

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
May 27, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13489

In the Matter of

POLLARD KELLEY
AUDITING SERVICES, INC.
and TERANCE KELLEY, CPA

Respondents.

ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO RULE 102(e) OF THE
COMMISSION'S RULES OF PRACTICE

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative proceedings be, and hereby are, instituted against Pollard Kelley Auditing Services, Inc. (“Pollard-Kelley”) and Terance Kelley, CPA (“Kelley” and, with Pollard-Kelley, “Respondents”) pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice to determine whether Respondents engaged in improper professional conduct.¹

¹ Rule 102(e)(1) provides, in pertinent part: “The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct.”

With respect to persons licensed to practice as accountants, Rule 102(e)(1)(iv) provides that “improper professional conduct” means:

(A) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or (B) either of the following two types of negligent conduct: (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.

II.

After an investigation, the Division of Enforcement and the Office of the Chief Accountant allege that:

A. SUMMARY

1. These proceedings arise out of Respondents' tampering with workpapers to conceal multiple deficiencies in their audit of Pegasus Wireless Corporation's 2006 financial statements. During the 2006 audit, Respondents violated numerous professional standards by failing to obtain written representations from Pegasus' management and failing to exercise due care and professional skepticism. In early 2008, nearly one year after completing the audit and after being sued by Pegasus investors for securities fraud, Respondents added additional workpapers to their audit documentation in an attempt to mask deficiencies in the audit. By creating workpapers after the fact and adding them to their audit documentation, without identifying the date they were added or the reason for adding them, Respondents violated Public Company Accounting Oversight Board ("PCAOB") Auditing Standard No. 3. Respondents' conduct, as further described below, constituted improper professional conduct within the meaning of Rule 102(e)(1)(ii) and (iv).

B. RESPONDENTS

2. Pollard Kelley Auditing Services, Inc. is a Colorado corporation licensed to do business in Colorado and Ohio. Pollard-Kelley is a public accounting firm registered with the PCAOB. According to corporate filings, its principal place of business is Kelley's Colorado home. Pollard-Kelley has five employees, including Kelley. The firm served as Pegasus' independent auditor from mid-2005 through approximately November 2007. As auditor, Pollard-Kelley opined that Pegasus' 2005 and 2006 financial statements were prepared in conformity with Generally Accepted Accounting Principles ("GAAP") and that Pollard-Kelley had conducted audits in accordance with the PCAOB's standards.

3. Terance Kelley, CPA, age 62, resides in Lake City, Colorado. He formed Pollard-Kelley and is its vice president of audit services. He performs the vast majority of the firm's audits and performed the audits of Pegasus' 2005 and 2006 financial statements, as well as quarterly reviews of Pegasus financial statements through approximately November 2007. He is licensed as a certified public accountant in Ohio.

C. RELATED PARTY

4. Pegasus Wireless Corporation is a Nevada corporation formed in 2000. After several failed enterprises, it became a shell company by 2003. In June 2005, through a series of reverse mergers, it acquired OTC Wireless, Inc., a private company incorporated in California that designs wireless networking devices. Pegasus had headquarters in Fremont, California, until about January 2007. It currently maintains a mailbox in Palm Beach, Florida. During the relevant period, its securities were registered pursuant to Section 12 of the Securities Exchange Act of 1934

("Exchange Act"). Its shares currently trade on the OTC Bulletin Board and briefly traded on NASDAQ in 2006. Pegasus filed for bankruptcy in January 2008.

D. RESPONDENTS' IMPROPER PROFESSIONAL CONDUCT

Pegasus' Fraud Scheme

5. From 2006 through 2008, Pegasus officers defrauded investors by creating backdated promissory notes memorializing a phony debt, which they used to issue unrestricted shares of Pegasus stock to individuals and entities they controlled. Pegasus issued nearly 480 million shares – 75% of its outstanding shares – based on the fake, backdated promissory notes, resulting in massive dilution of the existing shareholders' ownership interest. The individuals and entities who received shares dumped the stock on the open market and funneled many millions in proceeds to Pegasus officers.

