INITIAL DECISION RELEASE NO. 259
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11330

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

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| In the Matter of | : | |
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| RITA J. McCONVILLE, | : | INITIAL DECISON |
| and KEVIN M. HARRIS, C.P.A. | : | September 27, 2004 |
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APPEARANCES: Kenton E. Knickmeyer, John S. Kingston, and Renata E. Miller for Rita J. McConville

John L. Rogers, Ellen M. Wheeler, Gregory S. Bruch, and Julie A. Smith, for Kevin M. Harris

Polly A. Atkinson and Elizabeth Espinosa Krupa for the Division of Enforcement, Securities and Exchange Commission

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

## I. Background

On November 12, 2003, the Securities and Exchange Commission ("Commission") instituted this proceeding pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, 17 C.F.R. § 201.102(e)(1)(iii).[1] The Order Instituting Proceeding ("OIP") charged that: (1) Respondent McConville, beginning, at a minimum, from 2000 to July 13, 2001, violated Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and caused Akorn, Inc. ("Akorn"),[2] to violate Sections 13(a) and 13(b)(2) of the Exchange Act and Rules

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[1] The parties agree that the three hundred day time period for issuance of the Initial Decision began on December 7, 2003, the day after Respondent McConville received the OIP.
[2] The Commission issued an Order Instituting Cease-and-Desist Proceedings, Making Findings and Imposing a Cease-and-Desist Order as to Akorn. Akorn, Inc., 81 SEC Docket 446 (Sept. 25, 2003).

12b-20 and 13a-1 thereunder; and (2) in the period March 20, 2001, to September 2001, Respondent Harris willfully violated Rule 13b2-2, and caused and willfully aided and abetted Akorn's violations of Section 13(a) and Rules 12b-20, 13a-1 and 13a-13.

Both Respondents filed answers. I held six days of hearings in Chicago, Illinois, between March 22 and March 30, 2004. The Division of Enforcement ("Division") presented testimony from nine witnesses, including one expert, and introduced thirty exhibits. Respondent McConville presented herself and one expert witness, and introduced nineteen exhibits. Respondent Harris presented three witnesses, including one expert, and introduced sixty-two exhibits. The last brief was filed on July 21, 2004.[3]

## II. Pre-Trial Procedural Issues[4]

The parties filed a considerable number of motions in this proceeding. On February 26, 2004, I ordered the Division to submit for in-camera inspection any materials in the investigative file relating to witness interviews, which the Division had not made available to Respondents under Rule 230(b) of the Commission's Rules of Practice. I ruled on the in-camera materials on March 8, 2004.

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[3] "(Tr. __.)" refers to the transcript of the hearing. I will refer to the Division's exhibits as "(Div. Ex. __.)," Respondent McConville's exhibits as "(Resp. McC Ex. __.)," and Respondent Harris's exhibits as "(Resp. Harris Ex. __.)," respectively. The Division's Post-Hearing Brief and its Proposed Findings of Fact and Conclusions of Law are referred to as "(Div. Br.__.)" and "(Div. P. Findings __.)," respectively. Respondent McConville's Post-Hearing Brief is referred to as "(Resp. McC Br.__.). Respondent McConville filed Proposed Findings of Fact and Conclusions of Law, Objections to the Division's Proposed Findings of Fact and Conclusions of Law in Dispute, Corrected Objections, and Response to the Division of Enforcement's Proposed Findings of Facts and Conclusions. Respondent Harris's Post-Hearing Brief is referred to as "(Resp. Harris Br.__.)." Respondent Harris also filed a Counter Statement of Proposed Findings of Fact and Conclusions of Law. The Division filed replies to both Respondents' briefs. The Division's Post-Hearing Reply Briefs are referred to as "(Div. Reply McC__.)" and "(Div. Reply Harris__.)."

[4] On March 17, 2004, I granted a Motion to Quash a subpoena issued at Respondent McConville's request for the Secretary of the Commission to provide to Respondents certain documents, including internal Commission communications. I ruled, based on the Joint Motion of the General Counsel and Division to Quash filed on March 11, 2004, and Respondent McConville's Memorandum in Support of Her Motion to Strike The Joint Motion To Quash ("Memorandum"), received March 12, 2004. I missed a footnote in Respondent McConville's Memorandum that stated it was a discrete motion that did not constitute an opposition to the motion to quash and, if necessary, Respondent McConville would file her opposition to the motion to quash before the applicable deadline. The date for replies to the motion was March 18, 2004. I granted the Motion to Quash on March 17, 2004, and Respondent McConville filed a Memorandum In Opposition later that day. I read the Memorandum In Opposition and it did not cause me to change my ruling.

Also on February 26, 2004, I ordered the Division to deliver to Respondents a list of all documents withheld based on a claim of privilege.[5] The Division delivered a privilege log to Respondents on March 12, 2004, that listed forty-five items on two sheets with columns headed Document, Date, Author, and Recipient. On March 19, 2004, Respondent McConville filed a motion for an in-camera review of all documents withheld by the Division, or alternatively, a more definite statement of the privilege claimed ("Motion"). Respondent McConville faulted the Division for the lack of detailed information it provided and argues that the Division "failed to provide sufficient information to determine what privilege it claims to invoke and whether it has properly invoked that privilege for each withheld document." (Motion at 2.) She claimed the Division did not show that the attorney-client privilege was applicable because it failed to show that:

> (1) the asserted holder of the privilege is a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with the subject communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers, (c) for the purpose of securing primarily either an opinion of law or assistance in some legal proceeding; and (4) the privilege has been claimed and has not been waived by the client. Colton v. United States, 306 F.2d 633, 637 (2d Cir. 1962) (quoting United States v. United Shoe Machinery Corp., 89 F. Supp. 357, 358-59 (D. Mass. 1950)). The party asserting the privilege bears the burden of proving that the privilege applies and that the communication has remained confidential. See e.g., United States v. Silverman, 430 F.2d 106, 121-22 (2d Cir. 1970).

(Motion at 3.) Respondent McConville also claimed the Division did not: (1) identify where or why it claims the work-product doctrine is applicable; and (2) provide sufficient information to assess whether it properly invoked the "predecisional" privilege. Respondent McConville did not question that the materials were prepared by persons associated with the Commission, but argued that more detail is required because analysis of the work-product privilege changes as to Commission employees outside of the Division. (Tr. 1248-49.)

The Division's response to the Motion, dated March 19, 2004, argued that the list shows that the withheld documents are within the scope of Rule 230(b). The Division relied on claims of privilege and the portion of Rule 230(b) that allows it to withhold, with two exceptions, all internal memorandum, notes or writings prepared by a Commission employee. (Tr. 292-93, 299, 1245.) The Division believes its position to withhold documents is not limited to the attorney work-product doctrine. (Tr. 1250.) The Division denied that it showed the final action memorandum to its expert witness, and believes that no item on the privilege log has been shown to anyone not covered by the privilege. (Tr. 298-99, 1246-47.)

[5] I issued the ruling at a prehearing conference and confirmed it in an order issued February 27, 2004.

Respondent McConville is willing to assume that the forty-five items come within the terms of Rule 230(b) as "generally speaking, internal Commission memoranda." However, Respondent McConville maintains that the Rule's language "or is otherwise attorney work product" modifies the preceding language so that any internal memorandum, note, or writing prepared by a Commission employee has to be covered by the attorney work-product doctrine. (Tr. 295, 297, 300.)

I denied the Motion, but said I would revisit the subject at the conclusion of the hearing when I was able to research the subject. (Tr. 301-02.) Respondent McConville did not object to going forward prior to a ruling on the Motion. (Tr. 78-79.)

**III. Reconsideration of Ruling Made at the Hearing**

Rule 230(b)(1) provides that the Division may withhold a document if: "(i) the document is privileged; [or] (ii) the document is an internal memorandum, note or writing prepared by a Commission employee, other than an examination or inspection report as specified in paragraph (a)(1)(vi) of this rule, or is otherwise attorney work product and will not be offered in evidence." The comment that accompanied publication of Rule 230(b) in 1995, makes clear that the material covered by (b)(1)(ii) must come within the attorney work-product doctrine.

> Under paragraph (b), the Division can withhold documents under four exceptions. . . . Exception (2) protects as attorney work product internal documents prepared by Commission employees, which will not be offered in evidence. Work product includes any notes, working papers, memoranda or other similar materials, prepared by an attorney in anticipation of litigation. See Hickman v. Taylor, 329 U.S. 495 (1947); see also Fed. R. Civ. P. 26(b)(3) and (b)(5). Except to the limited extent specifically provided in paragraph (a), documents prepared by Commission staff are treated as attorney work product, and do not have to be made available pursuant to this rule. Accountants, paralegals and investigators who work on an investigation do so at the direction of the director, an associate director, an associate regional administrator or another supervisory attorney, and their work product is therefore shielded by the rule. A respondent's claim that work product should be turned over will necessarily be evaluated on a case-by-case basis.

Technical Amendments and Corrections to Final Rules, 60 Fed. Reg. 46,499 (Aug. 31, 1995).

The Commission in Orlando Joseph Jett, 62 SEC Docket 503 (June 17, 1996), vacated an administrative law judge's order that the Division produce for in-camera review memoranda that contained the staff's recommendations that the Commission institute the formal order of investigation and the administrative proceeding. The Commission held that:

> Rule 230(b) of our rules authorizes our staff to withhold certain documents, including internal memoranda, from disclosure to respondents in disciplinary proceedings. However, the rule explicitly states that it does not authorize the

withholding, contrary to the Brady doctrine, of any documents that contain material exculpatory evidence.

Id. at 503 n.3. In Piper Capital Management, Inc., 68 SEC Docket 3361 (Jan. 15, 1999), an administrative law judge noted that the Division did not substantiate its privilege claims; however, he found the Division's Rule 230 claims meritorious and granted a motion to quash subpoenas seeking documentation referring or relating to the Division's decision to conduct an examination of the Respondent, the examination, and all resulting recommendations, findings, or determinations. Id. at 3362.

I reaffirm my denial of the Motion. Rule 230(b) provides that documents prepared by Commission staff are treated as attorney work product, and do not have to be made available. The titles of the documents, the description of the documents, the description of the author as an SEC staff member in most cases, and representations by the Division are sufficient to establish that the materials are in-house Commission documents prepared or assembled by Division staff for this litigation and that they fall within the Rule 230(b)(1)(ii) definition of protected work product. The materials at issue here are not Brady materials and were not introduced into evidence.

## IV. Motion To Strike

On June 29, 2004, Respondent McConville filed a Motion to Strike Those Portions of the Division's Proposed Findings of Fact and Post-Hearing Brief Related to Allegations Not Raised in the OIP or Seeking Impermissible Inferences from Akorn's 2000 Form 10-K/A ("Motion to Strike") and a memorandum in support ("Memorandum"). Specifically, Respondent McConville wants paragraphs 44, 60-63, 68-71, 130, 191-193, 209, and a portion of 203, of the Division's Proposed Findings of Fact and Conclusions of Law stricken. (Motion to Strike at 2.) These paragraphs concern the following: (1) chargebacks and rebates; (2) a February 20, 2001, press release Respondent McConville authored announcing Akorn's 2000 earnings; (3) a management representation letter to the auditors that she signed; (4) factual material surrounding Akorn's restatement of its financial statements for 2000 and 2001; (5) an allegation that "[b]y the time Akorn's 10-K was filed, McConville knew, or was at least reckless in not knowing, that collections were not being pursued, that cash was being misapplied, that rebates were not being processed and/or issued, that aging and other management reports were not being produced and/or reviewed and that Akorn's accounts receivable were in such disarray that the real amount of accounts receivable was undeterminable;" and (6) that Respondent McConville lied to the auditors "when she represented that, to the best of her knowledge, the financial statements in Akorn's 10-K were fairly presented in conformity with GAAP." Respondent McConville also wants stricken portions of the Division's Post-Hearing Brief: (1) page 6 that talks about rebates; (2) page 13 that discusses Akorn's restated financials; and (3) two sentences on page 15 that refer to the loss Akorn would have shown on the Form 10-K for 2000 if it had followed the accounting used in the restatement. (Motion to Strike at 2.)

Respondent McConville argues that her Motion to Strike should be granted because the OIP made no charges regarding: (1) Akorn's chargeback and rebate reserve; (2) Akorn's February 2001 earnings announcement; (3) representation that the Akorn's financials were not prepared in accordance with generally accepted accounting principles ("GAAP"); or (4) Respondent McConville's CPA status. (Memorandum at 2-3.) According to Respondent McConville, these are new allegations and, as such, violate her right to notice and hearing under the due process clause of the Constitution. In addition, Respondent McConville charges that drawing an adverse inference against her from Akorn's amended 2001 Form 10-K ("Form 10-K/A") violates her due process rights because she was not involved in the decision to file an amended 2001 Form 10-K and she was denied discovery related to Akorn's decision to amend.

The Division filed a Response ("Div. Response") on July 7, 2004, that details how the material that Respondent McConville seeks to strike relates to allegations in the OIP about accounts receivable: (1) Respondent McConville knew that Akorn failed to accurately record and reconcile cash and credit remittances and had numerous books and records deficiencies; (2) Respondent McConville knew Akorn's accounts receivable deteriorated in 2000; (3) Akorn's Form 10-K for 2000 was in error in many respects and, if it had been correct, Akorn would have posted a $2 million loss; and (4) Respondent McConville did not tell the auditors the true condition of the accounts receivable. (Div. Response at 2.) The Division cites specific portions of the OIP that concern management representation letters, Respondent McConville's scienter, and Akorn's restatement. (Div. Response at 3-5.) The Division denies that it seeks any impermissible inferences based on Akorn's restatement. (Div. Response at 5.)

Respondent McConville filed a Reply Memorandum in Further Support of Her Motion to Strike ("Reply") on July 13, 2004, in which she reiterated her position that the OIP gave no notice that: (1) Akorn's accounting for chargebacks and rebates was at issue; (2) she allegedly violated Exchange Act Rule 13b2-2 by signing the management representation letters that represented that the financial statements were presented in conformity with GAAP; and (3) her authorship of the press release was going to be used to show scienter. (Reply at 1-7.) Respondent McConville also maintains that the Division is seeking to use Akorn's amended 2001 Form 10-K that includes restated financials for fiscal year 2000 as evidence to support its allegations. (Reply at 7-8.)

The cases cited by Respondent to support her due process claims are inapplicable to this situation. (Memorandum at 6.) Jaffee & Co. v. SEC, 446 F.2d 387, 394 (2d Cir. 1971), is clearly distinguishable on its facts. Jaffee involved a complicated factual situation where the court found that the OIP did not give notice to the broker-dealer respondent that it could be subject to derivative liability under Section 15(b)(5) of the Exchange Act. Id. at 393-94. Robert Bruce Lohman, 80 SEC Docket 1790, 1798 n.20 (June 26, 2003), is also distinguishable. There the Division argued to the Commission that the administrative law judge in assessing sanctions should have considered Respondent's lies to the staff during the investigation. The judge had refused to do so because the allegation was not in the OIP. The Commission agreed with the judge that a bar from association with any broker, dealer, or investment adviser would be appropriate even without consideration of this factor. In Russell Ponce, 73 SEC Docket 442, 464-65 n.49 (Aug. 31, 2000), aff'd, 345 F.3d 722 (9th Cir. 2003), the Commission did not allow the Division to argue that Respondent was not independent for the additional reason that he played a role in preparing the financial statements, conduct not charged in the OIP. Respondent is not specific as to what she relies on in the initial decision of Carroll A. Wallace, CPA, 73 SEC Docket 3969 (Dec. 18, 2000.).

Rule 200(b)(3) of the Commission's Rules of Practice requires that the OIP contain "a short and plain statement of the matters of fact and law to be considered and determined." 17 C.F.R. § 201.200(b)(3). The case law on the subject holds that the OIP should sufficiently inform a respondent of the charges so that he or she may adequately prepare a defense, but that a respondent is not entitled in advance of the hearing to disclosure of the evidence upon which the Division intends to rely. J. Logan & Co., 38 S.E.C. 827 (1959); M.J. Reiter Co., 39 S.E.C. 484 (1959); Charles M. Weber, 35 S.E.C. 79 (1953).

The OIP gave notice that the Division challenged Respondent McConville's participation in Akorn's Form 10-K, specifically accounts receivable, as well as its books and records, and her dealings with the auditors. The treatment of chargebacks and rebates is an integral part of Akorn's accounts receivable. Chargebacks and rebates are credits and the OIP charges that Respondent McConville knew that Akorn failed to promptly and accurately record and reconcile cash and credit remittances to invoices. There have been no surprises and Respondent McConville was allowed an opportunity at the hearing to defend herself as to all the Division's evidence. For all these reasons, I DENY the Motion to Strike.

## V. Issues

Did Respondent McConville: (1) violate Section 10(b) of the Exchange Act and Rule 10b-5 in connection with the Form 10-K and management representation letters; (2) cause Akorn to violate Section 13(a) of the Exchange Act, and Rule 13a-1 thereunder that require public companies to file annual reports with the Commission, and Rule 12b-20; (3) cause Akorn to violate Section 13(b)(2) of the Exchange Act that required Akorn to maintain books, records, and accounts that accurately reflect the transactions and dispositions of assets and maintain a system of internal accounting controls sufficient to prepare financial statements in accordance with GAAP; (4) violate Rule 13b2-2 that, in summary, prohibits any officer or director from making a materially false or misleading statement or omitting any material information to an accountant in connection with any audit or review of financial statements filed with the Commission; and (5) violate Section 13(b)(5) of the Exchange Act that prohibits a person from knowingly circumventing or failing to implement a system of internal accounting controls or knowingly falsifying any book, record or account specified in Section 12(b)(2), and Rule 13b2-1 that prohibits the falsification of any book, record, or account required by Section 13(b)(2)(A)?

Did Respondent Harris: (1) willfully violate Rule 13b2-2 by making false and misleading representations to Akorn's auditors and (2) cause and willfully aid and abet Akorn's violations of Section 13(a) of the Exchange Act, Rules 13a-1 and 13a-13 that require public companies to make annual or quarterly filings with the Commission, and Rule 12b-20?

## VI. Finding of Facts and Conclusions of Law

My findings are based on the record and my observation of the witnesses' demeanor. I applied preponderance of the evidence as the standard of proof. Steadman v. SEC, 450 U.S. 91 (1981). I have considered all proposed findings, conclusions, and arguments raised by the parties, and accept those consistent with this Initial Decision.

### A. Akorn, Rita J. McConville, and Kevin M. Harris

Akorn develops, produces, and sells pharmaceutical products that require prescriptions, primarily in the areas of ophthalmology and injectable pharmaceuticals, such as anesthesia and antidotes to industrial poison. (Tr. 108-09.) Akorn began in Abita Springs, Louisiana, in 1971, and grew by acquiring Taylor Pharmaceuticals, located in Decatur, Illinois, in 1992, and Pasadena Research Laboratories, Inc., in San Clemente, California, a developer and distributor of injectable pharmaceutical products, in May 1996. (Tr. 110, 568-69, 1082; Div. Ex. 5 at 4.) Akorn moved its headquarters from Louisiana to Buffalo Grove, Illinois, in August 1998, which is where Respondent McConville was located. (Tr. 95, 241; Div. Ex. 5 at 8.) Akorn had manufacturing facilities in Decatur, Illinois, and Somerset, New Jersey, and it distributed products purchased from other locations. (Tr. 109, 282.) Akorn also provided contract manufacturing. (Div. Ex. 5 at 4.) In its annual report for the year ended December 31, 2000 ("Form 10-K"), Akorn described itself as a manufacturer and marketer of diagnostic and therapeutic pharmaceuticals. (Id.)

Respondent McConville was chief financial officer ("CFO") and secretary of Akorn from February 28, 1997, until March 21, 2001.[6] (Tr. 81, 130; Div. Ex. 5 at 37.) During most of this time, Respondent McConville reported to Floyd Benjamin, Akorn's chief executive officer ("CEO").[7] (Tr. 534.) As CFO, Respondent McConville, a certified but unlicensed public accountant, supervised Akorn's corporate controller and the finance department. (Tr. 81-82, 717-18, 1079.) Thomas D. Costello, Akorn's controller from March 31, 2000, through November 15, 2002, headed the finance department and reported to Respondent McConville. (Tr. 99-100, 111-12.) Mr. Costello and Respondent McConville were responsible for

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[6] Respondent McConville received a Bachelor's degree from Northwestern University in 1979 and a Masters in Business Administration from the University of Chicago in 1982. (Tr. 1073.) In 1998, Akorn paid Respondent McConville a salary of $125,673, a bonus of $37,702, securities underlying options of $30,000, and other compensation of $3,726. In 1999, she received salary of $138,600, a bonus of $33,301, securities underlying options of $30,000 and other compensation of $3,333. In 2000, she received a salary of $151,716, with options of $55,000 and other compensation of $3,500. (Div. Ex. 5 at 36.) According to her expert, Respondent McConville was paid approximately $150,000 per year until early 2001, when higher paid employees were asked to take a pay cut. Her compensation was $120,000 a year from early 2001 until she left the company. Her bonuses ranged from $26,000 to $38,000 from 1997 through 1999. She realized a profit of $49,790 from 1997 Akorn stock options, and lost over $35,000 on the sale of Akorn stock that she had purchased in an employee stock option plan in September 2003. (Resp. McC Ex. 395 at 22-23.)

[7] Mr. Benjamin has Bachelor of Science degrees in biology and chemistry and a Master's degree in microbiology. (Tr. 586.) Mr. Benjamin has worked in the pharmaceutical industry in the areas of quality control, quality assurance, research and development, and regulatory affairs at Abbott Laboratories, American Hospital Supply Corp., Lyphomed, which was bought by Fujisawa, Neocrin, and Pasadena Research Labs. (Tr. 552-53, 586.) At Akorn, Mr. Benjamin's offices were located in Buffalo Grove, Illinois, and in San Clemente, California. (Tr. 569-70.)

Commission filings while she was CFO. (Tr. 534, 717.) In 2000, Respondent McConville had primary responsibility for maintaining and calculating chargebacks in Akorn's books and accounts. (Tr. 719, 1109.) Mr. Benjamin testified that Respondent McConville began preparation of the Form 10-K and that others worked with her on it before it was filed. (Tr. 535.) Mr. Benjamin's recollection supports Respondent Harris's testimony that a draft of the Form 10-K had already been prepared when he became CFO, and that he made a few minor narrative changes and inserted some language dealing with the need for liquidity and a footnote was added dealing with a loan before the Form 10-K was filed.[8] (Tr. 326-28.)

Since 1997, Respondent Harris has been director of taxes and planning of EJ Financial, a firm owned by Dr. John Kapoor's family to assist their financial interests. Dr. Kapoor is chairman of Akorn's board. (Tr. 252-53.) In late February or early March 2001, Dr. Kapoor directed Respondent Harris to attend meetings concerning Akorn's Northern Trust Bank ("Bank") loan, and he informed Respondent Harris on March 21, 2001, that the board had appointed him as Akorn's CFO. (Tr. 734-44, 1266.)

Deloitte & Touche ("Deloitte") was Akorn's auditor and issued an unqualified opinion of the financials that were part of Akorn's Form 10-K and reviewed Akorn's quarterly report for the quarter ended March 31, 2001 ("Form 10-Q"), the filings that are the subject of this proceeding. (Tr. 772, 924, Div. Exs. 5 at 21-22, 17.) In its review, Deloitte determined whether anything material occurred that required modification of the financial statements in the Form 10-Q. (Tr. 772-73.) Deloitte had been Akorn's auditor for several years. (Tr. 843.) Respondent McConville did not sign either the Form 10-K or the Form 10-Q. Respondent Harris signed both. (Div. Exs. 5, 17.) Respondent McConville, Respondent Harris and others in Akorn's management signed two representation letters for the Form 10-K.[9] (Div. Exs. 101, 102.) The first letter, dated February 23, 2001, was provided in connection with Deloitte's audit of Akorn's consolidated balance sheets as of December 31, 2000 and 1999, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years ended December 31, 2001. (Div. Ex. 101 at 1, 7.) The letter represented that to the best of their knowledge and belief:

> (1) The consolidated financial statements . . . are fairly presented in conformity with [GAAP].
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> . . . .

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[8] Kevin M. Harris was Akorn's CFO in 2001. (Tr. 1350-51.) Respondent Harris became a licensed certified public accountant ("CPA") in Illinois shortly after he earned a Bachelor of Science degree in accounting from Illinois State University in 1983. While working in the audit and tax sections of Arthur Andersen from 1983 until 1989, Respondent Harris earned a Masters in Taxation from DePaul University. (Tr. 245-47.) Respondent Harris worked for three other firms before he joined EJ Financial in 1997. (Tr. 248-52.)

[9] Respondent McConville signed both letters as Akorn's corporate controller, and Respondent Harris signed as Vice President, CFO, Secretary, and Treasurer. (Div. Exs. 101 at 7, 102 at 2.)

(18) Other than those disclosed, no events have occurred subsequent to December 31, 2000 that require consideration as adjustments to or disclosures in the consolidated financial statements.

(19) The Company is responsible for determining and maintaining the adequacy of the allowance for doubtful accounts receivable, chargebacks, rebates, returns and cash discounts as well as estimates used to determine such amounts. Management believes the allowances are adequate to absorb currently estimated uncollectible receivables in the account balances.

(Div. Ex. 101 at 1, 4.) The second letter, dated April 17, 2001, represented that:

(1) Other than the events described in paragraph 4 of Note G, there are no events which have occurred subsequent to February 23, 2001 that have a material effect on the financial statements that are in the filing or that should be disclosed in order to keep those statements from being misleading.

. . . .

(4) The Company has and will continue to take certain actions it believes are within its control and are necessary to meet the restrictive covenants of the amended credit agreement. Such actions include, but are not limited to, reducing its planned 2001 capital expenditure, increasing resources dedicated to collecting past due accounts receivable, implementing steps to control inventory levels, and reducing rebates and other discounts offered to its customers. . . .

(5) The Company has received a commitment from Dr. John Kapoor, its Chairman and interim [CEO], to provide $3 million of subordinated debt by May 15, 2001 as required by the Company's revolving credit agreement, as amended.

(Div. Ex. 102 at 1.)

From 1997 until 1999, Akorn billed customers and received payments at offices in Buffalo Grove, Illinois, Decatur, Illinois, and San Clemente, California. (Tr. 80-81, 94-95, 110.) Each office used a different and incompatible software system for tracking payments.[10] In the second half of 1999, Akorn centralized finance and all billing, receipt of payments, and accounts

[10] The finance office at Abita Springs, Louisiana, which relocated to Buffalo Grove, Illinois, in 1997, used a software program called Think and later a software program called Macola. The finance office at Decatur, Illinois, used a software program called Great Plains, and the finance office in San Clemente, California, used a software program called MAS-90. (Tr. 90-91.)

receivable onto Macola software used by its office in Buffalo Grove, Illinois.[11] (Tr. 110, 155.) Akorn shifted all systems, except accounts receivable, from Macola to the J.D. Edwards Enterprise Resource Planning ("J.D. Edwards"), a much more sophisticated information recording software package in 2001. (Tr. 305, 307, 321-22.) When Akorn began recording new receivables on J.D. Edwards beginning in early 2001, it did not carry over existing accounts receivable from Macola because Akorn's management information system ("MIS") personnel could not assure Respondent Harris that conversion would preserve the integrity of the data (Tr. 284-85, 306-07, 725-26.) As a result, Akorn had two sets of accounts receivable computerized records. (Tr. 1275.)

On December 31, 2000, Akorn had 395 full-time employees and another fifty-two at a wholly owned subsidiary, Akorn (New Jersey). (Div. Ex. 5 at 6.) Akorn reported net income of $4,647,000 in 1998; $6,670,000 in 1999; and $2,187,000 in 2000. (Div. Ex. 5 at 23.) Akorn's common stock was traded on the Nasdaq National Market in 1999 and 2000.[12] (Div. Ex. 5 at 9.)

Akorn's customers included pharmaceutical wholesalers and direct customers, such as individual optometrists, ophthalmologists, physicians, hospitals, other medical product suppliers, contract manufacturers, and group purchasing organizations. (Tr. 108-09, 311; Div. Ex. 5 at 4; Resp. McC Ex. 395 at 2.) Akorn's Form 10-K reported that "[d]uring 2000, the Company realized approximately 12% of its net sales from one customer. This customer is a distributor of the Company's products as well as a distributor. . . . The accounts receivable balance for this customer was approximately 22% of gross accounts receivable." (Div. Ex. 5 at 6-7.) From the evidence, it appears this customer was Cardinal Health, Inc. ("Cardinal"), Akorn's largest wholesale customer with the largest accounts receivable. Cardinal placed hundreds of orders with Akorn each month from different locations, which Akorn treated individually on its books. (Tr. 93, 96, 324, 390, 408-09, 857-58.) Akorn's sales to its five largest wholesale customers of various products was substantial. In fiscal year 2000, wholesale accounts amounted to forty-three percent of Akorn's sales. (Resp. McC Ex. 395 at 2.)

### B. Akorn's Accounting Procedures

Akorn's terms of sale varied with the customer and varied from thirty days to ninety days. Akorn's many contracts with Cardinal provided for payment in either sixty or ninety days. (Tr. 113-14.) Akorn did not charge interest on overdue bills. (Tr. 114.) Akorn's aging reports had a current bucket, and individual buckets for thirty to sixty days past due, sixty to ninety days past due, and over ninety days past due. (Tr. 308-09.)

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[11] Respondent Harris believes that Macola was installed prior to 2000 to address Y2K concerns. (Tr. 321.)

[12] Akorn was delisted from the Nasdaq on June 25, 2002, for failure to provide audited financial statements in its 2001 Form 10-K, filed April 16, 2002. Thomas D. Costello, 81 SEC Docket 3151, 3152 (Dec. 11, 2003).

Akorn issued an invoice at the list price with each shipment to Cardinal and other wholesalers. (Tr. 96.) The invoice identified the product by batch number. (Tr. 124.) The same batch number could appear on one hundred and fifty invoices. (Id.) Akorn could not match customer payments or credits to invoice numbers so that it could not post a receipt against a particular invoice. (Tr. 857.)

In Macola, open invoices were aged based on when they were booked to the receivables. However, cash, chargebacks, or rebates were aged based on when they were applied to the account.[13] (Tr. 314-15, 852-54.) The result was a mismatch, in that a credit would be posted to the customer's account when it was received, but the related invoice(s) remained open as a receivable and continued to age. (Tr. 316-17, 320-21, 853-54; Resp. McC Ex. 395 at 4.) According to a Deloitte workpaper for the 2000 audit, "[t]he Macola system has had problems with closed transactions being reopened when a paid invoice receives a credit against it. The result is that the aging of [accounts receivable] is inaccurate as the open items (original invoice, payment, and credit) appear in different aging categories depending on the dates of the transactions." (Resp. Harris Ex. 498 at 003434.) Respondent McConville admitted that "Any time a transaction was entered on a document number, it would bring every other transaction that was entered against that document number open." (Tr. 154.) Akorn's application of Macola did not allow a detailed review of the age of accounts receivable. (Tr. 153-54.)

**1. Allowance for Doubtful Accounts**

Akorn's assets are shown on its balance sheet "less allowance for doubtful accounts," which it defines as "trade receivable balances owed to the Company that are believed to be uncollectible." (Tr. 47; Div. Ex. 100 at 56.) Akorn applied a formula to evaluate "what amounts were in the aging buckets and applying a weighting factor to come up with the monthly accrual for bad debt." (Tr. 192.) In 2000, Akorn added $607,000 to the doubtful accounts reserve balance of $226,000 for a total of $801,000.[14] (Div. Ex. 5 at 27.) The resulting doubtful account allowance of $801,000 did not make any provision for the accounts receivable of Cardinal or any of the top five wholesale customers, and Akorn did not have a separate doubtful account for these wholesale customers. (Tr. 131, 350-51.) Respondent McConville and Mr. Benjamin represented to Dr. Kapoor, Respondent Harris, and Deloitte that the Cardinal and other wholesaler accounts receivable were collectible once they were reconciled. (Tr. 329, 779, 1200-02, 1271, 1276, 1360-62.)

**2. Akorn's Accounting for Chargebacks and Rebates**

"Akorn has historically offered volume rebates, trade show promotions and other price concession programs to wholesalers to entice wholesalers to purchase product." (Resp. McC Ex. 274 at 005790.) Akorn offered chargebacks as sales incentives. Chargebacks, the difference

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[13] Respondent McConville testified that when she began reconciling the Cardinal account in late 2000 or early 2001, she learned that Akorn and Cardinal had unresolved issues involving rebates going back to 1997. (Tr. 161-62; Div. Ex. 12.)

[14] Thirty-two thousand dollars was written off during the year. (Div. Ex. 5 at 27.)

between list price and the contract price to the end user, occurred when Akorn entered into contracts directly with its end-user customers. As a result of these contracts, wholesaler customers like Cardinal that sold to the end user ultimately owed Akorn less than the list price amount shown on the invoice if the chargeback was found to be valid. (Tr. 92, 205-06, 211-14, 1176.)

> Chargebacks are a unique allowance related to the [accounts receivable] account. It is required for sales made to wholesalers who in turn sell to third parties at a contract price (with Akorn) less than the [wholesalers'] purchase price from Akorn. Once the sale occurs to the third party, the wholesaler processes the chargeback to Akorn equal to the difference between the price paid for the product and eventual sales price. Historically, establishing the lag between the sale from Akorn to the wholesaler and the time the chargeback is processed has been unpredictable. Thus the needed Allowance for [chargebacks] has been difficult to estimate.

(Resp. Harris Ex. 498 at DT003433.) Chargebacks are a significant and unique concern in the pharmaceutical industry when selling through wholesalers, and they were a particular problem at Akorn because its use of Macola could not link a chargeback with a particular invoice; it could only link chargebacks with batches of the product.[15] (Tr. 224-25, 536, 722.) Because Akorn did not know the amount of the chargeback when it issued an invoice and booked a receivable, and GAAP requires that accounts receivable be accounted for at their net realizable value, Akorn established a chargeback and rebate reserve. (Tr. 208; Resp. McC Ex. 395 at 3.) Akorn imposed no time limits on when a wholesaler could submit chargebacks. (Tr. 93.)

Akorn offered rebates to Cardinal and other wholesalers with the goal of increasing sales under different programs with specific terms. (Tr. 190, 215-19; Resp. Harris Ex. 400.) Akorn offered Cardinal generic rebates, source rebates, volume rebates, and special rebates. (Tr. 215-19, 640-41.) Akorn treated rebates as open credits that were common and recurring; however, some types of rebates had time limits and some were non-recurring. (Tr. 187, 189-90, 634.)

On its books, Akorn entered the invoice amount in the accounts receivable subledger and it entered a credit to the reserve for chargebacks and rebates using a formula that varied depending on such factors as the product, historical information, and a computer program. (Tr. 103-04, 207-10, 221-22, 1112, 1114.) As Akorn explained in the notes to financial statements included in its Form 10-K:

> Allowance for Chargebacks and Rebates: The Company accrues an estimate of the difference between the gross sales price of certain products sold to wholesalers and the expected resale prices of such products under contractual arrangements with third parties such as hospitals and group purchasing organizations at the time of sale. As part of the Company's sales terms to wholesale customers, it agrees to reimburse wholesalers for such differentials

[15] It is not clear whether this was a deficiency in the Macola software or Akorn's application of the Macola system.

> between wholesale prices and contract prices. Because this allowance relates to amounts not yet collected from the wholesalers, this allowance is recorded as a reduction of accounts receivable. Similarly, the Company records an allowance for rebates related to contracts and other programs with wholesalers. The balance for these allowances was $3,296,000 and $3,174,000 as of December 31, 2000 and 1999, respectively.

(Div. Ex. 5 at 25.) Many chargebacks came to Akorn through an electronic data interchange ("EDI") with its wholesalers.[16] (Tr. 722.) Wholesalers did not necessarily wait for Akorn to approve the chargeback amount; rather, they took an immediate deduction against their outstanding invoices. (Resp. McC Ex. 395 at 3.)

When Cardinal took a deduction for a chargeback, rebate, or other allowance, it would list a debit memo number on the "remittance advice" it sent to Akorn. (Tr. 136.) A "remittance advice" from Cardinal often consisted of more than twenty pages of single-spaced type that referenced a lot of documents including invoice numbers, credit memos, debit memos, etc. (Tr. 197-98, 233, 319.) A single remittance advice could have multiple debit memo numbers. (Tr. 137-38.) The remittance advice cross-referenced the debit memoranda that Cardinal issued earlier. (Tr. 199.) The remittance advice included a single check that represented Cardinal's version of all the additions and subtractions due to chargebacks, rebates, etc., shown on the remittance advice. (Tr. 197-98, 721-22.) The remittance advice did not match any particular Akorn invoice(s). (Tr. 198.) Many times the remittance advice was insufficient to post the cash to the account properly and Akorn had to ask Cardinal for clarification on how it should apply the payment. (Tr. 318.).

Akorn's accounting department checked on the validity of deductions that Cardinal took on a remittance advice. (Tr. 151, 234-35.) Four people were assigned to post receipts from the five major wholesalers. (Resp. McC Ex. 395 at 4.) If Akorn approved a chargeback or rebate submitted by a wholesaler, it would credit the customer's accounts receivable and debit the chargeback and rebate reserve account. (Tr. 136-37, 221.) Because Akorn could not apply chargebacks to a specific invoice, it issued chargebacks as open credits to the wholesaler's account. (Tr. 124, 150-51, 232.) The result was a subtraction from accounts receivable and a subtraction from the reserve for chargebacks and rebates. (Tr. 225.) Akorn issued Cardinal a "bill back" for the amount of any unidentified or disputed items, and Akorn booked the bill back amount as an open item on Cardinal's accounts receivable. (Tr. 199.) If Akorn disputed Cardinal's credit claim, Akorn would keep the whole debit open. (Tr. 137.)

In summary, Akorn credited the invoice amount to gross accounts receivable and as a credit to revenue. For the same invoice, it posted (1) a chargeback and rebate estimate as a credit to the chargeback and rebate reserve and a debit to revenue, and (2) a doubtful account estimate as a credit to the doubtful account allowance and as a debit to expenses. When Akorn received a chargeback or rebate, it credited gross accounts receivable and debited the chargeback and rebate

[16] To reject a submission for a chargeback, Akorn had to convert the electronic information into a manual process and issued a bill back to the wholesaler. Unless Akorn did so quickly, the wholesaler took the deduction. (Tr. 1364.)

reserve. (Motion to Strike, Memorandum at 4.) On its financial statements, Akorn included an allowance for doubtful accounts, an allowance for chargebacks and rebates, an allowance for returns, and an allowance for inventory obsolescence as "Valuation and Qualifying Accounts." (Div. Ex. 5 at 41.) On its Form 10-K/A, Akorn stated that it "reduces gross sales and accounts receivable by the estimated chargeback amount when it sells product to a wholesaler," and later it "evaluates the chargeback allowance against actual chargebacks processed by wholesalers." (Div. Ex. 100 at 54.) It appears that assets and revenues were offset by an allowance for doubtful accounts and various reserves, including a reserve for chargebacks and rebates. (Tr. 273-74; Div. Ex. 5 at 22, 24.)

**C. Akorn's Financial Situation in Late 2000 and Early 2001**

Akorn had a $45 million line of credit from the Bank. (Tr. 1256; Div. Ex. 106 at 8.) Respondent McConville was Akorn's main contact with the Bank, and she knew of the Bank's concerns about extending the loan. (Tr. 1288-89, 1296-99.) Soon after February 20, 2001, the Bank informed Dr. Kapoor of its concerns that Akorn would violate the covenants in the outstanding loan due December 29, 2001, or the proposed amortization schedule for the loan extension.[17] (Tr. 261-62, 1256-58, 1260, 1296-99; Resp. Harris Ex. 579.) The Bank determined that Akorn's earnings were insufficient to support a $45 million line of credit since Akorn's 2000 earnings did not match the projections that the Bank used to grant the loan, and Akorn's collateral supported a $23,373,000 loan. (Tr. 269-70, 272, 1257; Resp. Harris Ex. 579.) The Bank insisted on several measures including changes to the loan covenants, a repayment schedule, and a $3 million contribution to capital from Dr. Kapoor to extend the loan until December 29, 2002.[18] (Tr. 266-67, 1256-57; Div. Ex. 5 at 29; Resp. Harris Ex. 579.) Deloitte informed Akorn that it would be obligated to issue a "going concern" opinion in connection with the audited financials that are part of the Form 10-K for the year ended December 31, 2000, if Akorn did not obtain a waiver from the Bank by April 17, 2001, of Akorn's non-compliance with certain financial covenants at least until January 1, 2002. (Tr. 1300; Resp. Harris Ex. 524.)

On March 7, 2001, Dr. Kapoor named Russ Abraham, Jack Maire, Respondent Harris, and Respondent McConville as a team to thoroughly analyze Akorn's accounts receivable and to determine their accuracy and any necessary write-offs by the end of March, and he ordered

[17] The evidence on this point is contradictory. In a press release issued February 20, 2001, Akorn stated that the year-end balance on its line of credit was $44.4 million and that it was seeking to extend the line an additional year from the December 29, 2001, due date, as well as covenant relief for 2001. (Div. Ex. 6 at 2.) However, the Bank told Dr. Kapoor that, in essence, Akorn had defaulted on its loan. (Tr. 1256.)

[18] The Bank wanted a projection of cash flows, which involved the collection of receivables, management of payables, capital expenditures, and consideration of expenses. Respondent Harris talked with Mr. Maire, Mr. Costello, and Respondent McConville in arriving at the assumptions used in modeling the collection of receivables from the direct customers, the contract manufacturing customers, and the wholesale customers. (Tr. 1359-60.)

Akorn to stop all discounts, rebates, and other incentives to wholesalers immediately.[19] (Div. Ex. 58 at 1-2.) It appears that this formal team was not assembled, but Mr. Maire took charge and he worked with Respondents Harris and McConville, Mr. Costello, and Akorn accounts receivable personnel, which some people referred to as the "Cardinal collections team."[20] (Tr. 280, 322-25, 1095, 1274-75; Resp. McC Ex. 395 at 12.)

On March 20, 2001, Akorn's board removed Respondent McConville and Mr. Benjamin from their positions as CFO and CEO, respectively.[21] (Div. Ex. 56.) Respondent Harris replaced Respondent McConville and became Akorn's Interim CFO on March 21, 2001.[22] (Tr. 282, 381, 940-41, 1352.) Respondent Harris knew in late February 2001 that Akorn's accounts receivable were growing faster than sales, and that Akorn had almost maximized the $45 million line of credit. (Tr. 262-65, 267.) Mr. Maire reported to Respondent Harris after March 21, 2001. (Tr. 733.) Respondent Harris was unsure when the first invoice or first receivable was recorded in the J.D. Edwards system. (Tr. 307.) Respondent Harris quickly hired eight more people to work on collecting accounts receivable from wholesalers and an outside collection agency to focus on direct customers, and people with MIS skills to produce more detailed reports on the age of accounts receivable.[23] (Tr. 283-84, 305, 307-09, 311-13, 391-92.)

Mr. Costello was not surprised that an accounts receivable summary for Akorn, dated April 9, 2001, showed that as of March 31, 2001:

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[19] Mr. Maire had extensive experience in the area of accounts receivable during fifteen years at Baxter Pharmaceutical, and also at Lyphomed, now Fujisawa, and Option Care. (Tr. 396-99.) The president of Option Care loaned Mr. Maire to Akorn from the beginning of March through May 2001. (Tr. 400-01, 439.) Dr. Kapoor was a shareholder in Lyphomed and Option Care and is board chairman at Option Care. (Tr. 399, 403.) Mr. Maire worked at companies affiliated with Dr. Kapoor for eighteen years prior to April 2002. (Div. Ex. 88.)

[20] Mr. Maire had worked with Respondent McConville at Lyphomed and Option Care. (Tr. 439.) As part of the Cardinal team, Respondent McConville began reconciling the Cardinal account in a spreadsheet format at a specific level of detail after March 21, 2001. (Tr. 82, 410.)

[21] Mr. Benjamin moved to a vice chairman position, and was no longer involved in the issues that are the subject of this proceeding. (Tr. 551, 570; Div. Ex. 56.) Dr. Kapoor became CEO on an interim basis. (Tr. 940; Div. Ex. 56.)

[22] Dr. Kapoor paid Respondent Harris about $39,000 for working at Akorn from March 21 through September 11, 2001, and stock options for 50,000 shares, which he has not exercised. (Tr. 381-82.) Before he became CFO, Respondent Harris had focused on how Dr. Kapoor should structure his $3 million contribution to Akorn, and how Akorn could reduce expenditures. (Tr. 281-82.)

[23] Mr. Maire believed that Akorn needed skilled people in accounts receivable to handle credits for chargebacks and rebates. (Tr. 312-14.)

Akorn's total accounts receivable was over $25,276,025;
Akorn's top-five wholesalers had accounts receivable of $13,457,516;
Cardinal's accounts receivable was $4,625,561; and
Akorn's top-five wholesale customers had $5,428,850 past due over sixty-one days, which included $1,539,521 past due from Cardinal.[24]

(Tr. 748; Div. Ex. 18.) These numbers were consistent with the age of accounts receivable when Mr. Costello began working at Akorn on March 31, 2000. (Tr. 716-17, 749, 751.)

**D. Akorn's Form 10-K for the Fiscal Year Ended December 31, 2000**

On April 17, 2001, Akorn filed its Form 10-K signed by Dr. Kapoor, CEO and Director; Respondent Harris, CFO (Principal Financial Officer and Principal Accounting Officer); and Mr. Benjamin, Dr. Daniel E. Bruhl, and Doyle S. Gaw, Directors. (Tr. 325-26; Div. Ex. 5.) Akorn's Form 10-K reported net sales of $66.927 million, net income of $2.187 million, and total assets of $96.518 million, with $24.144 million consisting of "trade accounts receivable (less allowance for uncollectibles of $801[thousand])." (Div. Ex. 5 at 22-23.) Akorn increased its allowance for uncollectible accounts from $266,000 at December 31, 1999, to $801,000 at December 31, 2000. (Tr. 1096-97; Div. Ex. 5 at 22.)

Akorn's allowance for doubtful accounts in its Form 10-K did not include any estimates for Cardinal and other large wholesalers. Akorn, principally Respondent McConville and Mr. Costello, represented to the auditors that it was not trying to collect from Cardinal many of the 1999 and pre-1999 debits that it had on its books, because credits for many 1999 and pre-1999 Cardinal accounts receivable were in the recent aging buckets. (Tr. 937-38, 961-62; Div. Ex. 63.) According to Mario Delgado, Deloitte's audit manager on the engagement, Akorn did not have any amounts in the allowance for doubtful account for Cardinal or any of its top-five wholesalers because "management's belief at the time was that the top-five wholesalers did not present a collection risk," and the auditors' tests agreed with that conclusion. (Tr. 768.) Respondent McConville and Mr. Costello told Mr. Delgado that the top-five wholesalers had the ability and intent to pay accounts receivable. (Tr. 769.) Deloitte had several conversations with Respondent Harris after he became CFO and when the Form 10-K was filed. (Tr. 880-82.) Mr. Delgado "understood that Akorn management was meeting with individuals at Cardinal trying to clarify what balances were outstanding." (Tr. 900.) When the Form 10-K was filed on April 17, 2001, Mr. Delgado understood from Akorn that Cardinal was going to pay in full. (Tr. 900-01, 925, 962.)

[24] The Commission instituted a proceeding against Mr. Costello with respect to these matters. On December 11, 2003, the Commission accepted Mr. Costello's Offer of Settlement and ordered him to cease and desist from committing or causing any violations and any future violations of Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13b2-2, and from causing any violations and any future violations of Section 13(a) and 13(b)(2) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13. Thomas D. Costello, 81 SEC Docket 3151 (Dec. 11, 2003). Mr. Costello, an unlicensed CPA, left Akorn in September 2001. (Tr. 338.)

> Yes, all indications as we understood them from those conversations were positive. It seemed like as we understood it Cardinal was being responsive and positive feedback being received from Cardinal, not the least of which was a check for $900,000, things appeared to be moving along in the right direction from a collection standpoint.

(Tr. 900-01.) Deloitte did not know that Mr. Maire was looking at Akorn's accounts receivable and collectibility, and Akorn did not show Deloitte Mr. Maire's summary report on accounts receivable dated March 15, 2001.[25] (Tr. 771-72.)

Mr. Benjamin did not tell Respondent Harris that Akorn's accounts receivable from the major wholesalers were not collectible when he reviewed the final draft of the Form 10-K on or about April 17, 2001, because "[Akorn] hadn't collected it so [Respondent Harris] knew it was an issue." (Tr. 570-71.)

### E. Akorn's Treatment of the Cardinal Account

Mr. Benjamin knew in early 2001 that Akorn and Cardinal disagreed on what Cardinal owed Akorn. (Tr. 554-56, 585.) In a March 15, 2001, letter to Cardinal, Mr. Benjamin acknowledged receipt of Cardinal's initial payment, a check for $913,745.15, and that it "represents a very small portion of the difference between the accounts on the two sets of books. There remains in excess of $5 million to be reconciled."[26] (Div. Ex. 89; Resp. McC Ex. 284.) As part of its wholesale agreement with Cardinal, Akorn had granted rebates on preferred products or source rebates. (Tr. 1376.) In his March 15, 2001, letter, Mr. Benjamin requested that Cardinal reverse the following rebates: $513,775 in source rebates in 1999; $322,294 in source rebates in 2000; and $98,442 and $339,144 for quarter-end 2000 incentive discounts. The letter asked for quick resolution based on the burden Cardinal's actions placed on Akorn's cash flow. (Resp. McC Ex. 284.) On April 16, 2001, Mr. Benjamin received a written opinion from a law firm confirming Akorn's position that Cardinal had inappropriately taken rebates on all products, which were applicable to only certain products. (Tr. 561-62; Resp. Harris Ex. 400.) Cardinal's view, however, was quite different. As of April 16, 2001, Cardinal's "aged trial balance net of discount" with Akorn showed $1,079,516.99 in Cardinal's favor. (Tr. 203-05.)

Between March 21, 2001, and mid-July 2001, when she left Akorn, Respondent McConville worked to reconcile Cardinal accounts payable records and Akorn's accounts receivable records relating to Cardinal as a member of the "Cardinal team" or Cardinal account group. (Tr. 125, 165, 200-01, 322-23, 454-55.) McConville prepared information, which

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[25] During the investigation of these matters, the Division showed Deloitte documents relating to Akorn's Form 10-K and Form 10-Q that Deloitte had never seen. (Tr. 964.)

[26] Respondent McConville described reconciling accounts as explaining the difference between what Akorn's records showed as a customer's open invoices (accounts receivable) and what the customer's records showed that it owed Akorn (accounts payable). (Tr. 135-42, 419.) She characterized an account as "reconciled" when the differences were identified, and "unreconciled" as when the reasons were unexplained. (Tr. 141-42.)

became the basis of a spreadsheet like "Cardinal Account Reconciliation Based on 4/6/01 Cardinal Aging." (Tr. 200; Resp. McC Ex. 270.) The spreadsheet shows Cardinal with an open balance in accounts receivable aging (amounts past due) of $4,073,787.37.[27] (Tr. 142-45, 1205; Resp. McC Ex. 270.) This sum, plus Cardinal's claim of a positive balance of about $825,000, resulted in a total difference to be reconciled of $4,898,904.87. (Tr. 140; Resp. McC Ex. 270.) On April 11, 16, and 30, 2001, Respondent McConville sent Cardinal, for payment, copies of open invoices for 1999 and 2000, and some pre-1999 and 2001 invoices, which did not appear on Akorn's aging report for Cardinal. (Tr. 145; Div. Ex. 92.)

**F. Akorn's Form 10-Q for the Quarter Ended March 31, 2001**

Respondent Harris and others at Akorn initiated meetings and conversations with Cardinal beginning on April 25, 2001, to renegotiate the contracts and to discuss Cardinal's receivables on Akorn's books. (Tr. 341.) It became clear to Respondent Harris that Akorn would have to litigate with Cardinal to collect on the accounts receivable. (Tr. 342.) Dr. Kapoor and Akorn's board agreed in early May 2001, that it was not in Akorn's business interest to sue Cardinal for the amounts shown in its accounts receivable account. (Tr. 1277-79.) Akorn filed a Form 12b-25, Notification of Late Filing, on May 15, 2001, stating that it could not timely file its Form 10-Q for the quarter ended March 31, 2001, because of management changes and system conversion issues and that it expected changes in a number of financial reserves would be significant and have a material adverse impact on earnings. (Resp. Harris Ex. 586 at 4.) Akorn's Form 10-Q, filed May 22, 2001, which Respondent Harris signed, reflected Akorn's business decision to write off the outstanding balances and to reach new terms with Cardinal. (Tr. 342, 346-47; Div. Ex. 17 at 6-7.) Note F to the financials titled "Change in Accounting Estimates" indicates that an analysis completed in May 2001, showed that it was necessary to increase Akorn's March 31, 2001, allowance for chargebacks and rebates to $6,961,000 from $3,296,000. (Div. Ex. 17 at 6.) The Form 10-Q also stated that:

> Based upon its recent unsuccessful efforts to collect past due balances, the Company has updated its analysis of potentially uncollectible accounts receivable balances and has increased the allowance to $8,321,000 at March 31, 2001 from $801,000 at December 31, 2000. The expense for the three months ended March 31, 2001 was $7,520,000.

(Div. Ex. 17 at 7.) The increase in the reserve for doubtful accounts was based on the assumption that Akorn would not collect on fifty percent of the 2000 accounts receivable and one hundred percent of all 1999 and pre-1999 accounts receivable from Akorn's top-five wholesalers including Cardinal. (Tr. 350-51; Div. Ex. 18.)

[27] Resp. McC Ex. 269 and Resp. Harris Ex. 451 are two similar exhibits. Both show Cardinal's open balance in accounts receivable aging as $3,662,196. There appears to be a discrepancy which could mean that Respondent McConville sent Cardinal the pre-1999 invoices on April 30, 2001 (Div. Ex. 92 at 3), rather than on April 21, 2001 (Resp. McC Ex. 270). (Tr. 1206-07.)

Respondent Harris decided that Akorn should increase the uncollectible accounts receivable reserve by $5.67 million in the Form 10-Q based on the aging schedule for Akorn's accounts receivable prepared by Mr. Maire, dated April 9, 2001. (Tr. 353-55; Div. Ex. 18.) As part of its review, Deloitte requested a greater increase in the reserve because of the Cardinal account, which caused Respondent Harris, or someone he supervised, to do additional analysis and increase the reserve amount by $1.65 million to $7.32 million.[28] (Tr. 353-56, 915; Div. Ex. 18.) The April 9, 2001, aging report also shows a total of $22.7 million of past due accounts receivable, with five wholesalers responsible for $9.64 million. (Div. Ex. 18.) Cardinal's past due accounts receivable were almost $4.3 million. (Tr. 357; Div. Ex. 18.) Respondent Harris determined that according to Statement of Financial Accounting Standards No. 5, Accounting for Contingencies ("FAS 5"), this was a change in estimate driven by new information, not the correction of an error or the misunderstanding of information available at the time. (Tr. 775-76.)

Note H to the financials, which were part of the Form 10-Q, reported that Akorn failed to make a $1.3 million required principal payment on its existing bank debt, and that Dr. Kapoor had not provided the $3 million cash infusion because "he believes that material changes in the Company's financial position and the Company's covenant violations on the senior bank debt prevented the Company from complying with certain representations and warranties, which were to be contained in the subordinated debt financing and thereby necessitated a delay in funding the subordinated debt." (Div. Ex. 17 at 7.)

Deloitte's workpapers for Akorn's 2000 audit noted that "[d]uring the fourth quarter 2000, Akorn identified, estimated and recorded approx. $1.5 million of rebates related to Cardinal that it had not explicitly previously recorded," and that "[o]ld management believed it didn't have a significant exposure for rebates granted to wholesalers." (Resp. McC Ex. 274 at 4.)

On October 7, 2002, Akorn filed an Annual Report on Form 10-K/A as Amendment 2 to its Form 10-K filed on April 16, 2002, for the purpose of giving effect to the restatement of Akorn's consolidated financial statements for the years ended December 31, 2000 and 2001, and to file the report of its independent auditors. Note S, titled Restatement, states in part "that the $7,520,000 increase in [Akorn's] allowance for doubtful accounts that was recognized during the three months ended March 31, 2001, should have been recognized at December 31, 2000 and that bad debt expense for the years ended December 31, 2000 and 2001 was understated and overstated, respectively, by a corresponding amount." (Div. Ex. 100 at 82.) The Form 10-K/A restated the net income of $2,187,000 reported on Akorn's Form 10-K as a net loss of $2,414,000. (Div. Ex. 100 at 82-83.)

[28] Deloitte's "review" has substantially less scope than an audit, and relies much more heavily on management's representations. (Tr. 773.) As part of a review, Deloitte performed procedures to determine whether there is anything that is material that requires modification of the financial statements presented in the Form 10-Q. (Tr. 772-73.)

## G. Division's Expert –Gordon Yale[29]

Mr. Yale believes that: (1) the Form 10-K and the Form 10-Q contained financial statements that were materially false and misleading and Akorn's senior management had no reasonable basis to believe that the financials were accurate or prepared in accordance with GAAP; (2) the financial statements in the Form 10-K failed to disclose that Akorn's accounts receivable were materially overstated by at least $571,893, and that Akorn could not accurately quantify the overstatement; (3) the financial statements in the Form 10-Q "concealed the chronic disarray of Akorn's books and records" and violated GAAP by presenting financial statements for the year 2000 that were not restated; and (4) the financial statements in the Form 10-Q improperly reported the loss provisions in the current period as a "change of estimate" thus concealing that Akorn's prior financial statements had been materially false and misleading. (Div. 106 at 1-2.)

Mr. Yale asserts that Respondent McConville represented to Deloitte in February and April of 2001 that $1,241,000 of Cardinal's 1999 accounts receivable were fully paid or offset by credits, and that Deloitte's workpapers showed the Cardinal account with a negative receivable balance of $95,630 from 1999 and only $293,138 from invoices prior to 1999. (Div. Ex. 106 at 11.) At the same time, however, Respondent McConville was seeking immediate payment from Cardinal of $1,886,776 in 1999 and prior year open invoices. (Id.)

## H. Respondent McConville's Expert –Lynda Harbold Schwartz[30]

Working with a team of professionals with accounting, audit and financial experience, Ms. Schwartz concluded that: (1) Respondent McConville's role was limited to reconciling the Cardinal account after March 21, 2001; (2) Mr. Yale's assertion that Respondent McConville made untruthful representations to Deloitte is unsupported by the evidence; (3) Mr. Yale's assertion regarding accounting misstatement mischaracterizes evidence, including Cardinal account reconciliation and account team notes; (4) Mr. Yale provides no basis for asserting that Akorn's accounting systems were inadequate; and (5) in 2000, Respondent McConville did not profit from Akorn in excess of her base salary. (Resp. McC Ex. 395 at 2, 10-11.)

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[29] Mr. Yale has a Bachelor of Arts degree from the University of Colorado and a Masters in Accountancy from the University of Denver. He is a CPA and a certified fraud examiner. Since 1998, he has been with the Yale Group in Denver, Colorado. His professional work experience includes employment with various types of financial firms, and he has written, consulted, and lectured extensively. (Div. Ex. 106.)

[30] Ms. Schwartz, a general partner with Ernst & Young LLP ("E&Y"), is a CPA employed in E&Y's Global Investigations and Dispute Advisory group. Ms. Schwartz holds a Bachelor of Arts degree from the University of Massachusetts at Amherst. Ms. Schwartz has provided expert testimony in depositions, arbitrations, mediations, and trials, and has made numerous public presentations both in written and oral form. (Resp. McC Ex. 395 at 1 and Attachment 1.)

Ms. Schwartz concluded that Mr. Yale's opinions regarding the Form 10-Q are not relevant to Respondent McConville because there is no evidence that Respondent McConville took part in any discussions relating to the chargeback reserve, allowance for uncollectible accounts, sales return reserve, or inventory obsolescence reserve for the first quarter of 2001. (Resp. McC Ex. 395 at 11.) However, Ms. Schwartz also concluded that Respondent McConville had reviewed and seen drafts of the financial statements in February 2001. (Resp. McC Ex. 395 at 9.) Ms. Schwartz believes that, on its face, Akorn's Form 10-K shows that accounts receivable were deteriorating in that they were increasing at a higher rate than net sales. (Tr. 1054.) In Ms. Schwartz's opinion, the evidence does not support a conclusion that Akorn's internal controls were insufficient. (Resp. McC Ex. 395 at 22.)

For reasons stated later in this Initial Decision, I find the record does not support Ms. Schwartz's expert opinion that Respondent McConville made no false representations and that Akorn's accounting system was adequate.

### I. Respondent Harris's Expert – Brian T. Moore[31]

Mr. Moore rejects the Division's allegations against Respondent Harris for the following reasons:

1. The allegation that Respondent Harris knowingly signed a management representation letter on April 17, 2001, that falsely stated that "Akorn's $801,000 allowances for doubtful accounts receivable 'are adequate to absorb currently estimated uncollectible receivables in account balances'" does not consider the meaning of these terms in accounting literature and the statement is true "unless specific requirements are satisfied for accruing a charge to income for an estimated loss through the accounting for the allowance for doubtful accounts." (Resp. Harris Ex. 570 at 3.)

2. The allegation that Respondent Harris knowingly signed a management representation letter on April 17, 2001, that falsely stated that "'no events had occurred since 2/23/2001 that have a material effect on financial statements . . . or that should be disclosed in order to keep those statements from being misleading'" does not consider the meaning of these terms in accounting literature. (Id. at 4.)

3. The allegation that the allowance for doubtful accounts in the Form 10-K was inadequate "does not appropriately take into account applicable accounting principles governing the establishment of loss reserves." (Id.)

[31] Mr. Moore is a partner with Capstone Corporate Recovery, LLC, a financial advisory firm. Mr. Moore is a graduate of the College of William & Mary, and has been a CPA since 1982. He had a twenty-three-year career with Arthur Andersen, LLP, and was with FTI Consulting, Inc., from June 2002 to February 2004. Mr. Moore has been involved in testifying and advising in commercial disputes, arbitrations, and restructuring situations. He has been appointed by courts as a special auditor, examiner, and advisor. (Resp. Harris. Exs. 570, 592.)

4. The explanation in the Form 10-Q that a change of estimate was the reason for the $7.52 million increase in the allowance for doubtful accounts was proper. (Id. at 4-5.)

Mr. Moore believes that Respondents McConville and Harris and Mr. Benjamin were the relevant people working on the reconciliation and that in May 2001, "you have a new body of information" that "was a lot different than before that." (Tr. 1319.) Mr. Moore notes that Mr. Yale's statement that Akorn could not quantify material losses on accounts receivable on April 17, 2001, shows that Akorn lacked an essential requirement for recording an increase to the allowance for doubtful accounts in the Form 10-K. (Resp. Harris Ex. 570 at 5-6.) Mr. Moore considered that the new information occurred after Akorn filed the Form 10-K when negotiations ceased, Cardinal imposed strict criteria for payment, Mr. Harris and Dr. Kapoor decided it was not in Akorn's business interest to sue, and the parties discussed renegotiating their agreements. (Tr. 1319-21.)

Mr. Moore takes issue with Mr. Yale's claim that Akorn should have processed rebates that would have reduced Akorn's net income by 16.3%. According to Mr. Moore, processing the rebates would have had no effect on income and does not support Mr. Yale's contention that a restatement was required. (Resp. Harris Ex. 570 at 6.) Mr. Moore finds no support for any suggestion that Akorn's Form 10-K or Form 10-Q were deficient because the financials did not deduct "the amount of the unwarranted source rebates." (Id.) Finally, Mr. Moore is critical of Mr. Yale for failing to acknowledge the brief time that Respondent Harris served as CFO and that during this time Akorn's senior officers uniformly believed that the accounts receivable were collectible. (Resp. Harris Ex. 570 at 7.) Mr. Moore considers that Respondent Harris's signature on the management representation letter should be evaluated with consideration, given the fact that he was required as CFO to sign even though he had only recently joined Akorn. (Resp. Harris Ex. 570 at 19.)

According to Mr. Moore, even if one concluded that Akorn had an impairment of assets on December 31, 2000, and it was something other than a change in estimate, the information available on February 23, 2001, and April 17, 2001, did not meet the criteria of FAS 5 for accruing a loss. (Resp. Harris Ex. 570 at 23-24.) I disagree. Mr. Moore admitted on cross-examination that: (1) he used the term "facts known" to describe how Accounting Principles Board Opinion No. 20, Accounting Changes ("APB 20") ¶ 13, defines error when the opinion uses the term "facts that existed," and (2) he relied on FAS 5 ¶ 8 to support his position without mentioning the requirements of FAS 5 ¶ 10, which I find are relevant. (Tr. 1306, 1309-12.) As noted in the following findings, I disagree with Mr. Moore's interpretation of the facts and the application of GAAP to those facts.

### J. Did Respondent McConville Violate Section 10(b) of the Exchange Act and Rule 10b-5 by Acting Fraudulently in Connection with the Form 10-K and Management Representation Letters?

The OIP charges, among other things, that Respondent McConville: (1) engaged in accounting fraud by drafting and reviewing Akorn's financial statements that she had no reasonable basis for believing were accurate or in accordance with GAAP; (2) knew from at least 2000 to at least April 2001, that Akorn did not promptly and accurately record and reconcile remittances and that it did not accurately record, reconcile, and age its receivables; (3) reviewed Akorn's Form 10-K, which did not disclose any impairment of the $24.1 million accounts receivable; and did not establish a reserve for any of Akorn's accounts receivable for its largest wholesale customers during fiscal year 2000; (4) signed a representation letter to the auditors acknowledging that Akorn was responsible for determining and maintaining the adequacy of the allowance for doubtful accounts receivable and representing that the allowances are adequate to absorb currently estimated uncollectible receivables; and (5) signed a second representation letter dated April 17, 2001, that falsely represented that no events had occurred since February 23, 2001, that had a material effect on the financial statements in the Form 10-K.[32] (OIP at 2-3.)

The Division alleges in its Post-Hearing Brief, that:

> Rita McConville violated the securities laws by causing [Akorn] to falsely overstate its net income in its 2000 10-K by over $4.5 million and show a $2.2 million profit rather than the $2.4 million loss it actually incurred. McConville also violated the securities laws by causing Akorn to maintain books and records which misstated Akorn's assets. In addition, McConville falsely assured Akorn's auditors that the financial statements in Akorn's 2000 10-K complied with GAAP and that she did not know of any events which would materially impact those financial statements. Despite her assurances, at the time the 10-K was filed McConville knew or was reckless in not knowing that Akorn's accounts receivable, its largest asset was substantially impaired.

(Div. Br. at 1.)

Section 10(b) of the Exchange Act makes it unlawful to use or employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance in contravention of the rules and regulations prescribed by the Commission for the protection of investors. Rule 10b-5 prohibits any person by use of any means or instrumentality of interstate commerce, or of the mails, or any facility of a national securities exchange in connection with the purchase or sale of any security: (1) to employ any device, scheme, or artifice to defraud; (2) to make any untrue statement of material fact or to omit to state a material fact necessary to make the statements made, not misleading; or (3) to engage in any act, practice, or course of business which operates or would operate as a deceit or fraud on any person. To violate Section 10(b) or Rule 10b-5 a person must have acted with scienter, defined as "a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976); C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988). The scienter requirement can be satisfied by a showing that a person acted recklessly. See Novak v. Kasaks, 216 F.3d 300, 308-10 (2d Cir. 2000); Greebel v. FTP Software, Inc., 194 F.3d 185, 198-201 (1st Cir. 1999); Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1281-82 (11th Cir. 1999); In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 549-51 (6th Cir. 1999); In re Advanta Corp. Sec. Litig., 180 F.3d 525, 534-35 (3d Cir. 1999); Sanders v. John Nuveen & Co., 554 F.2d 790 (7th Cir. 1977).

[32] The evidence is that Respondent McConville signed the letter dated February 23, 2001, and the letter dated April 17, 2001, on or about April 17, 2001. (Tr. 1161-62.)

The case law on the subject of securities fraud has given the "in connection with" criterion broad meaning. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968). The "in connection with" requirement is met in this situation because Respondent McConville's conduct involved material information about Akorn that was made available to the investing public for use in deciding whether to buy or sell Akorn securities that were publicly traded on the Nasdaq National Market. (Div. Ex. 5 at 9.) The conduct at issue involved use of the mails, the electronic transmission of data and shipments between Akorn's offices in Illinois and Cardinal's facilities outside Illinois, and other instrumentalities of interstate commerce.

Akorn's financial statements in its Form 10-K were materially false and omitted material information required to make them not misleading because they materially inflated Akorn's accounts receivable, net sales, and assets. Information is material when there is a substantial likelihood that a reasonable investor would consider it important in determining how to act. Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988). The management representation letters in connection with the Form 10-K, falsely represented that the financial statements were presented in conformity with GAAP, that no events occurred subsequent to December 31, 2000, that necessitated adjustment or disclosure in the financial statements, and that the allowances for doubtful accounts receivable, and chargebacks and rebates were adequate.

Based on the following facts and others in this record, I find it was material error for the financial statements in Akorn's Form 10-K to omit in the reserve for doubtful accounts an amount for its top-five wholesale customers.

> On March 15, 2001, Akorn's CEO wrote to Cardinal that in excess of $5 million that Akorn claimed Cardinal owed still needed to be reconciled. (Resp. McC Ex. 284.) Akorn had not received additional funds from Cardinal or accomplished a reconciliation by April 17, 2001.
>
> On March 19, 2001, Akorn's top-five wholesalers had some $14.3 million (57.2%) out of a total $25 million in accounts receivable.[33] It was impossible to assess from Akorn's books and records what accounts receivable of the top five wholesalers were collectible and what the magnitude of the write offs might be. The wholesale accounts receivable had never been worked and the problems went back three or four years. The books and records contained a substantial volume of duplicate accounts. And, Akorn did not have adequate accounts receivable aging reports for the collection process. (Div. Ex. 77.)
>
> As of March 31, 2001, Akorn had total accounts receivable of $25,276,025, of which $13,457,516 (53.2%) was due from the top-five wholesalers with $5,428,850 (40.3%) of their accounts receivable past due over sixty-one days. (Tr. 748; Div. Ex. 18.) Cardinal's accounts receivable was $4,625,561, (18.3% of the total accounts receivable) with $1,539,521 (33.3% of its total accounts receivable) past due over sixty-one days. (Tr. 748; Div. Ex. 18.)

[33] The percentage calculations are rounded off to the nearest tenth of a percent.

> In February 2001, Akorn's president and CFO visited Cardinal to try to collect some $4 million of unpaid invoices that went back several years. (Tr. 123, 191, 194-95, 554-55, 1133-35.) In response, Cardinal, on or about March 9, 2001, informed Akorn that some invoices had already been paid, agreed that it would look into others, paid $913,745.15, and declared that the issues Akorn raised were resolved and it was in a debit position. (Div. Ex. 89.)

These facts are material because they establish that Akorn was not going to collect one hundred percent of its accounts receivable from its top-five wholesale customers, which would adversely impact Akorn's financial statements.

**1. Respondent McConville Had Significant Responsibility for and Reviewed the Form 10-K**

Respondent McConville claims that after Akorn consolidated its financial offices in 1999, she just reviewed and commented on the draft of the Form 10-K prepared by the controller and presented it to the signers and the board. (Tr. 126.) She denies, however, that she reviewed the Form 10-K at issue here, but acknowledges drafting the "stock option footnote." (Tr. 127, 129.) I find the following evidence persuasive that Respondent McConville had significant responsibility for Akorn's Form 10-K and that she reviewed a draft of the Form 10-K that did not differ significantly from the Form 10-K that was filed.

Until March 21, 2001, Respondent McConville, as Akorn's CFO, was responsible for Akorn's financial statements. She supervised Mr. Costello, and assisted the auditors in preparing the Form 10-K. Mr. Delgado began working with Respondent McConville when he joined the account late in the first quarter of 2000. Deloitte addressed its November 28, 2000, engagement letter to Respondent McConville, who was ultimately responsible for working with the auditors. (Tr. 85; Resp. Harris Ex. 542.) During the field work, the auditors received most of the information from Respondent McConville and her staff. (Tr. 872.) Mr. Delgado testified that Respondent McConville and Mr. Costello were the auditor's primary contacts. (Tr. 85, 815; Resp. Harris Ex. 542.) Respondent McConville met with Mr. Delgado, and she was present at various meeting with the auditors in 2000 and 2001. For example, she attended an interim status meeting with the auditors on December 21, 2000, she met with the auditors when they finished their field work, and she attended the auditors' meetings with Akorn's audit committee. (Tr. 83, 101, 115, 190; Harris Exs. 523, 544, 545.) Deloitte considered the financials done except for the Bank loan, but not in final form when it completed its field work on February 23, 2001. (Tr. 881-83.) Respondent Harris acknowledged that Respondent McConville together with Mr. Costello and Deloitte participated in preparing the Form 10-K. (Respondent Harris Answer at 5.) Deloitte had Respondent McConville sign two management representation letters on or about April 17, 2001, after she ceased being CFO, for the representations she made while Deloitte was performing the audit. (Tr. 948-49, 1160-62; Div. Exs. 101, 102.)

Respondent McConville testified during the investigation that she believed that she had reviewed a draft of the Form 10-K. (Tr. 128-30.)

> The 10-K, I had performed my normal oversight review functions up to that point in time. The draft – so I had already reviewed the early draft of the document. After March 21st I was not involved in the final phase of the document. So whatever changes were made from March to when it was finally filed, no, I was not.

(Resp. McC Ex. 395 at 13.) Respondent McConville's expert witness concluded that Respondent McConville "performed her normal procedures as a reviewer of the financial statements in February," and Respondent McConville "had seen drafts of the financial statements prior to her demotion." (Resp. McC Ex. 395 at 9.) Respondent McConville told Ms. Schwartz that she did "analytical review procedures," and she "made inquiries of people who were knowledgeable." (Tr. 1063.) Ms. Schwartz understood that, as CFO, Respondent McConville was a participant in the audit process, and she "reviewed drafts of the balance sheets, the income statements, and that part of the financial statements." (Tr. 1064-65.)

Further support for Respondent McConville's participation in preparation of the Form 10-K is the fact that the press release she authored, issued on February 20, 2001, before Akorn filed the Form 10-K, contains the same numbers for net sales, net income, and gross profit that appear in the Form 10-K. (Tr. 810-11; Div. Exs. 5 at 22-23, 6 at 1-2.)

For all these reasons, I find that Respondent McConville had significant responsibility for the financials in the Form 10-K.

**2. Respondent McConville Knew or Was Reckless in Not Knowing That Akorn's Form 10-K Was Materially False and Misleading and Not in Accordance with GAAP**

**a. Problems Collecting Accounts Receivable and Failure of Allowance for Doubtful Accounts to Include Wholesale Customers**

The record contains a number of instances where Respondent McConville's position is not credible. For example, in addition to her denial that she reviewed the Form 10-K, Respondent McConville claims that she does not recall when the board became concerned about the increased age of Akorn's accounts receivable. Her claim is not credible because she was responsible for reporting Akorn's financials results to the board and in 1999 and 2000, Akorn's accounts receivable were increasing at a much faster rate than sales. (Tr. 116-18, 262-63, 1090-91; Resp. McC Ex. 395 at 5.) It is a fact that the older a receivable is the more difficult it is to collect. (Tr. 412.) A major factor for the increased age of Akorn's accounts receivable was increased sales to wholesale customers whose invoices were older than the invoices of Akorn's direct customers due to different contract terms for repayment. (Tr. 116-18.) Generally, end users were to pay in thirty days, while most wholesale customers were to pay in thirty or ninety days. (Tr. 114.)

Mr. Benjamin recalled that accounts receivable, in particular the non-collection of aged accounts receivable, was a concern throughout 2000, especially near the end of the year, and the issue was unresolved at year end.[34] (Tr. 537-38.) Mr. Delgado was generally aware in 2000 that Akorn's audit committee was not pleased with the level of collections.[35] (Tr. 958.) Akorn increased its efforts to collect accounts receivable in the last quarter of 2000, because cash was tight, Akorn had major capital projects underway, and the Food and Drug Administration had not approved any new products for Akorn in some time. (Tr. 119-20.) Mr. Benjamin directed Respondent McConville and the vice president of sales to determine whether the amounts were collectible, and if so, to develop a collection plan. (Tr. 538.)

The auditor's letter to Akorn's board on the completion of the 1999 audit was dated February 25, 2000, close to the end of field work, but Akorn received the letter no earlier than July or August 2000, after it had had an opportunity to draft responses to the auditor's observations and recommendations. (Tr. 1122-23; Div. Ex. 49.) In the 1999 audit, Deloitte observed on accounts receivable:

> Management has not reviewed the accounts receivable aging in detail due to the size of the report. The cause of this issue is that paid invoices are subsequently being reclassified as open when a credit is applied to the invoice. As a result, the invoice, payment, and credit, are shown in the accounts receivable aging. We also noticed instances of credits and payments being misapplied to customer accounts. . . .
>
> After the Accounts Receivable Manager left the Company, we noted a buildup in accounts receivable during the year as collections slowed. Consequently, management is not effectively and efficiently collecting on those outstanding balances. As a result, days sales outstanding have increased to approximately 102 days in 1999 as opposed to 84 days in 1998. A new manager was employed in November 1999.

(Div. Ex. 49 at 5.) Deloitte recommended that Akorn reconcile customer accounts with the customers, beginning with wholesale accounts, and that it begin mailing out monthly or quarterly statements to customers to facilitate more timely collection of accounts. (Div. Ex. 49 at 5.)

The February 25, 2000, letter includes management's response to each observation. Respondent McConville and Mr. Costello represented that with respect to accounts receivable, Akorn had "begun an effort to reconcile all customer accounts and pursue payment of aged balances," that Akorn's accounts receivable personnel were focusing on major wholesale customers, and that "[m]anagement has retained experienced temporary labor to help handle daily cash application activity so as to allow Company accounts receivable staff the time to

[34] Mr. Benjamin consistently represented to the board that Akorn's accounts receivable were collectible. (Tr. 1283.)

[35] On June 11, 2002, the Division notified Mr. Delgado and Richard Caffarelli, Jr., that it intended to recommend that the Commission bring an enforcement action against them in connection with Deloitte's audit of Akorn's 2000 financial statements. (Resp. Harris Ex. 587.) There is no record that the Commission has done so. (Resp. Harris Br. 26 n.19.)

pursue the aged balances and general account cleanup." (Tr. 155, 1122-23; Div. Ex. 49 at 5.) Akorn told the auditors that it sent statements to all customers and that it put procedures in place to send out monthly statements. (Div. Ex. 49 at 5.) Management's goal was "significant collection/resolution by June 30, 2000 and complete cleanup by August 31, 2000." (Div. Ex. 49 at 5.) Respondent McConville and Mr. Costello did none of these things. According to Respondent McConville, Akorn did not do what it told the auditors it would do because "[t]here were a lot of other activities going on." (Tr. 155-56, 1127.)

Despite representations to auditors, Akorn did not act to "step up" collections of accounts receivable payable until the end of 2000. (Tr. 119.) By the fall of 2000, Akorn had only collected $200,000 on 1997 through 1999 invoices of $600,000 to $700,000. (Div. Ex. 106 at 4.) Respondent McConville tried to set up a meeting with Cardinal's controller in November 2000, but that the meeting did not take place.[36] (Tr. 121.) Late in the fourth quarter of 2000, Dr. Kapoor directed Respondent McConville and Mr. Benjamin to "go out to Cardinal and get some money." (Tr. 120.)

Akorn's net sales during the fourth quarter of 2000 were almost $2 million lower than the fourth quarter of 1999, due primarily to a $1.8 million increase in the wholesaler rebate and chargeback reserve recorded in the fourth quarter. (Tr. 1114-15; Div. Ex. 6.) The February 20, 2001, press release that Respondent McConville prepared reported a net loss for the fourth quarter of $2.2 million compared to net income of $1.8 million in the fourth quarter of 1999. (Tr. 1115; Div. Ex. 6.) Akorn attributed the loss to several factors, including a $2.7 million increase in the reserve for slow-moving and obsolete inventory and the $1.8 million increase in the bad debt reserve. (Tr. 1115-19; Div. Ex. 6 at 1; Resp. Harris Ex. 409.) Respondent McConville acknowledges that in late 2000, someone at Akorn, possibly the controller, believed that the reserve for chargebacks and rebates, which was in excess of $3 million, might not be adequate to cover Akorn's exposure for the year ended December 31, 2000. (Tr. 159-60.) Dr. Kapoor was disappointed in the year-end results and urged Respondent McConville to make sure that reserves were sufficient and that "there isn't anything else."[37] (Tr. 1119-20.) Respondent McConville assured him that she had examined all assumptions behind the reserves. (Id.)

The Audit Committee minutes on April 20, 2000, state that "the accounts receivable aging had deteriorated further, with fully one-third of the receivables at over 90 days," and the auditors noted that Akorn would have to establish a reserve for aged accounts if substantial improvement did not occur in the next quarter. (Div. Ex. 106 at 7-8.) Respondent McConville

[36] Mr. Yale relies on Respondent McConville's Wells submission that is not in evidence to support his statement that Respondent McConville and Mr. Benjamin visited Cardinal in November 2000, but made no real progress in speeding collections. (Div. Ex. 106 at 8.)

[37] Dr. Kapoor holds an undergraduate degree in pharmacy and a Doctor of Philosophy degree in medicinal chemistry. Dr. Kapoor went to work at Lyphomed in 1978 and was part of a leveraged buy out of Lyphomed in 1990 when he entered the investment business. (Tr. 1251-52.) Dr. Kapoor worked with Mr. Benjamin at Lyphomed around 1987. (Tr. 1254.) Dr. Kapoor bought a fifteen to twenty percent interest in Akorn in a private transaction around 1991. (Tr. 1253-54.)

reported to the Audit Committee that, at the end of the second quarter, the aging position had improved with two major wholesalers now current, and, at the end of the third quarter, that the age of accounts receivable had deteriorated only slightly. She did not reveal that approximately twenty-four percent of accounts receivable appeared to be from 1999 and prior years. (Div. Ex. 106 at 8.)

At Dr. Kapoor's directive, Respondent McConville and Mr. Benjamin met with Cardinal representatives in February 2001, and presented them with open invoices for over $50,000 that Respondent McConville was able to assemble in a short time.[38] (Tr. 191, 194-95, 554-55, 1133-35.) At that time, Respondent McConville believed that Cardinal owed Akorn approximately $4 million in unpaid invoices. (Tr. 122-23.)

On March 9, 2001, Cardinal issued Akorn a check for $913,745.15. Cardinal maintained that the check put it in a $100,000 credit position with Akorn, and resolved the issues that Respondent McConville and Mr. Benjamin had raised at the February meeting. (Tr. 185-86, 191-92; Div. Ex. 89.) On March 9, 2001, Mr. Roberts of Cardinal sent an e-mail to Respondent McConville and Mr. Benjamin recapping the meeting and stating that: Cardinal's accounts payable had been requesting invoices from Akorn; problems with Akorn's billing system in late 2000 caused an error; that many 1999 and 2000 invoices had been paid; Akorn needed to supply additional information; and pending questions existed over the interpretation of contract terms for "1999 & 2000 Preferred products rebates." Mr. Roberts stated that the information in his communication resolved all the matters from the meeting. (Div. Ex. 89.)

Respondent McConville knew that Cardinal's payment was for invoices Akorn issued in 2000, that Cardinal claimed that it had paid some of the 2000 and 1999 invoices, and that there was no proof of delivery for some of the other 2000 and 1999 invoices. (Div. Ex. 106 at 10.) Mr. Benjamin expected that Cardinal would pay after Akorn "worked the books" as part of the reconciliation process and showed Cardinal that the amounts were owed. (Tr. 563-64.) When she returned from the meeting with Cardinal, Respondent McConville turned over work on reconciling the Cardinal account to the person or persons working on accounts receivable. (Tr. 1150.)

In 2000, Nancy Phillips, assistant controller from March 1999 through September 2001, and Joanne Alfaro, manager of the finance department's accounts receivable function beginning in August 2000, told Akorn's management they believed the reserve for doubtful accounts was insufficient. (Tr. 966, 978-79; Resp. McC Ex. 395 at 4.)

The auditor's letter to Akorn's audit committee, dated February 23, 2001, at the end of field work reported that:

> The Company continues to have significant issues with its accounts receivable records. The current situation is due to various reasons ranging from system

[38] Respondent McConville was able to present Cardinal with approximately $1 million of Akorn invoices that were not on Cardinal's books because Cardinal had given Akorn its accounts payables aging. (Tr. 1135-36; Div. Ex. 106 at 10.)

> deficiencies to inexperienced staff. Adding to the problem is the significant volume of unsupported credits that are taken by some customers. The Company has been unable to keep up with identifying and supporting unauthorized credits that it could then discuss with the customers. Additionally, the Company's accounts receivable aging has such a significant amount of credits that are not applied to a specific invoice that the aging categories no longer present meaningful information.
>
> During our audit we noted several instances of misapplied payments and credits. Additionally, certain accounts receivable are being disputed by the customer. Several audit confirmation replies we received included information from the customer that allowed the Company to identify where the Company has misapplied a credit or a payment (i.e., the Company had recorded the credit in accounts receivable but not against the particular invoice to which it related). This suggests that there may be other misapplied payments and credits within the accounts receivable records.
>
> These issues, which have emerged over time, have led to a lack of adequate supporting documentatio[n] to allow the Company to quickly reconcile disputed accounts and provide definitive evidence to its customers to support and collect outstanding balances. Instead, the Company has to undertake a laborious process in order to determine whether accounts receivable balances are appropriately stated, given the likelihood of a misapplied credit and/or payment.
>
> The Company lacks formal procedures to timely monitor and challenge credits taken by a customer to ensure that they are appropriate.

(Div. Ex. 39 at 6.) The auditors recommended that Akorn maintain accurate accounts receivable records and suggested creation of a task force to reach this goal. (Div. Ex. 39 at 6.)

#### b. Accounts Receivable – Billing, Recording Credits, Reconciling Accounts

The evidence is overwhelming that Akorn's accounting for accounts receivable had major deficiencies, and that its books and records were in disarray, which Respondent McConville knew, or was reckless in not knowing. According to Mr. Costello:

> Akorn had thousands of products, so every invoice could have 10, 20, 50 line items on it and they could have 10, 20, 50 invoices in a week and so payment cycles being what they are alone just on straight invoices could lead to 3,400 line items on a customer's remittance, add to that the uniqueness of this industry in which you have returns which every industry has which has rebates which is kind of unique in this industry and chargebacks which are very unique to this industry and all of those credits are coming back, most of which -- many of which are coming back electronically.

> . . . you have to start reconciling data that comes back different than what you anticipated it to be.
>
> . . . we would print out for example an aging of one location of one customer and it would be 50 lines per page and it would chew up 80 pages, so it's hard for someone posting cash to go in and find a line item on a remittance and go through 4,000 lines of detail to find it. . . . There were relational numbers that allowed you to go and find it, but sometimes the customers didn't always use the same number that we used and so they would create some problems.
>
> . . . .
>
> . . . from the practical sense, it was almost impossible [for a person to process a 300-line remittance in one day]. It was just very hard to find the information. Remember, there was two things going on. There was not only the volume issue and the fact that there was just an inordinate amount of line items, but we also had some systematic issues . . . .

(Tr. 721-22, 724-25.) In some cases, it was impossible for Akorn to post in a single day a payment from a large wholesaler to all the line items it should be posted against, so the payment was entered as unapplied cash. (Tr. 723.) When it became necessary to reconcile Akorn's accounts receivable with Cardinal's accounts payable, Respondent McConville admitted:

> Because there were so many individual line items, about 6,000 line items in the combined accounts. It was very difficult to do the reconciliation process. I likened it to a puzzle. You're taking all of these items and trying to relate the items in the account to each other. Relate debits to credits and matching them up and tying them together.

(Tr. 1151.)

Mr. Maire's March 15, 2001, report to Dr. Kapoor on the status of Akorn's accounts receivable completed in just ten days of study is compelling evidence that the problems were enormous and that some accounts receivable were uncollectible:

> I regret that I cannot provide an assessment of what is collectible and what the magnitude of write-offs might be. A determination on the collectibility will require a substantial amount of time (months) and work.
>
> **Assessment of the Existing Situation**
>
> . . . The A/R totals just under $25MM. The past due totals $18 MM or 72%.
>
> . . . Five wholesalers contribute $14.3 MM of the $16.8 MM [owed by sixteen wholesalers as recorded on Macola].

. . . **the wholesaler accounts have never been worked.** We are talking about an accumulation of problems over a **3 or 4 year period.** This provides us with a legacy of pages and pages of A/R reports on each of those five accounts, consisting of a maze of transactions including: open invoices, partially paid invoices, billbacks, credits for return goods, credits for damaged goods, credits for shipments not received, credits for billing errors, rebate credits, chargeback credits, deductions taken arbitrarily by the wholesaler, situations where the wholesaler used credits multiple times, and unapplied cash. These transactions go back as far as 1996.

While all those transactions are a routine part of the job, the fact that the A/R has not been worked, let alone routinely, magnifies the task to an incredibly detailed undertaking requiring the skills of highly analytical and experienced accounts receivable people. That level of staffing does not presently exist at Akorn. In addition, there is a wide array of process and systems issues that severely complicate matters. . . .

**Issues**

. . . A/R prior to 2001 is in Macola. This duplicates work and complicates matters considerably. For example, customers receive two statements, one from each system and have to piece them together. The Akorn A/R staff has to work between two sets of Accounts Receivable to get a full picture of what the customer owes. Payment checks from the customer must be split up and applied to the appropriate system.

The new system apparently was installed prematurely and corners were cut to save expenses. The system is not functioning well.

The staff was not trained on the new system.

No management reports exist that trend sales, cash, A/R aging, reserves, unbilled, or DSO. Therefore, the A/R could not have been properly monitored.

A/R aging reports have not been previously printed. The staff has no way to set collection priorities. Producing a simple aging report in descending dollar sequence proved to be a week-long task to accomplish, and then only with outside consulting help because no one within the building knew how to do it.

Present staffing in the A/R department is insufficient and the quality of the existing staff is weak.

. . . .

Chargebacks may be a problem area. I have not been able to fully investigate that area as yet, but I believe we may have a problem with the interface between the chargebacks system and the J.D. Edwards system. This statement is premature, but Dave Hignite has given me indications that such a problem exists.

. . . .

There is a problem with substantial volume (thousands?) of duplicate accounts in the system. . . .

No credit limit or credit check function existed prior to 2001. . . . Staffing was not added to manage the credit function and it is not working efficiently or effectively. . . .

Sales policies (rebates, special deals, loading) have all contributed heavily to the A/R problem.

. . . .

Organizationally, the A/R collection function, customer service, chargebacks processing, maintenance of the customer data base records, and contract file maintenance are fragmented and strewn about various departments. . . .

**Recommendations**

. . . I see no quick fixes. . . . It will take a minimum of a month to get people on board.

. . . .

. . . There is a lot of work to be done. (emphasis in original)[39]

(Div. Ex. 77.) Mr. Maire testified during the investigation that: (1) Respondent McConville was unaware that Akorn was not doing accounts receivable reconciliations and collections; (2) Akorn had substantial amounts of older receivables which are harder to collect; and (3) it would be likely that some receivables would have to be written off. (Div. Ex. 106 at 9, 10.)

Ms. Phillips worked closely with Respondent McConville.[40] (Tr. 967.) Ms. Phillips was experienced in working with Macola and her duties were systems oriented and general accounting. (Tr. 966, 982; Resp. McC Ex. 395 at 4.) She did not supervise the accounts receivable department. (Tr. 1004.) On assuming her position, Ms. Phillips found that Akorn lacked documentation for many of its accounts receivable. (Tr. 966-68.) Ms. Phillips knew that

[39] Mr. Maire did not discuss his report with Respondent McConville, and she did not see it while she was employed at Akorn. (Tr. 444, 1174.)

[40] Ms. Phillips deliberately misstated on her resume that she was Akorn's controller. (Tr. 992; Div. Ex. 76.)

wholesalers often insisted on proof of delivery ("POD") before paying an open invoice and that PODs are unavailable from third parties after nine months to a year.[41] (Tr. 969.) Ms. Phillips testified to a number of problems in Akorn's finance department that included: (1) reconciling accounts receivable; (2) Akorn had only one or two "collectors"; (3) chargebacks were not being posted to the right accounts; (4) persons doing reconciliation did not have the required skills and Akorn refused to hire qualified staff; and (5) there were a lot of old items in accounts receivable, which no one was trying to collect. (Tr. 967-76, 978.) Ms. Phillips worked very little with Respondent Harris. (Tr. 977.)

According to Mr. Costello, Akorn could do some summary aging reports, but it could not review the entirety of the accounts receivable aging. (Tr. 723-24.) In December 2000, Mr. Delgado believed that Akorn's accounts receivable aging information was unreliable, and he considered the aging reports that Akorn generated to be of little or no value. (Tr. 801, 932-33.) Deloitte generated its own aging reports using data from Akorn's Macola program. (Tr. 934; Div. Ex. 63.) Respondent McConville, on the other hand, maintained that Akorn could generate accounts receivable aging reports. (Tr. 98-99, 1197.)

The evidence is that, on aging reports and material matters related to Akorn's Form 10-K, Respondent McConville knowingly or recklessly misled people. For example, Respondent McConville represented to the auditors between March and July 2000 that Akorn expected to achieve significant collection/resolution of accounts receivable by June 30, 2000, and complete cleanup by August 31, 2000, when she knew, or had reason to know, that it was impossible and never happened; she represented to Dr. Kapoor in February 2001 that all the reserves were sufficient when she knew Akorn had not made any provision in the allowance for doubtful accounts for possible non-payment by Cardinal and its other four top-wholesale customers. (Tr. 768, 1119-20; Div. Ex. 49 at 5.) Moreover, Respondent McConville's testimony that Akorn's aging reports were usable contradicts her representation to Mr. Maire that Akorn could not print out aging reports on accounts receivable, and that she was unaware of any trend reports. (Tr. 413-14, 441, 443, 1197.) As noted, Mr. Costello and Mr. Delgado confirmed that Akorn could not produce aging reports for its accounts receivable. This fact contradicts Mr. Benjamin's belief that the weekly one-page summary of an aging report that he received from Respondent McConville was based on a valid aging report. (Tr. 586-87.) Mr. Benjamin also incorrectly believed, based on information from Respondent McConville, that Akorn could not credit receipts to an invoice on occasion. In fact, Akorn's Macola system could not match invoices with subsequent payments or credits. (Tr. 316-20, 546-47, 832, 852-54.)

In the first quarter of 2001, Respondent McConville and Mr. Costello gave Mr. Delgado the impression that reconciliation of Cardinal's accounts receivable was "progressing very positively," and they appeared optimistic about collecting Cardinal's accounts receivable. (Tr. 779.) The management letter dated April 17, 2001, that Respondent McConville signed does not mention that questions existed about the collectibility of Akorn's accounts receivable from Cardinal. Mr. Delgado would have considered this fact a significant event. (Tr. 767; Div. Ex.

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[41] UPS will furnish POD up to a year. (Tr. 1366.)

102.) Deloitte did not become aware that Akorn was encountering difficulties in collecting accounts receivable until May 2001.[42] (Tr. 963.)

Also, on April 11, 2001, Respondent McConville resubmitted to Cardinal for payment, unpaid 1999 and earlier invoices totaling $1,886,776, and on April 16, 2001, she sent Cardinal additional 2001 open invoices totaling $93,613. (Tr. 1159; Div. Ex. 106 at 11.) These submissions contradict Respondent McConville's conduct in February 2001, when she caused Mr. Delgado to believe that there were no significant Cardinal balances outstanding on Akorn's books for 1999 and prior years. (Div. Exs. 63, 106 at 11.)

The evidence establishes that at least by April 17, 2001, Respondent McConville knew, or was reckless in not knowing, that: (1) Akorn's financials were materially false and misleading in that Akorn's income statement materially overstated net income because the reserve for doubtful accounts did not include any amounts for Cardinal or any other wholesale customer, and the balance sheet materially overstated Akorn's accounts receivable, the largest category of assets; and (2) Akorn's financial statements were not presented in conformity with GAAP.

### c. Misrepresentation in Management Letters that Audit Conducted in Accordance With GAAP

The Financial Accounting Standards Board promulgates GAAP, which are the "conventions, rules, and procedures that define accepted accounting practice." Barron's Dictionary of Finance and Investment Terms 234-35 (5th ed. 1998). The Commission's Regulation S-X at 17 C.F.R. § 210.1-02(d) (1983) requires that the financial statements of a public corporation must be audited by an accountant in accordance with generally accepted auditing standards. United States v. Arthur Young & Co., 465 U.S. 805, 811 n.6 (1984).

FAS 5, which is part of GAAP, provides that:

Accrual of Loss Contingencies

8. An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if both of the following conditions are met:

a. Information available prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.

[42] Prior to the filing of the Form 10-K, Mr. Delgado had not been shown a response that Respondent Harris received from Cardinal dated May 20, 2001, informing Akorn that thirty-seven of forty-two 1999 invoices for $443,220.09, which Akorn had resubmitted for payment, had been paid previously. (Tr. 779; Resp. McC Ex. 282.)

b. The amount of loss can be reasonably estimated.

Disclosure of Loss Contingencies

. . . .

10. If no accrual is made for a loss contingency because of one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure 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. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such estimate cannot be made. (footnotes omitted)

Financial Accounting Standards Board, Original Pronouncements, vol. I, 35-36 (2003/2004 ed.)

I reject Mr. Moore's expert opinion that the balance in the doubtful account reserve, which did not consider Akorn's wholesale accounts, was adequate because accounting standards for inclusion in reserves required that a loss be "probable" and "reasonably estimated" (Resp. Harris Ex. 570 at 4, 23-24.) The evidence is that in mid-April 2001, it was highly probable, if not certain, that Akorn would not collect one hundred percent of the accounts receivable from its top-five wholesale customers. When it filed its Form 10-Q on May 22, 2001, about one month after filing its Form 10-K, Akorn was able to estimate a $7,520,000 increase in its allowance for doubtful reserves and a $3,665,000 increase in its reserve for chargebacks and rebates. (Div. Ex. 17 at 6-7.) Also, Mr. Moore's expert opinion does not consider the language in paragraph 10 of FAS% that states if no accrual is made for a loss contingency because one or both of the contingencies in paragraph 8 are not met, "disclosure 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." (Tr. 1308-11; Resp. Harris Ex. 570.) FAS 5 defines reasonably possible as "[t]he chance of the future event or events occurring is more than remote but less than likely." Financial Accounting Standards Board, Original Pronouncements, vol. I, 34 (2003/2004 ed.) On April 17, 2001, there was more than a reasonable possibility, it was certain, that Akorn would not recover from Cardinal and other top wholesale customers a substantial portion of the accounts receivable shown in its financial statements, less the allowance for doubtful accounts and reserve for chargebacks and rebates.

For all the reasons stated, I find that Respondent McConville violated Section 10(b) of the Exchange Act and Rule 10b-5b therunder. Respondent McConville had significant responsibility for, and reviewed, the Form 10-K and she knew, or was reckless in not knowing, when she signed the management representation letters on or about April 17, 2001, that the financial statements were materially false and misleading and not in accordance with GAAP. It was highly unlikely that Akorn would collect a substantial portion of accounts receivable from Cardinal and other wholesale customers and it had made no allowances for this loss. The result was that the accounts receivable, net income, and assets were materially overstated.

**K. Did Respondent McConville Cause Akorn to Violate Section 13(a) of the Exchange Act, and Rule 13a-1 That Requires Public Companies to Make Periodic Filings With the Commission, and Rule 12b-20?**

Section 13(a) and Rules 12b-20 and 13a-1 are reporting provisions. Section 13(a) requires that every issuer of a security registered pursuant to Section 12 file with the Commission information, documents, and annual and quarterly reports as the Commission may require. Rule 13a-1 requires that every issuer of a security registered pursuant to Section 12 file an annual report. The contents of the filings must be accurate. SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1165 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979); SEC v. Kalvex, Inc., 425 F. Supp. 310, 316 (S.D.N.Y. 1975); SEC v. IMC International, Inc., 384 F. Supp. 889, 893 (N.D. Tex. 1974). Rule 12b-20 mandates that periodic reports contain such further material information as may be necessary to make the required statements not misleading. Violations of Section 13(a) or the Commission's rules thereunder do not require a showing of scienter. SEC v. McNulty, 137 F.3d 732, 740-41 (2d Cir. 1998); Savoy Indus., Inc., 587 F.2d at 1167; SEC v. Wills, 472 F. Supp. 1250, 1268 (D.D.C. 1978). Akorn violated Section 13(a) and Rules 12b-20 and 13a-1 because, for the reasons set forth above, the Form 10-K that it filed with the Commission was materially false and misleading.

The verb "cause" means "[t]o bring about or effect." Black's Law Dictionary 213 (7th ed. 1999). The Commission has held that to exercise authority under 21C of the Exchange Act there must be findings that: (1) a primary violation occurred; (2) there was an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation. Robert M. Fuller, 80 SEC Docket 3539, 3545 (Aug. 25, 2003), pet. denied, 2004 U.S. App. LEXIS 12893 (D.C. Cir. Apr. 23, 2004). All those elements are present here. Respondent McConville caused Akorn to commit these violations because she made significant contributions to the Form 10-K, she reviewed it, and she signed representation letters to the auditors that the information in the filing was true to the best of her knowledge and belief. Respondent knew, or should have known, that her conduct would contribute to Akorn's violations.

**L. Did Respondent McConville cause Akorn to violate Section 13(b)(2) of the Exchange Act and Did She Violate Rule 13b2-2?**

Section 13(b)(2)(A) of the Exchange Act provides that every issuer with securities registered pursuant to Section 12 must make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer. Section 13(b)(2)(B) requires that these issuers also devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP and to maintain accountability for assets.

Rule 13b2-2 makes it unlawful for an officer of an issuer to make or cause to be made a materially false or misleading statement to an accountant or omit or cause another person to omit any material information necessary to make the statements made not misleading in connection with an audit of financial statements or reports filed with the Commission. Rule 3b-2 defines the term officer to include a secretary, treasurer or principal financial officer, comptroller or principal accounting officer and any person who performs corresponding functions for an issuer. Scienter is not required to prove a violation of § 13(b) and the rules therunder. See McNulty, 137 F. 3d at 740-41.

The Division alleges that Respondent McConville's malfeasance as Akorn CFO caused Akorn to violate Section 13(b)(2) in that: (1) Akorn's books and records did not accurately reflect the true state of its accounts receivable and (2) Akorn's lack of adequate internal accounting controls was the cause of its inaccurate accounts receivable books and records. (Div. Brief at 17-18.)

The Division charges that Respondent McConville violated Rule 13b2-2 by signing management representation letters on or about April 17, 2001. According to the Division, the letters affirmed that: (1) Akorn's financial statements in the Form 10-K were fairly stated in conformity with GAAP, and (2) no events had occurred since February 23, 2001, that would have a material effect on the financial statements or that should be disclosed in order to keep those statements from being misleading. Yet Respondent McConville knew in late February or March 2001, that there was a discrepancy of approximately $4 million between Akorn's records of its accounts receivable from Cardinal and Cardinal's records of its accounts payable to Akorn, and that the 1999 and 2000 invoices she presented to Cardinal in February 2001 as "open" had already been paid. (Tr. 122-23; Div. Exs. 89, 101, 102; Resp McC Ex. 284; Div. Brief at 23.)

The overwhelming evidence in this record is that Akorn was in violation of Section 13(b)(2) because its books and records for accounts receivable and related accounts were inaccurate and did not accurately and fairly reflect the disposition of assets, and its system of internal controls did not provide reasonable assurances that its financial statements would be in accord with GAAP. Respondent McConville was responsible for these matters and she failed to carry out her responsibilities. Respondent McConville knew or should have known that her conduct would contribute to Akorn's violation of Section 13(b)(2).

In addition, I find that Respondent McConville violated Rule 13b2-2 because, as detailed in this initial decision, she made false representations to the auditors. For example, she represted that Cardinal's accounts receivable were collectible and no doubtful account allowance was appropriate for Akorn's top-wholesale customers, and she signed the management representation letters when she knew that the financials were incorrect with respect to accounts receivable and the financial statements were not prepared in accordance with GAAP, when she knew or should have known that this conduct violated the Commission's rules.

I reject the multitude of reasons offered by Respondent McConville as to why she did not cause Akorn's violation of Section 13(b)(2) and violate Rule 13b2-2. Respondent McConville was Akorn's CFO and Secretary for all of 2000 and until March 20 or 21, 2001. Respondent McConville signed the management representation letters as Comptroller on or about April 17, 2001. The evidence is that she held that title at that time.

**M. Did Respondent McConville Violate Section 13(b)(5) of the Exchange Act and Rule 13b2-1?**

Section 13(b)(5) of the Exchange Act states that "[n]o person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record or account described in [13(b)(2)]." Rule 13b2-1 makes it unlawful for a person, directly or indirectly, to falsify any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act. Scienter is also not required for a violation of Rule 13b2-1. McNulty, 137 F.3d at 740-41.

Respondent McConville's claim that Akorn had sufficient internal controls, including aging reports, and her dismissal of the auditor's concerns about Akorn's books and record for accounts receivable as systemic pharmaceutical industry problems without any solutions beyond Akorn's existing practices are contrary to the evidence. (Tr. 150-52, 1197-98.)

Respondent McConville earned an MBA and was an unlicensed but certified public accountant. Based on her education and work experience, I find that Respondent McConville violated Section 13(b)(5) and Rule 13b2-1 because she knew that Akorn did not have a system of internal accounting controls for its account receivables necessary for the preparation of accurate financial statements, and Respondent McConville played a significant role in creating the material errors in Akorn's books, records, and accounts.

**N. Did Respondent Harris Willfully Violate Rule 13b2-2 by Making False and Misleading Representations to the Auditors in Connection With the Form 10-Q and Management Letters Relating to the Form 10-K?**

I have detailed previously the reasons why it was material error for the financial statements in Akorn's Form 10-K to omit in the reserve for doubtful accounts an amount for its top-five wholesalers.

The Division charges Respondent Harris with willfully violating Rule 13b2-2 in two ways. First, the Division alleges that in connection with the Form 10-Q Respondent Harris "willfully violated Rule 13b2-2 by telling Deloitte that the addition[al] $7.5 million [to the doubtful account] reserve recorded in the first quarter of 2001 was based on new information and was therefore a change of estimate, rather than an error." (Div. Br. at 25.) The Division cites APB 20 ¶ 13 and FAS 16, as authority for its claim that Akorn should have restated its 2000 financials because the $7.5 million addition to the doubtful account reserve in the Form 10-Q was based on error and not a change in estimate. (Div. Br. at 16-17; Div. Reply Harris at 4.) The Division argues that Respondent Harris told Deloitte in May 2001 "that Akorn was getting 'push back' from Cardinal Health and that Cardinal was requiring proof of delivery that it had not previously required" when Respondent Harris knew, but did not tell Deloitte that the bulk of the old invoices that Akorn presented to Cardinal had already been paid and POD was a problem on very few invoices. (Div. Reply Harris at 3.) According to the Division, the POD requirement was commonplace in the industry, and the reason Akorn could not collect on outstanding invoices was either because the amounts were not owed, or because Akorn could not tell which invoices had been paid. (Div. Br. at 25.) The Division cites the adopting release for Rule 13b2-2 to support its claim that the test for materiality is whether the misstatement had the potential of keeping the auditor from discovering a false book or record. Promotion of the Reliability of Financial Information and Prevention of the Concealment of Questionable or Illegal Corporate Payments and Practices ("Adopting Rel."), 16 SEC Docket 1143 (Feb. 15, 1979). (Div. Reply Harris at 2-3.)

Next, the Division alleges that Respondent Harris violated Rule 13b2-2 "because Akorn's failure to disclose in its 2000 10-K that its accounts [receivable] were impaired violated GAAP." (Reply Br. Harris at 4.) The Division cites FAS 5 for the proposition that disclosure of an impairment is required "if the impairment is only reasonably possible or the amount of the impairment cannot be reasonably estimated." (Id.) The Division faults Akorn for having no doubtful account reserve for its top-five wholesale customers who had "almost $15 million of accounts receivable, almost three quarters of which were past due." (Id.)

Respondent Harris contends that to establish a Rule 13b2-2 violation the Division must show that Respondent Harris: (1) made a misstatement or omission; (2) the misstatement or omission was material; and (3) had the requisite mental state [sic]. (Resp. Harris Br. at 32.) He cites several court decisions to support his position that a violation requires an intent to mislead or recklessness. SEC v. Autocorp Equities, Inc., 292 F. Supp. 2d 1310, 1332 (D. Utah 2003) (citing United States v. Bradstreet, 135 F.3d. 46 (1st Cir. 1998), cert. denied, 523 U.S. 1122 (1998); SEC v. Solucorp Indus., Ltd., 274 F. Supp. 2d 379, 420-21 (S.D.N.Y. 2003)). The Division does not dispute Respondent Harris's position that scienter is required to prove a violation of Rule 13b2-2.[43] (Div. Reply Harris at 3.) Respondent Harris contends further that the materiality test is the same as that applied under Rule 10b-5 of the Exchange Act. See, e.g. SEC v. Buntrock, No. 02C2180, 2004 U.S. Dist. LEXIS 9495, at *33 (N.D. Ill. May 25, 2004).

Respondent Harris denies that he made false representations to the auditors, concerning the increase in the doubtful account reserve in the Form 10-Q. Rather, Respondent Harris informed Deloitte that the substantial increase in the accounts receivable reserve was the result of Akorn's business decision made after April 25, 2001, not to pursue collection against its major customers. (Resp. Harris Br. at 34.) Respondent Harris disputes the Division's claim that Akorn could not collect on the accounts receivable. He contends that Akorn was entitled to the accounts receivable and could prove it. (Resp. Harris Br. at 36.) Finally, Respondent Harris asserts that the Division has not shown with respect to the Form 10-Q that any alleged misstatement or omission was material or that he acted recklessly or with the intent to mislead.

Respondent Harris advances several reasons why the Division's claim of a Rule 13b2-2 violation is invalid. Among other things, he maintains that the contents of the first management representation letter he signed in connection with the Form 10-K was true to the best of his knowledge and belief. (Resp. Harris Br. at 41-42.) Respondent Harris emphasizes that he was Akorn's CFO for a very short period before the Form 10-K was filed and during that time he worked primarily on negotiating Akorn's Bank loan. (Resp. Harris Br. at 45.) Respondent Harris argues that no event, as that term is defined in the accounting literature, occurred between

[43] The adopting release for Rule 13b2-2, however, specifically rejected a scienter requirement. Adopting Rel., 16 SEC Docket at 1153.

February 23 and April 17, 2001. (Resp. Harris Br. 45-46.) Respondent Harris also maintains that he signed on the advice of counsel. (Resp. Harris Br. at 46-47.)

As an initial matter, I reject Respondent Harris's position that scienter is required for a violation of Rule 13b2-2**.** The following language by the United States Court of Appeals for the Second Circuit is determinative:

> First, the court's ruling that lack of scienter would not be a defense to the claims under § 13 and the regulations thereunder was consistent with precedent in this Circuit and with the Commission's interpretive regulations indicating that scienter is not an element of civil claims under these provisions. See generally SEC v. Koenig, 469 F.2d 198, 200 (2d Cir. 1972 (upholding finding of § 13(a) liability, without mention of scienter, of top corporate officer for failure to include required information in SEC reports); "Promotion of the Reliability of Financial Information and Prevention of the Concealment of Questionable or Illegal Corporate Payments and Practices," Exchange Act Release No. 34-15570, 16 S.E.C. Docket 1143, 1151, 1979 WL 17892 at * 9-* 10 (February 15, 1979) (no scienter requirement inserted in SEC Rule 13b2-1, 17 C.F.R. § 240.13b2-1, because § 13(b) of the 1934 Act "contains no words indicating that Congress intended to impose a 'scienter' requirement"). The Commission's interpretations of § 13 and of its own regulations thereunder are entitled to deference. See, e.g. Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43, 82 L. Ed. 2d 694, 104 S. Ct. 2778 (1984) (mandating deference to administering agency's reasonable statutory interpretations); Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 417-18, 89 L. Ed. 1700, 65 S. Ct. 1215 (1945) (same with respect to agency's interpretation of its own regulations). Further the district court's view that scienter is not a prerequisite to civil liability under § 13 is supported by the fact that in 1988, Congress amended § 13(b) to provide that "knowing[]" falsification is required before "criminal liability shall be imposed," Foreign Corrupt Practices Act Amendments of 1988, Pub. L. No. 100-418, § 5002, 102 Stat. 1415, 1415 (1988) (codified at 15 U.S.C. § 78m(b) (1944) (emphasis added)); see also H. Conf. Rep. 100-576, at 916 (1988), reprinted in 1988 U.S.C.C.A.N. 1547, 1949-50, plainly implying that falsification of the information to be filed in accordance with § 13(b) need not be knowing in order to lead to civil liability.

McNulty, 137 F.3d at 740-41.

### 1. Management Letters and Form 10-K

After he became CFO on March 21, 2001, until the Form 10-K was filed on April 17, 2001, Respondent Harris spent considerable time arranging the $3 million cash infusion by Dr. Kapoor that the Bank required. Also, persons at Akorn and Deloitte assured him that accounts receivable were adequately handled in the Form 10-K. Despite this evidence, however, I find that the preponderance of the evidence is that Respondent Harris knew, or should have known, before April 17, 2001, that Akorn had serious problems with its accounts receivable of its top-five wholesale customers and that its accounts receivable books and records were unreliable and that this situation could materially impact its financial statements in its Form 10-K. I reach this conclusion because Mr. Maire reported to Respondent Harris as Akorn's CFO. The evidence is that Dr. Kapoor arranged for Mr. Maire, who had worked for Dr. Kapoor for a number of years, to come to Akorn and assess the accounts receivable situation. (Tr. 402.) Dr. Kapoor trusted Respondent Harris, and believed he would assist his efforts to "save this company." (Tr. 732-33, 1269, 1283-84.) Respondent Harris was a member of the group headed by Mr. Maire that worked on the Cardinal account. Even though Mr. Maire shared his findings with few people, and would only acknowledge that he might have discussed the March 19, 2001, report with Respondent Harris, the evidence is compelling that Mr. Maire would not have withheld such significant and startling information about Akorn's accounts receivable from Respondent Harris.

Deloitte had several conversations with Respondent Harris after he became CFO. (Tr. 880.) Deloitte did not raise the subject of the doubtful account reserve with Respondent Harris. (Tr. 881-82.) No one at Akorn, including Respondent Harris, told Deloitte that Mr. Maire was doing a report for Dr. Kapoor on Akorn's accounts receivable or about the findings in Mr. Maire's report dated March 19, 2001. (Tr. 768-71.) As part of the audit, Deloitte spent considerable effort on the subject of accounts receivable, and it would have made further inquiries if it had been aware of Mr. Maire's report. (Id.) As a CPA with some experience in reporting by public companies, Respondent Harris knew Deloitte should have had this information, or he was reckless in not knowing.

In the management representation letters, Respondent Harris represented that to the best of his knowledge and belief the financial statements were in conformity with GAAP and that Akorn's estimates of the reserve accounts were reasonable. FAS 5 defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain . . . or loss . . . ." Financial Accounting Standards Board, Original Pronouncements, vol. I, 34 (2003/2004 ed.). Paragraph eight of FAS 5 provides that an estimated loss shall be accrued by a charge to income if it is probable that an asset had been impaired at the date of the financial statements and the amount of the loss can be reasonably estimated.

I reject Mr. Moore's expert opinion that FAS 5 was not applicable when Respondent Harris signed the management representation letters for the Form 10-K because the information was not available. (Resp. Harris Ex. 570 at 24.) It was certain by April 17, 2001, that Akorn was not going to recover all the accounts receivable from its top-five wholesale customers and that its assets had been impaired. The fact that Respondent Harris was able to estimate the required increase in the reserve for doubtful accounts on May 22, would indicate that a reasonable estimate was possible one month earlier.

By not informing Deloitte of Mr. Maire's findings, and by signing the representation letters, Respondent Harris, an officer of Akorn, violated Rule 13b2-2 by willfully making a materially false or misleading statement to Deloitte or omitting or causing another person to omit any material information necessary to make the statements made not misleading in connection with an audit of financial statements or reports filed with the Commission.[44] In view of the facts detailed above, Respondent Harris knew, or should have known, these representations were false and misleading.

I reject Respondent Harris's reliance on counsel defense. The courts have required that a person using the reliance on counsel defense establish good faith and: (1) a complete disclosure to counsel; (2) requested counsel's advice as to the legality of the contemplated action; and (3) received advice that action was legal. See SEC v. Savoy Indus., Inc., 665 F.2d 1310, 1314 n.28; Markowski v. SEC, 34 F.3d 99, 104-05 (2d Cir. 1994); see also SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1101-02 (2d Cir. 1972). The reliance on counsel defense requires more than is shown on this record. Respondent Harris's reliance on counsel defense fails because the record does not show that he made a complete disclosure in good faith to counsel and asked for and received advice that his proposed actions were legal.

**2. Form 10-Q**

Opinions of the Accounting Principles Board are part of GAAP. (Tr. 1305-06.) APB 20 distinguishes errors from changes of estimate. Paragraph thirteen of APB 20 provides that "[e]rrors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared." Financial Accounting Standards Board, Original Pronouncements, vol. III, 247 (2003/2004 ed.). Paragraph ten of APB 20 provides that: "[c]hanges in estimates used in accounting are necessary consequences of periodic presentations of financial statements. Preparing financial statements requires estimating the effects of future events. . . .Thus accounting estimates change as new events occur, as more experience is acquired, or as additional information is obtained."

I find that Respondent Harris violated Rule 13b2-2 by representing to Deloitte that Akorn's $7.5 million increase in its doubtful account reserve was based on new information and was therefore a change in estimate and not an error. The new information, according to Respondent Harris, was that after April 17, 2001, when Akorn filed its Form 10-K, Cardinal began to require additional levels of proof before it would pay its accounts receivable. (Tr. 774-75.) I reject Respondent's change of estimate arguments for several reasons. Akorn's $7.5 million increase in the doubtful accounts reserve in its Form 10-Q was to correct Akorn's error in not establishing a doubtful account reserve for the accounts receivable for its top wholesale customers, as discussed above. Akorn's accounts receivable books and records and its position vis-à-vis its wholesale customers on accounts receivable did not change after April 17, 2001. Contrary to Mr. Moore's claim in support of Respondent Harris, the large increase in the allowance for doubtful accounts and the allowance for chargeback and rebate reserve in the Form 10-Q was not caused by "'additional information and subsequent developments,' (and particularly the business decision by Akorn that it could not risk a lawsuit against Cardinal)." (Resp. Harris Ex. 570 at 23.) Accounting principles required Akorn to give investors accurate information about its accounts receivable even if it sued Cardinal to recover funds.

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[44] To act willfully, requires an intent to do the act which constitutes the violation. Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000).

Additional reasons for rejecting Respondent Harris's position is that it would harm investors to allow a company who failed to report a deteriorating accounts receivable situation to decide whenever it suits them to write off the amounts and give investors after-the-fact notice by claiming it was a change in estimate. Finally, given the state of Akorn's books and records for accounts receivable, Akorn would have to mount a time consuming and expensive effort before it had any chance of recovering on these invoices, and, even then, success is questionable. It is therefore highly questionable that the new event was that Akorn decided to relinquish viable accounts receivable claims.

For the reasons set forth above, I find that Respondent Harris willfully violated Rule 13b2-2 by making false and misleading representations to the auditors about material matters or by omitting material information in connection with the Form 10-Q and Management Letters Relating to Form 10-K. Respondent Harris knew, or should have known, that his conduct violated Rule 13b2-2.

**O. Did Respondent Harris Cause and Willfully Aid and Abet Akorn's Violations of Section 13(a) of the Exchange Act, Rules 13a-1, and 13a-13 that Require Public Companies to Make Annual or Quarterly Filings With the Commission, and Rule 12b-20?**

All of these provisions, except Rule 13a-13, have been described previously. Rule 13a-13 requires that an issuer with securities registered pursuant to Section 12 of the Exchange Act that is required to file an annual report pursuant to Section 13 of the Exchange Act, file quarterly reports on Form 10-Q.

Aiding and abetting violations of the securities laws involve three elements: (1) a primary violation by another party; (2) awareness or knowledge by the aider and abettor that his or her role was part of an overall activity that was improper; and (3) that the aider and abettor knowingly and substantially assisted in the conduct that constituted the primary violation. <u>See</u> <u>Rolf v. Blyth, Eastman Dillon & Co.</u>, 570 F.2d 38, 47-48 (2d Cir. 1978); <u>Woods v. Barnett Bank of Fort Lauderdale</u>, 765 F.2d 1004, 1009-10 (11th Cir. 1985); <u>Investors Research Corp. v. SEC</u>, 628 F.2d 168, 178 (D.C. Cir. 1980); <u>Woodward v. Metro Bank of Dallas</u>, 522 F.2d 84, 94-95 (5th Cir. 1975).

The primary violation requirement is satisfied because it follows from the finding I made immediately above, that Akorn violated Rule 13a-13 in connection with its Form 10-Q because information in the filing was false and misleading. As noted previously, Akorn also violated Section 13(a) of the Exchange Act, Rule 13a-1, and Rule 12b-20 in connection with its Form 10-K because that filing was materially false and misleading. It bears repeating that the contents of the filings must be accurate. <u>SEC v. Savoy Indus., Inc.</u>, 587 F.2d 1149, 1165. Respondent Harris willfully aided and abetted Akorn's violations because he knew when he signed both the Form 10-K and the Form 10-Q, or was at least reckless in not knowing, that the information was false, misleading, and inaccurate that his actions substantially assisted in Akorn's violations. Respondent Harris had the requisite mental state for aiding and abetting liability. <u>See</u> <u>Zion Capital Mgmt. LLC</u>, 81 SEC Docket 3063, 3077 (Dec. 11, 2003). Moreover, someone who willfully aided and abetted a violation necessarily caused those violations. See Graham and Voss, 53 S.E.C. 1072, 1085 n. 35 (Nov. 30, 1998).

## VII. Public Interest

The Division recommends that: (1) Respondent McConville be ordered to cease and desist, pursuant to Section 21C of the Exchange Act, and to disgorge all salary, bonuses, and stock options received, and prejudgment interest, and (2) Respondent Harris be ordered to cease and desist pursuant to Section 21C of the Exchange Act, ordered to disgorge salary received while he was at Akorn, and sanctioned pursuant to Rule 102(e) of the Commission's Rules of Practice, 17 C.F.R. § 201.102(e). (Div. Br. 25-28, Div. Reply Harris at 7-8, Div. Reply McC at 13.) The Division would have Respondent McConville disgorge $154,000 and Respondent Harris disgorge $38,000. (Div. P. Findings at 19.)

Section 21C(a) of the Exchange Act authorizes the Commission, where there is a finding that a person has violated a provision of the Exhange Act or any rule thereunder, to order that person to cease and desist from committing or causing such violation and any future violation of the same provision or rule. Section 21C(e) authorizes the Commission to enter an order requiring disgorgement, including reasonable interest, in any cease-and-desist proceeding. Rule 102(e) of the Commission's Rules of Practice provides:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . .
>
> . . . .
>
> (iii) to have willfully violated, or willfully aided or abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

WHX Corp. v. SEC, 362 F.3d 854 (D.C. Cir. 2004) and KPMG Peat Marwick LLP, 74 SEC Docket 384 (Jan. 19, 2001), recon. denied, 74 SEC Docket 1351 (Mar. 8, 2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002) are lead cases on the imposition of a cease-and-desist order by the Commission. In KPMG, the Commission stated:

> Along with the risk of future violations, we will continue to consider our traditional factors in determining whether a cease-and-desist order is an appropriate sanction based on the entire record. Many of these factors are akin to those used by courts in determining whether injunctions are appropriate, including the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the respondent's opportunity to commit future violations. In addition, we consider whether the violation is recent, the degree of harm to

> investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings.

74 SEC Docket at 436.

I find that it is necessary to impose a cease-and-desist order against Respondent McConville. As Akorn's CFO until March 21, 2001, Respondent McConville's conduct was the primary cause of Akorn's violations and she also committed violations herself. The violations involved significant provisions of the securities statute and Commission regulations enacted to protect public investors. The violations were recurrent and occurred over an extended period of time. Despite compelling evidence, the record shows that even as late as the hearing in this proceeding, Respondent McConville continued to misrepresent the events that occurred at Akorn in 2000 and 2001. Based on these considerations and Respondent McConville's failure to recognize or acknowledge wrongdoing, I find these sanctions necessary to protect public investors and the capital markets in the future.

I further find it appropriate to order Respondent McConville to disgorge $115,858, which is half the salary she received from Akorn in 2000 and four months of her salary in 2001, plus prejudgment interest.[45] Disgorgement "is an equitable remedy meant to prevent the wrongdoer from enriching himself from his wrongs." SEC v. Huffman, 996 F.2d 800, 802 (5th Cir. 1993). "[D]isgorgement need only be a reasonable approximation of profits causally connected to the violation." SEC v. First City Fin. Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989). Disgorgement in Commission cases generally involves commissions or trading profits. Disgorgement of Respondent McConville's salary is appropriate because the root cause of the violations was her failure to perform her responsibilities as CFO and she should not be allowed to benefit from her illegal conduct. The Commission has previously ordered the disgorgement of salary where a person's conduct provided "a sufficient causal nexus to the funds targeted for disgorgement." Sky Scientific, Inc., Initial Decision No. 137, 69 SEC Docket 945 (Mar. 5 1999), final, 69 SEC Docket 2170 (May 4, 1999).

I deny the Division's request for a cease-and-desist order as to Respondent Harris because the record does not show a risk that Respondent Harris will violate Exchange Act Rule 13b2-2, and cause and willfully aid and abet violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1 and 13a-13 in the future. The decision in WHX Corp. v. SEC, 362 F.3d 854), warns against the imposition of cease-and-desist orders as a knee-jerk response to a finding of a violation. Respondent Harris's violations of Rule 13b2-2 and his aiding and abetting Akorn's violations of Section 13(a) of the Exchange Act and Rules 13a-1 and

[45] The OIP charges Respondent McConville with violations beginning in "at least 2000 to at least April 2001." (OIP at 2.) The illegal activities that led to the violations began in the summer of 2000 with representations to the auditors and continued through on or about April 17, 2001, with her signing of the management representations letters. For these reasons, I will order that Respondent McConville disgorge $75,858, or half her $151,716 annual salary for the year 2000, and four months of her $120,000 annual salary for the year 2001. I have not considered stock options received outside the relevant period.

13a-13 are serious matters. However, there are several significant mitigating circumstances that persuade me that Respondent Harris's conduct does not merit a cease-and-desist order and there is minimal risk that he will commit future violations.

Respondent Harris did not cause Akorn's failures with respect to accounting for accounts receivable from its top wholesalers. Respondent Harris arrived after the problems surfaced, and he was put there to fix them. Dr. Kapoor placed Respondent Harris, his employee, at Akorn to save the company, because he believed Respondent Harris was very knowledgeable and he had confidence in him. (Tr. 1267-69.) Respondent Harris did not seek the assignment at Akorn. While at Akorn, Respondent Harris accomplished substantial positive measures to resolve the books and records problems with accounts receivable. He implemented a method for processing chargebacks electronically and, by the time he returned to his position at Dr. Kapoor's company, Respondent Harris had begun, but had not completed, electronic invoicing at Akorn. (Tr. 1365-66.)

Respondent Harris spent less than six months at Akorn. Respondent Harris only received a salary of approximately $39,000 for almost six months work and stock options for 50,000 shares, which he has not exercised. (Tr. 381-82.) There is no evidence that Respondent Harris benefited financially from his actions and there is evidence that he has suffered professionally. (Tr. 1410-11.) Finally, I found Respondent Harris to be a credible witness based on my observation of his demeanor, testimony, and examination at the hearing. Respondent Harris was very knowledgeable and his testimony was forthright. There were no instances where his testimony or positions contradicted or changed from those he had taken during the investigation of these matters.

I deny the Division's request that Respondent Harris be ordered to disgorge approximately $39,000 and 50,000 Akorn stock options for the mitigating circumstances stated. Finally, I deny the Division's request that Respondent Harris be sanctioned pursuant to Rule 102(e) of the Commission's Rules of Practice. This measure tarnishes an accountant's professional career for life, and, for the reasons stated I find it too severe in these circumstances.

## VIII. Record Index

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items described in the record index issued by the Secretary of the Commission on September 10, 2004.

## IX. Order

Pursuant to Section 21C of the Securities Exchange Act of 1934, I ORDER, that:

1. Rita J. McConville shall cease and desist from committing any violations and any future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2, and causing any violations and any future violations of Sections 13(a) and 13(b)(2) of the Exchange Act and Rules 12b-20 and 13a-1.

2. Rita J. McConville shall disgorge the sum of $115,858, and prejudgment interest, calculated from May 1, 2001, through the last day of the month preceding the month in which payment is made pursuant to Commission Rule 600.[46] 17 C.F.R. § 201.600.

Rita J. McConville shall pay disgorgement and prejudgment interest on the first day following the day this Initial Decision becomes final by United States postal money order, wire transfer, certified check, bank cashier's check, or bank money order payable to the U.S. Securities and Exchange Commission. Payment with a cover letter should identify Rita J. McConville as the Respondent in Administrative Proceeding No. 3-11330, and should be delivered by hand or courier to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312. A copy of the cover letter should be sent to the Commission's Division of Enforcement.

3. The Division's request for sanctions against Kevin M. Harris for the violations found in this Initial Decision is denied.

This order shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Brenda P. Murray
Chief Administrative Law Judge

[46] The illegal acts ended in April 2001 when Respondent McConville signed the management representation letters. The prejudgment interest will begin on the first day of the month following the illegal conduct. Rule 600(b) of the Commission's Rules of Practice prescribes the underpayment rate of interest established under 26 U.S.C. § 6621(a)(2) and that interest on the sum to be disgorged shall be compounded quarterly. 17 C.F.R. § 201.600(b).