

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64289A / April 8, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3269A / April 8, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14339

In the Matter of

**Kempisty & Company, CPAs,
P.C., Philip C. Kempisty, CPA
and John Anthony Rubino, CPA,**

Respondents.

CORRECTED
**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT**
TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF
1934 AND PUBLIC ADMINISTRATIVE
PROCEEDINGS PURSUANT TO
SECTION 4C OF THE SECURITIES
EXCHANGE ACT OF 1934 AND RULE
102(e) OF THE COMMISSION'S
RULES OF PRACTICE, AND NOTICE
OF HEARING

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and that public administrative proceedings be, and hereby are, instituted pursuant to Section 4C(2) and (3)¹ of the Exchange Act and Rule 102(e)(1)(ii) and (iii)² of the Commission’s Rules of Practice against Kempisty and

¹ Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

² Rule 102(e)(1)(ii) and (iii) provide, in relevant part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before the Commission . . . to any person who is found . . . (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or . . . (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

Company, CPAs, P.C., Philip C. Kempisty and John Anthony Rubino (collectively, “Respondents”).

Summary

These proceedings arise out of quarterly reviews and an audit performed by Kempisty & Company, CPAs, P.C. (“Kempisty & Company”), of the financial statements of its client, Kentucky Energy, Inc. (“Kentucky Energy”),³ for the year ended December 31, 2005. In these financial statements, Kentucky Energy improperly accounted for warrants and convertible notes it had issued to third parties. Kempisty & Company rendered an unqualified report stating that, in the firm’s opinion, the financial statements presented fairly the financial position of the company in conformity with⁴ generally accepted accounting principles (“GAAP”). In fact, the financial statements were not presented in conformity with GAAP and the resulting errors were material. Moreover, the respondents failed to comply with Public Company Accounting Oversight Board (“PCAOB”) auditing standards (“AU”)⁵ in carrying out the relevant audits and reviews.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

Kempisty & Company, CPAs, P.C. (“Kempisty & Company”), is an audit firm with offices in New York City. It is a public accounting firm registered with the Public Company Accounting Oversight Board. Kempisty & Company was the independent auditor for Kentucky Energy at all relevant times from 2003 until the company dismissed it on February 13, 2009.

Philip C. Kempisty, CPA, 61 (“Kempisty”), is the founding partner and majority shareholder of Kempisty & Company. He has been licensed as a CPA in the state of New York since 1974.

John Anthony Rubino, CPA, 67 (“Rubino”), has been a partner/member in Kempisty & Company since 1989. He is licensed as a CPA in the states of New York and Nevada. Rubino worked for a series of CPA firms in the New York City area before joining Kempisty & Company in approximately 1980.

³ The company was named Quest Minerals and Mining Corp. during the relevant time.

⁴ The Kempisty report did contain an explanatory paragraph describing substantial doubt about the entity’s ability to continue as a going concern and an emphasis of matter paragraph describing that potential adverse rulings in ongoing litigation could result in a loss of the company’s operating assets.

⁵ “AU” refers to the specific sections of the codification of the American Institute of Certified Public Accountants (“AICPA”) professional standards, known as the Statements on Auditing Standards, as issued by the Auditing Standards Board of the AICPA. These standards have been adopted by the PCAOB following passage of the Sarbanes-Oxley Act of 2002 (“SOx”). References in this order are to the standards in effect at the time of the relevant conduct.

B. FACTS

Issuance of convertible notes and warrants by Kentucky Energy

1. Kentucky Energy's 2005 financial statements, like those for the preceding year, were prepared by a consultant to the company. This consultant's father was the Vice President, Secretary and a director of Kentucky Energy. Kempisty and Rubino had no specific knowledge of the consultant's education or experience in accounting but were aware that he was not a CPA.

2. Beginning in 2004 and continuing into 2005, Kentucky Energy obtained a series of loans from third parties evidenced by notes convertible into common stock.⁶ As an additional incentive to the lenders, Kentucky Energy issued warrants along with each note. Kentucky Energy's consultant needed to account for warrants for the first time in preparing the company's financial statements for inclusion in its Form 10-KSB for the year ended December 31, 2004. Rubino had never previously dealt with the issue of how to account for warrants or a beneficial conversion feature of a convertible note, both of which are derivatives.

