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IN THE UNITED STATES DISTRICT COURT  
DISTRICT OF UTAH, NORTHERN DIVISION

SECURITIES AND EXCHANGE COMMISSION,	:	Civil Action No.
	:	
Plaintiff,	:	
	:	
v.	:	COMPLAINT FOR PERMANENT
	:	INJUNCTION AND OTHER
	:	RELIEF
DUANE V. MIDGLEY,	:	2:96CV 0783G
	:	
Defendant.	:	
	:	
	:	
	:	
	:	

Plaintiff Securities and Exchange Commission ("Commission"),  
for its Complaint alleges as follows:

1. Defendant Duane V. Midgley ("Midgley") has engaged,  
and, unless restrained and enjoined, will continue to engage, in  
transactions, acts, practices and courses of business which  
constitute violations of Section 10(b) of the Securities Exchange

Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5] and Section 34(b) of the Investment Company Act of 1940 ("Investment Company Act") [15 U.S.C. § 80a-33(b)].

#### **AUTHORITY TO BRING THIS ACTION**

2. Plaintiff Commission brings this action pursuant to Sections 21(d)(1) and 21(d)(3)(A) of the Exchange Act [15 U.S.C. §§ 78u(d)(1) & 78u(d)(3)(A)] and Sections 42(d) and 42(e)(1) of the Investment Company Act [15 U.S.C. §§ 80a-41(d) & 80a-41(e)(1)] to permanently restrain and enjoin defendant Midgley from engaging in the transactions, acts, practices and courses of business described herein, and transactions, acts, practices and courses of business of similar purport and object and for other relief.

#### **JURISDICTION AND VENUE**

3. This Court has jurisdiction over this action pursuant to Sections 21(d)(3)(A), 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d)(3)(A), 78u(e) & 78aa] and Sections 42(e)(1) and 44 of the Investment Company Act [15 U.S.C. §§ 80a-41(e)(1) & 80a-43].

4. Defendant Midgley, directly or indirectly, has made use of means or instrumentalities of interstate commerce or of the mails in connection with the transactions, acts, practices and courses of business described in this Complaint.

5. Venue in this action is proper pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa] and Section 44 of the Investment Company Act [15 U.S.C. § 80a-43]. Certain of the transactions, acts, practices and courses of business constituting the violations alleged herein occurred within the District of Utah. Additionally, defendant Midgley resides and has an office within the District of Utah.

#### THE DEFENDANT

6. Midgley, age 63, resides in Salt Lake City, Utah, and is a certified public accountant who is currently suspended from appearing or practicing before the Commission. In the Matter of Duane V. Midgley, C.P.A., Exchange Act Rel. No. 36229 (September 14, 1995).

#### SUMMARY OF THE FRAUDULENT SCHEME

7. In early December 1991, Midgley was retained as the independent auditor for two new investment companies (i.e., mutual funds) known as Public Funding Portfolios, Inc. ("PFP") and American Vision Funds, Inc. ("AVF") (collectively the "Funds"), which Funds became registered with the Commission shortly thereafter.

8. On December 17 and 27, 1991, Midgley signed unqualified audit reports regarding, respectively, PFP's December 2, 1991, and AVF's December 27, 1991, initial Statements of Assets and Liability ("Balance Sheets"). In each audit report, Midgley

falsely stated that he had examined the Balance Sheet in accordance with Generally Accepted Auditing Standards ("GAAS"), and that the Balance Sheet presented fairly that Fund's financial position as of the date of the Fund's balance sheet, in conformity with Generally Accepted Accounting Principles ("GAAP").

9. In fact, PFP's and AVF's Balance Sheets did not conform to GAAP in that they falsely represented that the Funds each had been capitalized with approximately \$200,000 of "cash equivalents." These assets were in fact grossly overvalued because:

- a. The assets had not been fairly valued in good faith by the Funds' directors, as required by the Investment Company Act.
- b. The assets consisted of unmarketable shares in an inactive shell corporation, IT Bancorp. Group of Companies, Inc. ("IT Bank") with no current or prospective operations, not "cash equivalents," as represented by the Balance Sheets, which are short term, highly liquid investments.

Moreover, the Funds did not own the assets as of the dates of the Balance Sheets. The Funds' Balance Sheets further failed to conform to GAAP in that they failed to disclose the cost of the

Funds' investments in the IT Bank shares, and they failed to disclose the two persons who controlled the Funds.

10. Midgley's representations that he had audited the Funds' Balance Sheets in conformity with GAAS were also false in that he failed to:

- a. Obtain adequate technical training so that he could competently perform the audits.
- b. Adequately plan the audits.
- c. Obtain sufficient competent evidential matter regarding the date the Funds acquired the securities, how they were valued, and whether they were in fact "cash equivalents."
- d. Issue an adverse or qualified opinion stating that the Funds' Balance Sheets in fact were not presented in conformity with GAAP.
- e. Exercise due professional care.

11. On January 24, 1992, Midgley signed an unqualified review report on an updated AVF Balance Sheet dated January 24, 1992, falsely stating that he had reviewed AVF's Balance Sheet in accordance with standards set forth by the American Institute of Certified Public Accountants ("AICPA") and had determined that no material modifications needed to be made to that Balance Sheet to bring it into conformity with GAAP. In fact, in order for AVF's updated Balance Sheet to conform to GAAP, modifications

materially lowering the \$5,550,000 value AVF then placed on its unmarketable IT Bank stock and the \$64,200,000 value AVF placed on its similarly unmarketable promissory note holdings were necessary; as well as disclosure of the Funds' control persons and that the IT Bank stock was not, in fact, a "cash equivalent."

#### **MIDGLEY'S FRAUDULENT REPRESENTATIONS**

**A. Midgley Falsely Represented In His Audit Reports That He Conducted His Audits In Accordance With GAAS And That The Balance Sheets Were Presented Fairly In Conformity With GAAP**

12. In December 1991, Michael Carnicle ("Carnicle") and Michael Hansen ("Hansen"), two undisclosed principals of the Funds, filed registration statements with the Commission in order to register the Funds as nondiversified open-end management investment companies under the Investment Company Act [15 U.S.C. §§ 80a-1 et seq.]. PFP's registration statement became effective on December 19, 1991, and AVF's registration statement became effective on December 31, 1991.

13. The following Balance Sheets were included in the registration statements:

PUBLIC FUNDING PORTFOLIOS, INC.  
STATEMENT OF ASSETS AND LIABILITY  
DECEMBER 2, 1991

ASSETS

Cash Equivalents	\$200,250	
Organizational Costs	<u>\$ 41,305</u>	
Total Assets		\$241,555

LIABILITY

Accrued Org. Costs	<u>\$ 41,305</u>	
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<u>NET ASSETS</u>		\$200,250
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AMERICAN VISION FUNDS, INC.  
STATEMENT OF ASSETS AND LIABILITY  
DECEMBER 27, 1991

ASSETS

Cash Equivalents	\$200,000	
Organizational Costs	<u>\$ 35,305</u>	
Total Assets		\$235,305

LIABILITY

Accrued Org. Costs	<u>\$ 35,305</u>	
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<u>NET ASSETS</u>		\$200,000
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14. In December 1991, while in Salt Lake City, at the direction of Carnicle and Hansen, Midgley audited PFP's initial Balance Sheet dated December 2, 1991, and AVF's initial Balance Sheet dated December 27, 1991.

15. On December 17, 1991, Midgley signed and issued an unqualified "Independent Auditor's Report" on PFP's initial Balance Sheet which stated in relevant part:

We have audited the statement of assets and liability of Public Funding Portfolios, Inc.-Capital Appreciation Portfolio (the "Fund") as of December 2, 1991. . . .

We conducted our audit in accordance with generally accepted auditing standards. . . .

In our opinion, such statement of assets and liability presents fairly, in all material respects, the financial position of the Fund at December 2, 1991 in conformity with generally accepted accounting principles.

16. On December 27, 1991, Midgley signed and issued an unqualified "Independent Auditor's Report" on AVF's initial Balance Sheet which stated in relevant part:

We have audited the statement of assets and liability of American Vision Funds, Inc.-Growth and Income Fund (the "Fund") as of December 27, 1991. . . .

We conducted our audit in accordance with generally accepted auditing standards. . . .

In our opinion, such statement of assets and liability presents fairly, in all material respects,



the financial position of the Fund at December 27, 1991 in conformity with generally accepted accounting principles.

17. Carnicle and Hansen, with Midgley's explicit written permission, included the PFP and AVF audit reports in their respective Investment Company Act registration statements which were filed with the Commission. The PFP and AVF registration statements became effective on December 19 and December 31, 1991, respectively.

18. Midgley knew when he consented to have his audit reports included in the Funds' registration statements that Carnicle and Hansen, on behalf of the Funds, would publicly disseminate the registration statements. Specifically, Carnicle told Midgley that he and Hansen planned to file the registration statements with the Commission and thereafter use them to sell shares of the Funds to the public.

1. Midgley Falsely Represented In His Audit Reports That The Funds' Balance Sheets Conformed To GAAP

a. The Funds Did Not Own The "Cash Equivalents" As Of The Balance Sheet Dates

19. PFP's Balance Sheet failed to conform to GAAP in that, contrary to its representations, PFP did not own its purported cash equivalents, which consisted of 40,050 shares of IT Bank stock, as of its Balance Sheet date. Specifically, as of the

Balance Sheet date of December 2, 1991, PFP had not exchanged consideration to acquire the purported cash equivalents with Howard Ray, their seller ("Seller"). Rather, PFP did not exchange 13,350 of its shares with a purported NAV of \$15 per share for the IT Bank stock valued at \$5 per share until December 30, 1991, twenty-eight days after the Balance Sheet date and eleven days after PFP's registration statement became effective.

20. Similarly, AVF's Balance Sheet failed to conform to GAAP, in that, contrary to its representations, AVF did not own its purported cash equivalents, which consisted of 40,000 IT Bank shares, as of its Balance Sheet date of December 27, 1991, in that it had not exchanged consideration with the Seller of the purported cash equivalents to acquire them. Rather, AVF did not exchange 10,000 of its shares with a purported NAV of \$20 per share for the IT Bank stock until January 23, 1992, twenty-seven days after the Balance Sheet date, and twenty-three days after AVF's registration statement became effective.

**b. The Assets Were Not Valued In Conformity With GAAP**

21. Assuming the Funds in fact owned the shares, the Funds' initial Balance Sheets also were not presented fairly in conformity with GAAP because the Funds did not properly value the IT Bank stock. The Funds did not have reliable price quotations available to support the \$5 per share valuation of the IT Bank stock on the Balance Sheets. Rather, the Funds, at the direction

of Carnicle and Hansen, valued the IT Bank stock at \$5 per share using false bid price quotations obtained from the Seller, who was the President of the sole marketmaker firm for the stock. The Seller, Howard Ray, who owned or controlled all of the outstanding stock of IT Bank, an inactive shell corporation with no assets or operations, fabricated and provided the Funds with the false bid price quotations.

22. The fabricated false bid price quotations for IT Bank shares could not easily be verified in part because IT Bank stock did not trade on a stock exchange; nor was IT Bank stock listed in the quotation system maintained by the National Association of Securities Dealers or in the "pink sheets" published by the National Quotation Bureau.

23. Additionally, assuming the Funds in fact owned the shares, the Balance Sheets were not presented fairly in conformity with GAAP because the Funds' directors did not value the unmarketable IT Bank stock as of the Balance Sheet dates. Section 2(a)(41)(B)(ii) of the Investment Company Act [15 U.S.C. § 80a-2(a)(41)(B)(ii)] and Rule 2a-4(a)(1) thereunder [17 C.F.R. § 270.2a-4(a)(1)] require investment companies to value securities for which market quotations are not readily available at fair value as determined in good faith by their boards of directors. Moreover, when making a valuation determination, the fund's directors should inquire into what an owner of the

securities might reasonably expect to receive for the securities upon their current sale. Codification of Financial Reporting Policies, § 404.03.b.iv., Fed. Sec. L. Rep. (CCH) ¶ 38,221, at 38,425.

24. In this case, the Funds' directors did not even attempt to value the IT Bank stock. Moreover, the Funds did not make a good faith valuation of the stock in accordance with Section 2(a)(41)(B)(ii) and Rule 2a-4(a)(1) thereunder because the purported \$5 per share bid price quotations did not bear any reasonable relation to the price that an owner of the stock would expect to receive upon its sale if the owner knew that IT Bank was an inactive shell corporation with no current or prospective operations. Therefore, the Balance Sheets falsely represented that the Funds had made a good faith valuation of the IT Bank stock, and that the valuation was a fair value.

**c. The Assets Were Falsely Termed "Cash Equivalents"**

25. The Balance Sheets were not presented fairly in conformity with GAAP because the IT Bank stock was not, in fact, a "cash equivalent." Paragraph 8 of Statement of Financial Accounting Standards ("SFAS") No. 95, "Statement of Cash Flows," defines cash equivalents as short-term, highly liquid investments that, among other things, are readily convertible into known amounts of cash. Cash equivalents generally have maturities of three months or less. Id. Accordingly, examples of "cash

equivalents" include certain U.S. Treasury bills, commercial paper, and money market funds. Id.

26. In this case, the IT Bank stock was not readily convertible into known amounts of cash because, as alleged above, it was unmarketable. Therefore, the Balance Sheets falsely represented that each Fund's capital was equivalent to approximately \$200,000 of cash, when in fact each Fund had no tangible capital.

**d. The Cost Of The Funds' Investments Was Not Disclosed**

27. The Funds' Balance Sheets further failed to conform to GAAP in that they failed to disclose the cost of the Funds' investments (i.e., the IT Bank Stock) and failed to provide a separate schedule of those investments as required under Articles 6-03(d) and 12-12 of Commission Regulation S-X [17 C.F.R. §§ 210.6-03(d) & 210.12-12]. Moreover, the Funds' Balance Sheets failed to state in a note, as required by Article 6-03(d) of Regulation S-X, the methods used in determining the value of the IT Bank stock. In fact, the Funds did not disclose any information about the purported cash equivalents, including that they were composed of unmarketable IT Bank stock.

e. Carnicle's And Hansen's Control Over The Funds Was  
Not Disclosed

28. The Balance Sheets failed to conform to GAAP in that the Funds failed to disclose Carnicle's and Hansen's control over the Funds in the footnotes to the Balance Sheets as required by paragraph 4 of SFAS No. 57, "Related Party Disclosures," and instead falsely stated that V. Thayne Whipple II, the President ("President") of the Funds' registered investment adviser ("Adviser") would manage the Funds.

2. Midgley Falsely Represented That He Conducted His  
Audits In Accordance With GAAS

29. In the performance of his audits of the Funds' initial Balance Sheets, Midgley failed to comply with seven of the ten major GAAS provisions. Specifically, Midgley failed to:

- a. Obtain adequate technical training so that he could competently perform the audits;
- b. Adequately plan the audits;
- c. Obtain sufficient competent evidential matter;
- d. Issue adverse or qualified opinions stating that the Funds' Balance Sheets in fact were not presented in conformity with GAAP, in violation of three of the four GAAS reporting standards; and
- e. Exercise due professional care in conducting the audits and in issuing his audit reports.

a. Midgley Failed To Obtain Adequate Technical Training So That He Could Competently Perform The Audits

30. GAAS provides that an audit must be performed by a person having adequate technical training and proficiency as an auditor. AICPA Codification of Statements on Auditing Standards ("AU"), § 210.01. As part of this training, the auditor of an investment company must be familiar with the Investment Company Act and the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C. § 80b-1 et seq.]. AICPA Audit and Accounting Guide, Audits of Investment Companies ("Investment Company Audit Guide") (1987), ¶ 1.22.

31. Midgley violated § AU 210.01 because, at the time of the audits, he was not familiar with the Investment Company Act or the Advisers Act, and, particularly, with the requirements regarding valuation of fund assets consisting of securities.

b. Midgley Failed To Adequately Plan The Audits

32. GAAS also requires that an auditor obtain knowledge of the client's business and industry and plan the audit with a proper degree of professional skepticism to achieve reasonable assurance that material errors or irregularities will be detected. See AU §§ 311.01, 311.03, 311.08, 316.05 & 316.08. The auditor should also select proper procedures to test whether the investment company has complied with its own stated

investment policies and restrictions. See Investment Company Audit Guide, ¶ 2.123.

33. Midgley violated AU § 311.03 because he did not understand the Funds' business or the mutual fund industry at the time of the audits, or even know that he was auditing mutual funds. In fact, Midgley did not even read the Funds' Investment Company Act registration statements before conducting his audits.

34. Midgley violated AU §§ 311.01 and 311.08 when he failed to adequately plan his audits. Midgley never selected audit procedures to test whether the Funds had properly valued the IT Bank stock and complied with all other applicable investment company accounting requirements. He also failed to select or employ audit procedures to determine whether the Funds had complied with their own stated investment policies and restrictions. Investment Company Audit Guide, ¶ 2.123. As a result, Midgley did not discover that the Funds had violated their stated investment policies and restrictions by issuing their shares to acquire the unmarketable IT Bank stock.

35. Midgley violated AU §§ 316.03, 316.05, and 316.08 when he failed to plan his audits with a proper degree of professional skepticism. Midgley did not select audit procedures to search for errors, irregularities or material misstatements on the Balance Sheets, even though Carnicle's and Hansen's undisclosed



control over the Funds required extension or modification by Midgley of his audit tests.

c. Midgley Failed To Obtain Sufficient Competent Evidence To Support His Unqualified Audit Reports

36. GAAS requires that an auditor obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements under audit. AU §§ 326.01. Evidential matter obtained from independent third parties provides greater assurance of reliability. AU § 326.19a. Similarly, representations from management are not a substitute for those auditing procedures necessary to afford a reasonable basis for an audit opinion. See AU § 333.02. Midgley failed to comply with these standards in conducting his audits.

i. Midgley Failed To Obtain Sufficient Competent Evidence Showing That The Funds Owned IT Bank Stock

37. For an investment company audit, the auditor must obtain evidence showing that the investment company owns the securities in its investment portfolio. See Investment Company Audit Guide, ¶ 2.116. The auditor may obtain this evidence by, among other things, physically examining the investment company's securities or confirming their ownership with the investment company's custodian. Investment Company Audit Guide, ¶ 2.124.

38. During his audit of PFP's Balance Sheet, Midgley failed to obtain any competent independent evidence to support PFP's purported ownership of 40,050 IT Bank shares as of December 2, 1991, its Balance Sheet date. Among other things:

- a. Midgley failed to physically examine PFP's purported IT Bank stock certificates.  
Accordingly, Midgley never discovered that IT Bank certificates had not in fact been issued to PFP as of PFP's Balance Sheet date.
- b. Midgley failed to attempt to confirm PFP's possession of IT Bank stock certificates with PFP's purported custodian. Accordingly, Midgley never discovered that PFP did not have a custodian.
- c. Midgley never communicated with the President of PFP concerning this transaction. If Midgley had done so, he would have discovered that the President, who had legal authority to manage PFP's investments, had no knowledge of PFP's purported ownership of IT Bank stock.
- d. Midgley failed to contact PFP's transfer agent to determine whether PFP had in fact issued 13,350 PFP shares to acquire the IT Bank stock, as represented in its registration statement.

Accordingly, Midgley never discovered that PFP did not in fact exchange its shares for the IT Bank stock until December 30, 1991, several weeks after PFP's Balance Sheet date of December 2, 1991.

39. Instead of performing the above audit procedures, Midgley sought a confirmation from IT Bank's transfer agent showing that IT Bank stock had been issued to PFP. The IT Bank transfer agent sent Midgley a document (the "Transfer Agent Document") showing that PFP did not own any IT Bank stock as of the PFP Balance Sheet date. Specifically, the Transfer Agent Document indicated that the transfer agent had not transferred IT Bank shares into PFP's name until December 6, 1991, four days after the PFP Balance Sheet date.

40. Nevertheless, after receiving assurances from Carnicle, an undisclosed principal of the Fund, that PFP owned IT Bank stock at its Balance Sheet date, Midgley ignored the adverse information about PFP's ownership of the stock contained in the Transfer Agent Document.

41. Similarly, during his audit of AVF's Balance Sheet, Midgley also failed to seek or obtain any competent independent evidence to support AVF's purported ownership of 40,000 IT Bank shares as of December 27, 1991, its Balance Sheet date. Among other things:

- a. Midgley failed to attempt to contact AVF's purported custodian during the AVF audit to confirm AVF's possession of IT Bank shares. Accordingly, Midgley never discovered that AVF did not have a custodian.
- b. Midgley failed to contact the IT Bank transfer agent during the AVF audit. Accordingly, Midgley failed to discover that the transfer agent did not hold any IT Bank shares on deposit in AVF's name at the AVF Balance Sheet date, and had not issued any IT Bank shares in AVF's name. In fact, the transfer agent did not even receive AVF's IT Bank shares from the Seller until January 20, 1992, approximately three weeks after the December 27, 1991, date of AVF's balance sheet and after Midgley completed the AVF audit.
- c. Midgley failed to contact AVF's transfer agent during the AVF audit. Accordingly, he never discovered that AVF did not in fact exchange 10,000 of its shares to acquire the IT Bank stock until January 23, 1992, almost four weeks after AVF's December 27, 1991, Balance Sheet date.

ii. Midgley Failed To Obtain Sufficient Competent Evidence Showing That The Funds Had Properly And Reasonably Valued The IT Bank Stock

42. For an investment company audit, the auditor also must obtain sufficient evidence showing that the investment company has properly and reasonably valued its securities. See Investment Company Audit Guide, ¶¶ 2.116, 2.136, 2.139 & 2.144.

43. During the PFP audit, Midgley failed to obtain independent evidence showing that PFP had properly and reasonably valued its IT Bank stock on its Balance Sheet. In fact, the only "evidence" that Midgley obtained concerning the stock's valuation were three computer printouts ("Reuters Printouts") that were faxed to him by the Seller, the sole marketmaker in the stock, showing bid and ask price quotations for IT Bank stock that the marketmaker had recently submitted to the Reuters News Service in Europe, as shown below:

<u>Date</u>	<u>Bid</u>	<u>Ask</u>	<u>Volume</u>
Dec. 11, 1991	5.00	5.50	22,500
Nov. 11, 1991	5.00	5.50	11,000
Sept. 27, 1991	5.00	5.50	42,500

44. The bid and ask price quotations shown on the Reuters Printouts were false for two reasons. First, the price quotations were false because the stock of IT Bank, an inactive shell corporation, was unmarketable and therefore grossly overvalued. Second, the price quotations were false because IT

Bank stock did not trade on any securities exchange or elsewhere at any time, including on the Reuters Printout dates, or on the PFP Balance Sheet date of December 2, 1991.

45. Midgley did not perform any audit procedures to verify the \$5 per share bid price shown on the Reuters Printouts. For example, he did not seek comparable bid price quotations, including a quotation for PFP's Balance Sheet date, from other brokerage firms and therefore never discovered that such price quotations were not available from any source other than the Seller.

46. Midgley also failed to verify the trading volume figures shown on the Reuters Printouts to determine if the IT Bank stock was readily marketable. For example, Midgley did not ask the IT Bank transfer agent to confirm that shares had been transferred on or around the Reuters Printout dates and therefore never discovered that no share transfers had occurred.

47. During the AVF audit, Midgley failed to obtain any evidence from third parties that AVF had properly and reasonably valued its IT Bank stock. Instead, he relied on the false price quotations shown on the Reuters Printouts to value the stock even though the Reuters Printouts did not contain a price quotation for any date later than sixteen days before the AVF Balance Sheet date. Midgley did not contact the Seller to obtain a price

quotation for December 27, 1991, the AVF Balance Sheet date, and did not perform any other audit procedures.

48. Midgley also failed to seek evidence showing that the value of the IT Bank stock, as stated on the Funds' Balance Sheets, reflected the good faith determination of either Fund's board of directors of a fair value of the IT Bank stock. See Section 2(a)(41)(B)(ii) of the Investment Company Act [15 U.S.C. § 80a-2(a)(41)(B)(ii)] and Rule 2a-4(a)(1) thereunder [17 C.F.R. § 270.2a-4(a)(1)]. In particular, Midgley never made inquiries to determine whether the directors had participated in the valuation process, whether the directors had approved of using the Reuters Printouts to value the IT Bank stock, or whether the Reuters Printouts contained reliable pricing information concerning IT Bank stock.

49. Finally, by not obtaining sufficient competent evidence about the Funds' valuation of its IT Bank stock, Midgley failed to discover that the Funds also had violated their own stated investment policies and restrictions by purportedly exchanging their shares for the unmarketable IT Bank stock.

**iii. Midgley Failed To Obtain Sufficient Competent Evidence To Support The Funds' Classification Of The IT Bank Stock As A "Cash Equivalent"**

50. During the audits, Midgley failed to obtain any independent evidence from third parties to support the Funds'

classification of IT Bank stock as a "cash equivalent" on the Balance Sheets. Nevertheless, he concluded that the IT Bank stock was a cash equivalent based on the false price quotations contained in the Reuters Printouts.

51. Midgley did not attempt to determine whether the IT Bank stock met the definition of a cash equivalent under paragraph 8 of SFAS No. 95, "Statement of Cash Flows," which defines "cash equivalents" as short-term, highly liquid investments that, among other things, are readily convertible into known amounts of cash, and which generally mature within three months or less. Instead, the only purported audit procedure that Midgley performed in assessing IT Bank stock's cash equivalent status was to review IT Bank's 1990 annual report. The report showed that: (1) the Seller was an affiliate of IT Bank; (2) IT Bank only had a small number of shareholders; and (3) IT Bank stock was not actively traded. Notwithstanding the above information revealed to Midgley by his review of the IT Bank annual report, Midgley failed to object to the Funds' classification of the stock as a cash equivalent.



d. Midgley Failed To Issue Appropriate Adverse Or Qualified Audit Opinions Stating That The Balance Sheets Were Not Presented Fairly In Conformity With GAAP

52. Midgley violated three of the four general standards of reporting under GAAS in that:

- a. Midgley's audit reports falsely stated that the Funds' Balance Sheets were presented in accordance with GAAP;
- b. Informative disclosures in the Funds' Balance Sheets were not reasonably adequate but were not stated in Midgley's audit reports to be inadequate; and
- c. Midgley's audit reports failed to contain a clear-cut indication of the character of his work.

See AU § 150.02 (first, third and fourth general reporting standards).

53. Among other things, GAAS requires that an auditor issue a qualified or adverse report when the balance sheet under audit is not presented fairly in conformity with GAAP, including when an investment company does not own or has not valued securities on its balance sheet in a reasonable manner. See AU §§ 508.49 & 508.67; Investment Company Audit Guide, ¶ 2.147.

54. GAAS further requires that the auditor express his opinion that a client's balance sheet is presented fairly and in conformity with GAAP only when, in the auditor's judgment, the balance sheet reflects the underlying events and transactions in a manner that presents the financial position stated within a range of acceptable limits, that is limits that are reasonable and practicable to attain in financial statements. AU § 411.04. Midgley violated GAAS when, without a reasonable basis for his opinions, he falsely stated that the Funds' Balance Sheets were presented fairly in conformity with GAAP.

55. Similarly, GAAS also requires that the auditor express a qualified or adverse opinion when financial statements do not disclose all information required by GAAP. AU § 431.03. The auditor should, if practicable, provide the omitted information in his audit report. AU § 431.03.

56. Midgley failed to issue adverse audit reports on the Funds' Balance Sheets. Midgley should have issued adverse audit reports because the Balance Sheets were materially misstated in that they listed IT Bank stock as the Funds' only tangible asset even though the Funds: (1) did not own the stock as of the dates of the Balance Sheets; (2) had falsely attributed values of \$200,250 (PFP) and \$200,000 (AVF) to the IT Bank stock even though the stock was not marketable and was grossly overvalued

and (3) had improperly classified the unmarketable IT Bank stock as a "cash equivalent."

57. Midgley also violated AU § 431.03 when he did not express an adverse opinion on the Funds' Balance Sheets even though the Balance Sheets failed to disclose:

- a. As required under Articles 6-03(d) and 12-12 of Commission Regulation S-X [17 C.F.R. §§ 210.6-03(d) & 210.12-12], that the Funds' "cash equivalents" were not, in fact, cash equivalents but instead consisted of unmarketable IT Bank stock.
- b. Carnicle's and Hansen's control over the Funds, as required by SFAS No. 57. See AU 431.03. Among other things, Carnicle is a convicted felon, having been convicted in 1987 of possessing counterfeit U.S. currency.

Midgley further failed to include the above information omitted by the Funds in his audit reports as required by GAAS.

58. Moreover, Midgley's audit reports failed to contain a clear-cut indication of the character of his audit work. For example, the reports did not state that Midgley had failed to confirm or physically examine the securities purportedly owned by the Funds. See Codification of Financial Reporting Policies, §

404.03(a), Fed. Sec. L. Rep. (CCH) ¶ 38,221, at 38,424;

Investment Company Audit Guide, ¶ 9.1.

**e. Midgley Failed To Exercise Due Professional Care  
In Conducting The Audits And Preparing His Audit  
Reports**

59. GAAS requires that the auditor exercise due professional care in performing an audit and in preparing the audit report. AU § 230.01. The auditor exercises due professional care when, among other things, he gives consideration to relevant evidence regardless of whether it corroborates or contradicts assertions in the client's financial statements. AU § 326.23.

60. By failing to obtain adequate technical training, to adequately plan the audits, to obtain sufficient competent evidential matter, and to comply with GAAS reporting standards, as alleged above, Midgley failed to exercise due professional care during his audits of the Funds' Balance Sheets and in preparing his audit reports.

**B. Midgley Falsely Represented That AVF's Updated Balance Sheet  
Conformed To GAAP**

**1. AVF Grossly Overvalued Its Assets On Its Updated  
Balance Sheet**

61. Shortly after the Funds began operating, Carnicle and Hansen prepared a new Balance Sheet for AVF dated January 24,

1992, which falsely stated that AVF had total assets of \$69,785,305, of which 92% were liquid assets. AVF's assets consisted of "publicly traded stocks" purportedly valued at \$5,550,000, which in fact were shares of unmarketable IT Bank stock; unmarketable promissory notes purportedly valued at \$64,200,000; and \$35,305 of organizational costs.

62. The promissory notes were listed as "commercial paper" on the new AVF Balance Sheet. Generally, commercial paper consists of readily marketable short-term promissory notes. Thus, to qualify as commercial paper, notes must be issued by large corporations with very high credit ratings.

63. However, AVF's promissory notes did not qualify as commercial paper. With one exception, all of the issuers of the promissory notes were shell corporations with no assets or operations. Specifically, the promissory notes consisted of:

- (1) a \$14 million promissory note issued by APC of Utah, Inc.;
- (2) a \$2 million promissory note issued by Denham Aircraft Services Corp., a small active Florida corporation whose main asset was an inventory of obsolete aircraft parts;
- (3) a \$6 million promissory note issued by Tampa Heritage Group Utah, Inc.;
- (4) a \$28 million promissory note issued by Southern Resorts, Inc.;
- (5) a \$4.75 million promissory note issued by Zeta Enterprises, Inc.;
- (6) a \$4.75 million promissory note issued by

Long Health Enterprises, Inc.; and (7) a \$4.7 million promissory note issued by Longer Enterprises, Inc.

64. AVF's promissory notes did not trade on a stock exchange; nor were their prices listed in the quotation system maintained by the National Association of Securities Dealers, or in the pink sheets published by the National Quotation Bureau. The notes also had not been rated by any commercially available rating service (Fitch, Standard & Poors, or Moody's). Therefore, AVF had no reasonable basis for labeling the notes as commercial paper, valuing them at a total of \$64,200,000 on its updated Balance Sheet, or claiming that AVF's assets were 92% liquid.

2. Midgley Issued A False Unqualified Review Report On AVF's Updated Balance Sheet

65. In January 1992, Carnicle and Hansen hired Midgley to review the updated AVF Balance Sheet at Carnicle's office in Salt Lake City.

66. After completing his review of the updated AVF Balance Sheet, Midgley signed and issued an unqualified review report dated January 24, 1992, which stated in relevant part:

We have reviewed the accompanying balance sheet of American Vision Funds, Inc., Growth and Income Fund, as of January 24, 1992 in accordance with standards established by the American Institute of Certified Public Accountants. . . .

[B]ased on our review, we are not aware of any material modifications that should be made to the accompanying financial statement in order for it to be in conformity with generally accepted accounting principles.

67. Midgley's review report was false and misleading for two reasons. First, the report was false and misleading because Midgley did not conduct his review in accordance with AICPA standards, as explained below. Second, the review report was false and misleading because, contrary to the report's conclusion, AVF needed to make material modifications to the new Balance Sheet in order to bring it into conformity with GAAP. Appropriate modifications would have involved restating to a materially lower amount the value that AVF placed on its unmarketable IT Bank stock and promissory note holdings and stating that AVF had little or no liquidity, and disclosing certain other material facts.

a. Midgley Failed To Conduct His Review Of AVF's Updated Balance Sheet In Accordance With AICPA Standards

68. An accountant performs a review by making inquiries and performing analytical procedures on financial statements to establish a reasonable basis for expressing limited assurances that there are no material modifications that should be made to

the financial statements in order for them to be presented fairly in conformity with GAAP. AICPA Statement on Standards for Accounting and Review Services, § 100.04.

69. As during the course of his audits of PFP and AVF, Midgley failed to make any inquiries concerning the proper valuation of IT Bank stock during his review of AVF's updated Balance Sheet.

70. Midgley also failed to perform any analytical procedures or make inquiries concerning the valuation and marketability of AVF's promissory notes during his review of AVF's updated Balance Sheet. Moreover, he did not consider or question whether the promissory notes had been properly classified as commercial paper on the updated Balance Sheet.

**b. After Concluding During The Review That IT Bank Stock Was Not A Cash Equivalent, Midgley Failed To Withdraw His Prior Audit Reports Or Make Corrective Public Disclosure**

71. During his review of AVF's updated Balance Sheet, Midgley concluded that IT Bank stock was not, in fact, a "cash equivalent." As a result, Midgley directed Carnicle and Hansen to reclassify the IT Bank stock as "publicly traded stock" on the new Balance Sheet.

72. Even though Midgley's prior audit reports were false and misleading because the Funds' initial Balance Sheets falsely



listed IT Bank stock as a cash equivalent, Midgley did not withdraw his prior audit reports or make corrective public disclosure that his reports were incorrect as required by GAAS. See AU §§ 561.06 - 561.08.

3. Midgley Knew That His AVF Review Report Would Be Publicly Disseminated But Did Not Disclose That It Was False And Misleading

73. In late January or February 1992, while conducting his review or shortly after issuing his review report, Midgley was told by Carnicle that his review report would be publicly disseminated. Carnicle told Midgley that he and Hansen planned to use the report in their efforts to sell shares of the Funds to the investing public and to prove to investors that AVF's assets were 92% liquid.

74. Even though Midgley knew, or was reckless in not knowing, that his review report and AVF's updated Balance Sheet were both false and misleading, Midgley failed to withdraw his review report or disclose publicly that information.

4. An AVF Shareholder Used False Representations From Midgley's Review Report To Fraudulently Obtain Margin Credit

75. During February 1992, Carnicle and Hansen directed the President of AVF to sign and issue a letter to Arie From ("From") stating that AVF had \$69.7 million of assets as of January 24,

1992, and that Midgley had confirmed the 92% liquidity of those assets.

76. On approximately February 17, 1992, From, an accomplice of Carnicle and Hansen, and a defendant in SEC v. Carnicle, et al., opened a brokerage account at FSI Futures, Inc. ("FSI"), a futures brokerage firm located in New York City. He deposited 65,000 PFP shares and 49,500 AVF shares into the account and provided materially false information on the FSI new account form about his income, net worth, ownership of the Funds' shares and value of the shares.

77. Shortly after opening the FSI account, From provided FSI with copies of the Funds' false and misleading registration statements along with the President's letter described above attesting to the liquidity of AVF's assets.

78. On March 16, 1992, FSI provided From with a \$100,000 margin loan. FSI provided this margin credit after:

- (1) reviewing the Funds' registration statements, From's new account form and the President's letter;
- (2) checking the Funds' false NAV listings in the Wall Street Journal; and
- (3) erroneously concluding that Funds' shares would be suitable margin collateral.

COUNT I

FRAUD IN CONNECTION WITH THE  
PURCHASE OR SALE OF SECURITIES

**Violations of Section 10(b) of the Exchange Act**  
**[15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder**  
**[17 C.F.R. § 240.10b-5]**

79. The allegations contained in paragraphs 1 through 78 are realleged and incorporated herein by reference.

80. Defendant Midgley, by engaging in the conduct described in paragraphs 12 through 78 above, directly or indirectly, in connection with the purchase or sale of securities, by the use of the means or instrumentalities of interstate commerce, or of the mails, with scienter: (1) employed devices, schemes, or artifices to defraud; (2) made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (3) engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon any person.

81. By reason of the foregoing, defendant Midgley violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5].

**COUNT II**

**FALSE STATEMENTS IN REGISTRATION STATEMENTS**

**FILED WITH THE COMMISSION**

**Violations of Section 34(b) of the Investment**

**Company Act [15 U.S.C. § 80a-33(b)]**

82. The allegations contained in paragraphs 1 through 60 are realleged and incorporated herein by reference.

83. Defendant Midgley, by engaging in the conduct described in paragraphs 12 through 60 above, made untrue statements of material fact in his audit reports included in the PFP and AVF registration statements filed with the Commission, and omitted to state in his audit reports included in the registration statements facts necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading.

84. By reason of the foregoing, defendant Midgley violated, and unless restrained and enjoined will continue to violate, Section 34(b) of the Investment Company Act [15 U.S.C. § 80a-33(b)].

**PRAYER FOR RELIEF**

WHEREFORE, the Commission respectfully requests that the Court:

I.

Issue findings of fact and conclusions of law that defendant Midgley committed the violations charged and alleged herein.

II.

Enter an order in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure permanently enjoining defendant Midgley and his agents, servants, employees and attorneys, and those persons in active concert or participation with any of them, who receive actual notice of the order by personal service or otherwise, and each of them, from engaging in the transactions, acts, practices and courses of business described herein, and from engaging in conduct of similar purport and object, in violation of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5] and Section 34(b) of the Investment Company Act [15 U.S.C. § 80a-33(b)].

III.

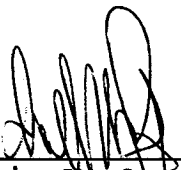
Enter an order directing defendant Midgley to pay civil penalties pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 42(e) of the Investment Company Act [15 U.S.C. § 80a-41(e)].

IV.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in

order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

DATED: September 11, 1996

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Dennis K. Arnold  
Attorney for Plaintiff  
Securities and Exchange Commission