

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 51516 / April 11, 2005

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2229 / April 11, 2005

ADMINISTRATIVE PROCEEDING
File No. 3-11890

In the Matter of	:	
	:	
	:	ORDER INSTITUTING PUBLIC
	:	ADMINISTRATIVE AND
	:	CEASE-AND-DESIST
GREGORY DAVIS, CPA and	:	PROCEEDINGS PURSUANT TO SECTION
BKR METCALF DAVIS	:	21C OF THE SECURITIES EXCHANGE ACT
	:	OF 1934 AND RULE 102(e) OF THE
	:	COMMISSION'S RULES OF PRACTICE,
	:	MAKING FINDINGS, AND IMPOSING
Respondents.	:	REMEDIAL SANCTIONS AND A
	:	CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission (“Commission” or “SEC”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Gregory Davis, CPA (“Davis”) and BKR Metcalf Davis (“Metcalf Davis”) (together referred to as “Respondents”) pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 102(e)(1)(ii) and (iii) of the Commission's Rules of Practice.¹

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

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

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

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the “Offers”) which the Commission has determined to accept.² 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 to the Commission’s jurisdiction over them and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondents’ Offers, the Commission finds³ that:

A. RESPONDENTS AND RELATED PARTIES

Respondents

1. **Metcalf Davis** (formerly known as Metcalf, Rice, Fricke and Davis), located in Atlanta, Georgia, is an accounting firm that provides professional services including auditing and tax work. It is a member of BKR International Association, a network of affiliated accounting firms. Metcalf Davis was Chancellor Corporation’s (“Chancellor”) independent auditor from February 1999 to October 2001.

2. **Davis**, age 53, is a certified public accountant and resides in Lilburn, Georgia. He has been a partner of Metcalf Davis since 1990. Davis served as the engagement partner for the firm’s audits of Chancellor’s 1998 and 1999 financial statements as well as the restatements in

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...to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules or regulations thereunder.

² As part of a final resolution of the Commission’s claims against them, Davis and Metcalf Davis have also agreed to settle a pending civil action by consenting to the entry of a district court judgment ordering Davis to pay a civil monetary penalty of \$25,000 and Metcalf Davis to pay a civil monetary penalty of \$50,000. *SEC v. Chancellor Corp. et. al.* (D. Mass., Civil Action No 03-10762-MEL).

³ The findings herein are made pursuant to Respondents’ Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

2000 of its previously filed 1998 and 1999 financial statements.

Related Parties

3. **Chancellor Corporation** is a Massachusetts corporation with headquarters in Boston, Massachusetts, which was principally engaged in buying, selling and leasing new and used transportation equipment such as trailers and trucks. From 1983 to 2001, Chancellor's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act. On March 9, 2001, Chancellor filed a Form 15 terminating its Commission registration because it had fewer than 300 shareholders. In August 2001, one of the firm's creditors filed an involuntary bankruptcy action against Chancellor in U.S. Bankruptcy Court in the District of New Jersey and the court appointed a receiver to liquidate the company's assets.

B. FACTS

Summary

4. Respondents Davis and Metcalf Davis engaged in improper professional conduct in connection with the audits of Chancellor's 1998 and 1999 financial results, as well as the interim reviews of Chancellor's quarterly results for the first three quarters of 2000. Davis and Metcalf Davis aided and abetted Chancellor to materially overstate its revenue, income and assets for 1998 in its Form 10-KSB. Davis and Metcalf Davis also aided and abetted Chancellor, in two Forms 10-KSB-A for 1998, and in a Form 10-KSB and Form 10-KSB-A for 1999, to materially misrepresent and improperly disclose the nature and substance of fees purportedly owed to a related party, which was the company's largest shareholder and controlled by the company's CEO and chairman of the board of directors. Finally, Davis and Metcalf Davis aided and abetted Chancellor to provide materially misleading disclosure in the Forms 10-QSB for the first three quarters of 2000 related to the use of the proceeds from a line of credit obtained by the company.

5. First, along with Chancellor's management, Davis and Metcalf Davis aided and abetted Chancellor to improperly account for the acquisition of a subsidiary, MRB, Inc. ("MRB"), as a business combination in its 1998 year-end financial statements, although the acquisition was not completed until 1999. This premature consolidation of the subsidiary's financial results caused Chancellor to overstate its 1998 revenue by \$19 million or 177%. Davis and Metcalf Davis concluded that the 1998 consolidation was properly recorded although it did not conform with GAAP. Their position was based in significant part on a document that was produced in circumstances indicating that it might have been fabricated by Chancellor's management. Respondents failed to inform Chancellor's audit committee of the possibility of management fraud.

6. Second, in connection with Chancellor's acquisition of MRB, Davis and Metcalf Davis, along with Chancellor's management, aided and abetted Chancellor to record a fee of

\$3.3 million to an entity controlled by the CEO of Chancellor, for purported acquisition consulting services that were never rendered. The baseless payment was also improperly capitalized rather than being reported as an expense. As a result, Chancellor reported assets of \$29.5 million rather than \$26.2 million. If Chancellor had recorded the fee as an expense, it would have reported a net loss of \$2.45 million for 1998. By capitalizing the fee, Chancellor was able to report a net income of \$850,000.

7. Third, after interaction with the Commission's Division of Corporation Finance, Chancellor submitted two Form 10-KSB-As, amending its original 1998 Form 10-KSB, and one Form 10-KSB-A, amending its 1999 Form 10-KSB. Davis and Metcalf Davis, along with Chancellor's management, aided and abetted Chancellor to make misleading disclosures in these filings related to the \$3.3 million fee purportedly owed to the related party controlled by Chancellor's CEO. In its amended filings, Chancellor took the position that \$2.2 million of the fee was actually a contingent liability that did not need to be recorded when the acquisition was consummated because its repayment was based on the future profitability of MRB. Davis accepted the recharacterization of the fee even though he still had insufficient evidence that it was legitimate.

8. Finally, Davis and Metcalf Davis also reviewed and approved language in Chancellor's Forms 10-QSB for the first three quarters of 2000 that failed to meaningfully disclose the misuse of Chancellor loan proceeds from a line of credit by Chancellor's CEO, Brian Adley ("Adley"), and they failed to take any steps to determine the nature of the transaction.

9. By their conduct, Davis and Metcalf Davis willfully⁴ violated Section 10A of the Exchange Act and willfully aided and abetted Chancellor's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder; and engaged in improper professional conduct under Rule 102(e)(1) of the Commission's Rules of Practice.

Chancellor's Premature MRB Consolidation

10. In August 1998, Chancellor entered into a letter of intent to acquire a subsidiary, MRB. The acquisition closed on January 29, 1999. Chancellor included MRB's financial results from August 1, 1998 forward in Chancellor's 1998 reported results.

11. Under generally accepted accounting principles ("GAAP"), in order for Chancellor to make the MRB acquisition effective and consolidation proper as of August 1, 1998, it was necessary that there be a written agreement giving Chancellor effective control over

⁴ "Willfully" as used in this Order means knowingly committing the act which constitutes the violation. See *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir.1965).

MRB as of that date.⁵ In early February 1999, Chancellor gave the company's auditors at the time (the firm which Metcalf Davis later replaced ("predecessor auditors")) a purported Management Agreement, backdated to August 1, 1998, that Chancellor's management claimed gave Chancellor control over MRB's affairs. The predecessor auditors, however, found the terms of this agreement insufficient to support the conclusion that Chancellor controlled MRB as of August 1998.

12. The predecessor auditors informed Chancellor's CEO, Adley, and its audit committee in a memorandum dated February 8, 1999 and again at a board meeting on February 12, 1999, that consolidation of MRB's 1998 financial results with Chancellor's did not comport with GAAP. They provided accounting literature that outlined the criteria to be satisfied in order for Chancellor properly to consolidate MRB's 1998 financial results and identified specific deficiencies in the Management Agreement.

13. Upon receiving this information, Adley directed Chancellor's acting CFO to create another document, the "First Amendment" to Chancellor's Management Agreement with MRB, which was falsely dated August 17, 1998, in order to meet the criteria for consolidation by correcting the deficiencies in the Management Agreement identified by the predecessor auditors. The First Amendment to the Management Agreement provided that Chancellor would assume control of MRB's daily operations in August 1998 and that from then on MRB was required to submit significant decisions to Chancellor for approval.

14. The two controlling shareholders of MRB never saw or approved the First Amendment to the Management Agreement in August 1998. Moreover, its terms were inconsistent with the actual relations between the two companies before the January 1999 acquisition. Control did not in fact effectively pass to Chancellor until the January 1999 closing.

15. The substance of the First Amendment to the Management Agreement did not cause the predecessor auditors to change their position that Chancellor could only properly account for the MRB acquisition as of January 1999. On February 25, 1999, Chancellor dismissed the predecessor auditors.

16. After dismissing the predecessor auditors, Chancellor engaged Metcalf Davis to conduct the independent audit of its 1998 financial statements. Chancellor provided the backdated Management Agreement and the fabricated First Amendment to Davis. The predecessor auditors described to Metcalf Davis the sequence of events by which they received

⁵ Paragraph 93 of APB No. 16 (Business Combinations) states that the date of acquisition of a company should ordinarily be the date the acquisition agreement is consummated. However, a business combination may be accounted for as of a designated date before consummation of the agreement "if a written agreement provides that effective control of the acquired company is transferred to the acquiring corporation on that date without restrictions except those required to protect the stockholders or other owners of the acquired company."

the First Amendment (i.e. the prior auditors identified specific deficiencies in the Management Agreement and then the company came forward with the First Amendment that seemed on its face to correct the issues). Moreover, the predecessor auditors told Metcalf Davis that they had questions about the authenticity of the First Amendment.

17. During March 1999, Chancellor gave Davis and Metcalf Davis additional documents purportedly demonstrating Chancellor's control of MRB during 1998. These documents included letters and memoranda, fabricated in March 1999, but bearing dates during 1998, which purportedly instructed MRB's officers to act on various business matters.

Chancellor's Recording of Vestex's Improper Consulting Fees

18. In connection with its acquisition of MRB, Chancellor improperly recorded \$3.3 million in consulting fees payable to Vestex, Chancellor's largest shareholder and a firm wholly owned by Chancellor's CEO, Adley. The fees were purportedly for work by Vestex in finding, introducing and negotiating the MRB acquisition and securing financing for it. In fact, however, there was no basis for the consulting fees because Vestex did not find or negotiate the MRB acquisition or provide any other significant services to Chancellor in connection with the MRB acquisition.

19. In April 1999, Adley directed fabrication of documents to support the \$3.3 million Vestex fee. The fabricated documents included a Chancellor board resolution dated September 11, 1998 directing Chancellor to pay Vestex \$3.25 million at the closing of the MRB acquisition for its services in connection with the acquisition; a promissory note from Chancellor payable to Vestex in the amount of \$3.475 million; and a consulting agreement between Chancellor and Vestex. The fabricated documents were given to Metcalf Davis.

20. Davis requested documents from Adley and other Chancellor employees showing that consulting services had actually been rendered, including bills and time records. Neither Adley nor anyone else at Chancellor ever provided any such documents to Davis or Metcalf Davis.

21. Chancellor recorded the \$3.3 million Vestex consulting fee as a capitalized asset of Chancellor, rather than as an expense on Chancellor's income statement. Under GAAP, "incremental costs" payable to an outside consultant in a business combination may be capitalized, but fees payable to employees or entities controlled or owned by employees, such as Vestex, are internal costs that must be expensed. If Chancellor had recorded the fee as an expense, it would have reported a net loss of \$2.45 million for 1998. By capitalizing the fee, Chancellor was able to report a net income of \$850,000 and overstate its assets by \$3.3 million.

Respondents' Improper Conduct In the Chancellor Audits

22. At the time Chancellor retained Metcalf Davis to audit its 1998 financial statements, Metcalf Davis had three partners (including Davis) and a professional staff of about 20 accountants.

23. Davis was the engagement partner responsible for auditing Chancellor's financial statements for 1998 and 1999. Davis was the sole partner in Metcalf Davis' commercial auditing department during 1999 and was also the partner responsible for monitoring the firm's quality control system.

24. In addition to Davis, the Chancellor audit team included a concurring partner, a senior manager and a staff accountant.

25. Davis, with input from the senior manager, concluded that it was proper under GAAP to record the MRB acquisition as of August 1, 1998 because Chancellor had the necessary control of MRB as of that date. Davis arrived at this conclusion even though he knew that the predecessor auditor had previously determined that accounting for the acquisition as of August 1, 1998 did not comply with GAAP.

26. Davis, in reaching his conclusion, relied on the Management Agreement and the First Amendment to the Management Agreement as the evidence of Chancellor's control even though he knew that there were issues raised as to the authenticity of the First Amendment. For example, Davis was aware that the senior manager had raised concerns about the authenticity of the First Amendment, which was not referred to in the papers that Metcalf Davis had received from the predecessor auditor on the issue and which seemed to address all of the deficiencies in the Management Agreement raised by the predecessor auditor.

27. Neither Davis nor any other Metcalf Davis auditor questioned Adley or any other Chancellor representative about the authenticity of the First Amendment despite their concerns. Nor did Davis or any other Metcalf Davis auditor confirm the existence, date or terms of the First Amendment with the MRB shareholders during the audit. Indeed, for his part, Davis took little or no steps to confirm the authenticity of the documents on which the 1998 consolidation date depended.

28. Davis, the concurring partner and the senior manager were all aware of the possibility that Chancellor's management had fabricated the First Amendment, if not other documents as well, yet they never attempted to communicate that fact to Chancellor's audit committee, its board of directors, or the Commission. Metcalf Davis' report to Chancellor's audit committee on the propriety of the August 1, 1998 consolidation date, which was signed by Davis and reviewed by the senior manager and the concurring partner, did not refer to the issue.

29. Davis personally performed the audit fieldwork for Chancellor's 1998 related party transactions, such as those with Vestex, because he deemed this to be a high-risk audit area. Davis knew that Chancellor had written off \$1.1 million in related party fees during 1997 and that substantial adjustments to related party fees had been made as a result of the 1997 audit. The predecessor auditors' work papers that Davis reviewed stated that adjustments were necessary because, *inter alia*, the described services had not been performed or there was inadequate documentation for the transactions. During Davis' examination of the 1998 related party transactions, Davis questioned Adley about the basis for the \$3.3 million in fees payable to Vestex for services received in connection with MRB's acquisition. On the last day of his fieldwork at Chancellor, Davis received three documents (all of which had been fabricated) to support the fees: a copy of a board resolution authorizing Chancellor to pay Vestex fees of \$3,250,000 for services relating to MRB's pending acquisition; a copy of a \$3,475,000 note payable to Vestex that included \$3.3 million owed for services supposedly received in connection with the MRB acquisition; and a purported agreement between Chancellor and Vestex relating to consulting services.

30. Davis was aware that the senior manager had raised issues about the Vestex fees, noting that the work papers contained no documentation to support the nature or value of the supposed services for which the fees were being charged.

31. Davis questioned Adley and Chancellor's president, Franklyn E. Churchill ("Churchill"), about the fees, which totaled approximately 70% of the stock transaction, and asked Adley and Chancellor's controller for invoices or other documents showing that services had, in fact, been rendered. However, Davis never received those documents, and instead, Davis relied on oral representations from Adley and Churchill that Vestex had performed the services.

32. Davis reviewed Chancellor's draft 1998 Form 10-KSB, including the footnote referring to related party transactions. This footnote did not comply with GAAP because it did not adequately disclose information necessary to understand the fees for the MRB transaction, including the services purportedly justifying these charges or how the charges were determined. Davis, however, did not ensure that these items were added to the text.

33. Davis also approved Chancellor's improper capitalization of the purported \$3.3 million MRB fees to Vestex as "incremental costs" payable to an outside consultant in a business combination. This treatment was inconsistent with GAAP, which provides that fees payable to employees or entities controlled or owned by employees, such as Adley's entity Vestex, are internal costs that must be expensed.⁶ Davis approved this treatment even though he knew that the capitalized \$3.3 million in fees represented approximately 10% of Chancellor's total reported assets and that capitalizing rather than expensing the fees would cause Chancellor to report a profit rather than a loss for 1998.

⁶ See Paragraph 76 of APB Opinion No. 16 (Business Combinations) and Interpretation No. 33 of APB 16.

34. On April 16, 1999, Chancellor filed a Form 10-KSB for the year ended December 31, 1998. Chancellor's financial statements accounted for its acquisition of MRB as of August 1, 1998, and consolidated MRB's financial results with those of Chancellor. As a result, Chancellor reported annual revenues of \$29,639,000, 177% higher than the \$10,708,000 revenue figure for Chancellor without the MRB consolidation; annual net income of \$850,000, rather than \$524,000 (62% higher); and assets of \$29,569,000, rather than \$8,186,000 (261% higher).

35. This accounting treatment did not comport with GAAP because during 1998 Chancellor did not have a written agreement establishing effective control nor did it actually have the effective control of MRB needed to justify accounting for MRB's acquisition as of 1998.

36. Chancellor's 1998 Form 10-KSB falsely represented that Adley's Vestex entity had handled the acquisition of MRB and provided consulting, financing and other services in connection with the acquisition. It falsely stated that as part of those services Vestex had obtained \$3.5 million in financing for Chancellor.

37. GAAP requires that financial statements include disclosure of material related-party transactions, including information deemed necessary to gain an understanding of the effects of the transactions on the financial statements. The transaction between Chancellor and Vestex was a related-party transaction, and GAAP required disclosure of the specific facts relating to the \$3.3 million fee.

38. The 1998 Form 10-KSB did not comport with GAAP because, although it disclosed that Chancellor incurred costs of \$3.405 million in acquiring MRB, it did not disclose that these costs consisted almost entirely of consulting fees charged by Vestex. It did not disclose the lack of any basis for the fees.

39. The \$3.3 million MRB-related Vestex fee accrued by Chancellor was included in Chancellor's reported financial results. The fee should not have been included because it lacked economic substance. Even if it had been a legitimate fee, GAAP required that it should have been recorded as an expense. The fee was improperly capitalized. As a result, Chancellor overstated its assets at year-end 1998 by 11%.

40. Davis signed and authorized issuance of the Metcalf Davis auditors' report on Chancellor's 1998 year-end financial statements. The report falsely stated that Chancellor's financial statements were fairly presented in conformity with GAAP and that Metcalf Davis' audit had been performed in accordance with generally accepted auditing standards ("GAAS").

41. Davis also signed Metcalf Davis's audit reports for both of Chancellor's restatements of its 1998 financial results in 2000. After the Commission's Division of Corporation Finance raised questions about the nature of the \$3.3 million in Vestex fees and required that they be expensed, rather than expense the entire \$3.3 million, Chancellor took the new position that \$2.2 million of the purported fees was actually a contingent liability that did

not need to be recorded when the acquisition was consummated because its repayment was based on the future profitability of MRB. Davis accepted Chancellor's revised position even though he still had insufficient evidence concerning the nature of the Vestex fees and no evidence showing that any services were rendered. Davis accepted this new position solely on Adley's oral representations, which was inconsistent with the representations in the original Form 10-KSB and the fabricated supporting documents that Chancellor had provided Davis.

42. Davis, with insufficient evidence to support Chancellor's representations concerning the Vestex fees, and also without a review conducted by the concurring partner, signed a Metcalf Davis audit report containing an unqualified opinion, which was included in Chancellor's Form 10-KSB-A filed in January 2000 for the year ended December 31, 1998. The amended Form 10-KSB, which Davis approved, remained materially misleading with respect to the fees, which were improperly disclosed because there was no evidence of Vestex providing the services to justify them.

43. Davis continued to fail to substantiate the propriety of Chancellor's related party disclosures in the financial statements included in the second amended Form 10-KSB-A, filed in June 2000 for the year ended December 31, 1998. When that filing was being prepared, Adley gave Davis a draft memo that listed the supposed components of the \$3.3 million Vestex fees; however, Davis did not take any steps to verify its accuracy. Davis nevertheless signed the Metcalf Davis audit report, which expressed an unqualified opinion as to Chancellor's revised restated financial statements.

44. Davis signed the Metcalf Davis audit reports for the misleading Forms 10-KSB and 10-KSB-A filed by Chancellor for the year ended December 31, 1999, which continued to falsely reflect the nature and validity of the fees that Vestex was supposed to have earned in connection with the MRB transaction and the fees that it still had the potential to earn.

45. Metcalf Davis issued its audit report on Chancellor's 1998 financial statements before its concurring partner completed his review. Metcalf Davis also issued unqualified reports on both of Chancellor's restated 1998 financial statements, filed in 2000, without any concurring partner review.

46. Davis reviewed and approved Chancellor's Forms 10-QSB for the fiscal quarters ended March 31, 1999, June 30, 1999, September 30, 1999, March 31, 2000, June 30, 2000, and September 30, 2000, which, as described above, were materially misleading in their description and treatment of the Vestex fees. Davis also reviewed and approved language in Chancellor's Forms 10-QSB for the first three quarters of 2000 which failed to meaningfully disclose Adley's misuse of Chancellor loan proceeds from a line of credit, without sufficient evidence to determine the nature of the transaction to which the Forms 10-QSB referred.

Davis and Metcalf Davis Engaged In Improper Professional Conduct

47. Davis and Metcalf Davis violated applicable professional standards in connection with the audit of Chancellor's 1998 and 1999 financial statements, which did not comport with GAAP. They did so knowingly or recklessly, or acted highly unreasonably in circumstances where they knew or should have known that heightened scrutiny was warranted.

48. GAAS requires that auditors conducting an audit exercise due professional care and maintain a proper level of professional skepticism. (Codification of Statements on Auditing Standards (1998) ("AU") - AU 230.01; AU 230.07). Auditing standards also require auditors to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements under audit. (AU 326.01; AU 326.21; AU 326.22). Under GAAS, representations from management are not a substitute for the application of auditing procedures necessary to afford a reasonable basis for the auditor's opinion. (AU 333.02). When an auditor becomes aware of information concerning a possible illegal act, the auditor should obtain an understanding of the nature of the act, the circumstances in which it occurred, and sufficient other information to evaluate the effect on the financial statements. (AU 317.10). An auditor has a responsibility to perform an audit to obtain reasonable assurance that material misstatements in financial statements due to fraud are detected. (AU 312.08; AU 316.01). If management does not provide satisfactory information that there has been no illegal act or if an auditor becomes aware of a possible illegal act, GAAS require additional audit steps to be performed, such as confirming a significant transaction with other parties to the transaction. (AU 317.11).

49. With respect to related-party transactions, GAAS require that auditors obtain sufficient evidence to understand the purpose, nature, extent and financial statement effect of the transactions. (AU 334.09). They must plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. If the auditor is unable to obtain sufficient competent evidential matter or determines that the financial statements do not comport with GAAP, GAAS provide that the auditor should express a qualified or an adverse opinion and should provide the correct information in his reports. (AU 431.03; AU 508.22, 508.23; AU 508.35).

50. Davis and Metcalf Davis failed to exercise due professional care or obtain sufficient competent evidential matter to verify that the MRB acquisition was properly recorded. They knew that management's insistence on a 1998 acquisition date resulted in a significant increase in reported revenues, so that heightened scrutiny of the acquisition date was needed. However, they failed to extend the audit procedures to confirm with the MRB shareholders the existence of control in 1998.

51. Davis and Metcalf Davis failed to critically assess documents they suspected might have been fabricated by Chancellor's management. The predecessor auditors described to Metcalf Davis the sequence of events by which they received the First Amendment (i.e. the prior

auditors identified specific deficiencies in the Management Agreement and then the company came forward with the First Amendment that seemed on its face to correct the issues). Moreover, the predecessor auditors told Metcalf Davis that they had questions about the authenticity of the First Amendment. Davis and Metcalf Davis did not question anyone at Chancellor about the authenticity of the documents during the audit. In spite of concern that the documents might have been fabricated by Chancellor's management, Davis relied on the documents as support for the 1998 acquisition date. He failed to maintain a proper level of professional skepticism, as required by GAAS.

52. Davis and Metcalf Davis further failed to comply with GAAS when they failed to report to Chancellor's audit committee the possibility that the company's senior management had fraudulently created the First Amendment.

53. Davis and Metcalf Davis further failed to comply with GAAS in connection with the review of the accounting for Chancellor's fee to Vestex related to the MRB transaction. They failed to obtain sufficient evidential matter to support recording the Vestex fee, particularly evidence sufficient to understand the purpose, nature, extent and financial statement effect of this related party transaction, as required by GAAS. They also failed to exercise the required professional skepticism.

54. Davis and Metcalf Davis knew from Chancellor's 1997 Form 10-KSB, and the prior auditors' work papers and management letter that fees to Vestex had been written off in the prior years because they were not verifiable and were booked when not earned. They ignored indications that the MRB-related Vestex fees were similarly unsupported. They knew that Chancellor's management had not responded to Davis's requests for documents evidencing the services for which the fees were charged. They improperly relied on management's unsupported oral representations that the services had been rendered rather than following GAAS by extending audit procedures to Vestex.

55. Davis and Metcalf Davis knew that capitalizing the MRB-related Vestex fee resulted in Chancellor materially increasing its reported assets and income. They recklessly disregarded specific GAAP requirements stating that these costs should be expensed. They thereby failed to exercise due professional care.

56. Metcalf Davis failed to comply with its quality control procedures by filing its report on Chancellor's 1998 financial statements before its concurring partner had completed his concurring partner review. (AU 161.02). Metcalf Davis further failed to comply with its procedures by issuing unqualified reports on both of Chancellor's restated 1998 financial statements filed in 2000, without any concurring partner review.

C. SECURITIES LAW VIOLATIONS

57. Section 10A(a)(1) of the Exchange Act requires auditors to design audit procedures that reasonably assure detection of illegal acts that have a material effect on financial statements. Section 10A(b)(1) of the Exchange Act provides that if in the course of an audit an accountant learns that an illegal act may have occurred, the accountant must take further steps and ensure that the issuer's audit committee is adequately informed of the illegal acts that have been detected. *SEC v. Solucorp Industries Ltd.*, 197 F. Supp. 2d 4, 10 (S.D.N.Y. 2002) (auditor may be found liable for failure to notify audit committee of concern that contract supporting revenue recognition might be backdated; motion for summary judgment on Section 10A count denied).

58. Davis and Metcalf Davis had information indicating that Chancellor's senior management might have fraudulently created the First Amendment to the Management Agreement in order to support Chancellor's accounting position regarding the appropriate consolidation date for MRB. They took no steps to confirm the existence of the First Amendment with the MRB shareholders in accordance with GAAS. Accordingly, they willfully violated Section 10A(a)(1) by failing to determine whether or not senior management had committed fraud.

59. Davis and Metcalf Davis willfully violated Section 10A(b)(1) when they failed to inform Chancellor's audit committee of the suspected senior management fraud.

60. Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act to file quarterly and annual reports with the Commission and to keep this information current. Exchange Act Rule 12b-20 requires that all reports filed pursuant to Section 13 contain all additional information necessary to ensure that the statements made in them are not misleading. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979).

61. Davis' conduct resulted in issuance of unqualified audit reports on the 1998 and 1999 financial statements contained in the Forms 10-KSB, which were materially misleading. He reviewed and approved the company's 1999 and 2000 quarterly reports. Davis knew that there was no evidence to support recording the Vestex related party fee in Chancellor's records and knew or was reckless in not knowing that the accounting treatment for the fee did not conform to GAAP. In connection with Chancellor's restatement adjustments, Davis aided and abetted and caused Chancellor's violations by again issuing an unqualified auditors' reports on the restatements, even though he knew or was reckless in not knowing that Chancellor's removal of \$2.2 million in fees in the restatements was unsupported and that there were no documents to support the remaining \$1.1 million of expenses recorded in the restatements.

62. Metcalf Davis issued audit reports on Chancellor's 1998 and 1999 financial statements and its restated financial statements filed in 2000, which falsely stated that

Chancellor's financial statements were fairly presented in conformity with GAAP and that the firm's audits had been conducted in accordance with GAAS. Metcalf Davis aided and abetted and caused the issuance of the misleading financial statements due to a systemic lack of controls at Metcalf Davis. Davis himself was responsible for the firm's quality control function. Further, Metcalf Davis violated its own procedures by issuing its report on Chancellor's 1998 financial statements before its concurring partner had completed his review and by issuing unqualified reports on both of Chancellor's restated 1998 and 1999 financial statements without any concurring partner review.

63. By filing materially misleading Forms 10-KSB and 10-KSB-A for fiscal years ended December 31, 1998 and December 31, 1999 and 1999 and 2000 quarterly reports, Chancellor violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 and 13a-13 thereunder. Davis and Metcalf Davis willfully aided and abetted and caused Chancellor's violations of these provisions.

D. FINDINGS

64. Based on the foregoing, the Commission finds that Davis willfully committed violations of Section 10A of the Exchange Act.

65. Based on the foregoing, the Commission finds that Davis willfully aided and abetted and caused Chancellor's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

66. Based on the foregoing, the Commission finds that Davis engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii), as defined by Rule 102(e)(1)(iv)(A), of the Commission's Rules of Practice, by recklessly engaging in conduct that resulted in violations of professional standards in connection with the 1998 and 1999 Chancellor audits.⁷

67. Based on the foregoing the Commission finds that Davis, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, willfully violated and willfully aided and abetted Chancellor's violations of the Federal securities laws and rules thereunder.

68. Based on the foregoing, the Commission finds that Metcalf Davis willfully committed violations of Section 10A of the Exchange Act.

69. Based on the foregoing, the Commission finds that Metcalf Davis willfully aided and abetted and caused Chancellor's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

⁷ Rule 102(e)(1)(iv)(A) defines "improper professional conduct" under Rule 102(e)(1)(ii) as "intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards."

70. Based on the foregoing, the Commission finds that Metcalf Davis engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii), as defined by Rule 102(e)(1)(iv)(A), of the Commission's Rules of Practice, by recklessly engaging in conduct that resulted in violations of professional standards in connection with the 1998 and 1999 Chancellor audits.

71. Based on the foregoing the Commission finds that Metcalf Davis, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, willfully violated and willfully aided and abetted Chancellor's violations of the Federal securities laws and rules thereunder.

IV.

Undertakings

Respondent Metcalf Davis has agreed to the following undertakings:

1. Metcalf Davis will not perform any audit services for any public company for a period of one (1) year from the date of entry of this order.
2. If Metcalf Davis engages in public company accounting, Metcalf Davis will incorporate into its quality control system specific procedures that are designed to provide reasonable assurances that all public company audits are performed, supervised, reviewed, documented, and communicated in accordance with the relevant professional, regulatory and firm requirements. Metcalf Davis will maintain a professional development program designed to provide reasonable assurances that personnel serving public company audit clients participate in professional development activities in accordance with firm guidelines and in subjects relevant to their responsibilities, including but not limited to training in SEC rules and regulations.
3. Metcalf Davis will establish for personnel serving public company audit clients minimum qualifications for audit partners, senior managers, audit managers, audit seniors and concurring review partners that focus on experience in public company audits and experience in addressing significant accounting and auditing issues affecting the registrant's business. Metcalf Davis will establish procedures for documenting the qualifications, training and current responsibilities of senior audit personnel assigned to each public company audit engagement.
4. Metcalf Davis will ensure that personnel assigned to public company audits have the experience, technical training and proficiency required in the circumstances. Metcalf Davis will assign personnel based on such factors as: engagement size and complexity; specialized experience and expertise required; personnel availability and the involvement of supervisory personnel; timing of the work to be performed; and continuity and rotation of personnel.
5. Should Metcalf Davis determine that it desires to engage in activities that require it to be registered with the PCAOB, prior to registering with the PCAOB, Metcalf Davis will hire an independent CPA consultant (the "Independent Consultant"), who is not unacceptable to the

SEC staff. Metcalf Davis will require the Independent Consultant to review and ensure the accuracy of the information to be provided to the PCAOB. Metcalf Davis will require the Independent Consultant to review the firm's established quality control system, including but not limited to those policies and procedures specific to public company audits. Metcalf Davis will require the Independent Consultant to assess the adequacy of the design of the firm's quality control system. Additionally, Metcalf Davis will require the Independent Consultant to review the required documentation supporting the qualifications of the personnel to be assigned to public company audits. Thereafter, Metcalf Davis will require the Independent Consultant to issue a report to the SEC and the PCAOB.

6. Upon becoming registered with the PCAOB and performing audits of public companies, Metcalf Davis will require the Independent Consultant, during the first such audit, to review the audit to ensure that it is conducted in accordance with professional standards, including the standards of the PCAOB, generally accepted accounting principles and independence requirements. The review will include, but not be limited to, a review of all audit work papers, discussions with assigned audit personnel and inquiries regarding significant accounting and auditing matters. Thereafter, Metcalf Davis will require the Independent Consultant to issue a review report to the SEC and the PCAOB that describes the procedures performed. Further, Metcalf Davis will require the Independent Consultant to provide either a negative assurance that the audit was conducted in accordance with professional standards or, if necessary, indicate that he/she cannot make such an assurance. Metcalf Davis will require the Independent Consultant to set forth the reasons that he/she was not able to provide a negative assurance.

7. Metcalf Davis agrees to require the Independent Consultant, if and when retained, to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Metcalf Davis, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the staff of the Boston District Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Metcalf Davis, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

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

A. Davis shall cease and desist from committing or causing any violations and any future violations of Section 10A of the Exchange Act; and from causing any violations and any future violations of Sections 13(a) of the Exchange Act, and Rules 12b-20, 13a-1 and 13a-13 promulgated thereunder;

B. Davis is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After five (5) years from the date of this order, Davis 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 Davis' 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. Davis, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("PCAOB") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

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

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

d. Davis acknowledges his responsibility, as long as Davis appears or practices before the Commission as an independent accountant, to comply with all requirements

of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by Davis to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues, if any, with the applicable state boards of accountancy. However, if state licensure is dependant 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 Davis' character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Metcalf Davis shall cease and desist from committing or causing any violations and any future violations of Section 10A of the Exchange Act; and from committing or causing any violations and any future violations of Sections 13(a) of the Exchange Act, and Rules 12b-20, 13a-1 and 13a-13 promulgated thereunder;

F. Metcalf Davis is censured pursuant to Rule 102(e)(1).

G. Metcalf Davis shall comply with the undertakings set forth in Section IV above.

By the Commission.

Jonathan G. Katz
Secretary