Improper accounting for warrants and beneficial conversion feature

3. Rubino told the consultant that he would need to value the warrants using the Black-Scholes option pricing model. Accordingly, the consultant found a Black-Scholes calculator on the internet. This calculator called for him to fill in variables for the warrants' "equity price," "strike price," "volatility," "riskless interest rate," and "time to maturity," and would then generate a Black-Scholes valuation. For "volatility" and "interest rate," however, the consultant simply inserted the generic numbers provided as an example by the website, rather than calculate the actual volatility of Kentucky Energy stock and determine the real riskless interest rate. In fact, Kentucky Energy's stock price was far more volatile than that listed in the website example.

4. Using this method, the consultant arrived at a value for the warrants issued during the last quarter of 2004. He recorded that value as an expense on the company's statement of operations and sent his draft financial statements to Kempisty & Company.

5. Rubino, however, contacted the consultant and told him that he should have recorded the warrant valuation as an asset on the company's balance sheet, rather than as an expense on its statement of operations, and that he should then have amortized that amount over the life of the underlying convertible notes. Not only was this accounting treatment incorrect, but both Rubino and the consultant ignored the necessity to provide for the beneficial conversion feature of the notes.

6. In fact, accounting for the warrants in accordance with GAAP required that the proper inputs be used in the Black-Scholes option pricing model. Kentucky Energy should have

⁶ One series of notes issued during 2005 was not convertible and one note did not have warrants attached, however.

allocated the loan proceeds first to the notes and the warrants; and then, from the portion allocated to the notes, reallocated that to the notes and the beneficial conversion feature of the notes. The amount of proceeds allocable to the warrants and the beneficial conversion feature would be accounted for as paid-in-capital and as a discount to the face amount of the note. The note should have been recorded net of this discount on the balance sheet and the discount should have been amortized to interest expense in the statement of operations over the life of the notes.

7. Rubino testified that he did not know whether or not the consultant was a CPA, what his accounting background was, or whether he was familiar with GAAP. Even after he decided that the consultant's first set of financial statements was incorrectly prepared, Rubino took no further steps to verify the consultant's competence.

GAAP failures

8. For the first quarter of 2005, using the same methodology established in 2004, the consultant arrived at a value of \$15,694,422 for the warrants, and that amount less amortization of \$1,881,139, or \$13,813,283 was recorded as an asset on the company's balance sheet. In the subsequent quarters of 2005, the consultant continued to calculate the warrant valuation improperly and to record it as an asset which, for each of the first two quarters, amounted to over 60% of Kentucky Energy's total assets. On the company's statements of operations, the warrant amortization expense increased correspondingly, and on its 2005 year-end statement of operations amounted to 70% of Kentucky Energy's net loss. Throughout this period, the consultant continued to fail to consider the effect of the beneficial conversion feature of the promissory notes. The combined valuation of the warrants and the beneficial conversion features should not have exceeded the proceeds the company had received from the notes, which amounted to \$1,875,000 at the end of the first quarter and \$3,105,000 at the end of 2005, and they should not have been recorded as an asset.

9. For its year ended December 31, 2005, as a result of its improper accounting for the warrants and convertible notes, Kentucky Energy recorded the warrant asset in the amount of \$3,097,903 on its balance sheet, reflecting the ensuing quarters' amortization as an expense on its statements of operations. In so doing, the company overstated total assets by 43% and overstated its net loss by 197%. It also materially overstated paid-in capital, retained deficit, shareholders' equity and expenses. This improper accounting was material to balance sheets and statements of operations contained in its quarterly filings for 2005 as well. For example, its assets were overstated by approximately \$13.8 million, or 213%, in the financial statements contained in its Form 10-Q for the first quarter of 2005 and its net loss was overstated by approximately 174% for the second quarter of 2005.

Audit and Reviews

10. Kempisty & Company, Kempisty and Rubino conducted quarterly reviews and a year-end audit of Kentucky Energy's financial statements for the 2005 year. In the report filed with the Form 10-KSB filed by the company on May 9, 2006, Kempisty and Co. stated that the financial statement presented fairly the financial position of the company at December 31, 2005.

On these engagements, Rubino was the engagement partner and Kempisty was the concurring review partner. They were the only auditors who worked on this engagement, and in fact were the only partners and auditors in the firm at the time.

PCAOB auditing standards failures by Rubino as the engagement partner

Lack of training and proficiency.

11. Rubino lacked the necessary training and proficiency as an auditor to properly interpret the professional guidance under GAAP having to do with accounting for warrants and convertible notes. The workpapers reflect no analysis to support treating the warrants as assets on Kentucky Energy's balance sheet. Nevertheless, he sought no outside advice on these issues. In fact, Rubino did not realize that in accounting for the warrants he was dealing with derivative instruments requiring a careful analysis for proper accounting.

12. PCAOB auditing standards require that the audit be performed by "a person or persons having adequate technical training and proficiency as an auditor." AU § 210.01. PCAOB Auditing Standards further require that "[t]he auditor with final responsibility for the engagement should know, at a minimum, the relevant professional accounting and auditing standards . . ." AU § 230.06.

Failure to exercise due professional care and skepticism and to obtain sufficient competent evidential matter.

13. Rubino also failed to obtain and sufficiently examine, read and understand all of the underlying documents evidencing the note/warrant transactions. The workpapers did not contain copies of all the relevant agreements underlying the convertible note financings. There is no evidence that Rubino evaluated this documentation to understand how the transactions should be accounted for under GAAP.

14. Rubino knew that Kentucky Energy's consultant had limited knowledge of accounting and GAAP, yet he failed to review in sufficient detail the Black-Scholes assumptions and analysis the consultant had used, therefore failing to discover that he had merely used the generic volatility and interest rate numbers off the website rather than obtain the correct numbers for Kentucky Energy.

15. PCAOB auditing standards require that "[d]ue professional care is to be exercised in the planning and performance of the audit and the preparation of the report." AU § 230.01. Among other things, due professional care requires that an auditor exercise professional skepticism, defined as "an attitude that includes a questioning mind and a critical assessment of audit evidence." AU § 230.07. Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence. AU § 230.08. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest. AU § 230.09.

16. PCAOB auditing standards also require that "[s]ufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 326.01. To be competent, evidence, regardless of its form, must be both valid and relevant. AU § 326.21. In addition, the auditor should "recognize the possibility that the financial statements may not be fairly presented in conformity with generally accepted accounting principles ..." and should "consider relevant evidential matter regardless of whether it appears to corroborate or contradict the assertions in the financial statements." AU § 326.25. Management representations "are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 333.02.

Failure to comply with relevant PCAOB auditing standards regarding auditing of derivatives

17. In fact, PCAOB auditing standards provide specific guidance to auditors in planning and performing auditing procedures for assertions about derivative instruments that are made in an entity's financial statements. AU§ 332. This guidance states that the auditor may need special skills or knowledge to plan and perform auditing procedures for certain assertions about derivatives and securities. AU§ 332.05.

18. Rubino failed to, among other things:

- Understand the application of generally accepted accounting principles for assertions about derivatives (AU§ 332.05)
- Understand the determination of fair value of derivatives, including the reasonableness of key assumptions (AU§ 332.05 and AU§ 332.40)
- Alter its risk assessment and audit procedures based on the entity's inexperience with a derivative (AU§ 332.08)
- Obtain evidence supporting management's assertion about fair value of the derivative (AU§ 332.35) and
- Evaluate whether the presentation and disclosure of derivatives are in conformity with generally accepted accounting principles (AU§ 332.49).

Thus, Rubino failed to fulfill his responsibilities under PCAOB auditing standards for auditing those instruments.

PCAOB auditing standards review failures by Rubino as the engagement partner

19. In addition to the audit failures, Rubino failed to comply with the specific standards applicable to interim reviews of Kentucky Energy's 2005 quarterly financial statements. These standards, set forth in AU § 722, provide guidance on the nature, timing and extent of the procedures to be performed by an independent accountant when conducting a review of interim financial information.

20. The objective of a review of interim financial information is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with GAAP. AU § 722.07. The standards specifically require the accountant to perform certain procedures when conducting a review of interim financial information, including, but not limited to inquiring of management about unusual or complex situations that may have an effect on the interim financial information, and matters about which questions have arisen in the course of applying the review procedures and significant journal entries and other adjustments. AU § 722.18.

21. The unusual or complex situations, referred to in the above paragraph, specifically include the use of derivative instruments and unique terms for debt that could affect classification. AU § 722.55 (Appendix B). Rubino, however, did not give adequate consideration to the analysis and classification of the derivative instruments recorded in the financial statements.

22. Finally, the same standards relating to adequate technical training and proficiency, due professional care and professional skepticism apply to reviews as well as audits. AU § 722.01. Therefore, Rubino's audit failures for Kentucky Energy's year ended 2005 apply equally to the quarterly reviews.

PCAOB auditing standards failures by Kempisty as the concurring review partner

23. Kempisty, as the concurring review partner, was responsible for performing an objective review of significant auditing, accounting, and financial reporting matters that came to his attention, and was an integral part of the resolution of matters prior to the issuance of the firm's audit report. SEC Practice Section ("SECPS") §1000.39 (Appendix E).⁷ On the basis of that review, Kempisty was required to conclude that no matters came to his attention that caused him to believe that the financial statements of Kentucky Energy were not in conformity with GAAP in all material respects, and that the firm's audit was performed in accordance with the standards of the PCAOB.

24. Kempisty was required, among other things, to review documentation of the resolution of significant accounting, auditing and financial reporting matters. His review of the financial statements and management documentation should have alerted him to the mistakes in valuing and classifying the warrant.

25. Kempisty had additional specific responsibilities with respect to the concurring review of Kentucky Energy's interim financial statements. For a review conducted on interim financial information on financial statements in an SEC client's quarterly Form 10-Q or 10-QSB filing, a member firm's policies and procedures should require discussion with the concurring partner reviewer, prior to the completion of the review, about any matters identified in the review that involve a significant risk of material misstatement of the financial statements. Any such involvement should be documented. SECPS §1000.39 (Appendix E).

⁷ This references concurring partner review standards set by the AICPA which were adopted by the PCAOB following passage of SOx. Kempisty & Company was a member of the SEC Practice Section of the AICPA from 1991 until the formation of the PCAOB, making it subject to these standards.

26. Although testimony indicates that Kempisty did discuss the warrant/convertible note accounting issue with Rubino, the workpapers for the interim reviews do not contain any documentation of such discussions nor of matters identified in the review that involve a significant risk of material misstatement of the financial statements.

27. Finally, as a general matter, Kempisty as concurring reviewer was required to have “sufficient relevant technical expertise and experience” to perform his duties. SECPS §1000.39 (Appendix E). In this matter he was therefore required to have technical expertise and experience in the area of accounting for derivatives, including warrants and convertible notes. The standards also require that a concurring reviewer seek assistance from other individuals to supplement his knowledge when necessary.

28. As concurring reviewer for both the interim reviews and year-end audit, Kempisty lacked the expertise and experience necessary to understand that the instruments involved in the transactions were derivatives. He also failed to seek outside professional assistance to understand how to properly account for such items.

Misstatement in Audit Report

29. In this matter, Kempisty & Company, Kempisty and Rubino’s audit report falsely states that they conducted their audit in accordance with the standards of the PCAOB, and that in their opinion the financial statements of Kentucky Energy were presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. In fact, they were not.

C. VIOLATIONS

1. As a result of the conduct described above, Kempisty & Company, Kempisty and Rubino willfully aided and abetted and caused Kentucky Energy’s violations of Sections 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

2. As a result of the conduct described above, Kempisty & Company, Kempisty and Rubino engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice, and willfully aided and abetted and caused Kentucky Energy’s violation of the federal securities laws, pursuant to Section 4C(a)(3) of the Exchange Act and Rule 102(e)(1)(iii) of the Commission’s Rules of Practice.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate that public administrative and cease-and-desist proceedings be instituted, to determine

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondents an opportunity to establish defenses to such allegations;

B. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing any violation and any future violation of Sections 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder; and

C. Whether, pursuant to Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice, Respondents should be censured or denied, temporarily or permanently, the privilege of appearing or practicing before the Commission as accountants.

IV.

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

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

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

This Order shall be served forthwith upon each Respondent personally or by certified mail.

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

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except

as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not “rule making” within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary