased receivables was the sole source from which noteholders would be repaid. NCFE concealed its non-permitted uses of noteholder funds by, among other things, making false and misleading statements in its annual financial statements, including the 1998 consolidated financial statements ("1998 Financials").

3. During the course of the 1998 audit, Southworth was aware that NCFE was making these non-permitted loans to various providers through the programs, which made up the vast majority of NCFE's business. Many of those providers did not have the ability to repay those loans. The 1998 Financials did not adequately disclose the non-permitted loans, the resultant scope of the violations of the indentures, or the consequences that such violations had on NCFE's liquidity and its ability to continue as a going concern. NCFE's 1998 Financials also did not reflect a sufficient reserve for the material impairment of its receivables portfolio that existed as of December 1998. Yet, Southworth signed an unqualified audit report that erroneously stated that

² The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

NCFE's 1998 Financials were prepared in accordance with Generally Accepted Accounting Principles ("GAAP") and that the audit had been conducted in accordance with Generally Accepted Auditing Standards ("GAAS").

4. During the course of the 1998 audit, Southworth learned information suggesting that NCFE was reporting inaccurately aged receivables and including ineligible receivables in monthly investor reports ("investor reports") on the performance of the individual programs. In addition to PwC's audit of NCFE's consolidated financial statements, NCFE retained PwC to perform certain non-audit, agreed-upon procedures on one investor report each year for each individual program. NCFE distributed the investor reports every month to the indenture trustees ("trustees" or "indenture trustees"), who in turn provided them to ratings agencies. NCFE also provided copies of the investor reports to investors upon request. This inaccurate reporting by NCFE management should have caused Southworth to question management's integrity and triggered his obligations under GAAS to address evidence of possible fraud and illegal acts by NCFE. Southworth failed to do so and instead continued to place undue reliance on management representations, including representations that non-permitted loans were collectible at the values ascribed to them by NCFE and that the indenture trustees for the programs and noteholders were aware of the non-permitted loans.

5. After NCFE fired PwC as its auditor in early 2000, the successor audit firm of NCFE (the "Successor Auditor") reviewed PwC's workpapers and interviewed Southworth by telephone. In the interview, the Successor Auditor asked Southworth whether he had concerns about NCFE management's integrity. Southworth stated that he had no such concerns. Southworth did not respond fully because Southworth did not also disclose any of the following matters that were relevant to management integrity: (i) NCFE was making non-permitted loans; (ii) NCFE was reporting inaccurately aged receivables and including ineligible receivables on investor reports; and (iii) PwC's internal risk-assessment system rated NCFE's integrity and ethics as "high risk."

6. After this discussion with Southworth, the Successor Auditor subsequently accepted NCFE as a client.

7. NCFE's fraud went undetected until 2002. From early 2000 through 2002, NCFE raised nearly \$2.5 billion from noteholders in continuance of its fraud.

B. RESPONDENT

8. **Press C. Southworth**, age 59, of Columbus, Ohio, was an audit partner at PwC (and its predecessor, Coopers & Lybrand, LLP ("Coopers")) from 1985 until he retired in 2001. Southworth was the engagement partner on the audits for NCFE's 1995-1998 financial statements. Southworth is a certified public accountant, who was licensed in Ohio until his license lapsed in December 2006, after his retirement from PwC.

C. OTHER RELEVANT ENTITY

9. **PwC** is a Delaware limited liability partnership with its principal offices located in New York, New York. PwC (and its predecessor, Coopers) served as NCFE's auditor for NCFE's financial statements for the years 1995-1998.

D. FACTS

NCFE Background

10. From 1991 through its bankruptcy in November 2002, NCFE acted through its individual programs to purchase medical accounts receivable from healthcare providers. The programs raised the funds for the purchase of accounts receivable through private offerings of notes to institutional noteholders under SEC Rule 144A, which exempts certain offerings to "qualified institutional buyers" from the Securities Act. Nearly all of the program indentures required the programs to use the note proceeds exclusively to purchase patient-specific healthcare accounts receivable from healthcare providers. The programs and note offerings were structured as asset-backed securitizations, with the notes being fully collateralized by the purchased medical accounts receivable and cash reserves held in the programs. From 1991 through 2002, NCFE's subsidiaries issued more than \$17 billion in asset-backed notes through private placements.

11. NCFE's programs were governed by indenture agreements among NCFE's servicing agent, the programs themselves, and the trustees. With the exception of one small program, the indentures required all of the programs to engage only in one type of business activity: the purchase of the "eligible" medical accounts receivable of a hospital, physicians' group, or other healthcare provider. "Eligible receivables" were defined only to include the insured portion of a receivable for which medical services had already been rendered. The programs purchased the receivables at a price equal to 97% of the receivables' estimated collectible value.

12. The indentures also required the programs to comply with certain requirements designed to protect noteholders from loss. Failure to comply with certain key provisions of the indentures constituted an event of default. If NCFE could not cure the defaults within a specified time period, the indentures required the program indenture trustees to declare a principal amortization event, which would cause the program to cease purchasing receivables and would require the trustee to begin distributing cash collections on the healthcare receivables to program investors in repayment of their principal and interest. For example, to ensure that the programs always had sufficient collateral to cover the notes, the program agreements required that at all times the programs have cash reserves and eligible receivables equal to at least 111% of the amount of notes outstanding ("collateral coverage test"). If the collateral dropped below 111% for more than seven days, the programs were required to begin repayment of investors' principal and interest from the cash received on the repayment of the healthcare receivables. The indentures also required healthcare providers to immediately replace receivables that became older than 180 days ("defaulted receivables") with new eligible receivables. If the provider did not, the value of the defaulted receivables was to be deducted from the next funding to that provider, and the defaulted receivables could not be counted as eligible collateral for purposes of the collateral coverage test.

13. The programs required an annual audit of NCFE's consolidated financial statements. NCFE provided those consolidated financial statements to the program indenture trustees, the rating agencies that rated the notes, and some of the noteholders upon request.³

NCFE's Use of Note Proceeds in Violation of the Indentures and Misrepresentations to Noteholders

14. From at least 1994 until 2002, NCFE used noteholder funds to make non-permitted loans, which was in violation of the indentures and contrary to NCFE's representations to noteholders. NCFE used significant amounts of noteholder funds to provide unsecured loans to healthcare providers that had already sold all of their medical accounts receivable to NCFE and had no additional such receivables to sell. Most of these providers had incurred significant operating losses over a period of years and required additional funding in order to avoid bankruptcy. NCFE made many of these non-permitted loans to providers that were or became owned in whole or in part by NCFE's principals.

15. NCFE's non-permitted loans were far riskier than purchased eligible accounts receivable. Because eligible receivables were to be paid by highly rated third-party payors, such as insurance companies, HMOs, and government programs such as Medicare and Medicaid, for medical services that had already been rendered and billed to the payors, the eligible receivables were of high credit quality. By contrast, NCFE's ability to collect on non-permitted loans was in many cases speculative, because the non-permitted loans were in substance unsecured loans to severely financially distressed borrowers or loans secured by collateral other than healthcare accounts receivable. In fact, NCFE had very poor collection experience on its non-permitted loans, and in some cases NCFE went more than a year without receiving any payments from certain providers.

16. The amount and significance of the non-permitted loans, as a percentage of the gross receivables reported on NCFE's balance sheet, grew significantly during the period in which PwC audited NCFE's financial statements. Non-permitted loans comprised over 50% of NCFE's receivables portfolio by the end of 1998.

17. NCFE's practice of making non-permitted loans caused the programs to be undercollateralized, with eligible receivables plus cash reserves falling well short of the required 111% value of the notes. This should have caused an immediate acceleration in the maturity of the notes and early amortization of the programs.

18. NCFE obscured its non-permitted loans and the resulting indenture violations by making false and materially incomplete disclosures in the 1998 Financials. Footnote 8 to the 1998 Financials disclosed that "the Company is not in compliance with various provisions of the Trust Indentures[.]" Nonetheless, the 1998 Financials departed from GAAP because they did not properly disclose the nature and scope of these indenture violations and that NCFE was in default

³ NCFE's audited financial statements and PwC's audit reports were not included in the offering documents for the notes. However, NCFE provided the audited financial statements and PwC's audit reports to noteholders upon request.

and could not cure many of these violations. To the contrary, NCFE's 1998 Financials stated that, in the Company's opinion, the indenture violations in the programs "can be cured or do not represent material performance or covenant defaults." That statement was false and misleading, notwithstanding NCFE's statement that "no assurance can be given that violations will be cured."

19. Footnotes 1 and 3 to the 1998 Financials divided NCFE's healthcare receivables into three categories: "provider receivables," "other provider receivables," and "provider advances." The footnotes provided the following definitions for NCFE's receivables: (1) "Provider receivables consist of purchased account receivables including various components of the client billing process such as third party settlements, disproportionate share, unbilled and monthly capitation amounts;" and (2) "[o]ther provider receivables, notes receivable, and equipment lease receivables represent advances against various forms of collateral including accounts receivable, real property and equipment." The term "provider advances" was not defined. NCFE's quantification and description of these three categories was inadequate to inform the reader of the existence or extent of any non-permitted loans in any particular program. The disclosures: (1) did not state that any of these categories of receivables contained non-permitted loans or the amount of the non-permitted lending; and (2) did not clearly define "provider receivables," "other provider receivables," or "provider advances" so that a reader could understand the nature and substance of each of those categories of receivables.

20. Further, NCFE failed to evaluate the impairment present in its receivables portfolio resulting from NCFE's non-permitted loans to severely financially distressed providers. NCFE's allowance for loan losses was inadequate given its non-permitted lending activity.

21. Noteholders eventually uncovered NCFE's fraud in October 2002, by which time NCFE's notes outstanding had grown to \$2.9 billion from \$1.25 billion in 1998, the year of PwC's last audit. The noteholders called their notes, which drove NCFE into bankruptcy in November 2002. By that point, however, most of NCFE's outstanding receivables were unsecured or backed by collateral that was virtually worthless. As a result, noteholders lost more than \$2 billion from NCFE's fraudulent scheme.

Southworth Knew That NCFE Was Using Investor Funds in Violation of the Indentures

22. Through PwC's audits of NCFE, Southworth knew about NCFE's widespread violations of the indenture agreements and also should have recognized the threats those violations posed to the noteholders' interests. The amount of the non-permitted loans was material to the programs' assets and to the 1998 Financials.

23. Southworth's concerns about NCFE's business practices were highlighted in a June 25, 1999 memorandum to NCFE management entitled, "Open Items and Additional Audit Procedures for NCFE As of June 25, 1999" (the "June 25 memo"). That memorandum was prepared by Southworth and others after NCFE's principals revealed to Southworth their (later-withdrawn) plans to take NCFE public in the near future. The June 25 memo stated the need to "[m]eet with the Trustees and Investors to discuss the Indenture issues that we have noted in our

audit. We need to ensure that all parties are aware of the items noted below and do not consider them to be material breaches, which could result in an Event of Default.” In the June 25 memo, several “Indenture issues” were identified, including:

- “Not forcing providers to repurchase all receivables that have aged out past 180 days”;
- “Inaccurately aged receivables being included on the Investor Reports (Location 99)”
- “Ineligible receivables brought on as collateral included in the Investor Reports (Location 99)”;
- “Whether the proformas, advances, and other items that are out of the ‘norm’ meet the definition of a purchased receivable pursuant to the sales and subservicing agreement.”

Southworth did not communicate with the trustees or noteholders about these issues before completing the audit of NCFE’s 1998 Financials, based on his assumption, unsupported by sufficient competent evidential matter, that the trustees and noteholders were already aware of NCFE’s violations.

24. As reflected in the June 25 memo, Southworth was aware that NCFE management included inaccurately aged and ineligible receivables on investor reports provided to the indenture trustees and noteholders. This inaccurate reporting allowed NCFE to show compliance with the collateral coverage requirements of the indentures and conceal events of default from the indenture trustees. Southworth should have known that the investor reports failed to reflect NCFE’s indenture defaults as a result of its non-compliance with the collateral coverage test. Southworth also was aware that NCFE management had recorded on its books and records \$175 million of “Location 99” receivables. PwC’s work papers documented that these Location 99 receivables lacked any detailed information, generally were over one year old, and that the agings of these receivables were “frozen.” Southworth therefore was aware that NCFE was not forcing providers to repurchase receivables that had aged out past 180 days, as required by the indentures. Southworth also learned that NCFE entered into its system accounts receivable amounts that represented “pro forma” revenues for medical services that providers might render in the future, assuming that the providers continued to remain in business. The pro forma receivables frequently represented periods of four to six months of operating revenues for a particular healthcare provider; these pro forma receivables inflated the medical accounts receivable and NCFE’s purported collateral amounts. Southworth should have known that the indentures did not permit the programs to purchase “pro forma” receivables. All of these facts should have indicated to Southworth that there were serious questions about NCFE management’s integrity, the possibility that NCFE management engaged in fraud or illegal acts, and whether NCFE’s 1998 financial statements were in conformity with GAAP.

NCFE's Departures from GAAP and Incomplete and Misleading Financial Statement Disclosures

25. In August 1999, Southworth signed an unqualified audit report on NCFE's 1998 Financials, stating among other things, that NCFE's financial statements were fairly presented in all material respects in conformity with GAAP. This statement was incorrect. NCFE's 1998 Financials included an allowance for losses at December 31, 1998 of \$22.2 million against a portfolio of provider receivables totaling \$1.223 billion, more than half of which was comprised of non-permitted loans to financially distressed healthcare providers. The programs required NCFE to establish holdback reserves from provider fundings that could be available to absorb up to 17% of each provider's credit and collection losses.⁴ However, the credit and collection losses far exceeded 17% of the receivables portfolio for many providers. The financial statements were not in conformity with GAAP because the holdback reserves and NCFE's allowance for losses were insufficient to cover the material losses arising from the impairment of unsecured loans that NCFE had made to healthcare providers. The financial statements also were not in conformity with GAAP because, although they disclosed the fact of indenture violations, they provided incomplete and misleading disclosure about the nature and significance of those violations, as discussed above. NCFE's violations of the indenture collateral coverage test constituted an event of default requiring NCFE to engage in early amortization of the programs in which there were violations.

26. More than half of NCFE's receivables portfolio consisted of non-permitted loans. Many of NCFE's customers had experienced significant operating losses over a period of several years and were experiencing severe liquidity problems. GAAP required NCFE to evaluate these facts and the degree to which these unsecured loans were impaired so that an appropriate provision for loss could be recorded in accordance with Statements of Financial Accounting Standards No. 5, "Accounting for Contingencies," and Statements of Financial Accounting Standards No. 114, "Accounting by Creditors for the Impairment of a Loan." NCFE did not perform an impairment evaluation in accordance with these accounting standards. Instead, NCFE fabricated collateral and ascribed excessive value to the collateral in order to avoid recognition of impairment losses. Southworth failed to perform sufficient audit procedures to identify the impairment in NCFE's receivables portfolio.

27. In footnote 8 to NCFE's 1998 Financials, NCFE provided additional detail on what was by far the most significant liability on NCFE's balance sheet -- "Notes Payable" -- and discussed the indenture violations in the programs. Although NCFE caused the programs to be in violation of the core provisions of the indentures which prohibited nearly all of the programs from engaging in any business other than the purchase of eligible healthcare receivables, NCFE's footnote description of the indenture violations minimized the significance of the indenture violations and failed to describe or provide any additional substantive information about the nature

⁴ NCFE's programs withheld 17% of the amount funded to providers as cash reserves primarily to provide additional collateral for noteholders, and secondarily to absorb credit or collection losses in the portfolio. These reserves totaled \$237 million at the end of 1998. These reserves could be used on a provider-by-provider basis to absorb the first 17% of losses incurred for a particular provider. However, the reserves for one provider could not be used to absorb losses in another provider's portfolio. Furthermore, in the event of early amortization of NCFE's programs, the cash reserves were to serve as collateral to guard against noteholder losses rather than to absorb losses in specific provider accounts or to be used as a receivables valuation account.

and dollar magnitude of the indenture violations or the programs in which the violations were occurring. Instead, NCFE's footnote misleadingly included management's false "opinion" that the violations "can be cured or do not represent material performance or covenant defaults." That footnote disclosure stated in pertinent part:

The Company is not in compliance with various provisions of the Trust Indentures, however, no Event of Default as defined in the Trust Indentures has been declared by any of the noteholders or trustees. The Company does not expect that an Event of Default will be declared in the near-term under current circumstances because among other matters the Programs are current as to all required interest payments and the Company has successfully concluded six previous Programs. Furthermore, in the opinion of the Company, the violations can be cured or do not represent material performance or covenant defaults, however, the determination of whether a violation is material is not entirely within the discretion of the Company and no assurance can be given that violations will be cured or that a Principal Amortization Event, as described below will not be declared by the trustees or noteholders.

Should an Event of Default be declared with respect to any of the Programs, a Principal Amortization Event would occur under which the respective program would be required to cease purchasing new eligible receivables and to apply all cash received to the principal and interest due on the related notes. This could negatively affect the Company's ability to fund its operations and Programs as well as its ability to fund new programs and enter into relationships with new providers.

28. The footnote 8 disclosure was incomplete and misleading because it failed to disclose information essential to an understanding of the nature of the indenture violations and that those violations constituted events of default. While the footnote stated that in the opinion of the Company the indenture violations in the programs "can be cured or do not represent material performance or covenant defaults," in fact many of the indenture violations could not be cured and were significant violations of the indentures. The disclaimer that "no assurance can be given that violations will be cured or that a Principal Amortization Event . . . will not be declared by the trustees or noteholders" did not adequately remedy that misleading statement. Absent the ability by NCFE to cure the program defaults resulting from these violations or obtain a waiver of these defaults, the indentures required the indenture trustees for the programs to commence a principal amortization event for the particular programs in which the defaults occurred.

NCFE Terminates PwC as NCFE's Auditor, and Southworth Communicates With the Successor Auditor

29. After PwC completed the 1998 audit, the engagement team performed its annual client continuance evaluation of NCFE to determine whether PwC should continue with NCFE as a client. As part of this review, Southworth participated in preparing a computer-generated audit risk assessment report for NCFE. During this post-1998 audit assessment process, the risk rating generated by PwC's risk rating system for NCFE's "Integrity and Ethics" increased from a mid-risk rating in 1998 to the highest risk rating as a result of the answers Southworth and others gave to questions in the report-generation process. Based in part on Southworth's answers on the risk assessment report and on the 1998 audit, PwC placed NCFE into a "high risk" category for purposes of PwC's risk assessment analysis.

30. In approximately February 2000, NCFE terminated PwC as NCFE's auditor, citing a litigation conflict between one of NCFE's largest customers and PwC as the reason for termination.

31. Upon PwC's termination as auditor, NCFE hired the Successor Auditor in April 2000. As part of the Successor Auditor's new client acceptance process, the Successor Auditor reviewed PwC's workpapers and interviewed Southworth by telephone. In this conversation, the engagement partner asked Southworth, among other things, whether PwC had concerns about the integrity of NCFE's management. Southworth responded that there were no such issues. Southworth did not respond fully because Southworth did not also disclose any of the following matters that were relevant to management integrity: (i) NCFE was making non-permitted loans; (ii) NCFE was reporting inaccurately aged receivables and including ineligible receivables on investor reports; and (iii) PwC's internal risk-assessment system rated NCFE's integrity and ethics as "high risk."

32. After this discussion with Southworth, the Successor Auditor subsequently accepted NCFE as a client.

E. Southworth's Departures From GAAS

Failure to Properly Plan and Perform the Audit to Obtain Reasonable Assurance About Whether the Financial Statements Were Free of Material Misstatement

33. GAAS requires that the auditor "plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." (AU § 110, Responsibilities and Functions of the Independent Auditor, at AU 110.02) In addition, the risk assessment process should "be ongoing throughout the audit" and should consider whether the "nature of audit procedures performed may need to be changed to obtain evidence that is more reliable or to obtain additional corroborative information." (AU § 316, Consideration of Fraud in a Financial Statement Audit⁵, at AU 316.33 & .28 (pre-

⁵ AU 316 was modified by Statement on Auditing Standards No. 99, Consideration of Fraud in a Financial Statement Audit, which was integrated into AU 316 in October 2002 and applied to audits of financial statements for

amendment), AU 316.68 & .52 (post-amendment)) Among the actions available to an auditor who uncovers evidence of possible fraud or illegal acts are: (1) considering whether the misstatements are indicative of fraud (AU 316.34 (pre-amendment), AU 316.75 (post-amendment)) or illegal acts (AU § 317, Illegal Acts by Clients, at AU 317.07); (2) evaluating the effect and considering implications for other aspects of the audit (AU 316.35 (pre-amendment), AU 316.77 (post-amendment)); (3) attempting to obtain additional evidential matter (AU 316.35 (pre-amendment), AU 316.77 (post-amendment)); (4) confirming significant information concerning the matter with the other party to the transaction or with intermediaries, such as banks or lawyers (AU 317.11); (5) informing the Audit Committee (AU 316.38 (pre-amendment), AU 316.79 (post-amendment)) or equivalent authority (AU 317.17); (6) considering whether to withdraw from the engagement and communicating the reasons to the Audit Committee (AU 316.36 (pre-amendment), AU 316.78 (post-amendment)); (7) consulting with the client's legal counsel (AU 317.10) and the auditor's own legal counsel (AU 317.22); and (8) issuing an audit report that is not unqualified (AU § 508, Reports on Audited Financial Statements, at AU 508.20-.63)

34. Contrary to GAAS, Southworth failed to adequately plan and perform the 1998 audit after learning of numerous facts that, either standing alone or in the context of other facts learned during the audit, warranted heightened scrutiny that should have alerted him to the possibility that NCFE's financial statements were materially misleading in that they contained insufficient disclosure of the nature and extent of NCFE's indenture violations, including non-permitted loans to financially troubled borrowers, and were not in conformity with GAAP. In auditing the 1998 Financials, Southworth failed to properly consider the implications of the scope and significance of the indenture violations. He also failed to probe NCFE's basis for asserting in footnote 8 that, in the Company's opinion, the violations were curable or immaterial.

35. Additionally, as described above, during the 1998 audit, Southworth became aware of information that should have suggested to him that NCFE had falsely reported in monthly investor reports that NCFE was using investor funds exclusively for the purchase of eligible receivables. Such information triggered Southworth's obligations under GAAS to inquire further into possible fraud and illegal acts.

36. If Southworth had exercised due care and professional skepticism, he would have taken significant steps to assess whether NCFE management was engaged in fraud or illegal acts. This failure to properly plan and perform the audit violated AU 316 and AU 317.

Failure to Obtain Sufficient Competent Evidential Matter, Exercise Due Care, and Exercise Professional Skepticism

37. Auditors need to obtain sufficient competent evidence "to afford a reasonable basis for an opinion regarding the financial statements under audit." (AU § 326, Evidential Matter, at AU 326.01) The validity and sufficiency of required evidence depends on the circumstances and the auditors' judgment, but the evidence should be competent, sufficient, and persuasive. (AU

periods beginning on or after December 15, 2002. These amendments did not apply to the 1998 NCFE audit. Therefore, all citations to AU 316 will include the pre-amendment citation in effect at the time of the audit, as well as the post-amendment citation to the current AU 316.

326.02 & .21-.22) Further, GAAS requires that auditors exercise due professional care in planning and performing an audit and in preparing the audit report. (AU § 230, Due Professional Care in the Performance of Work, at AU 230.01) Due professional care requires that the auditor exercise professional skepticism in performing audit procedures and gathering and analyzing audit evidence. (AU 230.07-.08) “In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest.” (AU 230.09) “Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence.” (AU 230.07; *see also* AU 316.27 (pre-amendment), AU 316.13 (post-amendment))

38. As set forth above, during the course of the 1998 audit, Southworth was aware that a substantial portion of NCFE’s finance receivables consisted of non-permitted loans instead of purchased eligible healthcare receivables. The non-permitted loans consisted of unsecured loans and loans secured by collateral such as real estate, equipment, and artwork. The audit workpapers documented that many of NCFE’s customers had incurred substantial operating losses over a period of years and were not capable of meeting or honoring their business obligations without continued financial support from NCFE; they were severely financially distressed and were dependent on NCFE to fund their negative operating cash flows. These providers did not possess eligible receivables to sell to NCFE, nor did they generally possess other assets of value that could serve as collateral.

39. Southworth did not properly assess the adequacy of NCFE’s allowance for losses. Southworth failed to properly evaluate how the providers’ negative operating cash flows, negative working capital, and negative net worth impaired their ability to repay the non-permitted loans made to them. Based on the evidence available to him, Southworth should have known that NCFE’s financial statements failed to reflect a sufficient reserve for material losses arising from the unsecured loans made to healthcare providers.

40. Southworth improperly accepted overvalued collateral such as pro forma receivables and the Location 99 receivables as an alternative to the purchased accounts receivable required by the indentures. Southworth did not exercise due care or professional skepticism in accepting fabricated collateral proffered by NCFE as an appropriate substitute for purchased accounts receivable. He failed to exercise appropriate professional skepticism or obtain sufficient competent evidence in support of the values that NCFE ascribed to the alternative collateral.

41. Southworth failed to properly evaluate the risk posed to the collectibility of NCFE’s finance receivables by the indenture violations in the programs. Southworth knew or should have known that if the indenture trustees for the programs declared a principal amortization event for the programs, NCFE’s ability to continue to fund the providers who owed money to NCFE would cease. Southworth failed to properly consider these matters when evaluating the adequacy of NCFE’s allowance for loan losses.

Issuance of an Unqualified Audit Report

42. GAAS requires that the auditor's report contain an opinion on the financial statements taken as a whole and contain a clear-cut indication of the character of the auditor's work. (AU 508.04) The auditor can determine that he is able to issue an audit report containing an unqualified opinion only if he has conducted his audit in accordance with GAAS and the financial statements comply with GAAP. (AU 508.07 & .22)

43. GAAS further requires that "[t]he [audit] report shall state whether the financial statements are presented in accordance with generally accepted accounting principles." (AU § 410, Adherence to Generally Accepted Accounting Principles, at AU 410.01) An auditor's report that financial statements are presented in accordance with GAAP should be based on, among other things, whether the financial statements "are informative of matters that may affect their use, understanding, and interpretation." (AU § 411, The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles", at AU 411.04)

44. Under GAAS, "[i]nformative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report." (AU § 431, Adequacy of Disclosure in Financial Statements, at AU 431.01) "The presentation of financial statements in conformity with generally accepted accounting principles includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth. An independent auditor considers whether a particular matter should be disclosed in light of the circumstances and facts of which he is aware at the time." (AU 431.02)

45. In auditing NCFE's 1998 Financials, Southworth acted unreasonably in rendering an audit report containing an unqualified audit opinion stating that the audit complied with GAAS and the financial statements comported with GAAP. As described above, NCFE's 1998 Financials did not comport with GAAP because they failed to reflect a sufficient reserve for the impairment of unsecured loans that NCFE had made to healthcare providers and made materially misleading disclosures regarding the NCFE program violations. As described above and below, Southworth did not comply with GAAS in conducting the audit.

Failure to Perform an Adequate Going Concern Analysis

46. AU § 341, The Auditor's Consideration of an Entity's Ability to Continue As a Going Concern, states in pertinent part that "[t]he auditor has a responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited." (AU 341.02) Among the conditions and events that may indicate substantial doubt about the entity's ability to continue as a going concern is "default on loan or similar agreements." (AU 341.06) "The auditor's evaluation is based on his knowledge of relevant conditions and events that exist at or have occurred prior to the completion of fieldwork." (AU 341.02) If "the auditor

concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph . . . to reflect that conclusion." (AU 341.12)

47. Southworth mistakenly concluded that NCFE could continue as a going concern, despite the material defaults in NCFE's programs. In doing so, he failed to adequately evaluate whether there was a substantial doubt about NCFE's ability to continue as a going concern for a reasonable period of time when NCFE had acquired a substantial portion of the assets on its balance sheet in violation of the indentures.

48. Moreover, to the extent that Southworth relied on management's representations that the indenture trustees and noteholders were aware of the indenture violations, such reliance itself was a departure from GAAS, which states in pertinent part that "representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." (AU § 333, Management Representations, at AU 333.02)

49. The significant and material indenture violations in the programs, and the significant impairment of NCFE's receivables, created a substantial doubt about NCFE's ability to continue as a going concern for a reasonable period of time, and Southworth's analysis of NCFE's ability to continue as a going concern constituted a departure from GAAS.

Communications with the Successor Auditor

50. Under GAAS, a predecessor auditor "should respond promptly and fully, on the basis of known facts, to the successor auditor's reasonable inquiries. However, should the predecessor auditor decide, due to unusual circumstances such as impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not to respond fully to the inquiries, the predecessor auditor should clearly state that the response is limited." (AU § 315, Communications Between Predecessor and Successor Auditors, at AU 315.10)

51. Southworth failed to respond fully to the Successor Auditor's reasonable inquiries about NCFE's management. In response to the Successor Auditor's inquiries about NCFE management's integrity, Southworth told the Successor Auditor that there were no issues with management integrity. Southworth did not respond fully because Southworth did not also disclose any of the following matters that were relevant to management integrity: (i) NCFE was making non-permitted loans; (ii) NCFE was reporting inaccurately aged receivables and including ineligible receivables on investor reports; and (iii) PwC's internal risk-assessment system rated NCFE's integrity and ethics as "high risk." Southworth's failure to respond fully to the Successor Auditor's inquiries constituted a departure from GAAS.

F. VIOLATIONS

52. Rule 102(e)(1)(ii) of the Commission’s Rules of Practice provides, in pertinent part, “[t]he Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . to have engaged in unethical or improper professional conduct.”

53. With respect to persons licensed to practice as accountants, such as Southworth, “improper professional conduct” under Rule 102(e)(1)(ii) includes, inter alia:

(B) negligent conduct, consisting of (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, or (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.

54. The conduct described above constitutes highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which Southworth knew, or should have known, that heightened scrutiny was warranted.

G. FINDINGS

55. Based on the foregoing, the Commission finds that Southworth engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Southworth is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After two (2) years from the date of this order, Southworth may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company’s financial statements that are filed with the Commission. Such an application must satisfy the Commission that Southworth’s work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Southworth, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board (“Board”) in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Southworth, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in Southworth’s or the firm’s quality control system that would indicate that Southworth will not receive appropriate supervision;

(c) Southworth has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Southworth acknowledges his responsibility, as long as he appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Southworth to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission’s review may include consideration of, in addition to the matters referenced above, any other matters relating to Southworth’s character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary