PCAOB
Public Company Accounting Oversight Board

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ORDER INSTITUTING DISCIPLINARY PROCEEDINGS, MAKING FINDINGS, AND IMPOSING SANCTIONS *In the Matter of Turner Stone & Company, LLP and Edward Turner, CPA,* *Respondents.*	PCAOB Release No. 2006-010 PCAOB No. 105-2006-002 December 19, 2006

Summary

By this Order, the Public Company Accounting Oversight Board ("Board" or "PCAOB") is censuring Turner, Stone & Company, LLP and barring Edward Turner, CPA, from being an associated person of a registered public accounting firm.[1/] The Board is imposing these sanctions on the basis of its findings concerning Respondents' violations of PCAOB rules and auditing standards in auditing the financial statements of one issuer client during 2004.

I.

The Board deems it necessary and appropriate, for the protection of investors and to further the public interest in the preparation of informative, fair, and independent audit reports, that disciplinary proceedings be, and hereby are, instituted pursuant to Section 105(c) of the Sarbanes-Oxley Act of 2002 ("Act") and PCAOB Rule 5200(a)(1) against Turner, Stone & Company, LLP ("Turner Stone" or "the Firm") and Edward Turner, CPA ("Turner") (collectively, "Respondents").

II.

In anticipation of institution of these proceedings, and pursuant to PCAOB Rule 5205, Turner Stone and Turner have each submitted an Offer of Settlement ("Offers") that the Board has determined to accept. Solely for purposes of this proceeding and any other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the Board's jurisdiction over them and the subject matter of these proceedings, which is admitted,

[1/] Turner may file a petition for Board consent to associate with a registered public accounting firm after two (2) years from the date of this Order.

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the Respondents each consent to the entry of this Order Instituting Disciplinary Proceedings, Making Findings and Imposing Sanctions ("Order") as set forth below.

III.

On the basis of Respondents' Offers and information obtained by the Board in this matter, the Board finds[2/] that:

A. Respondents

1. Turner Stone is a Texas limited liability partnership located in the state of Texas and licensed by the Texas State Board of Public Accountancy (License No. P04607). Turner Stone is registered with the Board pursuant to Section 102 of the Act and PCAOB Rules. Its office is located in Dallas, Texas.

2. Turner, 53, is a certified public accountant licensed by the Texas State Board of Public Accountancy (License No. 018002). He has been a principal owner of Turner Stone at all times relevant to this matter. Turner is an associated person of Turner Stone, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i).

B. Respondents Violated PCAOB Auditing Standards

3. In connection with the preparation or issuance of an audit report, PCAOB rules require that a registered public accounting firm comply with the Board's auditing standards.[3/] Under those standards, an auditor may express an unqualified opinion on an issuer's financial statements only when the auditor has formed such an opinion on the basis of an audit performed in accordance with PCAOB standards.[4/] Among other

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[2/] The findings herein are made pursuant to the Respondents' Offers and are not binding on any other person or entity in this or any other proceeding. The sanctions that the Board is imposing against Turner in this Order may be imposed only if Turner's conduct meets one of the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5). The Board finds that Turner's conduct described in this Order meets the condition set out in Section 105(c)(5)(A), which provides that such sanctions may be imposed in the event of "intentional or knowing conduct, including reckless conduct, that results in a violation of the applicable statutory, regulatory, or professional standard."

[3/] *See* PCAOB Rules 3100, 3200T.

[4/] *See* AU § 508.07, *Reports on Audited Financial Statements.*

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things, those standards require that an auditor exercise due professional care, exercise professional skepticism, and obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements.[5/] In connection with their audit of the fiscal year ("FY") 2003 financial statements of 21st Century Technologies, Inc. ("21st Century" or the "Company"), Respondents failed to exercise due professional care, failed to exercise professional skepticism, and failed to obtain sufficient competent evidential matter. Specific instances of Respondents' conduct constituting violations of PCAOB auditing standards are described below.

4. 21st Century is a Nevada corporation based in Las Vegas, Nevada. Its common stock is registered with the United States Securities and Exchange Commission ("Commission") under Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and is quoted on the OTC Bulletin Board and the Pink Sheets. 21st Century's public filings disclose that it is a business development company that provides long term debt and equity investment capital to support the expansion of companies in a variety of industries. At all relevant times, 21st Century was an issuer as that term is defined by Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

5. Turner Stone was engaged as 21st Century's independent auditor from 2000 through March 2005. Turner served as the lead engagement partner with ultimate responsibility to ensure that 21st Century's audit was conducted in accordance with PCAOB standards.

6. Turner Stone issued an audit report dated March 18, 2004, included in 21st Century's Form 10-K filed with the Commission on March 30, 2004, and in its Form 10-K/A filed with the Commission on December 3, 2004, in which it expressed an unqualified audit opinion on 21st Century's financial statements for FY 2003. The report stated that the Company's financial statements fairly presented its financial position in all material respects in conformity with U.S. generally accepted accounting principles ("GAAP").[6/] For the audit related to this audit report, Turner served as the lead engagement partner.

[5/] *See* AU § 150.02, *Generally Accepted Auditing Standards*; AU § 230, *Due Professional Care in the Performance of Work*; and AU § 326, *Evidential Matter*.

[6/] Turner Stone's audit report for 21st Century stated that its audit was conducted in accordance with generally accepted auditing standards in the United States of America ("GAAS"). Respondents were required to conduct the audit in accordance with the PCAOB's interim auditing standards pursuant to PCAOB Rule 3200T, which took effect on April 25, 2003. However, at the time Turner Stone performed the audit, the PCAOB's interim auditing standards were the same as GAAS

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1920 Bel Air LLC Transaction

7. 21st Century's consolidated FY 2003 financial statements reported that the Company loaned $1.25 million to an entity named 1920 Bel Air LLC ("1920 Bel Air"). The loan agreement, entered into on December 30, 2003, was for 90 days, with an interest rate of 10 percent per year. According to the documents contained in the audit work papers, 1920 Bel Air agreed to pay 21st Century both a loan origination fee and a mortgage fee, totaling $1 million, which was an amount equal to approximately 80 percent of the loan amount. On December 31, 2003, the last day of 21st Century's 2003 fiscal year, 21st Century recognized as revenue that $1 million, which represented approximately 300 percent of the Company's reported pretax income from continuing operations for fiscal year 2003.

8. At the time of the FY 2003 audit, Turner understood that GAAP required loan origination fees to be deferred and recognized over the life of the loan as an adjustment of yield,[7/] and he included in the work papers a memorandum describing the application of GAAP to the loan fees. During the audit, Turner reviewed the loan agreement. He also discussed the issue with management who, according to Turner's testimony, told him that the fees could be recognized as revenue, rather than deferred. Despite Turner's knowledge of the applicable GAAP, the timing of the transaction, its unusual terms, and its significance to reported income, Respondents merely deferred to management's position that recognizing the fees as revenue was appropriate. In doing so, Respondents failed to address appropriately this departure from GAAP.[8/]

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as it existed on April 16, 2003, and, until PCAOB Auditing Standard No. 1 took effect on May 24, 2004, it remained appropriate for auditors to refer to GAAS in their audit reports. Accordingly, although the reference to GAAS in Turner Stone's report for 21st Century was appropriate at the time, the standards pursuant to which the audit was required to be performed are more appropriately referred to as PCAOB auditing standards (or PCAOB standards), and that is how they are referred to in this Order.

[7/] The issue is addressed in Statement of Financial Accounting Standards 91, ¶ 5, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.*

[8/] An auditor's opinion that an issuer's financial statements are presented in conformity with GAAP must be based on an audit performed in accordance with PCAOB standards. PCAOB standards require an auditor to perform audit procedures sufficient to evaluate the issuer's adherence to GAAP. This Order's description of audit failures relating to GAAP departures in an issuer's financial statements necessarily reflects the

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9. In addition, Respondents failed to evaluate adequately or address appropriately 21st Century's failure to disclose that the transaction with 1920 Bel Air was a related party transaction. An individual who served as a 21st Century officer and director was named as a Managing Member of 1920 Bel Air as a condition of the agreement, and that same individual signed the loan agreement on 1920 Bel Air's behalf. Turner was aware of these facts and originally determined that the transaction was a related party transaction that should have been disclosed. Eventually, however, Respondents deferred to management's assertion that 1920 Bel Air was not a related party because the individual had no ownership interest in 1920 Bel Air. In so doing, Respondents failed to evaluate properly the application of the GAAP disclosure requirement, which does not depend upon an ownership interest,[9/] and failed to address appropriately the Company's departure from that requirement.

10. Respondents also failed to evaluate adequately management's financial statement assertions concerning the 1920 Bel Air transaction. Respondents obtained from 1920 Bel Air a confirmation related to the outstanding loan amount and the fee receivable, but that confirmation was signed by the 21st Century officer and director who also served as 1920 Bel Air's Managing Member. Because the confirmation was signed by an individual who was a 21st Century officer and director, and because the transaction was an unusual year-end transaction with a material effect on the financial statements, Respondents should have exercised a heightened degree of professional skepticism and should have considered whether there was a sufficient basis to conclude that the confirmation provided meaningful and competent evidence,[10/] but they failed to do so.

TransOne Investment

11. 21st Century's consolidated FY 2003 financial statements reported an investment in the equity securities of TransOne, Inc. ("TransOne") with a fair value of

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Board's judgment concerning the proper application of GAAP. Any such description of GAAP departures, however, should not be understood as an indication that the Commission has considered or made any determination concerning the issuer's compliance with GAAP.

[9/] The relevant principles are set out in Statement of Financial Accounting Standards 57, *Related Party Disclosures*.

[10/] *See* AU § 330.27, *The Confirmation Process*.

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$930,000 as of December 31, 2003. The consolidated financial statements also reflect that 21st Century recorded an unrealized gain of $805,000 related to this investment on December 31, 2003, which was approximately 240 percent of the reported pre-tax income from continuing operations for the year ended December 31, 2003.[11/] These items related to the conversion of a debt that TransOne owed 21st Century into an equity investment that 21st Century had in TransOne. Respondents failed to perform sufficient procedures related to the items in two significant respects.

12. First, Respondents failed to perform sufficient procedures to evaluate management's representation that the conversion occurred before the end of FY 2003. Documents contained in Turner Stone's audit work papers describe a November 2003 agreement between the Company and TransOne to loan TransOne up to $500,000. The loan was collateralized by TransOne's stock and accrued interest at a rate of 22 percent per year. At December 31, 2003, 21st Century had advanced one fourth of the maximum loan amount to TransOne under the loan agreement. Documents in the work papers evidence a decision by the Company to convert the debt to equity in TransOne, and, on December 31, 2003, the Company recorded a gain related to this conversion. The evidence reviewed by Respondents, however, was insufficient to conclude that the equity conversion occurred earlier than February 2004. A stock certificate and ledger for the TransOne investment, both contained in the audit work papers, indicate that 21st Century received 527,000 shares of TransOne stock on or about February 28, 2004. Turner also reviewed a copy of a January 19, 2004, letter sent by an individual who purported to be TransOne's president to a 21st Century executive, from which it appeared that, as of the date of the letter, the stock transfer had not yet occurred, and TransOne was going to pay off the $125,000 debt by issuing 560,000 shares of common stock to the Company. Turner was also aware that the letter contained conflicting information about the number of shares issued. Despite his knowledge of this information, Turner failed to perform sufficient procedures to evaluate management's assertions about the existence of this transaction at year-end.

13. Second, Respondents failed to perform sufficient procedures related to 21st Century's valuation of the equity investment in TransOne. 21st Century hired a

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[11/] The Company converted to a business development company effective on October 1, 2003. The conversion resulted in certain changes in accounting principles used by the Company, including that the Company began to record changes in the fair value of its investments in its statement of operations. Accordingly, the gain related to this transaction was recorded in income, whereas if it had occurred in the first nine months of 2003, it would not have been.

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specialist to value the TransOne investment, and the valuation report indicated that the fair value of the equity that the Company obtained in TransOne by converting the $125,000 debt was $930,000. The valuation report also contained revenue growth projections over five years that included 8,817 percent for the first year and 322 percent in the second year. Turner reviewed the valuation report and treated it as evidential matter in evaluating the assertion in the financial statements about the value of the investment in TransOne. In order to use the valuation report for that purpose, Respondents should have obtained an understanding of the methods and assumptions used by the specialist, and should have made appropriate tests of data provided to the specialist.[12/] Respondents failed to perform sufficient procedures to obtain an understanding of the methods and assumptions used by the specialist. They also failed to test the data provided to the specialist by TransOne.

Health Care Investors of America, Inc. Investment

14. 21st Century's consolidated FY 2003 financial statements reported an investment in Health Care Investors of America, Inc. ("HCIA"), a publicly traded issuer, with a fair value of $5.3 million as of December 31, 2003. The HCIA investment represented 39 percent of the total reported assets of 21st Century as of December 31, 2003. Documents in the audit work papers indicate that the reported fair value was based on a valuation report that the Company obtained from a specialist indicating that the fair value of certain HCIA preferred stock owned by the Company was $5.3 million.

15. Respondents failed to perform sufficient procedures related to 21st Century's valuation of the equity investment in HCIA. Respondents failed to obtain an understanding of the methods and assumptions used by the specialist regarding HCIA, in violation of PCAOB Standards.[13/] Respondents also failed to perform any procedures related to the data provided by HCIA to the specialist.

16. In addition, Respondents failed to perform sufficient procedures related to the confirmation of the existence of the HCIA investment. In lieu of sending a confirmation, Turner allowed a 21st Century executive to e-mail confirmation questions to an HCIA official. The e-mail questions did not directly address confirmation of 21st Century's ownership of the preferred stock and, in any event, Turner never received or learned of any response to the e-mail. In light of the non-response, Respondents

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[12/] *See* AU § 336.12, *Using the Work of a Specialist*.

[13/] *See, e.g., id.*

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should have performed alternative procedures to obtain the necessary evidence.[14/] Respondents, however, failed to perform any alternative procedures to obtain the necessary evidence concerning the investment.

Consideration of Fraud

17. The failures described above constitute departures from the PCAOB auditing standards cited above. In the specific circumstances of Respondents' audit of the Company's FY 2003 financial statements, those failures were compounded by Respondents' failure to respond appropriately to indicators of a risk of material misstatement due to fraud. An auditor's assessment of such risk should "be ongoing throughout the audit,"[15/] and an auditor should consider whether the "nature of auditing procedures performed may need to be changed to obtain evidence that is more reliable or to obtain additional corroborative information."[16/] Respondents not only failed to perform basic procedures adequately, but also failed to reassess the risks after learning about numerous facts that, either standing alone or in the context of other facts learned prior to the audit, warranted heightened scrutiny that should have alerted them to the possible need to extend or modify the audit tests. After being presented with numerous warning signs during the audit, such as the unusual, significant year-end transactions concerning 1920 Bel Air and TransOne, the related party nature of the 1920 Bel Air transaction, questionable confirmations, and conflicting evidential matter concerning the TransOne equity conversion, Respondents should have reassessed whether the nature of auditing procedures performed needed to be changed to obtain additional or more reliable corroborative information concerning 21st Century's revenues, accounts receivable, and investment valuations,[17/] but they failed to do so.

IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports, the

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14/ *See* AU § 330.31, *The Confirmation Process.*

15/ *See* § 316.68, *Consideration of Fraud in a Financial Statement Audit*.

16/ *See* AU § 316.52.

17/ *Id*.

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Board determines it appropriate to impose the sanctions agreed to in the Respondents' Offers. Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), Turner, Stone & Company LLP is censured;

B. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Edward Turner is barred from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i);

C. After two (2) years from the date of this Order, Turner may file a petition, pursuant to PCAOB Rule 5302(b), for Board consent to associate with a registered public accounting firm.

ISSUED BY THE BOARD.

J. Gordon Seymour
Secretary

December 19, 2006