6. Pegasus misled investors about why it issued the shares. For example, in the financial statements included in its quarterly report on Form 10-QSB for the quarter ended September 30, 2006, Pegasus stated: "During the third quarter the Company issued 5,276,016 shares to satisfy \$263,800 debt [sic] owed by the Company from prior to the change in control [in 2005]." Similarly, in the financial statements in its annual report on Form 10-KSB for the year ended December 31, 2006, Pegasus represented:

During 2006 the Company issued 7,376,016 shares of common stock to satisfy \$368,532 debt [sic] owed by the Company from prior to the change in control. . . . The Company is obligated on notes payable amounting to \$145,000 remaining balance which were undisclosed when current management took control of the shell company. These notes were entered into at various times in 2003 and were 2 year notes, all of which have matured. The notes . . . are convertible into common stock of the parent company at the discretion of the holder. Management two steps back failed to disclose these notes to subsequent management, thus current management was unaware of their existence.

In truth, Pegasus officers in 2006 concocted the debt as a means to enrich themselves.

Respondents' Deficient 2006 Audit

7. From mid-2005 through approximately October 2007, Respondents served as Pegasus' independent auditor, auditing the company's 2005 and 2006 financial statements and reviewing its quarterly statements through the second quarter of 2007.

8. In March 2007, during field work for the 2006 audit, Respondents noted Pegasus' disclosures that it had issued stock to pay previously undisclosed debt. The alleged debt described

in the September 30, 2006 10-QSB had grown inexplicably, from \$263,800 to \$368,532 at year-end, as had the number of shares issued. (Pegasus had additional debt, which had been previously disclosed, on its balance sheet.) Moreover, the number of shares issued by year-end based on the alleged debt (7,376,016) equaled more than one third of Pegasus' then-outstanding shares.

9. Respondents advised Pegasus in writing that they needed copies of "all agreements in connection with the conversion of \$368,532 of debt into common stock." Pegasus' CFO agreed to provide the information.

10. Respondents also requested Pegasus to explain the "basis for the 7,376,016 shares of common stock issued to satisfy \$368,532 of debt." On March 28, 2007, Pegasus' CFO replied in writing: "Huh? isn't that rather obvious." Kelley's contemporaneous notes reflect that he continued to have questions about the item.

11. Pegasus failed to provide the promised information or other substantiation or explanation for the alleged debt. Pegasus also failed to provide additional requested information to Respondents, including detail for prepaid expenses; a cash summary, bank reconciliations, and bank statements; supporting invoices for research and development purchases; a breakdown of the goodwill balance; and a copy of an acquisition agreement. Despite these open items, Respondents rendered an unqualified opinion on Pegasus' 2006 financial statements and affirmed its audit was in accordance with the PCAOB's standards. Pegasus included the opinion in its 2006 annual report on Form 10-KSB filed April 3, 2007.

12. Respondents also failed to obtain a written management representation letter from Pegasus for the 2006 audit.

13. PCAOB auditing standards require auditors to exercise reasonable diligence and due professional care in performing an audit. "Due professional care requires the auditor to exercise professional skepticism. . . [i.e.,] an attitude that includes a questioning mind and a critical assessment of audit evidence." AICPA Codification of Statements on Auditing Standards, "*Due Professional Care in the Performance of Work*," AU § 230.07. "The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. 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. Moreover, an auditor must obtain "sufficient competent evidential matter" to provide "a reasonable basis for forming an opinion." AU § 326.22.

14. In addition, PCAOB auditing standards establish a requirement that the auditor obtain written representations from management as part of an audit. AU § 333.01. The specific representations an auditor should obtain relate to, among other things, management's acknowledgement of its responsibility for the financial statements; its belief that the financial statements are fairly presented in conformity with GAAP, and the completeness of information provided. AU § 333.06. Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion and is ordinarily

sufficient to cause an auditor to disclaim an opinion or withdraw from the engagement. AU § 333.13.

15. Respondents departed from the standards described above by failing to obtain competent evidential matter for the alleged debt and other matters and failing to exercise professional skepticism.

16. Respondents further departed from these standards by failing to obtain a written management representation letter from Pegasus for the 2006 audit.

17. During reviews of Pegasus' quarterly financial statements for the quarters ended March 31, 2007, and June 30, 2007, Respondents continued to request information about the alleged debt and other items, but received nothing regarding the debt or other items.

Respondents Tampered with Workpapers When Their Audit Work Was Challenged

18. In late 2007, a Pegasus investor, seeking to represent a class of injured shareholders, sued Pollard-Kelley and others for securities fraud. Pollard-Kelley was served with the complaint on December 29, 2007.

19. On January 1, 2008, Kelley e-mailed a Pegasus officer noting that his firm had been named as a defendant. Kelley wrote: "THIS IS THE TIME TO GET THE FINAL SCHEDULES NEEDED FOR THE 2006 AUDIT TO ME!!!!!!"

20. On February 19, 2008, in connection with its investigation relating to Pegasus, SEC staff requested Pollard-Kelley to produce documents, including documents relating to Pegasus' disclosures about how and why it issued shares to pay the purported convertible debt.

21. In early 2008, having received notice that their audit work was under scrutiny, Respondents determined to add workpapers to their audit documentation. First, Respondents added a written management representation letter. The letter purported to reflect the CEO and CFO's confirmation that the 2006 financial statements are fairly presented in conformity with GAAP; that they made available to Pollard-Kelley all financial records and related data; and that they had no knowledge of fraud involving management. The letter was not signed by Pegasus' CEO or CFO. Rather, Kelley made a handwritten note on the last page of the letter: "Verbally acknowledged & confirmed . . . by [Pegasus' CFO] over the phone. Hard copy to follow."

22. When initially questioned about the workpaper, Kelley falsely testified that he believed he made the handwritten note in March 2007 and that he had the document in March 2007 when he signed off on the 2006 audit. Kelley, however, later stated that he added the workpaper to the audit documentation in 2008 and that his prior testimony was erroneous.

23. In addition to adding the written management representation letter to the audit documentation, Respondents added an undated memo to explain why they opined on Pegasus' 2006 financial statements despite numerous open items. The memo states:

At the time [Pegasus filed its 10-KSB] a request for additional information and support was made to the client [W]e were told the materials requested would be provided. The 45 day period of wrapping up audit documentation passed on May 13, 2007 without the receipt of the requested materials.

At that time the firm considered what it should do. Provisions of AU 390 were considered. The firm knew of no reason to suspect the accuracy of the filed financial statements. [The] CFO is a knowledgeable, competent experiences [sic] accountant, with many years experience. Past audits have shown a consistent accuracy of the Company's records under [the CFO's] leadership. We did not know or have any reason to believe the statements as filed were misleading

We concluded that even with the omitted procedures our audit work papers still supported our opinion. However, we will continue to try to obtain the information requested the complete the additional audit procedures for the items requested on [the 10-KSB filing date].

24. When Kelley created the document in early 2008 and added it, he was suspicious whether the CFO would ever provide the requested documents.

25. PCAOB Auditing Standard No. 3 provides that “[a] complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date” (i.e., the “date the auditor grants permission to use the auditor’s report in connection with the issuance of the company's financial statements”). ¶¶ 14-15. Although the standard recognizes that “[c]ircumstances may require additions to audit documentation after the report release date,” it states that “[a]ny documentation added must indicate the date information was added, the name of the person who prepared the additional documentation, and the reason for adding it.” ¶ 16.

26. Respondents departed from this standard by adding the written management representation to the audit documentation in early 2008 without indicating when it was added or the reason for adding it.

27. Respondents further departed from this standard by adding the undated memo to the audit documentation without indicating when it was added or the reason for adding it.

E. VIOLATIONS

As a result of the conduct described above, Respondents engaged in improper professional conduct as defined in Rule 102(e)(1)(ii) and (iv) in that their conduct (A) constituted intentional or

knowing conduct, including reckless conduct, that resulted in violation of applicable professional standards, or in the alternative, (B) constituted negligent conduct, consisting of (1) a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which Respondents knew, or should have known, that heightened scrutiny was warranted, or (2) repeated instances of unreasonable conduct by Respondents, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

III.

In view of the allegations made by the Division of Enforcement and the Office of the Chief Accountant, the Commission deems it appropriate that public administrative proceedings be instituted to determine:

A. Whether the allegations in Section II are true and to afford Respondents an opportunity to establish any defenses; and

B. What, if any, remedial action is appropriate against Respondents pursuant to Rule 102(e) of the Commission's Rules of Practice, including, but not limited to, censure and/or denying, temporarily or permanently, the privilege of appearing or practicing before the Commission.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served upon Respondents in accordance with the provisions of Rule 141 of the Commission's Rules of Practice, 17. C.F.R. § 201.141.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2)

of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary