

## NASD OFFICE OF HEARING OFFICERS

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| DEPARTMENT OF ENFORCEMENT,    | : |                               |
|                               | : |                               |
|                               | : |                               |
| Complainant,                  | : | Disciplinary Proceeding       |
|                               | : | No. C01020012                 |
| v.                            | : |                               |
|                               | : | Hearing Officer - AWH         |
| KELMOORE INVESTMENT CO., INC. | : |                               |
| (BD #22509)                   | : | <b>Hearing Panel Decision</b> |
| Palo Alto, CA                 | : |                               |
|                               | : |                               |
|                               | : | July 28, 2003                 |
| SHAWN KELMON YOUNG            | : |                               |
| (CRD #4089904)                | : |                               |
| Palo Alto, CA                 | : |                               |
|                               | : |                               |
|                               | : |                               |
| Respondents.                  | : |                               |

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**Member firm, through its registered Financial and Operations Principal, (1) engaged in securities transactions while failing to maintain minimum net capital, in violation of SEC Rule 15c3-1 and NASD Conduct Rule 2110, and (2) entered on its books and records a journal entry in the amount of \$200,000 for which there was no basis, in violation of SEC Rule 17a-3 and NASD Conduct Rules 3110 and 2110. Respondent firm censured and fined \$10,000; Respondent Financial and Operations Principal fined \$10,000 and suspended as a financial and operations principal for 30 business days; and Respondents assessed costs.**

### Appearances:

David A. Watson, Esq., and Cynthia A. Kittle, Esq.,  
for the Department of Enforcement

Frank R. Ubhaus, Esq.,  
for Kelmoore Investment Company, Inc., and Shawn Kelmon Young

## DECISION

### Introduction

On August 9, 2002, the Department of Enforcement (“Enforcement”) issued a two-cause Complaint in this matter against Kelmoore Investment Company, Inc.

(“Kelmoore”), and Shawn Kelmon Young (“Young”), alleging that Kelmoore, through Young, entered on its books and records a journal entry in the amount of \$200,000, for which there was no basis, and, as a result, it engaged in securities transactions while its net capital fell below the minimum required to engage in those transactions. Respondents filed an Answer to the Complaint and requested a hearing. On December 4, 2002, a hearing was held in San Francisco, California, before a Hearing Panel composed of the Hearing Officer and two members of the District 1 Committee. Both parties filed post-hearing submissions. On April 14, 2003, the Hearing Panel received into evidence one exhibit offered by Respondents, and rejected, as irrelevant, one other exhibit tendered by Respondents.

### **Findings of Fact<sup>1</sup>**

#### **Respondents and Their Employees**

Kelmoore has been a member of NASD since August 24, 1989. Its principal office is located in Palo Alto, California. It is a non-clearing broker-dealer, and does not hold client funds, nor are client funds at risk with Kelmoore. Tr. 137-38. It has over 400 stockholders. Tr. 162.

Shawn Kelmon Young is the daughter of one of the major stockholders of Kelmoore. *Id.* She is a certified public accountant who has been employed in public accounting since she graduated from college in 1986. On December 3, 1999, she began employment with Kelmoore as its Chief Financial Officer. In May 2000, she became registered as a Financial and Operations Principal (“FINOP”) for Kelmoore and has been so registered since that time. She has no disciplinary history. The December 2000 Net

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<sup>1</sup> References to Enforcement’s exhibits are designated as CX\_; Respondents’ exhibits, as RX\_; and the transcript of the hearing, as Tr.\_.

Capital Statement was the first such statement that she was directly responsible for filing on behalf of Kelmoore. Tr. 134, 136, 162-63.

When Young accepted employment with Kelmoore, it was “a small firm that wanted to go public and wanted to have a CPA at the helm.” Tr. 134. During the fourth quarter of 2000, Kelmoore had sustained losses of \$1,022,865. CX 3, at 2. In December 2000, Young was directly involved in the preparation of Kelmoore’s \$5,000,000 private placement offering that commenced on January 6 or 7, 2001. Tr. 139, 187; RX 10. That offering resulted in Kelmoore’s net capital increasing to nearly \$2,000,000 by February 2001. RX 4.

Alex Kim was hired by Young as Kelmoore’s controller on or about December 18, 2000. Tr. 53. Kim graduated from college with a degree in Economics and, for approximately the next ten years, worked in accounting positions. He attained the position of controller at two companies prior to his employment at Kelmoore. Those companies were not in the securities industry, and Kim had never heard of net capital computations prior to his employment at Kelmoore. *Id.*

Prior to Kim’s employment as controller, Kelmoore’s financial statements and net capital calculations had been prepared and filed by Cece Montgomery, the former Chief Financial Officer and FINOP for Kelmoore. Young succeeded Montgomery as Chief Financial Officer, and Kim succeeded Montgomery as controller. Montgomery was given the title of Treasurer, until she moved to a position in Human Resources. Montgomery was to have instructed Kim on net capital calculations. Tr. 54, 202-03. Once Kim prepared the net capital spreadsheet, Young was responsible for reviewing it and then entering the information into regulatory form filings. Tr. 140.

### Kim's Creation of Account 1061 – Investment Other

Kim created account 1061 – Investment Other as part of his preparation of a pro forma financial statement. He intended that account to reflect an estimate of unrealized gains and losses in the Kelmoore trading accounts. Tr. 55-56. When he created the account for the December 2000 pro forma, he intended to reverse the entry of the estimated figure in January 2001 when he prepared the actual financial statements for December 2000. By that time, he expected to have, in hand, the trading account statements for the month of December. Tr. 56-58; RX 7. By looking through prior spreadsheets prepared by Montgomery, Kim “kind of estimated” unrealized gains and losses, and arrived at the figure of \$200,000 which he entered into account 1061. Tr. 55-56. Kim began to prepare the pro forma financial statement at the end of December 2000 and finalized it in early January 2001.

Kelmoore had three proprietary investment, i.e. trading, accounts held at its clearing firm: accounts 910017, 910027, and 915019. At the end of December 2000, accounts 910017 and 915019 held no funds and no securities. Their balances were zero. CX 16. Account 910027 held \$321,469 in money market funds and \$5,000 in cash, for a total balance of \$326,469. It also had a negative \$4,000 securities balance. CX 6.

Kim did not know that, at any time during his preparation of his pro forma financial statement, he could have called the clearing firm to obtain month-end balances for the trading accounts and capital deposit account. Tr. 72. However, when he completed the worksheets for the December 2000 net capital calculation, he had the *actual* statements that showed the balances in the three proprietary trading accounts. Nevertheless, he included on his balance sheet both the \$200,000 estimate for the value

of those three accounts *and* their actual account values. He testified: “I didn’t catch it.”

Tr. 106. The estimates and actual values were also included in the net capital computation prepared by Kim for the end of 2000. CX 3, at 2-3. Kim testified that in retrospect, “I should have been fully trained, first of all. And you know, I thought basically everything would have been caught when Shawn [Young] reviewed it.” Tr. 97.

Kim testified that he told Young about the creation of account 1061 and that he was going to input a value of \$200,000. Tr. 74. However, Young testified that, if he did mention the account to her, “he probably said something passing in the hall.” Tr. 165. Otherwise, she had no recollection of any conversation about the account or the amount.

Kim provided Young with the balance sheet and his net capital computation. Tr. 78-80, 118, 120. On or about January 23, 2001, using Kim’s net capital computation and balance sheet, Young filed Kelmoore’s FOCUS Report with NASD. Tr. 140. Young testified that she did not adequately review Kim’s spreadsheet; she did not realize that the \$200,000 entry was an estimate; and that, had she realized that it was an estimate, she never would have filed the December 2000 net capital computation as presented. Tr. 142. She believed she missed noting the estimate because the filing was made at the last minute, and she was under time pressure. *Id.*

On January 31, 2001, Kim realized that he had not reversed the \$200,000 entry after reviewing the actual statements for the trading accounts. On discovering the omission, he reversed the entry on that date. However, he failed to notify Young of the reversal because he thought the reversal would correct the financial statement for the next period, and he did not realize that the reversal would affect the previous net capital computation. Tr. 98-99.

### NASD's Examination of Kelmoore

In February 2001, NASD staff member Raymond Lou performed a routine examination of Kelmoore. Although Lou looked at net capital computations, he did not raise a net capital issue at the exit conference. However, upon his review of Lou's examination, Chris LeVasseur, an NASD Supervisor of Examiners, discovered the \$200,000 entry in account 1061 and directed Lou to obtain documentation to support the entry. Tr. 19-20. In June 2001, LeVasseur spoke to Young, who was in London at the time. He told Young that Kelmoore must either provide the documentation supporting the entry or file appropriate notice that it had violated the net capital rule.<sup>2</sup> Tr. 20-21. If the \$200,000 had been eliminated from the net capital computation, Kelmoore would have had net capital that was approximately \$43,000 under its \$100,000 requirement. Tr. 23; CX 3. As a result of the phone conversation, Young submitted a "17a-11 Notice" to NASD and the SEC stating that NASD had determined that Kelmoore had insufficient net capital as of December 31, 2000. RX 4. In the letter, Young stated that she was "unaware of any communication problems [with NASD about the net capital issue] since your auditor left our offices several months ago with my staff," and that she was attempting to comply with NASD's demand to provide additional backup for the \$200,000 entry or give telegraphic notice of a deficiency, within 48 hours. *Id.*

By letter dated July 11, 2001, Young also sent Lou a copy of the original journal entry for the \$200,000 figure in the "Investment – Other" account. CX 13, at 3. The letter noted that the copy had been printed the day the letter was sent. On the copy of the

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<sup>2</sup> Enforcement contends that this conversation took place "after unsuccessful attempts to obtain documentation to support the \$200,000 entry." Enf. Post-hearing Brief, at 5. However, Kim testified that he sent Lou the documentation in April 2001. Tr. 208-09. LeVasseur believed that as of mid-May, NASD had not yet received any documentation. Tr. 20. Because Lou did not testify at the hearing, the Hearing Panel is unable to determine what information Kim supplied to Lou and at what time he did so.

entry, there were the following handwritten notations: “Journal Entry Made By: Alexander Kim/Controller” and “Journal Entry Reviewed By: Shawn Young/CFO.” The notations were signed by Kim and Young, respectively. *Id.* NASD had also asked for a signed written statement from the persons responsible for the \$200,000 entry. In an attachment to the July 11, 2001, letter, Young wrote:

The basis for the estimate prepared by the Controller and approved by me, was that in our judgment to the best of our knowledge and belief and without final statements to reconcile with, the \$200,000 journal entry represented what we estimated to be what our investment account totaled at that time.

I have verbally acknowledged to Mr. LeVasseur that in light of the facts as we know them now, approximately 6 months later, we have reversed the journal entry. Therefore, we have no further documentation to provide on this entry.

CX 13, at 4.<sup>3</sup>

### **Discussion**

On brief, Respondents concede that Kelmoore’s Net Capital Statement filed for the month of December 2000 was overstated by \$200,000, and that, for that month, Kelmoore failed to maintain a minimum of net capital. Respondents also concede that there was no basis for the journal entry in the amount of \$200,000 captioned “Investments – Other.” However, Respondents argue that the violations were the result of human error, not intentional or reckless conduct. Accordingly, Respondents believe that Kelmoore should be reproved for the error, and that Young should not be sanctioned at all.

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<sup>3</sup> Young’s July 11 letter also contained a revised net capital computation that excluded the \$200,000 estimate for the trading accounts. CX 13, at 5. However, LeVasseur’s testimony demonstrated that, with NASD’s adjustments to that statement, the revised computation still did not show Kelmoore to be in net capital compliance. Tr. 25-31. Also, Kelmoore’s pre-hearing submission contained another revised net capital computation that increased net capital by \$50,500 as a result of a settlement agreement with a former employee. However, NASD did not consider that amount in computing Kelmoore’s net capital because it was not on Kelmoore’s books at year end.

Enforcement contends that the violations were solely the responsibility of Young; that she knew of, and approved, Kim's creation of the \$200,000 estimate and its inclusion in the net capital computation; and that she did so to avoid dealing with the issue of insufficient net capital in the face of Kelmoore's private placement initiative. Accordingly, Enforcement seeks to fine Kelmoore \$5,000 for the net capital violation and \$5,000 for the false entry on its books, and to bar Young for the violations.

For net capital violations, the NASD Sanction Guidelines recommend a fine of \$1,000 to \$50,000, and a suspension for up to 30 business days. In egregious cases, the Guidelines suggest a lengthier suspension, an expulsion of the firm, and a bar for the Financial Principal. NASD SANCTION GUIDELINES, at 33. For record keeping violations, the Guidelines recommend a fine of \$1,000 to \$10,000, and suspension for up to 30 business days. In egregious cases, the Guidelines suggest a fine of \$10,000 to \$100,000, a lengthier suspension, an expulsion of the firm, and a bar for the Financial Principal. NASD SANCTION GUIDELINES, at 34.

Having considered both Young's and Kim's testimony and demeanor, the Hearing Panel concludes that the violations, for which Young was fully and solely responsible, were the result of negligent, and not intentional, conduct. She succeeded Montgomery as FINOP, and Montgomery, after a stint as Treasurer of Kelmoore, was relegated to a position in Human Relations, outside of her previous financial positions. Montgomery was distraught because she was not told that Young was hired to take her place. Tr. 136. Young's first mistake was to rely on Montgomery to train Kim, an accountant with no experience in the securities industry and no knowledge of net capital computations. Her mistake was compounded by failing adequately to review Kim's first attempt at net



capital computation and to note that it contained a new account captioned “Investment – Other.” She remained unaware of the error because Kim never told her that he had failed to reverse the \$200,000 entry before the net capital computation had been filed.

Young was candid in taking full responsibility for the erroneous entry and its effect on the true state of Kelmoore’s net capital insufficiency. Kim was also candid and credible when he testified that it was his determination to create account 1061, and that he did not do so for the purpose of affecting the net capital computation. Enforcement argues that Young intentionally approved Kim’s \$200,000 entry so that she could show Kelmoore to have sufficient net capital at the end of December 2000 and avoid any possible problem with the \$5 million private placement. However, Enforcement offered no evidence to support its argument, either as to Young’s alleged intent, or as to the potential effect of a net capital problem on the private placement. Thus, the argument is speculative. Under the circumstances, the Hearing Panel finds that Enforcement failed to prove that Young deliberately misrepresented the firm’s net capital. Moreover, had Young realized in December 2000 that net capital was a problem, she had several options to infuse additional capital into Kelmoore, including additions from the principals in the company, or from her grandmother who has a significant amount of the money in the company. Tr. 145-46. The amount of additional capital needed, approximately \$43,000, was relatively modest in light of the \$2,000,000 that was raised by February 2001 as a result of the private placement.

The Hearing Panel has considered a number of other factors. This was the first net capital report that Young had to file as FINOP. Because Kim’s worksheets and statements were given to her at the last minute, she had little time to review them. As a

consequence, she later altered the firm's procedures to give her more time to review them before making regulatory filings based on them. Nevertheless, Young should have been more vigilant in reviewing Kim's work in the first place. Because the firm does not handle customer funds, there was no harm to customers as a result of the violations. Young did not attempt to conceal the violations. She admitted that, by filing the report with NASD, she approved the \$200,000 entry. Tr. 169; CX 13. Finally, the principals of the firm were not aware of the net capital violation and the violation was cured within a month as a result of the capital raised through the private placement.

The FINOP's duties include "final approval and responsibility for the accuracy of financial reports submitted to any duly established securities industry regulatory body . . . supervision of individuals who assist in the preparation of those reports, [and] supervision of and responsibility for individuals who are involved in the actual maintenance of the member's books and records from which such reports are derived." Rule 1022(b)(2)(A), (C), and (E). Considering the nature and circumstances of the violations, and to impress upon Young the full scope of her responsibilities as a FINOP, the Hearing Panel believes that to remediate the violations and deter any future violations, Kelmoore should be censured and fined \$5,000 for each violation; and Young should be fined \$5,000 and suspended as a financial and operations principal for 30 days business days for each violation, with the suspensions to run concurrently. In addition, Kelmoore and Young will be jointly assessed costs of \$2,043.74, consisting of a \$750 administrative fee and a \$1,293.74 transcript fee.

## **Conclusion**

Kelmoore Investment Company, Inc. is (1) censured and fined \$5,000 for engaging in securities transactions while failing to maintain minimum net capital, in violation of SEC Rule 15c3-1 and NASD Conduct Rule 2110, and (2) censured and fined \$5,000 for entering on its books and records a journal entry in the amount of \$200,000 for which there was no basis, in violation of SEC Rule 17a-3 and NASD Conduct Rules 3110 and 2110. Shawn Kelmon Young is (1) fined \$5,000 and suspended as a financial and operations principal for 30 days business days for causing Kelmoore Investment Company, Inc. to engage in securities transactions while failing to maintain minimum net capital, in violation of NASD Conduct Rule 2110, and (2) fined \$5,000 and suspended as a financial and operations principal for 30 days business days for causing Kelmoore Investment Company, Inc. to enter on its books and records a journal entry in the amount of \$200,000 for which there was no basis, in violation of NASD Conduct Rules 3110 and 2110, the suspensions to run concurrently. Kelmoore Investment Company, Inc. and Shawn Kelmon Young are jointly assessed costs of \$2,043.74, consisting of a \$750 administrative fee and a \$1,293.74 transcript fee.

The sanctions shall become effective on a date determined by NASD, but not sooner than 30 days from the date this Decision becomes the final disciplinary action of NASD, except that, if this Decision becomes the final disciplinary action of NASD, the

suspensions shall become effective with the opening of business on Monday, September 15, 2003, and end at the close of business on Friday, October 24, 2003.

**SO ORDERED.**

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Alan W. Heifetz  
Hearing Officer  
For the Hearing Panel

Copies to:

Via First Class Mail & Overnight Courier  
Kelmoore Investment Co., Inc.  
Shawn Kelmon Young

Via First Class Mail & Facsimile  
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