



II.

On the basis of this Order and Mohalley's Offer, the Commission finds that:

A. THE RESPONDENT <sup>1/</sup>

John J. Mohalley, 47 years old, was a resident of San Francisco, California during the conduct that is the subject of this Order. In January 1992, he moved to Kuwait. He was a certified public accountant and was Vintage Group, Inc.'s Chief Financial Officer from February 1986 through March 1989. He was also a director of Vintage from February 1986 until January 1988.

Mohalley audited Vintage's financial statements for the fiscal year ended April 30, 1989 and reaudited Vintage's financial statements for the fiscal years ended April 30, 1988 and 1987. He owned 3,367 shares of Vintage's common stock from February 1986 through April 1990 and options to purchase 35,000 additional shares which he exercised shortly after issuing his fiscal year 1989 unqualified audit report.

B. OTHER ENTITY INVOLVED <sup>2/</sup>

Vintage Group, Inc. ("Vintage" or the "Company") was incorporated in Colorado in 1983. On June 25, 1986, Vintage elected to be regulated as a Business Development Company ("BDC") under Section 54(a) of the ICA. Its principal place of business is in San Rafael, California.

---

<sup>1/</sup> On September 29, 1993, the United States District Court for the Northern District of California permanently enjoined Mohalley from future violations of Sections 5 and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and from future aiding and abetting violations of Section 13(a) of the Securities Exchange Act of 1934 and Rules 12b-20, 13a-1, and 13a-13 thereunder and barred Mohalley from acting as an officer or director of any issuer having a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 or required to file reports pursuant to Section 15(d) of the Securities Exchange Act of 1934. See Litigation Release No. 13844 (October 21, 1993). Mohalley consented, without admitting or denying any of the allegations contained in the complaint, except as to jurisdiction which was admitted, to the entry of a final judgment of permanent injunction.

<sup>2/</sup> Any findings contained in the Commission's Order are solely for the purpose of these proceedings and are not binding on any person or entity named as a respondent in any other proceedings.

Vintage's securities are registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). As such, Vintage is required pursuant to Section 13(a) of the Exchange Act to file periodic reports with the Commission.

### C. VINTAGE FILES FALSE AND MISLEADING PERIODIC REPORTS

Starting with the fiscal period ended October 31, 1988 and continuing through the fiscal period ended January 31, 1990, Vintage issued financial statements compiled, in whole or part, by Mohalley that substantially overstated the fair value of Vintage's securities portfolio. These false and misleading financial statements were included in the reports on Forms 10-K and Forms 10-Q that Vintage filed with the Commission.

Throughout this fiscal period, Vintage valued its holdings, consisting almost entirely of restricted shares, by what it termed the "public market method". Under this method, Vintage used indications of interest from the National Quotation Bureau Pink Sheets ("Pink Sheets") or from penny stock market makers as the starting point for calculating the "value" of its securities holdings. The indications listed in the pink sheets and provided by the market makers were not "firm" for any quantity of shares and not reflective of any trading in the securities. Because of the limited trading market for the portfolio securities, Vintage often obtained only a single indication of interest for its holdings. Vintage then multiplied the indication of interests that it had solicited by the millions of restricted shares that it owned and applied a 30% to 50% haircut to the products. The results were then listed in Vintage's filings as the "values" of its holdings.

Vintage's valuation of the Company's holdings using the public market method was improper for several reasons. First, the formula was contrary to the required accounting treatment. The public market method can be used only if current public quotations are readily available for the securities in question. As mentioned above, Vintage used indications of interest appearing in the Pink Sheets or provided by market makers as the starting point for valuing the Company's securities. The indications of interest were not "readily available market quotes" under the accounting rules because they were not firm offers to buy or sell any quantity of shares, let alone the millions of shares held by Vintage. Even if the indications of interest solicited by Vintage fell within the definition of current market quotations, they could not be used by Vintage to value its restricted shares. Under the applicable literature, restricted securities by definition constitute shares for which

market quotations are not readily available. <sup>2/</sup> Accordingly, Vintage could not value its securities holdings by the public market method. Instead, the Company's Board of Directors was required to determine the fair value of its holdings in good faith, which it did not do.

Second, Vintage's use of the public market method was contrary to its own stated policy. As outlined in its periodic filings, Vintage was supposed to use this method only if it determined that an established public market existed for its holdings. In making this determination, the Company was supposed to consider "the trading volume, the number of shareholders, the number of market makers in the investee's securities, and the Company's percentage of ownership in the portfolio company, along with the trend in trading volume". Vintage did not consider any of these factors. Instead, Vintage used the "public market method" whenever the Company was able to find or solicit even a single indication of interest for a holding. Had Vintage followed the guidelines set out in its own disclosure documents, it could not have used the public market method because there was no public market for its holdings. The trading records of the National Association of Securities Dealers reflect that there was very limited, if any, trading of any of the securities in Vintage's portfolio, and very few, if any, active market makers. Consequently, there was no public market for the millions of shares owned by Vintage.

---

<sup>3/</sup> Accounting Series Release No. 113, dated October 21, 1969 ("ASR No. 113") explains:

Readily available market quotations refers to reports of current public quotations for securities similar in all respects to the securities in question. No such current public quotations can exist in the case of restricted securities. For valuation purposes, therefore, restricted securities constitute securities for which market quotations are not readily available. Accordingly, their fair values must be determined in good faith by the board of directors .... Consequently, the valuation of restricted securities at the market quotations for unrestricted securities of the same class would, except for most unusual situations, be improper.

Financial Reporting Codification, Section 404.04a, "The Problem of Valuation," Fed. Sec. L. Rep. (CCH) ¶ 38,212.

Third, the valuation method used by Vintage was improper because it ignored the underlying financial condition and business prospects of the companies in its securities portfolio. For example, as of the period ended April 30, 1989, only four of the nineteen companies in Vintage's securities portfolio were "operating" companies. Three of those four had received auditors' opinions qualified on a going concern basis. The remaining fifteen companies were inactive shell corporations. The values calculated by Vintage, even after the haircuts, far exceeded the fair market value of the securities in its portfolio.

D. MOHALLEY'S ROLE AS BOTH CHIEF FINANCIAL OFFICER AND "INDEPENDENT" AUDITOR

To ensure a favorable valuation of the Vintage's securities portfolio, Vintage's president terminated Coopers & Lybrand after the accounting firm issued its fiscal year 1988 audit report and made Mohalley, Vintage's Chief Financial Officer, the Company's "independent" auditor for fiscal year 1989.<sup>4/</sup> Mohalley was also engaged to reaudit the Vintage's financial statements for fiscal year 1987 and 1988. The reaudits were intended to supersede Coopers & Lybrand's 1987 and 1988 audit opinions.

Following his engagement as the Company's "independent" auditor, Mohalley compiled, in whole or part, Vintage's financial statements for fiscal year 1989. After completing the compilation, Mohalley purportedly audited Vintage's financial statements for fiscal year 1989 and reaudited Vintage's financial statements for fiscal years 1988 and 1987. On June 1, 1989, Mohalley issued an unqualified audit report with respect to his audit of Vintage's financial statements for fiscal year 1989 and his reaudit of Vintage's financial statements for years 1988 and 1987.<sup>5/</sup> Mohalley's audit report was included in the annual report on Form 10-K for fiscal year 1989 that Vintage filed with the Commission.

E. VINTAGE'S FRAUDULENT SALE OF SECURITIES

On March 1, 1990 Vintage filed a notification with the Commission pursuant to Regulation E [17 CFR 230.601 et seq.] in order to sell its shares to the general public. The Notification

---

<sup>4/</sup> Vintage discharged C&L after the accounting firm completed its audit work for fiscal year 1988 and before C&L began its audit work for fiscal year 1989.

<sup>5/</sup> It does not appear that Mohalley actually performed the audits for fiscal years 1987, 1988 or 1989. In response to Commission subpoenas, Mohalley claimed that his work papers for those fiscal years were lost when he moved offices.

filed with the Commission and the Offering Circular subsequently distributed to the offerees and purchasers included Vintage's audited financial statements for the year ended April 30, 1989 and Form 10-Q for the period ended January 31, 1990. As discussed above, these financial statements substantially overstated the fair market value of Vintage's securities portfolio. Pursuant to the Regulation E offering, Vintage sold approximately 2,000,000 shares to the investing public for approximately \$1,500,000.

F. VINTAGE'S FALSE AND MISLEADING MAY 1990 PRESS RELEASE

To boost or at least maintain the price of Vintage's stock, on May 14, 1990, Vintage issued a press release announcing Vintage's results of operations for the fiscal year ended April 30, 1990. Mohalley helped compile the financial information contained in the release. The release reported gross revenues of \$4,358,296 and net income of \$2,097,480 for fiscal year 1990.

This was a material misrepresentation of Vintage's revenues and income. Ninety four percent of the revenue and income reported was attributable to purported increases in the value of Vintage's investment portfolio. The release, however, made no reference to the unrealized nature of the purported gain and made it appear as if Vintage was generating some type of cash flow.<sup>6/</sup> In fact, Vintage had actually sustained a substantial loss for fiscal year 1990.

G. MOHALLEY'S VIOLATIONS OF THE FEDERAL SECURITIES LAWS

1. Mohalley's Willful Aiding and Abetting of Vintage's Failure to Comply with Regulation E and Resulting Violation of Section 5 of the Securities Act of 1933.

The registration exemption for BDC's under Regulation E of the Securities Act of 1933 ("Securities Act") applies only if the offering circular contains all of the required information specified in the Regulation. Absent compliance, the exemption under Regulation E is unavailable, and the issuer is subject to the registration and prospectus delivery requirements of Section 5 of the Securities Act (unless the offer is otherwise exempted by Securities Act Sections 3 or 4).

---

<sup>6/</sup> Under Generally Accepted Accounting Principles ("GAAP") and specific SEC rules, it is improper to present unrealized gain on investments as investment income. See AICPA, Audit and Accounting Guide, Audits of Investment Companies (3rd.Ed.), p. 105 ¶ 5.35 and pp. 111-118 (illustrative financial statements); and Reg. S-X, Section 210.6-07.

Vintage's offering circular was deficient since it did not contain financial statements that had been audited by an independent auditor. Item 7 of Schedule A to Regulation E (Section 230.610(a)) requires that a BDC include in its offering circular certain financial statements. Item 7 also requires that "the statements required for the issuer's latest fiscal year shall be certified by an independent public accountant in accordance with Regulation S-X."

The "independence" of an auditor is discussed extensively in the applicable accounting literature. Section 210.2-01(b) of Regulation S-X provides that an auditor will not be regarded as independent if the accountant was an officer or director of the audited company during the period covered by the engagement. See also AICPA Code of Professional Conduct, ET Section 101.02. Furthermore, the ownership of shares or options of the issuer during an engagement will impair the independence of an auditor. Reg. S-X, Section 210.2-01(b). In addition, an auditor who maintained the basic accounting records and prepared the financial statements that are then the subject of his or her audit will not be considered independent. Financial Reporting Codification, § 602.02.c.

Each of these impairments is present here. As discussed above, Mohalley was a director and the Chief Financial Officer of Vintage during the period covered by the audit engagement. In addition, Mohalley owned stock and options in Vintage at the time of and during the course of his audit engagement. Further, during all of fiscal 1987, 1988 and 1989, the years for which he also audited Vintage's financial statements, Mohalley maintained Vintage's books and records, prepared all of its basic accounting records and compiled, in whole or part, all of its financial statements. As such, Mohalley was not independent under Regulation S-X, the AICPA Code of Professional Conduct and the AICPA Codification of Statements on Auditing Standards.

Since the Vintage Offering Circular did not contain financial statements certified in accordance with Regulation S-X, Vintage could not make use of the exemption under Regulation E to avoid registration. Since the Company did not file a registration statement with the Commission and none of the other transactional exemptions were applicable, Vintage engaged in a public offer and sale of securities in violation of Sections 5(a) and 5(c) of the Securities Act.

Mohalley certified Vintage's fiscal year 1989 financial statements and consented to the use of his audit opinion in the Regulation E filing. As discussed above, Mohalley was not independent as contemplated by Regulation S-X and therefore could not certify Vintage's financial statements as its "independent auditor". Furthermore, the financial statements compiled and audited by Mohalley were not prepared in accordance with GAAP and

substantially overstated the value of Vintage's investment portfolio. Vintage could not have taken advantage of the exemption under Regulation E to avoid registration had it not been for Mohalley's substantial assistance. As such, Mohalley willfully aided and abetted the primary violations of Section 5(a) and 5(c) of the Securities Act.

2. Mohalley's Willful Aiding and Abetting of Vintage's Violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

As mentioned above, Vintage issued financial statements compiled, in whole or part, by Mohalley which substantially overstated the fair market value of Vintage's securities portfolio. These false and misleading financial statements were included in the reports on Forms 10-K and Forms 10-Q that Vintage filed with the Commission. In addition, Vintage's 1989 Form 10-K included an audit report issued by Mohalley which falsely stated that Vintage's financial statements for fiscal years 1989, 1988 and 1987 had been audited by an independent certified public accountant. As such, Mohalley willfully aided and abetted the primary violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

3. Mohalley's Willful Aiding and Abetting of Vintage's Violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

Vintage filed a notification with the Commission pursuant to Regulation E in order to offer and sell its shares to the general public. The Notification filed with the Commission and the Offering Circular subsequently distributed to the offerees and purchasers contained Vintage's financial statements for the year ended April 30, 1989 and quarter ended January 31, 1990 and Mohalley's unqualified audit report for the fiscal year ended April 30, 1989, 1988 and 1987. These materials were included in the Offering Circular to induce investors to purchase shares of Vintage. As discussed above, Vintage's financial statements, which Mohalley helped compile, misrepresented the fair market value of the Company's securities portfolio. In addition, Mohalley's audit report falsely stated that Vintage's financial statements had been audited by an independent certified public accountant. Furthermore, the May 14, 1990 Vintage press release, which Mohalley also helped compile, substantially overstated Vintage's gross revenues and net income for fiscal year 1990. As such, Mohalley willfully aided and abetted the primary violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

### III.

On the basis of the foregoing, it is appropriate and in the public interest to impose the sanctions which are set forth in the Offer submitted by Mohalley.

Accordingly, **IT IS HEREBY ORDERED** that, effective immediately, John J. Mohalley be and hereby is barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company.

By the Commission.

Jonathan G. Katz  
Secretary

LITIGATION RELEASE NO. 13966 /February 15, 1994

SECURITIES AND EXCHANGE COMMISSION v. JAMES H. O'HAGAN, (United States District Court for the District of Minnesota, No. 3-90 Civil 16) (RGR))

On Thursday, February 10, 1994, a jury hearing the case of United States v. O'Hagan, Crim. No. 4-92-219 (D. Minn.), criminally convicted defendant James H. O'Hagan ("O'Hagan") on all charges in a 57 count indictment. The jury verdict included thirty-four counts of securities fraud (under sections 10(b) and 14(e) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5 and 14e-3 thereunder), twenty counts of mail fraud, and three counts of money laundering arising out of his illegal insider trading in the securities of The Pillsbury Company ("Pillsbury"). O'Hagan engaged in insider trading while he was partner at the Minneapolis-based law firm of Dorsey & Whitney and after the firm had been retained as local counsel for Grand Metropolitan, PLC ("Grand Met") in connection with its efforts to take over Pillsbury.

With respect to the securities fraud counts, the indictment charged that O'Hagan violated section 10(b) and Rule 10b-5 thereunder, by misappropriating from Dorsey & Whitney and the firm's client, Grand Met, material, nonpublic information concerning Grand Met's plans to commence a tender offer for Pillsbury common stock. Over approximately a three week period commencing August 29, 1988, O'Hagan then purchased 2,400 Pillsbury call option contracts and 5,000 shares of Pillsbury common stock. The indictment also charged that O'Hagan's trading in Pillsbury securities violated section 14(e) of the Exchange Act and Rule 14e-3. After Grand Met publicly announced its plans to commence a tender offer for Pillsbury common stock, O'Hagan sold his Pillsbury securities holdings at substantially higher prices than what he had paid for the securities, and thereby realized an illegal profit of \$4.3 million.