

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
September 30, 2005

ADMINISTRATIVE PROCEEDING
File No. 3-12064

In the Matter of	:	ORDER INSTITUTING PUBLIC
	:	ADMINISTRATIVE AND CEASE-
	:	AND-DESIST PROCEEDINGS
GREGORY M. DEARLOVE,	:	PURSUANT TO SECTION 21C
CPA,	:	OF THE SECURITIES EXCHANGE
Respondent.	:	ACT OF 1934 AND RULE 102(e) OF
	:	THE COMMISSION'S RULES OF
	:	PRACTICE AND NOTICE OF
	:	HEARING
	:	
_____	:	

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), and Rule 102(e) of the Commission’s Rules of Practice against Gregory M. Dearlove, CPA (“Respondent” or “Dearlove”).

II.

After an investigation, the Division of Enforcement and the Office of the Chief Accountant allege that:

Summary

1. This matter concerns Dearlove’s repeated instances of reckless and unreasonable conduct within the meaning of Rule 102(e)(1)(ii) of the Commission’s Rules of Practice, and which caused the violations of the securities laws by his audit client, Adelpia Communications Corporation (“Adelpia”). Dearlove, a partner with Deloitte & Touche LLP (“Deloitte”), served as engagement partner on Deloitte’s audit of the financial statements of Adelpia for the year-ended December 31, 2000 (the “2000 Financial Statements”).

2. Adelpia’s 2000 Financial Statements were materially false and misleading and

failed to comply with Generally Accepted Accounting Principles (“GAAP”). In its Form 10-K for the year-ended December 31, 2000 (the “2000 Form 10-K”), Adelphia understated its co-borrowing debt by \$1.6 billion, overstated equity by at least \$368 million and improperly netted and failed to disclose related party receivables and payables between Adelphia and entities owned or controlled by members of Adelphia’s controlling shareholders, the Rigases (as defined below). Adelphia also failed to disclose the nature and extent of material related party transactions between Adelphia and the Rigases and the entities owned or controlled by them.

3. Dearlove knew or should have known that Adelphia’s 2000 Financial Statements had not been prepared in conformity with GAAP and that the audit he planned, directed and supervised of the 2000 Financial Statements (the “2000 Audit”) had not been conducted in accordance with Generally Accepted Auditing Standards (“GAAS”). Dearlove nonetheless signed an audit report containing an unqualified opinion on the 2000 Financial Statements, stating falsely that the audit was conducted in accordance with GAAS, that the financial statements were prepared in conformity with GAAP, and that they fairly presented Adelphia’s financial condition.

4. Based on his repeated instances of reckless, or at least unreasonable, conduct, Dearlove did not adhere to GAAS when he planned, directed and supervised the 2000 Audit and engaged in improper professional conduct as described herein within the meaning of Rule 102(e)(1)(ii) of the Commission’s Rules of Practice. His conduct resulted in an audit that did not comply with GAAS and in an unqualified audit report, which Adelphia filed with its 2000 Form 10-K, and caused Adelphia to violate Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-1 and 12b-20 thereunder.

A. RESPONDENT

5. Gregory M. Dearlove, 51, resides in Orchard Park, New York. A partner of Deloitte since June 1996, Dearlove was assigned to the Adelphia engagement in the summer of 1999 and served as the audit partner responsible for Deloitte’s planning and performance of its audit of the 2000 Financial Statements. Prior to serving as audit partner on the Adelphia engagement, Dearlove had been the managing partner for Deloitte’s Buffalo office, and had served as audit partner for other public companies; none of his prior engagements involved the cable industry. In late March 2001, Dearlove approved and signed Deloitte’s audit report containing an unqualified opinion on Adelphia’s 2000 Financial Statements. Thereafter, in September 2001, Dearlove resigned from Deloitte and, since that time, has served as the Chief Financial Officer and Vice President of Finance of Computer Task Group, an issuer whose securities are listed on the New York Stock Exchange. Dearlove is a certified public accountant, licensed in New York.

B. OTHER RELEVANT ENTITIES

6. Deloitte & Touche LLP is a Delaware limited liability partnership that is headquartered in New York City. Deloitte served as the independent auditor for Adelphia from at least 1986, the year when Adelphia’s securities became publicly traded, until May 14, 2002, when Deloitte suspended its work on the audit for the year-ended December 31, 2001, citing, among

other concerns, that Adelphia's books and records had been falsified. On April 26, 2005, the Commission issued its Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions against Deloitte, and the staff filed a settled action, entitled *SEC v. Deloitte & Touche LLP*, 05 Civ. 4119 (S.D.N.Y.). In these actions, the Commission alleged that Deloitte failed to conduct its audit of Adelphia in accordance with GAAS. Without admitting or denying the Commission's allegations, Deloitte agreed to pay a total of \$50 million and undertake certain remedial actions designed to strengthen its fraud detection program when auditing public companies.

7. Adelphia Communications Corporation, a Delaware corporation that was headquartered in Coudersport, Pennsylvania, is the sixth largest cable television operator in the United States. Prior to June 3, 2002, Adelphia's Class A shares were listed on the NASDAQ's National Market, while the Company's Class B shares were never publicly traded. Citing public interest concerns and Adelphia's failure to comply with NASDAQ Rule 431(c)(14), which requires an issuer, among other things, to timely file its Form 10-K, a NASDAQ Listing Qualifications Panel de-listed Adelphia stock, effective June 3, 2002. Adelphia shares are now quoted by Pink Sheets, LLC. Since June 25, 2002, Adelphia and its subsidiaries have operated under the protection of Chapter 11 of the U.S. Bankruptcy Code. In April 2005, the Commission and the United States Attorney's Office for the Southern District of New York ("USAO") reached an agreement to settle the civil enforcement action and resolve criminal charges against Adelphia and Adelphia's founder, John Rigas ("J. Rigas"), and his three sons, Timothy J. Rigas ("T. Rigas"), Michael J. Rigas ("M. Rigas") and James P. Rigas ("J.P. Rigas") (the "Rigas Defendants"). The settlement agreements with the Rigas Defendants, each dated April 24, 2005, were approved by the District Court for the Southern District of New York on May 31, 2005, and the settlement agreement with Adelphia, dated April 25, 2005, was approved by the Bankruptcy Court on May 20, 2005. Pursuant to the settlement agreements, Adelphia will obtain title to certain cable properties forfeited by the Rigas family members, and will deposit \$715 million into a victims' fund to be established in the District Court in accordance with the Non-Prosecution Agreement. Adelphia will make such payment at or about the time of its emergence from Chapter 11.

8. The Rigases include J. Rigas, T. Rigas, M. Rigas and J.P. Rigas, and J. Rigas's daughter, Ellen Rigas Venetis ("E. Rigas") and his spouse, Doris Nielsen Rigas ("D. Rigas"). At all relevant times, J. Rigas and members of his immediate family held five of Adelphia's nine Board of Directors positions, and exercised voting control of Adelphia stock. Specifically, J. Rigas was Adelphia's Chief Executive Officer and Chairman of its Board of Directors. T. Rigas, M. Rigas, and J.P. Rigas each were directors of Adelphia and held the positions, respectively, of Chief Financial and Accounting Officer, Executive Vice President for Operations, and Executive Vice President for Strategic Planning. J. Rigas and T. Rigas were found guilty, in *US v. John J. Rigas, et al.*, 02 Crim. 1236 (S.D.N.Y.)(LBS), of a total of eighteen counts of securities fraud, bank fraud and conspiracy to commit securities fraud, bank fraud, and making or causing to be made false statements in Commission filings. On June 20, 2005, the court sentenced J. Rigas to 15 years and T. Rigas to 20 years in prison. Pursuant to the settlement agreements resolving the Adelphia and Rigas civil enforcement action and the criminal charges, the Rigas Defendants will forfeit in excess of \$1.5 billion in assets that they derived from the fraud. The Rigas Defendants have also agreed

to entry of permanent injunctions enjoining them from the antifraud, periodic reporting, and record keeping and internal control provisions of the securities laws. The Rigas Defendants further agreed to entry of an order barring them from acting as officers or directors of any public company.

9. Rigas Entities consist of approximately 63 various partnerships, corporations, or limited liability companies exclusively owned or controlled by members of the Rigas family. While approximately fourteen of the Rigas Entities were engaged in the ownership and operation of cable television systems and other related ventures (the “Rigas Cable Entities”), the balance, or approximately forty-nine of the Rigas Entities, were involved in businesses completely unrelated to cable television (the “Rigas Non-Cable Entities”). Adelpia managed and maintained virtually every aspect of the Rigas Cable Entities, including maintaining their books and records on a general ledger system shared with Adelpia and its subsidiaries. Adelpia and the Rigas Entities participated jointly in a cash management system (“CMS”) operated by Adelpia. This resulted in the commingling of funds among the Adelpia CMS participants, including Adelpia subsidiaries and the Rigas Entities. As detailed below, the sharing by Adelpia and the Rigas Entities of the same management, general ledger system, and cash management system facilitated the fraud at Adelpia.

C. DEARLOVE’S CONDUCT

Dearlove’s Role as Engagement Partner on the Adelpia Engagement Team

10. In addition to his responsibilities under GAAS to “adequately plan[]” and supervise the audit, AU § 311.01, Dearlove’s responsibilities as engagement partner were set out in Deloitte’s Accounting and Audit Procedures Manual (the “AAPMS”). It assigned him overall, non-delegable responsibility for all aspects of a properly conducted audit:

The Engagement Partner has the final responsibility for the planning and performance of the audit engagement, including the assignment, on-the-job-training, and audit work of professional staff, and the implementation of decisions concerning matters that have been the subject of consultation. . . . The Firm delegates to the Engagement Partner the authority and the responsibility to determine the nature, timing and extent of auditing procedures that constitute an audit made in accordance with Firm policies and GAAS. The Engagement Partner must necessarily delegate to the Engagement Manager and client service staff a substantial portion of the work on audit engagements, but he or she cannot delegate the final responsibility. . . . The Firm delegates to the Engagement Partner the necessary authority to . . . form the audit opinion . . . on the financial statements. The Engagement Partner, in turn, is accountable to the other partners and to the Firm for the proper execution of that role.

11. It also specified that the engagement partner “[a]pprov[e] the audit planning memo, including the assessment of engagement risk and the planned approach for addressing specific identified risk. . . .” According to the AAPMS, a client’s level of audit risk represented a measure of the possibility that the financial statements as a whole may be subject to material misstatements due to errors or fraud during the period being audited. From at least 1998, Deloitte’s engagement teams had concluded that Adelphia presented “much greater than normal” audit risk, which was the highest level of risk that Deloitte could assign to any client under guidelines set forth in the AAPMS. In reaching this conclusion, Deloitte identified a number of what it called “pervasive risk factors,” posed by the Adelphia audit as a whole, and “specific risks” associated with particular account balances examined during the audit. Many of the pervasive risk factors and the specific risks were directly associated with Adelphia’s long-standing, complex, and intertwined relationship with the Rigases and Rigas Entities. The risk factors also considered Adelphia’s heavy reliance on debt and equity funding for its operating and capital needs.

12. Accordingly, the “specific risks” that Deloitte identified in its “Fraud, Control Environment, Engagement Risk” form (the “Audit Risk form”) for the 2000 Audit included “numerous related party transactions,” and further observed that because “[Adelphia and its subsidiaries] are highly leveraged, compliance with debt covenants is critical to the operations of these entities.” Deloitte considered these “specific risks” as affecting, among others, Adelphia’s account balances for “notes payable, long term debt and interest” and “cash.”

13. Deloitte’s AAPMS specified that Dearlove, as the engagement partner, approve the Audit Risk form for the 2000 Audit. Despite reviewing and approving the Audit Risk form for the 2000 Audit, Dearlove failed to tailor an audit approach that adequately addressed the specific risks identified in the Audit Risk form.

Adelphia’s and the Rigas Entities’ Co-Borrowing Facilities

14. Since at least 1996, Adelphia negotiated and established various commercial loans, credit facilities, and other credit arrangements for its benefit and the benefit of the Rigas Entities. Among these credit facilities were four facilities, dated respectively, March 29, 1996, May 6, 1999, April 14, 2000, and September 28, 2001 (the “Co-Borrowing Credit Facilities”), in which certain subsidiaries of Adelphia became co-borrowers with certain Rigas Cable Entities (hereafter, the “Rigas Co-Borrowers”). As of December 31, 2000, the total borrowing capacity under the three Co-Borrowing Credit Facilities then in existence was \$3.751 billion.

15. Under the terms of the Co-Borrowing Credit Facilities, each co-borrower had the ability to borrow up to the entire amount of the available credit under the applicable Facility. A key feature of the Co-Borrowing Credit Facilities was that each co-borrower was jointly and severally liable for the outstanding balance under that Facility.

16. As of December 31, 2000, the Co-Borrowing Credit Facilities were completely drawn down, making each co-borrower, including Adelphia, jointly and severally liable for the full \$3.7 billion outstanding. However, approximately \$1.6 billion of co-borrowing debt was

improperly excluded from Adelphia's balance sheet for the year-ended 2000 as an Adelphia liability. Moreover, Adelphia's 2000 Form 10-K included footnote disclosure that was misleading because it falsely suggested that all of the debt for which Adelphia was liable, including the \$1.6 billion owed by the Rigas Co-Borrowers, was properly reflected on Adelphia's balance sheet when it was not. This amount represented over 28% of Adelphia's reported bank debt and nearly 10% of Adelphia's reported total liabilities.

Dearlove Failed to Ensure That Adelphia's Disclosure of Its Liabilities Was Proper

17. Dearlove knew or should have known that all co-borrowing debt was a direct liability of Adelphia and should have been presented on Adelphia's year-end balance sheet. He knew or should have known that there was \$1.6 billion of co-borrowing debt which was not presented or disclosed in the 2000 Financial Statements.

18. Despite the risks relating to debt compliance and "substantial debt from unusual sources (e.g., related parties)" that were identified on Deloitte's Audit Risk form, Dearlove did not review the documentation underlying the Co-Borrowing Credit Facilities. Because he did not review the documentation, he was unaware that the credit agreements underlying the Co-Borrowing Credit Facilities described Adelphia's liability as "joint and several" with Rigas Co-Borrowers. Dearlove did not do any independent investigation into the propriety of Adelphia's treatment of co-borrowing debt during the 2000 Audit, and he failed to consider that increasing amounts over prior years were being borrowed under the credit facilities in 2000. Even though Adelphia entered into a new and significantly larger Co-Borrowing Credit Facility during his tenure as engagement partner, Dearlove took no steps, such as seeking a legal opinion or specifically conferring with any Deloitte technical accounting expert, to determine whether Adelphia's exclusions of co-borrowing debt from the 2000 Financial Statements was correct.

19. Dearlove accepted Adelphia's rationale for omitting Adelphia's true debt obligations without ensuring that Adelphia's rationale conformed to GAAP. Adelphia justified excluding the co-borrowing debt on the grounds that it was a mere "guarantor" of the Rigas Co-Borrowers, and therefore did not have to reflect such debt as a liability on its balance sheet. Even under Adelphia's characterization of the debt as a "guarantee," Dearlove knew or should have known that Adelphia did not perform the assessments required under Statement of Financial Accounting Standards ("FAS") No. 5 to determine if its potential contingency for the amount of co-borrowing debt that it excluded from its balance sheet was "probable" or even "reasonably possible" under FAS 5 and would have had to be disclosed.¹ In addition, Dearlove took no steps to determine whether the Rigas Entities had the financial wherewithal to repay the debt.

¹ FAS 5, Accounting for Contingencies, requires a company to include a contingent amount in its financial statements when that contingency is "probable." Paragraphs 10 and 11 of FAS 5 provide guidance on when a contingency needs only to be disclosed by a company in footnotes to its financial statements. Paragraph 10 provides, in pertinent part, that "[d]isclosure of the contingency shall be made when there is at least a *reasonable possibility* that a loss or an additional loss may have been incurred." [Emphasis added]. Under these principles, even if a loss contingency does not meet the threshold for inclusion in a company's financial statements,

20. During the 2000 Audit, members of the engagement team repeatedly proposed to Adelphia that Adelphia disclose the full amount of the co-borrowing debt, and inserted more explicit disclosure, including the amount of Rigas co-borrowing debt, in at least six drafts of Adelphia's 2000 Form 10-K. But when Adelphia's management resisted, Dearlove acquiesced in the footnote's language without requesting any written legal opinion of Adelphia's outside counsel or seeking accounting advice from Deloitte's technical accounting experts.

Dearlove Knew or Should Have Known That the \$1.6 Billion Was Adelphia's Liability and Should Have Been Reflected in Its Financial Statements

21. Adelphia's exclusion of co-borrowing debt from its balance sheet was also improper because virtually all of the co-borrowing debt excluded was in fact Adelphia's liability that had been improperly shifted from Adelphia's books to the books of the Rigas Co-Borrowers. Adelphia excluded co-borrowing debt from its balance sheet in a number of ways. It (i) "reclassified" some debt to the books of the Rigas Co-Borrowers through the use of sham journal entries; (ii) improperly transferred debt in connection with direct placements of Adelphia securities to the Rigases (approximately \$513 million in 2000); and (iii) recorded debt on the books of the Rigas Co-Borrowers without appropriate extinguishment of Adelphia's liability, even though Adelphia remained ultimately liable for such debt.

22. Adelphia's practice of drawing down co-borrowing funds into the CMS bank account used by Adelphia and the Rigas Co-Borrowers, but recording debt on the books of the Rigas Co-Borrowers, was improper. Adelphia's transfer of debt from one co-borrower to another did not conform to GAAP, which mandates that certain requirements be met before a liability can be extinguished.² Especially in light of the risks of debt covenant compliance that the Audit Risk form identified, Dearlove knew, or should have known, that Adelphia's 2000 Financial Statements did not accurately reflect the obligations of each co-borrower in conformity with GAAP.

disclosure of the contingency is still required where there is a reasonable possibility of having to incur a liability under the contingency. Paragraph 12 of FAS 5 goes further and states that when a contingency is a guarantee of indebtedness of others—which Adelphia claimed the Rigas co-borrowing debt was—a company should disclose the nature and amount of the guarantee even if the guarantee is assessed as "remote."

² FAS 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, required that once Adelphia drew down on the Co-Borrowing Credit Facilities, it had to either pay off the debt by the transfer of assets to the creditor or be legally released as primary obligor by the creditor, neither of which occurred. Attempting to "extinguish" debt by "assigning" it to a related party is not sufficient—the creditor must be paid or must legally release the borrower. (Although FAS 125 was superseded by FAS 140, effective March 31, 2001, the provisions discussed herein were carried over into FAS 140.)

Dearlove Improperly Failed to Object to Adelphia's Netting of Related Party Payables and Receivables

23. The Audit Risk form specified the following risk factors relating to Adelphia's related party transactions present during the 2000 Audit: (a) "the existence of a significant number of related-party transactions that have arisen outside the normal course of business"; (b) the existence of "significant affiliated entities or other related parties that [Deloitte] will not audit and with whom significant transactions might have occurred"; (c) that "the entity engage[s] in unique, highly complex, and material transactions, especially those close to year end, that pose difficult 'substance over form' questions"; and (d) the existence of "significant transactions with related parties."

24. Over the period covered by the 2000 Audit, Adelphia improperly netted, or offset, related party payables and related party receivables as of year-end, and presented only that net balance on its balance sheet in a line item called "Related-party Receivables—Net." This practice conformed to neither Regulation S-X, promulgated under Sections 13 and 15(d) of the Exchange Act, nor GAAP. It also obscured the extent and magnitude of the self-dealing and assisted Adelphia in creating the appearance of de-leveraging.

25. Adelphia was required by Regulation S-X, promulgated under Sections 13 and 15(d) of the Exchange Act, to report related party receivables and payables as gross numbers on its balance sheet. Generally, and except for limited circumstances and in the absence of an explicit and legal right of offset, Regulation S-X (Rule 5-02 of Regulation S-X) requires (1) related party receivables and related party payables be separately stated line items; and (2) indebtedness not current be separately disclosed.

26. In addition, netting is impermissible under GAAP. Accounting Research Bulletin 43, Chapter 1, para. 5 states: "Notes or accounts receivable due from officers, employees, or affiliated companies must be shown separately. . . ." Paragraph 7 of Accounting Principles Board Opinion No. 10 ("APB 10") states that "it is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists." Financial Accounting Standards Board Interpretation No. 39 ("FIN 39"), in turn, defines a right of setoff as "a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor." FIN 39, paragraph 5, sets forth four conditions that must be met for the right of set off to be proper:

- (a) Each of *two* parties owes the other determinable amounts;
- (b) The reporting party has the right to set off the amount owed with the amount owed by the other party;
- (c) The reporting party intends to set off; and
- (d) The right to set off is enforceable at law.

(Emphasis in original.)

27. Adelpia's practice of set off (netting) was a fraudulent device used to conceal its liabilities. No agreements existed that established any legal right by Adelpia to setoff amounts owed to it by the Rigas Entities or individual Rigases. Despite Dearlove's responsibility to be familiar with the foregoing accounting rules, and despite Dearlove's knowledge of the risks of related party transactions posed in this particular audit, he made no effort to satisfy himself that such agreements had been executed. No one on the engagement team appears to have questioned Adelpia's netting of unrelated balances -- whether specific affiliate receivables matched with affiliate payables to the appropriate entities -- and Dearlove never sought assurance that anyone had done so.

28. Adelpia's affiliate receivable line item changed significantly from the 1999 balance sheet to the 2000 balance sheet. The reported net receivables declined by 98%, reflecting a mere \$3 million net receivable for the 2000 fiscal year. Despite this dramatic decline, and the specific risks of related party transactions that the Audit Risk form identified, Deloitte's engagement team performed no test or analysis to determine the basis for Adelpia's significantly lower affiliate receivables. The auditors that Dearlove directed and supervised failed to perform basic audit procedures -- such as a fluctuation analysis or examination of the general ledger -- that would have alerted them to the reason behind the decrease in related party receivables.

29. Dearlove's failure to challenge Adelpia's practice of netting permitted Adelpia to conceal that Adelpia and its related party affiliates engaged in thousands of transactions, amounting to more than a billion dollars. If Dearlove had taken the appropriate action to require correction by Adelpia of its disclosure, Adelpia would have had to report that, as of the year-ended December 31, 2000, Adelpia had gross related party receivables of \$1.351 billion and gross related party payables of \$1.348 billion, much more relevant numbers.

Dearlove Facilitated Adelpia's Concealment of the CMS and the Thousands of Related Party Transactions that Arose from It

30. Apart from whether the related party transactions should have been netted against each other, Dearlove should have ensured that the specifics of individual material related party transactions were disclosed. Dearlove knew or should have known that Adelpia and the Rigases used the CMS as a central "treasury function" for Adelpia, its subsidiaries, and the affiliated Rigas Entities. Dearlove knew or should have known that thousands of related party transactions went through the CMS. The Millennium general ledger (which the auditors were aware of during their audit, but did not adequately review) was structured into cost centers that flowed into the CMS. The general ledger clearly recorded the thousands of intercompany transactions among and between Adelpia subsidiaries and Rigas Entities, and reflected other suspicious journal entries that indicated the existence of fraud at Adelpia. In addition, even a cursory review of bank statements would have shown that cash receipts for both public and private entities were deposited into Adelpia's First Union CMS account and that disbursements on behalf of public and private entities were paid from that same account.

31. Notwithstanding his familiarity with the risks posed by Adelphia's many related party transactions, Dearlove did not insist on adequate disclosure of them under FAS 57, Related Party Disclosures. FAS 57 states, among other things, that "[f]inancial statements shall include disclosures of material related party transactions" and specifies that such "disclosures shall include: (a) the nature of the relationship(s) involved; (b) a description of the transactions, including transactions to which no amounts or nominal amounts were ascribed . . . and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements; (c) the dollar amounts of transactions . . . and the effects of any change in the method of establishing the terms from that used in the preceding period; and (d) amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement." While Adelphia disclosed that it "provide[d] management and consulting services to" Rigas Cable Entities, there was no disclosure of the CMS or that the Rigas Cable Entities were CMS participants with Adelphia and its subsidiaries. Moreover, there was no disclosure that Adelphia personnel maintained the financial records of Rigas Non-Cable Entities as well as certain financial records of individual Rigases on the Millennium general ledger, and that CMS Participants also included individual Rigases and Rigas Non-Cable Entities. Given that individual Rigases and Rigas Non-Cable Entities were involved in activities and businesses wholly unrelated to Adelphia's businesses, the nature of Adelphia's related party transactions with Rigas Entities and individual Rigases was material and should have been disclosed under the terms and meaning of FAS 57.

32. In addition, contrary to the requirements of FAS 57, Dearlove's failure to examine the related party transactions allowed Adelphia to misstate the nature of a direct placement of Adelphia stock with the Rigases, a transaction which resulted in no new equity for Adelphia. Highland Holdings ("Highland"), a Rigas Entity, acquired \$368 million of Adelphia Class B shares for no consideration. Although Adelphia's public statements at the time stated that Highland had paid "immediately available funds," in fact Highland paid nothing and Adelphia booked an affiliate receivable from Highland for the purchase price of the shares—facts that were never disclosed. Adelphia further did not disclose that this receivable was never satisfied for cash but, along with other affiliate receivables, was netted against, and reduced by, the fake affiliate payables created by Adelphia's reclassifications of co-borrowing debt. While members of the engagement team were aware of a \$375 million receivable created in connection with this purchase, such a receivable created a stock subscription, which should have resulted in Adelphia recording a \$375 million contra-equity (a direct charge to equity).³ Instead, Adelphia's shareholders' equity was overstated by \$368 million. Dearlove knew, or should have known, that Adelphia's recordation of the \$368 million direct placement was not consistent with GAAP.

³ Based on a review of Adelphia journal entries, the \$7 million discrepancy appears to arise from an additional \$7 million of Adelphia Class B shares purchased on or about January 25, 2000. This additional purchase appears to have been funded by a \$7 million check from Highland that was signed by T. Rigas. Although the check is payable to Adelphia, contemporaneous journal entries in the Adelphia CMS indicate that the funds were ultimately deposited in an account of Coudersport Cable Television Company, a Rigas Entity, and thus should also have been treated as a contra-equity.

Dearlove's Conduct Departed from GAAS

33. GAAS requires that auditors exercise due professional care in performing an audit and in preparing the audit report. AU § 230.01. Due professional care requires that the auditor exercise professional skepticism in performing audit procedures and gathering and analyzing audit evidence. AU § 230.07-.08. "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, GAAS requires that an auditor must obtain "sufficient competent evidential matter" to provide "a reasonable basis for forming an opinion." AU § 326.22.

34. In exercising due care, GAAS requires that the audit partner supervise those to whom he delegates any of the audit procedures. AU § 311.11 sets forth the supervisory obligations of the audit partner: "Elements of supervision include instructing assistants, keeping informed of significant problems encountered, [and] reviewing the work performed. . . . The extent of supervision appropriate in a given instance depends on many factors, including the complexity of the subject matter and the qualifications of persons performing the work."

35. GAAS further requires that "representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of the auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 333.02. Heightened skepticism is especially warranted when a client has high audit risk, such as Adelphia. In fact, GAAS requires that both due professional care and professional skepticism increase with the risk assessment. See AU § 312.17.⁴

⁴ For instance, AU § 312.17, "Audit Risk and Materiality in Conducting an Audit," makes clear that, "[w]henver the auditor has concluded that there is significant risk of material misstatement of the financial statements, the auditor should consider this conclusion in determining the nature, timing or extent of procedures Ordinarily, higher risk requires . . . more extensive supervision by the auditor with final responsibility for the engagement during both the planning and the conduct of the engagement. Higher risk may cause the auditor to expand the extent of procedures applied, apply procedures closer to or as of year end, particularly in critical audit areas, or modify the nature of procedures to obtain more persuasive evidence." GAAS also requires that professional skepticism increase with the risk assessment. As set forth in AU § 316, *Fraud in a Financial Statement Audit*, at paragraph 27 (AU § 316.27), "examples demonstrating the application of professional skepticism in response to the auditor's assessment of the risk of material misstatement due to fraud include (a) increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions, and (b) increased recognition of the need to corroborate management explanations or representations concerning material matters — such as further analytical procedures, examination of documentation, or discussion with others within or outside the entity." (AU § 316.27 has been superceded by AU § 316.46 which became effective for audits of financial statements for periods beginning on or after December 15, 2002 and requires more extensive fraud audit procedures than did AU § 316.27.)

36. Dearlove departed from these GAAS standards in each of the areas at issue in the audit of Adelpia. As a consequence, Adelpia: (a) failed to record all co-borrowing debt on its balance sheet or otherwise disclose that a portion had been excluded; (b) failed to adequately disclose the nature and extent of related party transactions by improperly netting related party payables and receivables; and (c) overstated its shareholders' equity by \$368 million.

37. In planning the audit of Adelpia's co-borrowing debt, Dearlove made no effort to understand how Adelpia determined what portion of co-borrowing debt it owed and should record on its books and what portion was owed by Rigas Co-Borrowers and should be recorded on their books. Consequently, the audit plan did not address the unique fact that, of the total outstanding co-borrowing debt, only a portion was consolidated onto the financial statements of Adelpia and the balance appeared on the books of non-public entities. Instead, the audit plan called for testing co-borrowing debt for the borrowing group as a whole; no testing of co-borrowing debt was anticipated or performed at the parent or subsidiary level of Adelpia even though those amounts were consolidated onto the 2000 Financial Statements. In essence, Dearlove neither devised nor implemented any procedures to test whether the portion of co-borrowing debt reported by Adelpia was understated.

38. As a result, the extent of the procedures that the engagement team members working under Dearlove's direction and supervision performed at year-end to test co-borrowing debt was limited to sending a confirmation request to the lending banks on behalf of the borrowing groups as a whole for the total amount of debt outstanding under the borrowing group. No confirmation request was made for the portion of co-borrowing debt included on Adelpia's balance sheet. Had Dearlove directed the engagement team to send a confirmation request to the lending banks to confirm Adelpia's debt, they would have realized that the banks did not consider individual co-borrowers liable for different portions of co-borrowing debt, but instead considered Adelpia liable for the full amount of co-borrowing debt outstanding.

39. In addition, Dearlove's failure to examine (or to direct others to examine) the related party transactions violated his obligations under GAAS to "apply the procedures he consider[ed] necessary to obtain satisfaction concerning the purpose, nature and extent of these transactions and their effect on the financial statements." AU § 334.09. His disregard of these transactions allowed Adelpia to hide the nature and magnitude of the related party transactions and to misstate the nature of at least one direct placement of Adelpia stock with the Rigases, which resulted in no new equity for Adelpia.

Adelpia's Violations

40. Section 13(a) and Rule 13a-1 of the Exchange Act require issuers to file annual reports with the Commission and to keep this information current. Rule 12b-20 requires disclosure of such additional information as may be necessary to make the required statements not misleading. Courts have uniformly held that "the requirement that an issuer file reports under Section 13(a) embodies the requirement that such reports be true and correct." SEC v. Savoy Industries, 587 F.2d 1149, 1167 (D.C. Cir. 1978); see also United States v. Bilzerian, 926 F.2d

1285, 1298 (2d Cir. 1991). In addition, Rule 12b-20 requires disclosure of such additional information as may be necessary to make the required statements not misleading.

41. As described above, Adelphia misstated its total liabilities, equity, and related party receivables in its 2000 Form 10-K. Accordingly, Adelphia violated 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.

42. Adelphia also violated Section 13(b)(2)(A) of the Exchange Act by failing to make and keep books, records, and accounts that accurately, and in reasonable detail, reflected transactions and dispositions of its assets or liabilities. In addition, Adelphia failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in conformity with GAAP, thereby violating Section 13(b)(2)(B) of the Exchange Act. Adelphia's internal controls were not sufficient to prevent the recording of numerous false journal entries, including, among others, the reclassifications of debt, without proper basis or support.

D. VIOLATIONS

43. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. As a result of the conduct described above, Dearlove caused Adelphia's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) and Rules 13a-1 and 12b-20 of the Exchange Act because he knew or should have known that his failure to plan, conduct and supervise an audit that conformed to GAAS, and his approval of and signature on an unqualified audit report which Adelphia filed with its 2000 Form 10-K, would contribute to Adelphia's violations, including its filing of a misleading 2000 Form 10-K, its maintenance of an inadequate system of internal accounting controls, and its failure to keep its books and records in conformity with GAAP.

44. As a result of the conduct described above, Dearlove engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice. Rule 102(e)(1)(ii) provides, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission to any person who is found by the Commission to have engaged in improper professional conduct. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

45. As applicable here, improper professional conduct means "[i]ntentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards." Rule 102(e)(1)(iv)(A). Dearlove's failures to conform to GAAS in the planning, direction and supervision of the 2000 Audit constitute improper professional conduct under Rule 102(e)(1)(ii) as defined by Rule 102(e)(1)(iv)(A) of the Commission's Rules of Practice.

46. Alternatively, Rule 102(e)(1)(iv)(B) defines "improper professional conduct" as either of 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.

In light of the specific risks that Dearlove had identified in the planning of the 2000 Audit -- risks that pointed to the potential for fraud with respect to Adelpia's debt compliance and related party transactions -- his failure to conduct and supervise the 2000 Audit to address those risks and to insist on the appropriate disclosures mandated by GAAP with regard to Adelpia's debt and related party transactions, Dearlove engaged in "highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which" he knew, or should have known, warranted "heightened scrutiny." At the very least, his failures constituted repeated instances of unreasonable conduct "that indicate a lack of competence to practice before the Commission."

III.

In view of the allegations made by the Division of Enforcement and the Office of the Chief Accountant, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Rule 102(e)(1) of the Commission's Rules of Practice;

C. Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from causing violations of and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder, and whether Respondent should be ordered to pay disgorgement pursuant to Section 21C(e) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jonathan G. Katz
Secretary