The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against Paul Anthony Davis (“Davis”) pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”).

In anticipation of the institution of these proceedings, Davis has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Davis consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 (“Order”), as set forth below.
III.

FACTS

On the basis of this Order and Davis’ Offer, the Commission finds\(^1\) that:

A. Respondent

Davis, age 41, resides in Lafayette, Colorado. Davis is a founding partner of a venture capital firm located in Boulder, Colorado. In June 2003, Davis facilitated the creation of a company, Sourceworks USA LLC (“Sourceworks”), to enter into a software license transaction with Quovadx, Inc.

B. Related Party

Quovadx, Inc. (“Quovadx”), a Delaware corporation based in Englewood, Colorado, is a software company that sells software licenses and related services to the health care industry. Quovadx’s stock was registered with the Commission under Section 12(g) of the Exchange Act during the relevant time and traded on the NASDAQ National Market. During 2002 and 2003, Quovadx derived about one-third of its reported revenue from sales of software licenses, with the rest coming from maintenance and service contracts. Quovadx separately reported its software licensing revenue, which included sales of both software and licenses.\(^2\)

C. Summary

In the second quarter of 2003, Quovadx improperly recognized approximately $570,000 in software licensing revenue from the purported sale of software licenses to Sourceworks. Sourcework’s payment for that software was contingent upon Quovadx securing a contract for Sourceworks with the anticipated end-user of the software. As a result of this transaction, Quovadx materially overstated its software licensing revenue by over 9% for the second quarter of 2003 and violated the reporting provisions of the Exchange Act. On August 16, 2004, Quovadx restated its financial results to correct for the Sourceworks transaction, among others. Davis negotiated with Quovadx on behalf of Sourceworks and knew or should have known that Quovadx could not have recognized revenue from this transaction. Accordingly, Davis was a cause of Quovadx’s reporting violations.

D. Applicable Accounting Principles for Software Sales

As a public company, Quovadx was required to file quarterly and annual reports with the Commission that presented its financial results in conformity with Generally Accepted Accounting Principles (“GAAP”). AICPA Statement of Position 97-2, *Software Revenue Recognition* (“SOP 97-2”) governs the recognition of revenue for sales of software and software licenses.

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\(^1\) The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

\(^2\) Throughout this Order, “software sales” and “software license sales” are used interchangeably.
Under SOP 97-2, a company may not recognize revenue from a software license sale unless and until there is: persuasive evidence of an arrangement; delivery of the software; a fixed or determinable seller’s fee; and a reasonable probability of collecting the accounts receivable. Further, if payment is substantially contingent on the buyer’s success in distributing the product to the end user, either due to the terms of the deal or because the buyer is so undercapitalized that it cannot pay until it sells the product, the seller may not recognize the software license revenue at the time of sale.

In the second quarter of 2003, Quovadx recognized revenue from a transaction with Sourceworks that did not conform to SOP 97-2 and that materially overstated the company’s financial results.

E. The Sourceworks Transaction

In early 2003, a senior salesperson at Quovadx solicited the Veterans’ Administration (“VA”) to buy licenses for Quovadx’s Insurenet software, a product for processing patient medical insurance information. The VA refused to buy the licenses, but expressed an interest in using the software and periodically paying Quovadx a fee based on the number of insurance transactions that it processed. Quovadx was not interested in this proposal. The Quovadx salesperson therefore suggested a plan, approved by members of Quovadx’s then senior management, whereby Quovadx would sell the licenses to a third-party, which would then enter into a contract with the VA to offer the software on a per-use basis.

The Quovadx salesperson then contacted Davis, a partner of a Colorado-based venture capital firm, and proposed that Davis’ firm buy the Insurenet licenses from Quovadx. The Quovadx salesperson told Davis that, in return, Quovadx would negotiate a contract for the firm to license the software on a per-use basis to the VA. As the end of the second quarter of 2003 approached, Davis agreed in principle to this proposal. However, because the venture capital firm was not a software reseller, Davis said that the firm would not pay for the Insurenet licenses unless and until Quovadx obtained the promised user contract. The Quovadx salesperson expressed confidence that Quovadx would obtain the contract with the VA early in the third quarter. With that understanding, Davis facilitated the creation of a company, Sourceworks USA LLC, in late June 2003 to buy the Insurenet licenses from Quovadx and enter into the user contract with the VA. On June 30, 2003, Quovadx and Sourceworks executed a contract requiring Sourceworks to pay Quovadx $600,000 for the Insurenet licenses. The contract, which gave Sourceworks six months to pay Quovadx, did not indicate that Sourceworks’ payment to Quovadx was contingent upon Quovadx successfully negotiating a VA deal for Sourceworks.

Despite the material contingency to the Sourceworks transaction, Quovadx recognized the entire $600,000 in the second quarter, based upon the June 30, 2003 contract. It issued a press release on July 23, 2003, touting the company’s second quarter financial results, which included the Sourceworks revenue. For the next eight months, Quovadx attempted to secure a contract for Sourceworks. However, these negotiations ultimately failed. As a result, other than one $30,000 payment in August 2003, Sourceworks did not pay Quovadx for the Insurenet
licenses. Because Sourceworks did not pay the remaining $570,000, Quovadx’s new senior management and auditor reviewed the Sourceworks transaction in the Spring of 2004 and reversed the revenue as part of a restatement on August 14, 2004.

As a result of its improper recognition of the Sourceworks revenue, Quovadx overstated its software licensing revenues by $570,000, or approximately 9%, in the second quarter of 2003.

IV.

LEGAL CONCLUSIONS

Reporting Violations

Section 13(a) of the Exchange Act and Rules 13a-11, and 13a-13 thereunder require that issuers with securities registered under Section 12 of the Exchange Act, such as Quovadx, file quarterly reports with the Commission and keep this information current. These reports must be complete and accurate in all material respects. United States v. Bilzerian, 926 F.2d 1285, 1298 (2d Cir. 1991); SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1165 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979). Rule 12b-20 of the Exchange Act requires that an issuer’s periodic reports include any additional information “necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.” The issuer’s legal obligation “extends not only to accurate quantitative reporting of the required items in its financial statements, but also to other information, qualitative as well as quantitative, needed to enable investors to make informed decisions.” In re Sony Corp. and Sumio Sano, 67 SEC Docket 1609, 1998 WL 439898 at *4 (Aug. 5, 1998).

Quovadx improperly recognized revenue from the transaction with Sourceworks. As a result, Quovadx’s quarterly report for the second quarter of 2003 and its earnings release for the second quarter of 2003 (attached to the Form 8-K that Quovadx filed with the Commission on July 24, 2003) contained materially false and misleading statements concerning Quovadx’s software licensing revenue. Accordingly, Quovadx violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

Because he was involved in negotiating the Sourceworks transaction with Quovadx, Davis knew or should have known that the Sourceworks contract did not reflect the material contingency that existed in the deal – namely, that Sourceworks could not and would not pay for the Insurenet software license unless and until Quovadx negotiated the VA contract. Accordingly, Davis was a cause of Quovadx’s violations of Sections 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

3 Sourceworks has since demanded that Quovadx return the $30,000; Quovadx has not done so. Sourceworks, in turn, has rejected Quovadx’s demand for payment of the $570,000 balance due on the purchase of the licenses.

4 Owing to the Sourceworks transaction, Quovadx overstated its software licensing revenue in its July 23, 2003, Form 8-K, which incorporated its preliminary earnings results and its quarterly report for the second quarter of 2003 filed with the Commission on August 5, 2003.
V.

FINDINGS

Based on the foregoing, the Commission finds that Davis was a cause of Quovadx’s violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

VI.

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

Accordingly, IT IS HEREBY ORDERED that:

Pursuant to Section 21C of the Exchange Act, Davis cease and desist from causing any violations and any future violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary