

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 61315 / January 7, 2010**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3100 / January 7, 2010**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13489**

**In the Matter of**

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

**Respondents.**

**ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS  
PURSUANT TO RULE 102(e) OF THE  
COMMISSION'S RULES OF  
PRACTICE**

**I.**

On May 27, 2009, the Securities and Exchange Commission (“Commission”) instituted public administrative proceedings against Pollard Kelley Auditing Services, Inc. (“Pollard-Kelley”) and Terance Kelley, CPA (“Kelley”) (together, “Respondents”), pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.<sup>1</sup>

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

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

(A) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or (B) either of the following two types of negligent conduct: (1) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted. (2) repeated instances of

## II.

The Respondents have submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding 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, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Rule 102(e) of the Commission’s Rules of Practice (“Order”), as set forth below.

## III.

On the basis of this Order and Respondents’ Offer, the Commission finds that:

### Summary

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

### Respondents

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

3. Terance Kelley, CPA, age 62, resides in Lake City, Colorado. He formed Pollard-Kelley and is its vice president of audit services. He performs the vast majority of

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unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

the firm's audits and performed the audits of Pegasus' 2005 and 2006 financial statements, as well as quarterly reviews of Pegasus financial statements through approximately November 2007. He is licensed as a certified public accountant in Ohio.

### **Related Party**

4. Pegasus Wireless Corporation is a Nevada corporation formed in 2000. After several failed enterprises, it became a shell company by 2003. In June 2005, through a series of reverse mergers, it acquired OTC Wireless, Inc., a private company incorporated in California that designs wireless networking devices. Pegasus had headquarters in Fremont, California, until about January 2007. It currently maintains a mailbox in Palm Beach, Florida. During the relevant period, its securities were registered pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act"). Its shares most recently traded on the OTC Bulletin Board and briefly traded on NASDAQ in 2006. Pegasus filed for bankruptcy in January 2008.

### **Respondents' Improper Professional Conduct**

#### ***Pegasus' Fraud Scheme***

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

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

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

failed to disclose these notes to subsequent management, thus current management was unaware of their existence.

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

### ***Respondents' Deficient 2006 Audit***

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

8. In March 2007, during field work for the 2006 audit, Respondents noted Pegasus' disclosures that it had issued stock to pay previously undisclosed debt. The alleged debt described in the September 30, 2006 10-QSB had grown from \$263,800 to \$368,532 at year-end, as had the number of shares issued. (Pegasus had additional debt, which had been previously disclosed, on its balance sheet.) Moreover, the number of shares issued by year-end based on the alleged debt (7,376,016) equaled more than one third of Pegasus' then-outstanding shares.

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

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

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

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

13. PCAOB auditing standards require auditors to exercise reasonable diligence and due professional care in performing an audit. "Due professional care requires the auditor to exercise professional skepticism. . . . [i.e.,] an attitude that includes a questioning mind and a critical assessment of audit evidence." AICPA Codification of

Statements on Auditing Standards, “*Due Professional Care in the Performance of Work*,” AU § 230.07. “The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest.” AU § 230.09. Moreover, an auditor must obtain “sufficient competent evidential matter” to provide “a reasonable basis for forming an opinion.” AU § 326.22.

14. In addition, PCAOB auditing standards establish a requirement that the auditor obtain written representations from management as part of an audit. AU § 333.01. The specific representations an auditor should obtain relate to, among other things, management’s acknowledgement of its responsibility for the financial statements; its belief that the financial statements are fairly presented in conformity with GAAP, and the completeness of information provided. AU § 333.06. Management’s refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause an auditor to disclaim an opinion or withdraw from the engagement. AU § 333.13.

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

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

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

#### ***Respondents Added Documents to Their Audit Work Papers After the Audit***

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

19. On January 1, 2008, Kelley e-mailed the Pegasus CFO and CEO, stating: “We have been named defendants in [a lawsuit] against Pegasus, et al. Please give me a call and bring me up to date concerning this matter.” The e-mail further stated: “ALSO, THIS IS THE TIME TO GET THE FINAL SCHEDULES NEEDED FOR THE 2006 AUDIT TO ME!!!!!!”

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

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

22. Kelley, however, testified that he added the workpaper to the audit documentation in 2008.

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

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

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

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

24. When Kelley created the document in early 2008 and added it, he was still being told by the CFO of Pegasus that documentation was forthcoming, but he was suspicious whether the CFO would ever provide the requested documents.

25. PCAOB Auditing Standard No. 3 provides that "[a] complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date" (i.e., the "date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements").

¶¶ 14-15. Although the standard recognizes that “[c]ircumstances may require additions to audit documentation after the report release date,” it states that “[a]ny documentation added must indicate the date information was added, the name of the person who prepared the additional documentation, and the reason for adding it.” ¶ 16.

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

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

### **Violations**

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

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

(1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.

(2) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

### **Findings**

29. Based on the foregoing, the Commission finds that Respondents engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.

## **IV.**

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

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

A. Respondents are each denied the privilege of appearing or practicing before the Commission as an accountant.

B. After five years from the date of this order, Respondents may each request that the Commission consider his or its 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. If submitted by Kelley, such an application must satisfy the Commission that Kelley's 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

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondents, or the public accounting firm with which Kelley is associated, are registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondents, or the registered public accounting firm with which Kelley is associated, have been inspected by the Board and that inspection did not identify any criticisms of or potential defects in Kelley's or the firm's quality control system that would indicate that Kelley will not receive appropriate supervision;

(c) Respondents have resolved all disciplinary issues with the Board, and each has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondents each acknowledge his or its responsibility, as long as either Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

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

By the Commission.

Elizabeth M. Murphy  
Secretary