UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57244 / January 31, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 2779 / January 31, 2008

Admin. Proc. File No. 3-12064

In the Matter of

GREGORY M. DEARLOVE, CPA

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Causing Violations of Reporting Provisions

RULE 102(e) PROCEEDING

Grounds for Remedial Action

Improper Professional Conduct

Certified public accountant acting as engagement partner engaged in improper professional conduct in the audit of the financial statements of a public company and caused company's violations of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 12b-20. Held, it is in the public interest to order that accountant cease and desist from causing any violations or future violations of Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and 12b-20, and to deny the accountant the privilege of appearing or practicing before the Commission with a right to reapply after four years.

APPEARANCES:

Joseph V. Sedita, Benjamin M. Zuffranieri, Michelle Merola Kane, and Robert J. Fluskey, Jr., of Hodgson Russ LLP, for Gregory M. Dearlove.

Nancy A. Brown, Alistaire Bambach, Jack Kaufman, and Panayiota K. Bougiamas, for the Division of Enforcement.

Appeal filed: August 30, 2006
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I. Introduction

Gregory M. Dearlove, a certified public accountant and formerly a partner with the accounting firm Deloitte & Touche LLP ("Deloitte"), appeals from the decision of an administrative law judge. The law judge found that Dearlove, who served as the engagement partner on Deloitte's audit of the financial statements of Adelphia Communications Corporation ("Adelphia"), a public company, for the fiscal year ended December 31, 2000, engaged in improper professional conduct within the meaning of Rule of Practice 102(e). 1/ The law judge found that Adelphia's financial statements were not in accordance with generally accepted accounting principles ("GAAP"), and that Dearlove violated generally accepted auditing standards ("GAAS"). 2/ The law judge also found that Dearlove was a cause of Adelphia's

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1/ 17 C.F.R. § 201.102(e). Rule 102(e) permits the Commission to censure or deny, permanently or temporarily, the privilege of appearing or practicing before it to persons found to have engaged in improper professional conduct. As applied to accountants, "improper professional conduct" includes the following:

> (A) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or
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> (B) either of the following two types of negligent conduct:
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> (1) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.
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> (2) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

Rule 102(e)(1)(iv), 17 C.F.R. § 201.102(e)(1)(iv). With the passage in 2002 of Section 602 of the Sarbanes Oxley Act, Pub. L. No. 107-204, 116 Stat. 745, 794, this language was codified in Exchange Act Section 4C, 15 U.S.C. § 78d-3.

2/ The law judge concluded that Dearlove engaged in repeated instances of unreasonable conduct as well as a single instance of highly unreasonable conduct under Rule 102(e)(iv)(B)(1). However, it is unclear which conduct constituted the single instance of highly unreasonable conduct. We therefore decline to consider whether any of Dearlove's conduct was "highly unreasonable." We limit ourselves to the question of whether Dearlove engaged in "repeated instances of unreasonable conduct, each resulting in a violation of applicable standards, that indicate a lack of competence to practice before the Commission." Rule of Practice 102(e)(iv)(B)(2).

violations of the reporting and recordkeeping provisions of the Exchange Act. 3/ The law judge permanently denied Dearlove the privilege of appearing or practicing in any capacity before the Commission. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II. Background

Adelphia, a cable television company incorporated in Delaware and headquartered in Coudersport, Pennsylvania, was founded in 1952 by John Rigas and went public in 1986. Adelphia had several large subsidiaries, some of which were public companies, and Adelphia consolidated its financial statements with those of its subsidiaries. The Rigas family retained control over Adelphia through their exclusive ownership of Adelphia's Class B shares. 4/ Whenever Adelphia raised capital by issuing Class A shares, the Rigas family would arrange for Adelphia to make a direct placement of Class B shares so that the Rigases' ownership and majority voting interests would not be diluted. The Rigases' Class B stock was convertible into shares of Class A stock. In addition to their controlling ownership of Adelphia, the Rigas family held five of nine seats on Adelphia's board of directors.

Members of the family also owned several dozen private companies ("Rigas Entities"). The largest of these Rigas Entities also were engaged in the cable television business, and Adelphia used its own personnel, inventory, trucks, and equipment to provide services to the customers of these companies. Adelphia, its subsidiaries, and the Rigas Entities shared a centralized treasury system organized using cost centers, in which the cash balances of each company were separately maintained. Adelphia charged a fee for providing the Rigas Entities management, accounting, and other services.

By 2000, Adelphia was among the largest cable television and telecommunications providers in the United States. Adelphia had grown substantially at the end of 1999 by acquiring several other cable companies (more than doubling Adelphia's cable subscribers), and Adelphia continued to grow in 2000. Concomitant with this growth in assets, Adelphia's debt increased significantly. Between 1996 and 2000, Adelphia, its subsidiaries, and some Rigas Entities entered as co-borrowers into a series of credit agreements. By 1999, Adelphia and the Rigas Entities had obtained $1.05 billion in credit; in 2000, they tripled their available credit and drew down essentially all of the funds then available under the agreements.

Deloitte served as the independent auditor for Adelphia, one of its largest audit clients, from 1980 through 2002. The audits were complex. Several of Adelphia's subsidiaries filed their own Forms 10-K, and Adelphia frequently acquired other companies. For several years, Deloitte had concluded that the Adelphia engagement posed a "much greater than normal" risk of

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3/ 15 U.S.C. §§ 78m(a), 78m(b)(2)(A).

4/ Class A shares each received one vote; Class B shares each received ten.

fraud, misstatement, or error; this was the highest risk category that Deloitte recognized. Risk factors that Deloitte specifically identified in reaching this assessment for the 2000 audit included the following:

- Adelphia operated in a volatile industry, expanded rapidly, and had a large number of decentralized operating entities with a complex reporting structure;

- Adelphia carried substantial debt and was near the limit of its financial resources, making it critical that the company comply with debt covenants;

- Management of Adelphia was concentrated in a small group without compensating controls;

- Adelphia management lacked technical accounting expertise but nevertheless appeared willing to accept unusually high levels of risk, tended to interpret accounting standards aggressively, and was reluctant to record adjustments proposed by auditors; and

- Adelphia engaged in significant related party transactions with affiliated entities that Deloitte would not be auditing.

To help manage the audit risk, Deloitte planned, among other things, to increase Deloitte's management involvement at all stages of the audit "to ensure that the appropriate work is planned and its performance is properly supervised." It also proposed to heighten professional skepticism "to ensure that accounting estimates, related party transactions and transactions in the normal course of business appear reasonable and are appropriately identified and disclosed."

In 1999 and 2000, the American Institute of Certified Public Accountants ("AICPA") required that member firms rotate an engagement partner off the audit of a public company after seven years to bring a fresh perspective and maintain auditor independence. 5/ To replace Don Cottrill, the engagement partner who had conducted Adelphia's audits from 1993 to 1999, Deloitte asked Dearlove to assume responsibility as engagement partner for the audit of Adelphia's 2000 financial statements.

Dearlove, a Deloitte partner since 1986, had been an accountant working for the firm since he graduated from college in 1976. In 1997, Dearlove had become the managing partner for Deloitte's Buffalo and Rochester offices. Dearlove had served as the engagement partner on ten public company audits and the concurring review partner on several others. Nevertheless, Dearlove had no prior experience auditing companies in the cable television industry, and did not

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5/ See AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS ("AICPA"), SEC PRACTICE SECTION REFERENCE MANUAL § 1000.08(e).

immediately accept the assignment because Dearlove had not dealt before with audits of Adelphia's "complexity or sensitivity." Dearlove testified that, prior to the Adelphia audit, he "had never been in a greater than normal risk environment." After meeting with Cottrill and others on Adelphia's audit team, reviewing Adelphia's most recent financial statements and quarterly reports, and reading trade publications about the cable industry, Dearlove accepted the assignment in October 1999.

Dearlove began by shadowing Cottrill as he worked on Adelphia's 1999 financial statements. When the 1999 audit was completed, Deloitte's senior manager on the Adelphia audit team reviewed Adelphia's 1999 financial statements with Dearlove and explained the theory and history behind the accounting presentations therein. Dearlove also participated in the audit of the 1999 financial statements of one of Adelphia's subsidiaries that was considered to present the least sensitivity and risk. Dearlove assumed full responsibility for Adelphia's audit beginning with the quarterly review for the first quarter of 2000. Dearlove and other Deloitte partners agreed that the "much higher than normal risk" assessment continued to apply to the 2000 audit.

The staffing of Deloitte's audit team for the 2000 audit remained largely unchanged from prior years. The team consisted of about twenty staff accountants and tax professionals, divided into subgroups that were supervised by ten Deloitte managers and headed by senior manager William Caswell, who reported directly to Dearlove. Several of the Deloitte managers had significant prior experience auditing and reviewing Adelphia's annual and quarterly reports: Caswell had spent six years working on Adelphia engagements; Ivan Hofmann and Robert Fitzgerald, both audit managers, had each spent five years. In addition, Michael Lindsey served as the concurring partner as he had on Adelphia audits since 1996, and Stephen Biegel was assigned as risk review partner after serving in that capacity for the 1999 Adelphia audit. Dearlove had once met Caswell at a firm meeting but did not otherwise know any members of the Adelphia audit team when he assumed his role as engagement partner.

Deloitte devoted an estimated 21,000 hours to the audit of Adelphia's 2000 financial statements and related accounting advisory activities; Dearlove himself spent over 700 hours. Dearlove spent a total of ten to fifteen days on-site in Coudersport with the audit team. Dearlove participated in discussions with the team, reviewed workpapers and underlying Adelphia documents when the team brought them to his attention, and "worked through the issues" with his staff in what Dearlove characterized as a "consultative process." At the end of the audit, Dearlove looked at certain workpapers and drew conclusions as to whether the team completed its review. Dearlove testified that he also consulted Deloitte's national office on a number of accounting issues during the course of the audit, mostly involving revenue recognition.

On March 29, 2001, Deloitte issued its independent auditor's report, signed by Dearlove, which stated that it had conducted its audit in accordance with GAAS and that such audit provided a reasonable basis for its opinion that Adelphia's 2000 financial statements fairly presented Adelphia's financial position in conformity with GAAP. 6/

In January 2002, following the collapse of Enron Corporation, the Commission released guidance clarifying the disclosures that issuers should consider making with respect to, among other things, related party transactions. 7/ In reaction, Adelphia disclosed for the first time in a press release the extent of the Rigas Entities' co-borrowed debt. The disclosure alarmed investors and analysts, leading to a formal investigation by a special committee of Adelphia's board of directors into related party transactions between Adelphia and the Rigases that resulted in the public disclosure of the Rigas family's related party transactions as well as various accounting irregularities. Adelphia's stock price declined from about $30 per share in January 2002 to $0.30 per share in June 2002, and the stock was delisted from the Nasdaq market. After defaulting on various credit agreements, Adelphia filed for bankruptcy under Chapter 11 in June 2002.

In the wake of Adelphia's decline, the Department of Justice brought criminal fraud charges against several members of the Rigas family and other Adelphia officials. 8/ The Department of Justice declined to file criminal charges against Adelphia as part of a settlement in which Adelphia agreed to pay $715 million in stock and cash to a victims' restitution fund once the company emerged from bankruptcy. 9/

The Commission also brought several actions related to the decline of Adelphia. On April 25, 2005, Adelphia, John Rigas, and Rigas's three sons settled a civil injunctive action in which the respondents, without admitting or denying the allegations against them, were enjoined from committing or causing further violations of the antifraud, reporting, recordkeeping, and

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6/ Dearlove resigned his position with Deloitte in September 2001 and accepted an offer of employment to serve as a senior vice president and chief financial officer of a public company. There is no evidence in the record to suggest that the Adelphia audit was a cause of Dearlove's departure from Deloitte.

7/ Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations, 67 Fed. Reg. 3,746 (Jan. 25, 2002).

8/ James Brown, Adelphia's vice president of finance, and Tim Werth, Adelphia's director of accounting, both pled guilty. John and Timothy Rigas were convicted and sentenced to lengthy prison terms by the United States District Court for the Southern District of New York. The Court of Appeals for the Second Circuit affirmed the convictions on all but one of twenty-three counts and remanded the case for sentencing. See United States v. Timothy J. Rigas and John J. Rigas, 490 F.3d 208 (2d. Cir. 2007).

9/ See United States v. Rigas, 371 F. Supp. 2d 474 (S.D.N.Y.), aff'd, 409 F.3d 555 (2d Cir. 2005); In re Adelphia Commc'ns Corp., 327 B.R. 143 (Bankr. S.D.N.Y. 2005).

internal controls provisions of the federal securities laws. 10/ The next day, the Commission instituted and settled administrative proceedings against Deloitte under Rule 102(e). 11/ Without admitting or denying the Commission's allegations, Deloitte consented to the entry of findings that it engaged in repeated instances of unreasonable conduct with respect to the audit of Adelphia's 2000 financial statements. Deloitte also consented to a finding that it caused Adelphia's violations of those provisions of the Exchange Act that require issuers to file annual reports, make and keep accurate books and records, and devise and maintain a system of sufficient internal controls. Deloitte agreed to pay a $25 million penalty and to implement various prophylactic policies and procedures. The Commission also settled a civil action based on the same conduct in which Deloitte agreed to pay another $25 million penalty. 12/ Senior manager Caswell consented to Commission findings that he committed repeated instances of unreasonable conduct and agreed to a bar from appearing or practicing as an accountant before the Commission with a right to apply for reinstatement after two years. 13/

III. Applicable Professional Standards: The Requirements of GAAS

In determining whether to discipline an accountant under Rule 102(e)(1)(iv), the Commission has consistently measured auditors' conduct by their adherence to or deviation from GAAS. 14/ There are ten fundamental generally accepted auditing standards, consisting of three

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10/ See In re Adelphia Commc'ns Corp., 327 B.R. at 156-58; SEC and U.S. Attorney Settle Massive Financial Fraud Case Against Adelphia and Rigas Family for $715 Million, Press Rel. No. 2005-63 (Apr. 25, 2005), available at http://www.sec.gov/news/press/2005-63.htm.

11/ See Deloitte & Touche LLP, Securities Exchange Act Rel. No. 51606 (Apr. 26, 2005), 85 SEC Docket 1111.

12/ See SEC v. Deloitte & Touche LLP, No. 05-Civ.-4119 (PKC) (Apr. 26, 2005 S.D.N.Y.); SEC Charges Deloitte & Touche for Adelphia Audit, Press Rel. No. 2005-65 (Apr. 26, 2005), available at http://www.sec.gov/news/press/2005-65.htm.

13/ See William E. Caswell, CPA, Exchange Act Rel. No. 52538 (Sept. 30, 2005), 86 SEC Docket 1257.

14/ See, e.g., James Thomas McCurdy, CPA, 57 S.E.C. 277, 295 (2004) (basing Rule 102(e) finding on auditor's deviation from "fundamental principles of auditing," which included, among other things, failure to obtain sufficient competent evidential matter, render an accurate audit report, maintain an attitude of professional skepticism, and exercise due care), aff'd, 396 F.3d 1258 (D.C. Cir. 2005); Barry C. Scutillo, 56 S.E.C. 714, 746 (2003) (basing Rule 102(e) finding on auditor's "[r]eckless failures to comply with auditing standards," including, among other things, failure to maintain professional skepticism and

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General Standards, three Standards of Field Work, and four Standards of Reporting. 15/ As explained by the Division of Enforcement's ("Division's") expert,

> [t]he General Standards require the auditor to have adequate technical training and audit proficiency, maintain independence and exercise due professional care. The Standards of Fieldwork set forth the requirements for adequate planning and supervision of assistants, gaining an understanding of the company's internal controls, and gathering sufficient competent evidential matter. The Standards of Reporting provide that the auditor's report state the financial statements are presented in accordance with GAAP and if not, it must identify circumstances where GAAP is not observed.

These ten fundamental standards are amplified by Statements on Auditing Standards issued and codified by AICPA's Auditing Standards Board.

GAAS require auditors to plan the audit adequately and to properly supervise any assistants. 16/ Auditors must exercise due professional care in performing an audit and preparing a report. 17/ They must maintain an attitude of professional skepticism, which includes "a questioning mind and a critical assessment of audit evidence." 18/ They must obtain sufficient

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14/ (...continued)
to exercise due care); Michael J. Marrie, CPA, 56 S.E.C. 760, 791-93 (2003) (basing Rule 102(e) finding on auditors' reckless failure to conduct the audit in accordance with GAAS, including their failure to exercise professional skepticism and to obtain sufficient competent evidential matter), rev'd on other grounds, 374 F.3d 1196 (D.C. Cir. 2004) (reversing based on retroactive application of amended rule but noting that the requirements of GAAS to exercise due care and professional skepticism and to obtain sufficient evidential matter are "'standards to which all accountants must adhere'") (citing Potts v. SEC, 151 F.3d 810, 813 (8th Cir. 1998)).

As discussed in Section IX, the question of whether Dearlove caused Adelphia's violations of the reporting provisions of the securities laws is also informed by the degree to which he departed from the applicable standard of care, i.e., whether he acted negligently.

15/ AICPA, CODIFICATION OF STATEMENTS OF AUDITING STANDARDS § 150.02 (2000) (hereinafter, "AU § ___").

16/ AU §§ 311.01, 311.11.

17/ AU § 230.01.

18/ AU §§ 230.07-08.

competent evidential matter to afford a reasonable basis for an opinion with respect to the financial statements under review. 19/

Certain audit conditions require auditors to increase their professional care and skepticism, as when the audit presents a risk of material misstatement or fraud. 20/ When an audit includes review of related party transactions, auditors must tailor their examinations to obtain satisfaction concerning the purpose, nature, and extent of those transactions on the financial statements. 21/ Unless and until an auditor obtains an understanding of the business purpose of material related party transactions, the audit is not complete. 22/ As we have previously observed, these standards can overlap somewhat, and one GAAS failure may contribute to another. 23/

Dearlove urges us to compare the reasonableness of his conduct to a somewhat different standard. Dearlove argues, citing pattern jury instructions used by New York state courts in professional negligence cases, that the standard for determining negligence by an accountant should be based on whether the respondent "use[d] the same degree of skill and care that other [accountants] in the community would reasonably use in the same situation." Dearlove asks us to evaluate his actions in the context of the large, complex Adelphia audit and to determine whether Dearlove exercised the degree of skill and care that a reasonable engagement partner would have used in similar circumstances. Dearlove contends that this analysis "necessarily includes . . . conclusions previously reached by other professionals," a reference to the Adelphia audits Deloitte conducted from 1994 through 1999. Dearlove asserts that he could place some reliance on audit precedent. Moreover, in his view, the fact that prior auditors reached the same conclusions is "compelling evidence" that Dearlove acted reasonably.

The complexity of the Adelphia audit, the number of accountants assigned to it, the risk that Deloitte attributed to it, and the conclusions of prior auditors certainly provide context to our review. However, we reject any suggestion that the conduct of prior auditors should be a

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19/ AU § 326.22.

20/ AU §§ 312.17, 316.27.

21/ AU § 334.09.

22/ AU § 334.09(a) & n.6.

23/ McCurdy, 57 S.E.C. at 286 ("For example, a failure to maintain professional skepticism about information obtained from management can result in a failure independently to verify that information and gather sufficient competent evidential matter. Similarly, if an auditor fails to exercise due professional care, he may not obtain sufficient competent evidential matter to support an audit conclusion that the financial statements were prepared in compliance with GAAP.").

substitute for the standards established by GAAS. GAAS are the fundamental standards of auditing promulgated by auditors themselves. AICPA membership approved and adopted the ten fundamental auditing standards, i.e., the General, Field Work, and Reporting Standards. 24/ AICPA's Auditing Standards Board has developed and issued subsequent auditing standards "through a due process that includes deliberation in meetings open to the public, public exposure of proposed [standards], and a formal vote." 25/ These standards apply to audits of all sizes and all levels of complexity and describe the conduct that the accounting profession itself has established as reasonable, "provid[ing] a measure of audit quality and the objectives to be achieved in an audit." 26/ We therefore decline to create a separate standard of professional conduct for auditors that depends in each case on the behavior of a particular auditor's predecessors. The accounting profession itself has already prescribed the applicable standards.

Moreover, as required at the time by AICPA, Dearlove was assigned to the Adelphia audit to replace the incumbent engagement partner for the specific purpose of bringing a fresh perspective to the audit. The rotation of audit partners assigned to the audits of public companies has long been required of most independent auditors by AICPA and, more recently, by federal law. 27/ Deloitte itself recognized that audit partner rotation is "vital" to an auditor's objectivity and that "[t]he impartiality of the external audit is a critical component of the function auditors perform for issuers, their investors, and their potential investors, and measures that militate against complacency and reinforce the external auditor's professional skepticism can protect that impartiality." 28/ Reliance on prior audit conclusions, especially in areas of high risk, without

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24/ AU § 150.02.

25/ AU § 150.03.

26/ AU § 150.01. See also SEC v. Dain Rauscher, Inc., 254 F.3d 852, 857 (9th Cir. 2001) (noting that GAAS are a "time-honored standard set by an authoritative source recognized and followed throughout the profession" against which auditors' conduct can be judged); Potts v. SEC, 151 F.3d at 812 (stating that GAAS are "well-established norms of the accounting profession").

27/ See AICPA, SEC Practice Section Reference Manual § 1000.08(e) (promulgated in 1977 and requiring members, excepting small firms with few public-company clients, to rotate engagement partner from audit of public company every seven years); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 203, 116 Stat. 745, 773 (codified at 15 U.S.C. § 78j-1(j)) (making it unlawful for registered accounting firms to audit public companies if the lead audit partner or reviewing partner performed audit services for the company for the five preceding years).

28/ Deloitte & Touche LLP, Comment Letter of Deloitte & Touche LLP on the Commission's Proposed Rule Implementing Sections 201, 202, 203, 204, and 206 of the Sarbanes-Oxley

(continued...)

questioning whether that reliance was appropriate under the circumstances, defeats the purpose of auditor rotation – i.e., to preserve auditor independence and encourage critical thinking. 29/

On the record before us, we find that prior Deloitte audit conclusions offered little support for the conclusions reached in the 2000 audit. The record does not describe how the audits of prior financial statements were performed or what evidential matter supported those audit conclusions. Moreover, Dearlove's expert, while arguing that partner rotation does not require the new auditor to perform a "de novo audit of the client," nevertheless explained that an engagement partner "would perform . . . new audit procedures or GAAP research and consultation . . . to address changed conditions or professional standards." In 2000, Dearlove was presented with markedly different circumstances from those presented to prior teams: since 1999, Adelphia had tripled its co-borrowed debt, doubled its revenues and operating expenses, and acquired more cable subscribers. The changes implicated areas of the Adelphia audit that Deloitte had specifically identified as posing high risk, namely, its rapid expansion, substantial debt load, and significant related party transactions. Therefore, we reject Dearlove's argument that the similarity of prior audit conclusions lends reasonableness to his own audit, and we find no reason to reject GAAS as the standard by which we judge all audits.

IV. Netting of Related Party Payables and Receivables

A. Facts

Since the company went public in 1986, Adelphia netted, or offset against each other, accounts payable to and receivable from various Rigas Entities on its consolidated financial statements. Adelphia calculated its net receivable balance by subtracting the balances of all accounts payable that Adelphia and its subsidiaries owed to Rigas Entities from the balances of all the accounts receivable that the Rigas Entities owed to Adelphia and its subsidiaries. Dearlove testified that when he was transitioning onto the Adelphia audit engagement in the spring of 2000, he discussed Adelphia's practice of netting with the Deloitte senior manager who had worked on Adelphia's 1999 financial statement audit. Dearlove "learned about the history of it," and testified that netting wasn't "something that I dealt with often in my history." Dearlove "hadn't had a client that did that" before, at least not one that "had these types of related parties that netted." Dearlove testified that, in approving Adelphia's use of netting in the 2000 financial statements, he relied on the fact that prior Deloitte auditors, whom Dearlove considered "highly technically competent," had permitted it in the past. He also took "some comfort from the fact that the concurring partner and the risk partner in '99 were going to be the concurring partner and

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28/ (...continued)
Act of 2002 (Jan. 10, 2003), available at http://www.sec.gov/rules/proposed/s74902/deloitte1.htm#P400_127619.

29/ Strengthening the Commission's Requirements Regarding Auditor Independence, 68 Fed. Reg. 6,006, 6,017 (Feb. 5, 2003).

risk partner in 2000," because Dearlove "was the only one . . . coming up to speed. They had already gotten there. The issues were similar, the client was similar. The industry was the same."

Dearlove had been told by Adelphia management that they were concerned about the growing net receivable balance in the second quarter review, and that they would seek to reduce it through additional related party borrowing. Indeed, the audit team reviewed the net receivables Adelphia presented during each quarterly review and knew that Adelphia's net related party receivables were reported as $178 million at the end of 1999, $254 million at the end of the first quarter in 2000, $263 million at the end of the second quarter, and $19 million at the end of the third quarter. Ultimately, a line item titled "Related Party Receivables - Net" on Adelphia's balance sheet and Form 10-K for 2000 reported $3,071,000.

Adelphia's 2000 year-end gross related party accounts payable and receivable, however, totaled more than $1 billion each. Dearlove was aware of the dramatic reduction of the net balance and testified that the balance had dropped "as we expected it." However, Dearlove could not recall whether or how the audit team tested Adelphia's affiliate receivables, could not explain how his team tested management's explanations for the fluctuations in Adelphia's reported net balance, and could not recall having any discussions with his team about the propriety of Adelphia's netting.

B. Analysis

Accounting Principles Board Opinion No. 10 states that "[i]t is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists." 30/ Rule 5-02 of the Commission's Regulation S-X requires that issuers "state separately" amounts payable and receivable. 31/ FASB Interpretation 39, Offsetting of Amounts Related to Certain Contracts ("FIN 39"), defines a right of setoff as "a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to

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30/ Accounting Principles Board Opinion No. 10, ¶ 7.1.

31/ 17 C.F.R. §§ 210.5-02.3, 210.5-02.19. For Commission registrants, the rules promulgated under Regulation S-X have an authority similar to the highest-level GAAP pronouncements. See AU § 411.10 n.3.

another party by applying against the debt an amount that the other party owes to the debtor." 32/ It also provides that a right of setoff exists only when all of four conditions are met:

a. each of two parties owes the other determinable amounts;

b. the reporting party has the right to set off the amount owed with the amount owed by the other party;

c. the reporting party intends to set off; and

d. the right of setoff is enforceable at law. 33/

We conclude that Adelphia's presentation of a net figure for its related party payables and receivables violated GAAP. Because Adelphia netted the accounts payable and receivable of its various subsidiaries against the accounts payable and receivable of various Rigas Entities on a global basis, it did not comport with FIN 39's basic requirement that netting is appropriate only when two parties are involved.

Dearlove argues that FIN 39 prohibits only unilateral offsetting; that is, FIN 39 requires that at least two entities seek to offset, but it does not prohibit more than two entities from offsetting. We disagree. The "two-party" limitation on circumstances in which netting is permitted by FIN 39 is unambiguous. Moreover, FIN 39 is an exception to the general accounting rule that financial statements should present related party payables and receivables as gross figures; it is an exception that should be construed narrowly. 34/ FIN 39 itself specifically rejects the notion that offsetting is permissible among more than two parties except in very limited circumstances, none of which is applicable here. 35/

32/ An Interpretation issued by the Financial Accounting Standards Board ("FIN") is considered authoritative GAAP. See AU § 411.10(a).

33/ FIN 39 ¶ 5 (emphasis in original).

34/ FIN 39 ¶ 43 ("Some respondents indicated that the number of entities involved in the transaction is not relevant to the decision to offset. The general principle of a right of offset involves only two parties, and exceptions to that general principle should be limited to practices specifically permitted by the pronouncements indicated in paragraph 7 of this Interpretation.").

35/ FIN 39 ¶ 7 cites to certain provisions that permit offsetting regarding leases, insurance enterprises, pensions, income taxes, and other specialized situations. Dearlove has not argued that any of these provisions applies to Adelphia's netting, and we find that none applies.

Dearlove also suggests that Adelphia and its subsidiaries should be deemed to constitute one entity, while the Rigas Entities as a group constitute the other, thereby satisfying FIN 39's two-party requirement. However, FIN 39 allows offsetting only by two parties, and not by groups of entities claiming to be functionally equivalent to one party. Moreover, even if FIN 39 could be construed to permit a group of similarly-situated entities to be considered one "party" for purposes of FIN 39, such a construction is not acceptable here. Although Dearlove argues that "[t]he private entities were all owned by the Rigas family," the scant evidence in the record about the ownership of the Entities demonstrates that not every Rigas Entity whose accounts were netted with Adelphia's was owned in equal proportions by the same members of the Rigas family. For example, a Rigas Entity called Eleni Interiors was owned by John Rigas's wife, Doris Rigas, but she is not named as a member of the Rigas family partnership that owned several other Rigas Entities whose accounts Adelphia netted. There is no evidence in the record that Dearlove took any steps to determine the ownership structures of the Rigas Entities.

FIN 39 requires compliance with all four of its conditions; therefore, because Adelphia could not satisfy the first condition, FIN 39 was not available to Adelphia. 36/ Accordingly, we find that, based on Adelphia's failure to satisfy FIN 39's fundamental requirement that only two parties may offset, Adelphia's failure to report its related party payables and receivables as gross figures was a GAAP violation.

We also find that Dearlove's conduct in his audit of Adelphia's net presentation of affiliate accounts payable and receivable was at least unreasonable, resulting in several GAAS violations. As we have previously noted, Deloitte considered the Adelphia audit to present much greater than normal risk; under such circumstances, GAAS require "more extensive supervision by the auditor with final responsibility for the engagement during both the planning and conduct of the engagement" and should cause the auditor to "expand the extent of procedures applied, apply procedures closer to or as of year end, particularly in critical audit areas, or modify the nature of procedures to obtain more persuasive evidence." 37/ Where, as with Adelphia's practice of netting, a specific audit area involves related party transactions, GAAS require auditors to obtain an understanding of the business purpose of those transactions; if the auditor "lacks sufficient specialized knowledge to understand a particular transaction, he should consult

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36/ We note, however, that the record does not appear to support the conclusion that Adelphia could satisfy the remaining requirements. FIN 39 requires that the right of offset must be enforceable at law, and, although written agreements are not necessary to demonstrate enforceability, see FIN 39 ¶ 47, there is a dearth of evidence showing that such agreements existed. Moreover, the parties have not addressed how "legal constraints" such as state law and the federal bankruptcy code might have affected the legal enforceability of a right of offset. See FIN 39 ¶ 6 ("Legal constraints should be considered to determine whether the right of setoff is enforceable.").

37/ AU § 312.17.

with persons who do have the requisite knowledge." 38/ Dearlove, who admittedly had little experience with netting, knew that Adelphia management tended to embrace aggressive accounting interpretations and that they succeeded in dramatically reducing Adelphia's reported net affiliate receivables to deflect investor criticism.

Despite the need for increased attention to this audit area, there is no evidence, in the audit workpapers or elsewhere in the record, that Dearlove gave any consideration to the propriety of Adelphia's netting during the 2000 audit or that the audit team conducted any analysis of FIN 39's requirements. 39/ There is no evidence, in fact, that Dearlove made any attempt to determine the gross amounts of Adelphia's related party accounts payable and receivable, which each totaled more than $1 billion.

Instead, Dearlove accepted Adelphia's accounting treatment primarily, if not solely, because prior auditors had done so. This reliance on prior auditing conclusions was unreasonable because this audit generally called for heightened skepticism and because this account, in particular, involved related party transactions and a precipitous drop in the amount of net receivables that Adelphia reported compared to prior years. Moreover, Dearlove's unquestioning reliance on prior audit conclusions is precisely the result that audit partner rotation was designed to remedy. 40/ We also find that Dearlove's inattention to Adelphia's net presentation of related party receivables resulted in violations of applicable professional standards: Dearlove did not obtain sufficient competent evidential material to support his conclusion that Adelphia's netting was properly done, he did not exercise appropriate skepticism despite circumstances requiring heightened scrutiny, and he did not properly supervise the audit team to ensure that significant related party transactions like these were afforded appropriate review. 41/

Dearlove argues that the law judge's decision essentially attributed an alleged overall audit failure to Dearlove without identifying the conduct on which that responsibility is based. He contends that the law judge cannot hold Dearlove accountable for every audit failure simply

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38/ AU § 334.09(a) & n.6.

39/ An auditor does not violate GAAS simply by failing to document the basis for his audit conclusions in audit workpapers, and the Order Instituting Proceedings in this case did not charge Dearlove with having violated GAAS by failing to adequately document his work. Nevertheless, workpapers are ordinarily the foundation on which support for audit conclusions is demonstrated. See AU § 339 ("Audit documentation is the principal record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor in the engagement."). We consider the absence of work papers to be evidence that the audit team did not devote substantial, if any, effort to review the areas in question.

40/ See supra note 27 and accompanying text.

41/ AU §§ 230.07-08, 311.01, 311.11, 312.17, 316.27, 326.22, 334.09.

by saying that Dearlove was the individual in charge and is therefore liable. Even if we agreed that the law judge so erred, our de novo review cures any error that the law judge may have made. 42/ Our own review leads us to conclude that Dearlove's conduct was deficient because, despite the need for heightened scrutiny and despite his admitted lack of experience with the practice of netting in general, he did not pursue, or direct his team to pursue, the reason behind the dramatic reduction in Adelphia's net receivable balance; he did not consult with members of the audit team or anyone in Deloitte's national office about the issue; and he could not confirm that he ever considered FIN 39 during the audit. Taking note of the fact that Adelphia's practice of netting effectively defeated investor scrutiny of over $2 billion of related party accounts, we find that Dearlove's lack of attention to the issue was inconsistent with the requirements of GAAS.

V. Co-Borrowed Debt

A. Facts

As noted above, between 1996 and 2000, several Adelphia subsidiaries and some of the Rigas Entities had entered as co-borrowers into a series of three credit agreements with a consortium of banks. Although the agreements differed in the amount of credit available, their terms were substantially the same: each borrower provided collateral for the loan; each could draw funds under the loan agreement; and each was jointly and severally liable for the entire amount of funds drawn down under the agreement regardless of which entity drew down the amount.

Combining the features of term loans and revolving credit lines, the agreements permitted co-borrowers to draw funds and repay the loans at will and required almost no principal payments until the loans began to mature in 2004. The amount of debt outstanding under the agreements therefore could fluctuate as co-borrowers drew down and made payments on the loans. Cross-default provisions in the agreements provided that it was considered an event of default if the borrowers failed to timely pay any other substantial debts – co-borrowed or otherwise – they had assumed, which would permit the banks to demand immediate payment of

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42/ See Robert M. Fuller, 56 S.E.C. 976, 989 n.30 (2003), petition denied, 95 Fed. Appx. 361 (D.C. Cir. 2004). The law judge's opinion ceased to have any force or effect once Dearlove filed his petition for review. See Fundamental Portfolio Advisers, Inc., 56 S.E.C. 651, 679 n.44 (2003); 17 C.F.R. §§ 201.360(d), (e). For the same reason, we reject as moot Dearlove's complaint that certain of the law judge's findings of GAAS violations were ill-founded because the law judge, in finding that Dearlove failed to supervise the audit team, cited two auditing standards that were not specifically cited in the OIP. Similarly, we reject his complaint that the law judge appeared to base a GAAS failure on the fact that the audit team created no workpaper on the netting issue, which violation was not pled in the OIP.

all outstanding amounts. 43/ The agreements also provided that an event of default occurred if the Rigas family lost its majority control of the co-borrowing companies.

By year-end 2000, the total amount of co-borrowed funds drawn under the credit agreements was $3.751 billion, more than triple the $1.025 billion borrowed at year-end 1999. Of this amount, Adelphia subsidiaries had drawn approximately $2.1 billion, and Rigas Entities had drawn $1.6 billion.

Generally, an issuer must accrue on its balance sheet a debt for which it is the primary obligor. However, when an issuer deems itself to be merely contingently liable for a debt, Statement of Accounting Standards No. 5 ("FAS 5") provides the appropriate accounting and reporting treatment for that liability. 44/ FAS 5 establishes a three-tiered system for determining the appropriate accounting treatment of a contingent liability, based on the likelihood that the issuer will suffer a loss – that is, be required to pay the debt for which it is contingently liable. If a loss is "probable" (i.e., "likely") and its amount can be reasonably estimated, the liability should be accrued on the issuer's financial statements as if the issuer were the primary obligor for the debt. 45/ If the likelihood of loss is only "reasonably possible" (defined as "more than remote but less than likely"), or if the loss is probable but not estimable, the issuer need not accrue the loss but should disclose the nature of the contingency and give an estimate of the possible loss or range of loss, or state that such an estimate cannot be made. Even if the likelihood of loss is only "remote" (or "slight"), the issuer must still disclose the "nature and amount" of the liability. From 1997 through 1999, Adelphia had included in the liabilities recorded on its balance sheet the amount its own subsidiaries had borrowed, but it did not consider itself the primary obligor for the amount that the Rigas Entities had borrowed and therefore did not include that amount on its balance sheet. Instead, Adelphia accounted for the amounts borrowed by the Rigas Entities by making the following disclosure in the footnotes to its financial statements:

43/ The 2000 agreement provided that it was an event of default if "(a) Any Company fails to pay when due (after lapse of any applicable grace periods) any Debt of such Company (other than the Obligation) in excess (individually or collectively) of $25,000,000; or (b) the acceleration of any Debt of any Company, the principal amount of which Debt exceeds (individually or collectively) $25,000,000." "Debt" was defined as "all liabilities, obligations, and indebtedness . . . which in accordance with GAAP should be classified upon [the] balance sheet as liabilities. . . ." The 1999 and 1996 agreements contained similar provisions but applied to debts in the amount of $10 million or more and $7.5 million or more, respectively.

44/ A Statement of the Financial Accounting Standards Board ("FAS") is considered authoritative GAAP. See AU § 411.10(a).

45/ FAS 5 ¶ 8.

> Certain subsidiaries of Adelphia are co-borrowers with Managed Partnerships [i.e., Rigas Entities] under credit facilities for borrowings of up to [the total amount of all co-borrowed debt available to Adelphia and the Rigas Entities that year]. Each of the co-borrowers is liable for all borrowings under this credit agreement, although the lenders have no recourse against Adelphia other than against Adelphia's interest in such subsidiaries.

Deloitte had approved this treatment in the audits it conducted from 1997 to 1999.

In its 2000 financial statements, Adelphia planned to account for its co-borrowed debt in the same way it had in prior years. Adelphia concluded that it was the primary obligor for only the amount of co-borrowed debt that its own subsidiaries had drawn. Therefore, Adelphia included $2.1 billion as a liability on its balance sheet. 46/ Adelphia considered itself only contingently liable as a guarantor for the $1.6 billion that the Rigas Entities had drawn, and again concluded that disclosure of the co-borrowed debt in the notes to its financial statements would be adequate.

Dearlove knew that Adelphia considered the Rigas Entity debt to be a contingent liability for which its chances of suffering a loss were merely "remote," making accrual on the balance sheet unnecessary pursuant to FAS 5. Deloitte created no workpapers documenting its examination of Adelphia's decision. However, from the record, it appears that Deloitte considered the matter and focused its review on the likelihood, as defined by FAS 5, that Adelphia would have to pay the Rigas Entities' share of co-borrowed debt.

Dearlove estimated the value of the Rigas Entities' cable systems and assets by multiplying the number of Rigas Entity basic cable subscribers by the market value per subscriber as established by industry transactions in 1999 and 2000 and concluded that the Entities' subscriber assets were worth approximately $1 billion. Dearlove did not consider whether the Rigas Entities' cash flow was sufficient to service the debt, did not perform a cash flow analysis for the Rigas Entity co-borrowers, and did not know if the Rigas Entities serviced any portion of their co-borrowed debt with funds provided by Adelphia.

Dearlove also believed that, although the Rigas family was not legally obligated to contribute funds in the event of a default by the co-borrowers, the family would be economically compelled to protect their Adelphia holdings by stepping in to prevent a default by the Entities. Dearlove did not, however, conduct any inquiry into whether the family would, in fact, use their personal assets to prevent a default by Adelphia. Dearlove estimated the value of the Rigas family's holdings of Adelphia stock by multiplying the number of shares the Rigases owned by the price per Class A share, resulting in a figure of approximately $2.3 billion, which he

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46/ The $2.1 billion in co-borrowed debt was included as part of the $9.1 billion figure reported on Adelphia's 10-K as "subsidiary debt."

concluded was by itself ample to cover the debt and conclude his FAS 5 analysis. However, Dearlove did not determine if these Rigas family assets were already encumbered by other debt; he saw no financial statements or other proof of the family's financial condition other than local media reports that the Rigases "were billionaires." Dearlove testified that he "never asked them: Are you worth 2 billion, 3 billion or 10 billion?" Dearlove also did not consider whether disposing of some or all of the family's stock might result in a downward spiral in the stock's value or in a change in their control of Adelphia, an event of default under the co-borrowing agreements.

Dearlove testified that, at the end of the 2000 audit, he spoke to senior manager Caswell for about fifteen minutes regarding the requirements of FAS 5. During this meeting, they concluded that "the assets of the cable systems and the Adelphia common stock that the Rigases owned exceeded the amount of debt that was on the co-borrowed entities, and the overhang . . . exceeded the co-borrowing by hundreds of millions if not billions of dollars." Dearlove testified that, although other assets could have been included in a FAS 5 analysis, these two assets alone were sufficient to allow the auditors to conclude that Adelphia's contingent liability was remote. Deloitte therefore approved Adelphia's decision to exclude the Rigas Entities' $1.6 billion in co-borrowed debt from its balance sheet and to instead disclose the debt in a footnote to the financial statements.

When it reviewed the adequacy of the note disclosure that Adelphia planned to use (which was identical to the language it had used in previous years), the audit team initially believed the disclosure should be revised. During the 2000 quarterly reviews, audit manager Hofmann and others had repeatedly encouraged Adelphia management to disclose the specific dollar amount of Rigas Entity co-borrowings, but Adelphia continually ignored Deloitte's suggestions. Although Deloitte was unaware of it at the time, Adelphia management was purposefully working to obfuscate the disclosure of Rigas Entity co-borrowed debt.

In November 2000, at a third-quarter wrap-up meeting attended by Dearlove, Caswell, and Hofmann, Adelphia management (including Adelphia's vice president of finance, James Brown), agreed to make disclosures regarding the amounts borrowed by the Rigas Entities under the co-borrowing agreements. Caswell and Hofmann subsequently suggested improvements to the note disclosure in written comments on at least six drafts of the 10-K; they proposed adding language that would distinguish the amount of borrowings by Adelphia subsidiaries and Rigas Entities, such as the following: "A total of $__ related to such credit agreements is included in the Company's consolidated balance sheet at December 31, 2000. The [Rigas] Entities have outstanding borrowings of $__ as of December 31, 2000 under such facilities."

At the end of March 2001, as Deloitte was concluding its audit of the 2000 financials, Brown – despite his agreement in November 2000 to disclose the amount of Rigas Entity borrowing – informed the audit team that he did not think the additional disclosure was necessary. Instead, Brown proposed adding a phrase explaining that each of the co-borrowers "may borrow up to the entire amount available under the credit facility." Brown argued that his proposed language was more accurate than Deloitte's proposal, because the lines of credit could fluctuate and, as a result, it would be better to disclose Adelphia's maximum possible exposure. Caswell agreed to take Brown's language back to the engagement team, but he told Brown that he did not agree with Brown and did not think Deloitte would accept his proposed language. 47/

Notwithstanding Caswell's reaction, Brown soon afterwards presented his proposed language to the audit team, including Dearlove, Caswell, and Hofmann, during the audit exit meeting on March 30, 2001. Brown claimed that his proposed disclosure language had been discussed with, and approved by, Adelphia's outside counsel. Although Dearlove characterized the disclosure issue as "really one of the more minor points that [the audit team was] trying to reconcile at that point," the law judge did not credit this testimony. Dearlove testified that he was "concerned" about "making it clear to the reader how much Adelphia could be guaranteeing," and that Brown's language was "more conservative" but "wasn't necessarily what we were attempting to help clarify." Dearlove also testified that he told Brown, "I don't understand how that [proposed change] enhances the note" but that, after "an exchange back and forth relative to that," Dearlove "couldn't persuade him as to what he wanted." Nevertheless, Dearlove told Brown that he agreed with the proposal and approved the change. Caswell and Hofmann also indicated their agreement.

Dearlove did not understand, and did not ask, why Brown opposed full disclosure of the Rigas Entity debt. Dearlove did not seek Adelphia's permission to speak directly with Adelphia's outside counsel about Brown's proposed language. Nor did Dearlove attempt to verify that Brown actually presented the issue to Buchanan Ingersoll. 48/ Although Dearlove testified that he "believe[d] that we had communicated to both [risk reviewer] Steve Biegel through Bill Caswell and to [concurring partner] Mike Lindsey through Ivan Hofmann that we had proposed changes to various things in the document," he did not contact Lindsey or Biegel directly to ensure that they understood the changes to the disclosure language. 49/ Nevertheless, Dearlove

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47/ Caswell testified that he later discussed Brown's proposal with Dearlove and Hofmann, but Caswell does not recall the substance of the conversation, and no other testimony in the record illuminates the specifics of the engagement team's discussion.

48/ In fact, Brown had not consulted outside counsel about this issue.

49/ Moreover, neither Hofmann nor Caswell, during testimony, confirmed that they consulted, or were asked to consult, Biegel or Lindsey on this issue. Although Lindsey remembered reading a draft of the 10-K that included the team's recommended disclosure of the co-borrowed and guaranteed amounts, Lindsey did not recall seeing any draft of the 10-K that included Brown's language. Biegel testified that although he believed he had discussions with the audit team about co-borrowed debt, he did not recall any specific discussions; he also testified that he was not aware of any disagreement between Deloitte and Adelphia over the note disclosure.

testified that he believed the disclosure was GAAP compliant, and therefore Deloitte "didn't have a basis to force a change."

Adelphia's note disclosure of the co-borrowed debt, as it appeared in its 2000 Form 10-K with Brown's added language, read as follows:

> Certain subsidiaries of Adelphia are co-borrowers with Managed Entities under credit facilities for borrowings of up to $3,751,250[,000]. Each of the co-borrowers is liable for all borrowings under the credit agreements, and may borrow up to the entire amount of the available credit under the facility. The lenders have no recourse against Adelphia other than against Adelphia's interest in such subsidiaries.

B. Dearlove's Audit of Adelphia's FAS 5 Determination

The law judge found that the Division failed to prove that Adelphia violated GAAP by treating the Rigas Entities' co-borrowed debt as a contingent rather than a primary liability in its financial statements, or that Adelphia wrongly determined that its chances of having to repay that debt was only remote under FAS 5. The Division did not appeal the law judge's decision, and therefore we do not consider whether Adelphia violated GAAP by mis-applying FAS 5. 50/ Nevertheless, our inquiry does not end here: even assuming that Adelphia's accounting treatment

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50/ On July 23, 2007, Dearlove filed a motion to adduce additional evidence, seeking to add to the record on appeal excerpts of testimony given by James Brown in another proceeding that came to the attention of Dearlove's counsel when it was attached as an exhibit to a motion made by the Rigases in their criminal trial pending before the District Court for the Southern District of New York. Dearlove believes the testimony establishes two things.

As relevant here, Dearlove argues that one excerpt of the testimony establishes that the Rigas Entities had the financial wherewithal to pay their share of co-borrowed debt. Although Dearlove characterizes this as a "central issue in this proceeding," as we have just explained, whether Adelphia violated GAAP by incorrectly estimating its chances of having to pay the Rigas Entity debt is not before the Commission. Therefore, Dearlove does not meet the requirement of Commission Rule of Practice 452, 17 C.F.R. § 201.452, that the evidence he seeks to adduce be "material," and we decline to consider the proffered testimony in this context.

Dearlove next argues that a second excerpt establishes that a certain reclassification of debt was not a "sham" transaction. We deal with this portion of Dearlove's motion in our discussion of Adelphia's debt reclassifications, infra at note 72.

of the Rigas Entities' co-borrowed debt was GAAP-compliant, we may still find, as we do here, that an auditor's review of that accounting treatment violated GAAS. 51/

Deloitte, with Dearlove's participation and agreement, had concluded that the Adelphia audit generally presented a "much greater than normal risk" based on several factors, including its multiple related party transactions, recent significant growth in the company, and substantial debt load. Adelphia's accounting for co-borrowed debt, specifically, implicated all of these risk factors. GAAS require that when an audit presents an increased risk, the auditor must increase the professional care and skepticism he applies to his review, which may include, for example, "increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions." 52/ Despite the clear need for increased care and skepticism, Dearlove conducted only a cursory review of Adelphia's accounting for the Rigas Entities' share of co-borrowed debt. There is no evidence in the workpapers that Dearlove or the audit team conducted an analysis of Adelphia's potential for liability under the credit agreements; nor is there any evidence in the workpapers that he directed his team to conduct such an analysis. 53/ Instead, Dearlove's conclusion was based on a series of assumptions about the Rigas Entities' and the Rigas family's willingness and ability to pay the co-borrowing Rigas Entities' debt – assumptions that were either untested or inadequately tested.

First, Dearlove and the audit team assumed that all Rigas Entities were willing to liquidate their assets to cover other Entities' debts. There is no evidence that the team made any effort to confirm this assumption, or at least to confirm that the Rigas Entities whose assets were being pooled had identical ownership structures. Having made this untested assumption, the audit team did not analyze whether each Rigas Entity could service its own share of the debt, but instead examined only whether all the Rigas Entities taken together – including non-co-borrowers – owned sufficient assets to cover the debt. Although Dearlove concluded that the collective value of Rigas Entity cable subscribers and accounts receivable was sufficient to cover the debt, he did so without examining the consequences of liquidating those assets. Moreover, there is no evidence in the record that Dearlove considered that, in order to prevent default by

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51/ See Michael J. Marrie, CPA, 56 S.E.C. at 776 ("An auditor who fails to audit properly under GAAS should not be shielded because the audited financial statements fortuitously are not materially misleading. An auditor who skips procedures designed to test a company's reports or looks the other way despite suspicions is a threat to the Commission's processes. Even if an auditor's improper professional conduct does not result in false financial statements, it damages the integrity of the Commission's processes because filings with the Commission are unreliable if auditors certify that their audits were conducted in accordance with GAAS when in fact they were not."). Dearlove does not argue that he cannot be sanctioned under Rule 102(e) if no GAAP violation is found.

52/ AU § 316.27; see also AU § 312.17.

53/ See supra note 39.

virtue of the cross-default provisions in the co-borrowing agreements, the Rigas Entities' available assets would have to prove sufficient to service all significant debts of the co-borrowers. 54/

Dearlove also assumed that, if the Rigas Entities could not pay their share of co-borrowed debt, the apparently wealthy Rigas family would step in to cover any impending default on the debt. Dearlove did nothing to confirm the Rigases' willingness to pay the Entities' debt, instead relying on a general presumption that all persons can be assumed to act in an economically rational manner. Dearlove further concluded that the Rigases were, in fact, financially able to cover the debt, but based this conclusion on incomplete information: Dearlove's understanding of the Rigas family's wealth was based only upon their holdings of Adelphia stock and the media's portrayal of the family as "billionaires." Dearlove did not evaluate the liquidity of the Rigases' shares and did not address whether their liquidation might be so large as to cost them majority ownership of Adelphia, thereby triggering a default under the debt agreements. Further, he failed to consider or make any inquiry into the possibility that the Rigas family's assets – however substantial – were already encumbered by other obligations and therefore unavailable for use against the Entities' co-borrowed debt. Finally, Dearlove did not discuss his FAS 5 conclusion with anyone at Adelphia or consult with Deloitte's risk review or concurring partner.

Dearlove's failures in examining the critical assumptions underlying his FAS 5 determination were at least unreasonable in light of the circumstances of this audit area that clearly called for increased care and scrutiny. Adelphia's co-borrowed debt was a multi-billion-dollar related-party transaction used, in part, to finance recent significant growth in the company, and it represented a substantial portion of the company's total debt load of approximately $12 billion. Adelphia's accounting treatment of the debt warranted more than a brief discussion about assets potentially available for liquidation: it called, at least, for testing and analysis of the actual availability, liquidity, and encumbrances of those assets.

Each of Dearlove's failures to meaningfully review Adelphia's chances of suffering a loss, moreover, resulted in a violation of professional standards. Dearlove's cursory treatment of co-borrowed debt did not comport with the generally-applicable requirements of GAAS to exercise due professional care and professional skepticism, adequately plan the audit, and obtain sufficient competent evidential matter to afford a reasonable basis for his opinion that Adelphia's chances of incurring a loss were remote. 55/ Nor did Dearlove's review satisfy the GAAS requirement to apply increased professional care and skepticism to audit areas presenting

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54/ See supra note 43. If Dearlove or the audit team attempted to identify for FAS 5 purposes the amounts of all significant debt (as defined by the co-borrowing agreements) carried by the Rigas Entities and Adelphia subsidiaries, there is no evidence of this in the record.

55/ AU §§ 311.01, 311.11, 230.01, 230.07 - 08, 326.22.

increased risk. 56/ To the contrary, Dearlove failed to apply even basic – let alone heightened – scrutiny to Adelphia's accounting for co-borrowed debt.

Dearlove argues that it was reasonable for the audit team to base a FAS 5 analysis on a comparison of the debt of the borrower to the value of the borrower's assets, and that his consideration of FAS 5 was adequate given that Dearlove knew that the co-borrowers held substantial assets and that the Rigases were economically compelled to respond with their own substantial, personal assets to prevent default. Dearlove's argument fails to address the fact that the team's reliance on the value of these assets is unfounded because Dearlove did not confirm, nor ask his team to confirm, that the assets were actually available for application against the co-borrowed debt as well as unencumbered.

Dearlove also argued in his brief and at oral argument that his consideration of Adelphia's chances of incurring a loss, though consuming only fifteen minutes at year-end, was supported by "extensive liquidity testing and debt-covenant testing of the co-borrowing groups" that had occurred during Deloitte's quarterly reviews. Dearlove cites to his own testimony to prove that he "considered the contingency and potential for loss on a quarterly basis when reviewing the financial statements." However, there is no evidence in the workpapers that the team specifically considered Adelphia's contingent liability under FAS 5 during the quarterly reviews. 57/ Moreover, the quarterly debt testing evidenced in the workpapers focused on confirming principal due under various loan agreements and other debt, calculation of interest, and proper entry of the debt on the books of Adelphia and its subsidiaries. Dearlove testified that these quarterly reviews helped him become "knowledgeable about" the value of Adelphia stock owned by the Rigases, subscriber assets owned by various Rigas Entities, and receivables owed to Rigas Entities. As we have explained, any knowledge that Dearlove gained about the value of various Rigas Entity and Rigas family assets through quarterly reviews still required testing as to whether those assets were in fact unencumbered and available for use against the Rigas Entities' share of co-borrowed debt.

C. Adequacy of the Note Disclosure of Adelphia's Contingent Liability

We next consider whether Adelphia's footnote disclosure of Rigas Entity co-borrowings was appropriate under GAAP. As explained above, FAS 5 states that, when the likelihood of loss arising from a contingent liabilty is only remote, a company need not accrue the amount of debt on its balance sheet. However, FAS 5 requires that a company must still disclose the "nature and amount" of the liability when it is a guarantee of another's indebtedness. 58/

56/ AU § 316.27; see also AU § 312.17.

57/ See supra note 39.

58/ The law judge declined to consider whether Adelphia's footnote properly disclosed the "nature" of the guarantee, because he believed the Division had presented its argument
(continued...)

Adelphia disclosed the total amount of credit available to the co-borrowers ("up to" $3.75 billion) without indicating whether any portion of that available credit had actually been drawn down, much less that all of it had. This disclosure was inadequate to inform the investing public that Adelphia was already primarily liable for $2.1 billion and a guarantor for the remaining $1.6 billion that had been borrowed by Rigas Entities. Therefore, it did not comply with the requirement in FAS 5 to disclose the amount of the contingent liability.

We believe that Dearlove acted at least unreasonably in his audit of Adelphia's note disclosure, resulting in several violations of GAAS. In high-risk audit environments such as that presented by the Adelphia engagement, GAAS specifically recommend "increased recognition of the need to corroborate management explanations or representations concerning material matters – such as further analytical procedures, examination of documentation, or discussion with others within or outside the entity" when audit risk increases. 59/ The accounting for Adelphia's co-borrowed debt implicated the extensive related party transactions and high debt load that were part of the basis for Deloitte's high-risk assessment for the Adelphia audit. Management's insistence on its own accounting interpretation was precisely the behavior identified by the audit plan as presenting a much higher than normal risk of misstatement in the audit.

Moreover, Dearlove knew that the audit team believed that the previous years' footnote disclosure was inadequate and had urged additional disclosure that would have made clear the extent of Rigas Entity actual borrowings and Adelphia's potential liability therefor. Dearlove did not think Brown's language helped achieve Deloitte's goal of clarifying the extent of Rigas Entity debt and Adelphia's obligation as guarantor. Yet Dearlove accepted Brown's language without probing his reasons for the change, without understanding Adelphia's reasons for rejecting Deloitte's language, and without discussing the issue with the concurring or risk review partners assigned to the audit. This unquestioning acceptance of Brown's proposed disclosure language was a clear – and at least unreasonable – departure from the requirements of GAAS to apply greater than normal skepticism and additional audit procedures in order to corroborate management representations in a high-risk environment. Dearlove's conduct resulted in violations of applicable professional standards: Dearlove failed to exercise the level of professional care called for by the high-risk account and failed to employ professional skepticism in analyzing the note disclosure, 60/ and he failed to apply audit procedures necessary to afford a reasonable basis for an opinion regarding the financial statements. 61/

58/ (...continued)
too late when it raised the issue in its post-hearing reply brief. That decision has not been appealed and, as a result, is not before us.

59/ AU § 316.27.

60/ AU §§ 230.01, 230.07-08, 312.17, 316.27, 334.09; McCurdy, 396 F.3d at 1261-62.

61/ AU § 333.02.

Dearlove asserts that disclosure of the amount that the Rigas Entities could theoretically borrow (up to $3.75 billion) was more conservative than disclosure of the $1.6 billion that they had actually borrowed. We think the footnote disclosure was materially misleading to investors. "[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information." 62/ If "there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision," the information is material. 63/ A reasonable investor would think it significant that the footnote disclosure spoke only in terms of potential debt when, in fact, the entire line of credit had been borrowed and $1.6 billion of it was excluded from Adelphia's balance sheet but potentially payable by Adelphia. It was especially important for this information to appear in Adelphia's financial statements because investors had no access to the financial statements of the privately-held Rigas Entities. We therefore reject Dearlove's argument that Adelphia's note complied with FAS 5's requirement to disclose the amount of debt that Adelphia guaranteed.

Dearlove also contends that Financial Accounting Standards Board Interpretation ("FIN") 45, issued in November 2002, contains accounting guidance that supports his view that the disclosure was adequate under GAAP. In the alternative, Dearlove argues, FIN 45 evidences enough uncertainty about the appropriate GAAP treatment that we cannot second-guess the reasonableness of his conclusions. FIN 45, which interprets the requirements of FAS 5, specifies that the disclosure of a guarantee should state (a) the nature of the guarantee, (b) the maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee, (c) the current carrying amount of the liability, and (d) the nature of certain third-party assets against which the guarantor could use to cover a loss. 64/ Dearlove argues that disclosure of "up to $3.75 billion" represented the "maximum potential amount of future payments" that FIN 45 presents as the disclosure "most relevant to a reader."

FIN 45 does not alter our conclusion that Adelphia's disclosure was not GAAP-compliant. As an initial matter, FIN 45 was enacted after the 2000 Adelphia audit, and therefore is of only uncertain applicability here. To the extent FIN 45 has any relevance to Adelphia's disclosure, FIN 45 explains that, in disclosing the nature of a guarantee, an issuer should present "the approximate term of the guarantee, how the guarantee arose, and the events or circumstances

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62/ Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); see also SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (stating that a fundamental purpose of the federal securities laws is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor").

63/ SEC v. Rogers, 790 F.2d 1450, 1458 (9th Cir. 1986).

64/ FIN 45 ¶ 13.

that would require the] guarantor to perform under the guarantee." 65/ Whether Adelphia properly disclosed the nature of its guarantee of the Rigas Entities' co-borrowed debt is not before us; 66/ however, FIN 45's description of the factors relevant to the nature of the guarantee also informs the disclosure of the amount of the guarantee. Here, Adelphia's liability arose from a co-borrowing agreement under which Adelphia itself actually borrowed and recorded $2.1 billion and actually guaranteed $1.6 billion borrowed by Rigas Entities; Adelphia knew that it might have to pay this $1.6 billion if the Rigas Entities could not. In these circumstances, FIN 45 indicates that Adelphia should have disclosed that the amount of the guarantee was $1.6 billion, the maximum potential future payments for which Adelphia was then obligated as guarantor, rather than a hypothetical amount based on payoffs and borrowings that might never occur. In FIN 45, the FASB "observed that there are differing interpretations about the disclosures required of guarantors under [FAS 5]." 67/ However, under these circumstances, FAS 5's requirement to disclose the amount of the guarantee, a known sum, could not have been subject to differing interpretations by reasonable auditors. Accordingly, nothing in FIN 45 leads us to conclude that Dearlove reasonably exercised his professional judgment in deciding that the disclosure was adequate.

VI. Debt Reclassification

A. Facts

After the end of the second, third, and fourth quarters of 2000, Adelphia's accounting department transferred the reporting of approximately $296 million of debt from the books of Adelphia's subsidiaries to the books of various Rigas Entities. In exchange, Adelphia eliminated from its books receivables owed to it by the respective Rigas Entities in the amount of debt transferred. The three transfers were in the amounts of $36 million, approximately $222 million, and more than $38 million, respectively. 68/ In each instance, the transaction took place after the

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65/ FIN 45 ¶ 13(a).

66/ See supra note 58.

67/ FIN 45 ¶ 1.

68/ Although these amounts were clearly recorded as debts on the books of the subsidiaries, the record does not make clear from whom the money was borrowed. See Gregory M. Dearlove, Initial Dec. Rel. No. 623 (July 27, 2006), 88 SEC Docket 1808, 1841 n.33 (finding that although the OIP implied, and the parties assumed, that all of the reclassified debt was co-borrowed debt, the Division did not establish that to be true).

end of the quarter, and each transfer involved a post-closing journal entry that was retroactive to the last day of the quarter. 69/

A checklist prepared by Deloitte in anticipation of the 2000 audit showed that Deloitte was aware of a significant number of related party transactions that had arisen outside the normal course of business and that past audits had indicated a significant number of misstatements or correcting entries made by Adelphia, particularly at or near year-end. An audit overview memorandum recognized as a risk area that "Adelphia records numerous post-closing adjusting journal entries" and provided as an audit response, "[Deloitte] engagement team to review post-closing journal entries recorded and review with appropriate personnel. Conclude as to reasonableness of entries posted." An audit planning memorandum provided that "[p]rofessional skepticism will be heightened to ensure that . . . related party transactions . . . are appropriately identified and disclosed" and that auditors should "increase professional skepticism in [areas] where significant related party transactions could occur."

Dearlove testified that Deloitte had identified the Rigases' control of both Adelphia and the Rigas Entities as posing a special risk. 70/ Dearlove also testified that he believed it was important to know whose debt was whose, as between Adelphia and the Rigas Entities. He testified that he was "generally aware the debt was audited," but that he did not review the debt workpapers directly. He also testified: "I don't recall [debt] being [a] particularly sensitive area, . . . I don't recall issues raised to me of difficulties we had. I don't recall any particular conversation [I] had with the team" concerning the audit of the debt. The record does not show that Dearlove knew of the three journal entries involving debt reclassification at the time of the audit.

B. Analysis

Paragraph 16 of Statement of Accounting Standards No. 125 ("FAS 125"), Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, permits a

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69/ For example, after the end of the second quarter of 2000, Adelphia transferred the reporting of $36 million of debt from the books of UCA Corporation, an Adelphia subsidiary, to the books of Hilton Head Communications, a Rigas Entity. The entry was booked on July 14, 2000, and it involves a post-closing journal entry that was made retroactive to June 30, 2000.

70/ In planning the audit, Deloitte had identified Adelphia's complex organizational structure and the concentration of its management in a small group as factors contributing to the "much greater than normal" risk of fraud, misstatement, or error posed by the Adelphia engagement. See supra Section II (discussing general risk factors identified in audit planning).

debtor to derecognize a liability "if and only if it has been extinguished." 71/ FAS 125 ¶ 16 provides that a liability is extinguished if either (a) the debtor pays the creditor and is relieved of its obligation for the liability, or (b) the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.

When the Adelphia subsidiaries posted the debt in question to their books, they acknowledged their primary liability for the amounts posted. They could not properly remove the debt from their books without first satisfying the requirements of FAS 125 ¶ 16 that either (1) the Adelphia subsidiaries repaid the debt to the creditor during the relevant reporting periods, or (2) a creditor had released the subsidiaries from their liability for repayment. The evidence does not show, and Dearlove does not contend, that either of these events occurred. Adelphia's attempt to extinguish the debt unilaterally merely by shifting the reporting to the Rigas Entities violated GAAP and rendered its financial statements materially misleading by making Adelphia's debt appear less than it was. 72/

Dearlove points out that Elliot Lesser, the Division's expert, offered no opinion as to the alleged debt reclassifications, and made no assertion of any GAAP violation with respect to FAS 125. 73/ Without the support of expert testimony, Dearlove argues, the law judge, and by implication the Commission, may not find a violation of FAS 125. 74/ Dearlove's argument is incorrect. The Commission may consider expert testimony, but it is not bound by such testimony

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71/ FAS 125 was superceded by FAS 140, effective for extinguishments of liabilities occurring after March 21, 2001. The provisions discussed here were carried over unchanged into FAS 140.

72/ The law judge found that the $38 million debt reclassification after the end of the fourth quarter of 2000 was a sham transaction that had no rational purpose other than to reduce the level of debt that Adelphia reported in its public filings. We reach no conclusion as to whether that transaction was a sham because the resolution of that question does not alter our FAS 125 analysis. The Brown testimony that Dearlove seeks to introduce through his Rule 452 motion, see supra note 50, is irrelevant because we do not need to make a finding as to whether the transaction was a sham.

73/ Dearlove characterizes Lesser's testimony as an "obvious refusal" to adopt the Division's theory of a FAS 125 violation. The testimony to which Dearlove refers, however, was not related to the alleged FAS 125 violations. Rather, Lesser was responding to a request that he identify factors supporting his conclusion that the Rigas Entities' co-borrowed debt should have been booked as Adelphia's primary obligation under FAS 5.

74/ Dearlove makes a similar argument regarding the law judge's (and the Commission's) purported inability to find a GAAP violation with respect to Adelphia's accounting treatment of direct placements without expert testimony. See infra note 88.

even where it is available, and the absence of expert testimony does not preclude the Commission from making necessary findings with respect to principles of accounting. 75/

Dearlove does not dispute that "certain debt which had been posted to Adelphia was later posted to a Rigas entity." However, focusing on the statement in the Initial Decision that "[o]nce Adelphia's subsidiaries had posted this debt to their books they became primary obligors for the amounts posted," Dearlove argues that FAS 125 does not define the circumstances under which an entity recognizes debt that may be derecognized only under the FAS 125 criteria. He claims that the Initial Decision improperly "assumed without analysis" that the posting of debt in a ledger is such a circumstance. Dearlove argues that the application of FAS 125 is complex where entities are jointly and severally liable for an obligation. He argues that FAS 125 does not apply where an entity is secondarily or contingently rather than primarily liable. He asserts that Adelphia was arguably not required to recognize debt in cases where co-borrowed funds were intended to be used by other co-borrowers. 76/ He stops short, however, of saying that the funds at issue were so intended, and our review of the record yields nothing to support such a contention.

75/ Cf., e.g., Pagel, Inc., 48 S.E.C. 223, 230 (1985) (stating that law judge "highly sophisticated in securities matters with many years of experience in determining issues under the securities laws" could determine that manipulation occurred without expert testimony), aff'd, 803 F.2d 942, 947 (8th Cir. 1986) ("There is no reason to believe that the [proffered] expert's testimony would have added anything to this administrative adjudication directed and decided by a person already knowledgeable in securities regulation matters."). See also Haskins & Sells, Accounting Series Release No. 73 (Oct. 30, 1952), 1952 SEC LEXIS 1062, at *28 ("[W]hile the opinions of qualified expert accountants may be helpful, this Commission must in the last analysis weigh the value of expert testimony against its own judgment of what is sound accounting practice."). This conclusion also applies to the similar argument Dearlove asserts in connection with Adelphia's accounting for certain direct placements. See infra note 88.

Despite Dearlove's argument that FAS 125 is a "highly technical standard," we find its application to the facts at issue straightforward, and well within our expertise. We do not read For Liability Extinguishment, a December 2003 document by the Financial Accounting Standards Advisory Committee cited in Dearlove's reply brief and by his counsel at oral argument, as endorsing Adelphia's accounting treatment of the reclassified debt. Although that document indicates that there is some ambiguity as to the application of FAS 140 (the successor to FAS 125) where there is joint and several liability for a debt, nothing in that document supports the accounting treatment by Adelphia of its reclassified debt in this case.

76/ Dearlove adduces no support for his contention that the debts were not recognized when Adelphia booked them.

The record does not establish that all of the reclassified debt was co-borrowed debt, and the law judge correctly concluded that the impropriety of Adelphia's debt reclassification was unaffected by the question whether the debt was co-borrowed. In addition, Dearlove cites no authority to support his contention that FAS 125 is applicable only where primary obligors were required to recognize a liability, and we are aware of none.

In any event, the original recording of the debt on the subsidiaries' books is, at a minimum, circumstantial evidence of their receipt of money, whether co-borrowed or otherwise borrowed. Moreover, Adelphia gave up something of value when it transferred the reporting of the debt: it removed from its books corresponding amounts of receivables owed to it by Rigas Entities. The removal of the receivables is most reasonably viewed as a quid pro quo for the transfer of debt that was properly Adelphia's. Adelphia's subsequent transfer of that debt to the Rigas Entities was tied to the removal from Adelphia's books of receivables owed to it by the Rigas Entities and supports the conclusion that the subsidiaries received the money at issue from the lender.

The crucial question for the FAS 125 analysis is whether the debt was extinguished in one of the enumerated ways. If the debt was not extinguished as provided in FAS 125, the debtor may not derecognize it. We find that the debts were recognized when booked and that, because there was no evidence that the debts were extinguished under FAS 125 ¶ 16, the accounting treatment violated GAAP.

We also find that Dearlove's conduct in his audit of Adelphia's accounting for debt was at least unreasonable, resulting in several GAAS violations. As explained above, Dearlove knew that Adelphia had a large number of decentralized operating entities with a complex reporting structure, carried substantial debt, and engaged in significant related party transactions with affiliated entities that Deloitte would not be auditing. He also knew that Adelphia management tended to interpret accounting standards aggressively. Moreover, the audit plan specifically required that post-closing journal entries be examined in particular detail and that the audit team conclude as to their reasonableness. Dearlove knew that these factors, together with others, led Deloitte to identify the Adelphia audit as posing a "much greater than normal" risk of fraud, misstatement, or error. Additionally, Dearlove knew that Adelphia management netted its affiliate accounts payable and receivable and sought to reduce the amount of related party receivables it reported.

In this context, GAAS required Dearlove to consider the "much greater than normal" risk of the audit in determining the extent of procedures, assigning staff, and requiring appropriate levels of supervision. 77/ Additionally, he was required to "direct the efforts of assistants who [were] involved in accomplishing the objectives of the audit and [to] determin[e] whether those

77/ AU § 312.17.

objectives were accomplished." 78/ He was required to exercise "an attitude that includes a questioning mind and a critical assessment of audit evidence," 79/ "to obtain sufficient competent evidential matter to provide . . . a reasonable basis for forming a conclusion," 80/ and, after identifying related party transactions, to "apply the procedures he consider[ed] necessary to obtain satisfaction concerning the purpose, nature, and extent of these transactions and their effect on the financial statements." 81/

A reasonable engagement partner, under the circumstances present here, would have developed a much more thorough understanding of Adelphia's accounting for debt than Dearlove did and would have paid more attention to ensuring that the engagement team was asking the sorts of questions that would have brought matters like the accounting for reclassified debt to light (for example, questions about how Adelphia recorded debt or decided where debt belonged, how related party receivables were audited, and how Adelphia managed to reduce the receivable line item on its balance sheet by 98% over the prior year). A reasonable engagement partner would have specifically ensured that the requirement in the audit plan concerning post-closing journal entries was followed. Instead, Dearlove paid only cursory attention to the audit of Adelphia's debt and thus remained unaware of the existence – and thus the accounting treatment – of the debt reclassifications.

The reclassified debt involved post-closing journal entries of a magnitude significant enough to require the auditors to confront management and request an explanation, as required by Deloitte's audit planning documents. After discussing the entries with appropriate Adelphia personnel, Deloitte should have documented management's explanation, and Deloitte's conclusions as to whether the accounting treatment was reasonable, in the audit workpapers. The record does not show that any of these steps was taken. The failure to take them was, at the very least, unreasonable. 82/

Dearlove reiterates his general argument that his active involvement in the audit represented the reasonable conduct of an engagement partner in an audit of this complexity. He argues that he never learned of the three accounting events characterized as debt reclassification until after the conclusion of the audit and that, "although [he] was active in the audit, he did not have the clairvoyance to ask every question that is now at issue in this proceeding, or the ability, [six] years hence, to remember every question he did ask."

78/ AU § 311.11.

79/ AU § 230.07.

80/ AU § 326.22.

81/ AU § 334.09.

82/ Dearlove's view that FAS 125 is a "highly technical standard," see supra note 75, should have given him even more reason to devote particular attention to its application.

As the engagement partner, however, Dearlove was responsible for assigning tasks to and supervising assistants. 83/ He was required to review the work performed by each assistant to determine whether it was adequately performed and to evaluate whether the results were consistent with the conclusions to be presented in the auditor's report. 84/ Dearlove could not satisfy his duty to supervise by waiting passively for his subordinates to bring these matters to his attention. The audit plan itself directed the audit team to examine related party transactions and post-closing journal entries, and Dearlove himself admitted that he believed it was important to know whose debt was whose. In light of these facts, we find that Dearlove's failure to apprise himself of the circumstances of the debt reclassification was a clear violation of his GAAS obligations to exercise due professional care, supervise assistants, and gather sufficient competent evidential matter to support his audit conclusions. Dearlove's failure to be more proactive was at least unreasonable.

Accordingly, we find that Dearlove acted at least unreasonably in signing an unqualified audit opinion stating that Deloitte had conducted its audit in accordance with GAAS and that such audit provided a reasonable basis for its opinion that Adelphia's 2000 financial statements fairly presented Adelphia's financial position in conformity with GAAP.

VII. Direct Placements of Stock

A. Facts

During 2000, the Rigases acquired Adelphia Class B common stock through two direct placements. 85/ The first of these occurred in January 2000, when Adelphia issued $368 million of such stock to Highland 2000 L.P., a Rigas Entity partnership that was not a co-borrower ("Highland 2000-Rigas"). 86/ The second occurred in July 2000, when the Rigases acquired additional Adelphia Class B common stock through the issuance of approximately $145 million of such stock also to Highland 2000-Rigas. The Rigases financed both transactions with co-borrowed funds for which Adelphia was jointly and severally liable.

83/ AU § 311.01, 311.11.

84/ AU § 311.11.

85/ See supra Section II (describing the Rigas family's maintenance of control over Adelphia through direct placements of Class B shares).

86/ To help the reader more easily understand the series of transactions involved in the direct placements of stock, we have appended "-Rigas" or "-Adelphia," as appropriate, to names of entities.

1. The July 2000 Direct Placement

In July 2000, Highland Prestige Georgia, a Rigas Entity co-borrower ("Highland Prestige-Rigas"), drew down $145 million under the 2000 credit agreement. Highland Prestige-Rigas transferred the money to Highland Holdings, a Rigas Entity that was not a co-borrower ("Highland Holdings-Rigas"). Highland Holdings-Rigas then transferred $144,537,533 to Adelphia in exchange for shares of Adelphia stock. Adelphia recorded an increase in equity. Highland Holdings-Rigas assigned the Adelphia shares to its subsidiary, Highland 2000-Rigas.

2. The January 2000 Direct Placement

a. The Loan Transaction

The January 2000 direct placement used a similar model to the one in July, but was more complicated. In January, the co-borrowers collectively drew down $368 million under the 1999 credit agreement. At the request of the co-borrowers, the lenders wired the funds to the account of UCA, an Adelphia subsidiary ("UCA-Adelphia"). UCA-Adelphia recorded on its books the receipt of the $368 million in cash and a corresponding note payable in the same amount, evidencing debt owed by UCA-Adelphia to the lenders.

Adelphia later claimed that the co-borrowers mistakenly entered an incorrect account number in their wiring instructions and that the co-borrowers had intended that the $368 million drawn down under the credit agreement go to Hilton Head Communications, a Rigas Entity co-borrower ("Hilton Head-Rigas"), not to UCA-Adelphia. There is no indication that the co-borrowers notified the lenders of this alleged mistake in the wiring instructions. Adelphia did not return the $368 million to the lenders, nor did it transfer the cash to Hilton Head-Rigas, allegedly the intended recipient. Instead, Adelphia retained the money and used it to pay down preexisting debt of UCA-Adelphia and another Adelphia subsidiary.

In an attempt to make its books show that Hilton Head-Rigas, not UCA-Adelphia, was primarily responsible for the borrowed $368 million, Adelphia made journal entries on the books of both of these entities. Adephia transferred the $368 million "draw" (the recordation of debt from the lenders) from UCA-Adelphia to Hilton Head-Rigas, resulting in the removal of that debt from UCA-Adelphia's books and the recordation of that debt on Hilton Head-Rigas's books. There is no indication either that Adelphia tried to notify the lenders of this attempt to reallocate responsibility for the borrowed $368 million or that the lenders knew about (much less approved) the reallocation. To reflect UCA-Adelphia's retention of the $368 million it received from the lenders, Adelphia also recorded on UCA-Adelphia's books a note payable to Hilton Head-Rigas in the amount of $368 million, representing the $368 million that UCA-Adelphia "owed" Hilton Head-Rigas for the "miswired" cash it had retained. The borrowed $368 million had not been repaid to the lenders or given to Hilton Head-Rigas, but, at least as far as the journal entries were concerned, that debt was now the responsibility of Hilton Head-Rigas, not UCA-Adelphia.

b. The Stock Transaction

Also in January 2000, Adelphia issued $368 million worth of shares of Class B common stock to Highland Holdings-Rigas. Highland Holdings-Rigas did not pay Adelphia cash for the shares; instead, it gave Adelphia a note in the amount of $368 million, payable to Adelphia. Highland Holdings-Rigas then assigned the Class B shares to its subsidiary Highland 2000-Rigas. Adelphia increased its equity by $368 million and recorded the $368 million note receivable from Highland Holdings-Rigas as an asset in exchange for the stock, thus treating the transaction as a sale of stock.

c. Netting

As explained above, Adelphia's accounting for the January loan transaction resulted in the creation of a note payable by Adelphia to Hilton Head-Rigas in the amount of $368 million, and its accounting for the January stock transaction resulted in the creation of a $368 million note receivable from Highland Holdings-Rigas to Adelphia. Consistent with its practice of netting affiliate payables and receivables discussed above, Adelphia netted the $368 million note payable by Adelphia to Hilton Head-Rigas against the $368 million note receivable from Highland Holdings-Rigas to Adelphia, and both the payable and the receivable disappeared from Adelphia's books.

B. Analysis

As discussed above, 87/ FAS 125 ¶ 16 permits a debtor to derecognize a liability "if and only if it has been extinguished," and provides that a liability is extinguished only if either (a) the debtor pays the creditor and is relieved of its obligation for the liability, or (b) the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. When UCA-Adelphia received the borrowed $368 million and booked the loan, it became the primary obligor for that amount. At that point, FAS 125 applied, and Adelphia therefore could not properly remove the debt from UCA-Adelphia's books without first satisfying the requirements of FAS 125 ¶ 16. In other words, UCA-Adelphia could not extinguish the debt without showing either (1) that it repaid the debt to the lenders, or (2) that the lenders had released UCA-Adelphia from its liability for repayment. The evidence does not show, and Dearlove does not contend, that either of these events occurred. Neither Adelphia nor UCA-Adelphia repaid the debt to the lenders, and although Adelphia revised the books of both UCA-Adelphia and Hilton Head-Rigas to show a transfer of the liability, there is no indication that Adelphia notified the lenders that it no longer viewed UCA-Adelphia as liable, much less that the lenders agreed to the purported transfer or released UCA-Adelphia from liability. Thus, the liability was not extinguished as required by FAS 125, and Adelphia should have shown the liability on its balance sheet. Adelphia's attempt to extinguish the debt unilaterally merely by transferring the "draw" from UCA-Adelphia to Hilton Head-Rigas, rather than obtaining a release

87/ See supra Section VI.B.

from the lender or otherwise satisfying the requirements of FAS 125, violated GAAP and rendered Adelphia's financial statements materially misleading. 88/

Emerging Issues Task Force Consensus No. 85-1, Classifying Notes Received for Capital Stock (1985) ("EITF 85-1") provides that, when an enterprise receives a note, rather than cash, for the sale of capital stock, the enterprise should generally report the note receivable as a reduction of shareholders' equity and not as an asset. 89/ EITF 85-1 further provides that notes received for the sale of stock "may be recorded as an asset if collected in cash prior to issuance of the financial statements." Rule 5-02.30 of Regulation S-X requires public companies to show on the face of their balance sheets the dollar amount of any common stock shares subscribed but unissued, and to show subscriptions receivable as a deduction from shareholders' equity; these two entries offset each other, resulting in no net change to the total amount of equity shown on the balance sheet. 90/

Applying EITF 85-1 and Rule 5-02.30, we find that the January direct placement should have been treated as a stock subscription, with resulting reduction to shareholder equity, rather than as a stock sale. 91/ Adelphia received only a note, not cash, in payment for the shares it issued. The note therefore should have been recorded as a receivable, with a corresponding, offsetting reduction to equity.

We further find that netting the $368 million receivable against the $368 million payable that resulted from the loan transaction did not cause the receivable to be "collected in cash" for

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88/ The analytic basis for this finding is the same as that for the three instances of debt reclassification discussed supra in Section VI.B.

We have already rejected Dearlove's argument that we cannot find a violation of FAS 125 without expert testimony. See supra notes 74 and 75 and accompanying text.

89/ Consensus positions of the FASB Emerging Issues Task Force have a recognized position within the GAAP hierarchy. AU § 411.10. They represent the consensus position of the best thinking of the accounting profession on areas for which there are no specific standards. AU § 411.10 ¶ 3.

90/ 17 C.F.R. § 210.5-02.30. For Commission registrants, Commission rules have an authority similar to the most authoritative pronouncements within the GAAP hierarchy. AU § 411.10 n.3.

91/ The Division argued before the law judge that, under EITF 85-1, the July direct placement also should have been treated as a stock subscription rather than a stock purchase. The law judge found no GAAP violations with respect to Adelphia's accounting treatment of the July direct placement. Because the Division did not appeal, this issue is not before us.

purposes of EITF 85-1 analysis and thus did not permit Adelphia to report the receivable as an asset. Adelphia's netting of its payable to Hilton Head-Rigas against its receivable from Highland Holdings-Rigas was inappropriate, at the very least, because more than two parties were involved: Highland Holdings-Rigas, to whom Adelphia issued the Class B shares, was not the same entity as Hilton Head-Rigas, to whom Adelphia attempted to transfer the co-borrowed debt. 92/ Thus, even if the transfer of the borrowed funds from UCA-Adelphia to Hilton Head-Rigas and the resulting creation of a payable owed by Adelphia to Hilton Head-Rigas had been allowed under FAS 125, the netting was improper, the receivable was not satisfied in cash, and Adelphia therefore should have treated the stock transaction as a stock subscription. 93/

The effect of treating the transaction as a stock sale was that Adelphia showed an increase to equity of $368 million, with no offsetting reduction. In reality, Adelphia's financial position was not improved by either the January loan transaction or the January stock transaction. As discussed above, the $368 million that Adelphia received in January was borrowed from the lenders, and because the debt was not properly extinguished, Adelphia still owed the lenders that money. Moreover, until the receivable was collected, the increase to equity that Adelphia showed had to be offset by a reduction in equity because payment was in the form of a receivable, not cash.

92/ See supra Section IV.B (discussing two-party requirement for netting under FIN 39 and also stating that the record does not demonstrate that the Rigas Entities were owned in equal proportions by the same members of the Rigas family).

93/ Moreover, even if appropriate, Adelphia's netting of the payable to Hilton Head-Rigas against the receivable from Highland Holdings-Rigas in this case merely canceled out both amounts; it did not create cash.

Dearlove asserts that the Division raises the argument for the first time on appeal "that the stock purchase should have been recorded as a stock subscription because the receivable from [Highland Holdings-Rigas] to Adelphia could not be netted against the [note] payable from [UCA-Adelphia] to [Hilton Head-Rigas] under FIN 39." Contrary to Dearlove's assertion, neither the propriety of the netting nor the propriety of recording the transaction as a stock subscription was raised for the first time on appeal. The OIP charged that "Highland paid nothing [for the $368 million in Class B shares] and Adelphia booked an affiliate receivable from Highland [Holdings] for the purchase price of the shares . . . . [T]his receivable was never satisfied for cash, but, along with other affiliate receivables, was netted against, and reduced by, the fake affiliate payables created by Adelphia's reclassifications of co-borrowed debt." (Moreover, Dearlove testified at the hearing, "The Rigases collectively had $368 million worth of debt. They also owned $368 million worth of stock. The affiliated payable and the affiliated receivable netted to zero.") In the same paragraph, the OIP charged that Adelphia's receipt of a receivable that was not satisfied for cash in connection with the January direct placement "created a stock subscription."

Dearlove contends that the record shows that the $368 million borrowed in January should have gone to Hilton Head-Rigas originally, and that "the July direct placement looks exactly the way the January direct placement would have in the absence of a misposting," i.e., with the money drawn going to a Rigas Entity co-borrower rather than an Adelphia subsidiary. He argues that, if we accept his argument that the $368 million loan was originally intended for Hilton Head-Rigas, we cannot find a GAAP violation with respect to the January 2000 direct placement. On appeal, Dearlove moved to admit into evidence the supposedly exculpatory testimony of Adelphia treasury supervisor James Helms, which Dearlove claims to have discovered after the hearing. According to Dearlove, the testimony "conclusively establishes" that Hilton Head-Rigas rather than UCA-Adelphia was the intended recipient of the $368 million draw. 94/

The question whether the loan was intended for Hilton Head-Rigas rather than UCA-Adelphia does not affect our analysis under FAS 125. Whether or not the co-borrowers wanted the money to go to UCA-Adelphia, that is what happened: UCA-Adelphia received the money and booked the loan. UCA-Adelphia also kept the money and used the money. Having thus become the primary obligor, Adelphia was required to comply with FAS 125 ¶16 in order to extinguish its liability. As discussed above, it failed to do so. Because the co-borrowers' intent as to where the money should have been wired is irrelevant, Dearlove's newly introduced evidence, the Helms testimony, is also irrelevant. 95/

Dearlove's argument that "the July direct placement looks exactly the way the January direct placement would have in the absence of a misposting" is conjectural. We do not know what might have happened if the borrowed funds had gone directly to Hilton Head-Rigas or how the Class B shares might have been paid for under those circumstances. We base our conclusions on what did happen: Adelphia got a receivable in exchange for the shares and booked the

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94/ See Commission Rule of Practice 452, 17 C.F.R. § 201.452 (stating that a motion to introduce new evidence "shall show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously"). The Office of the General Counsel, acting pursuant to delegated authority, granted Dearlove's motion on September 13, 2006. Dearlove's allegedly belated discovery of this testimony is the lynchpin of his argument that he was denied due process by the failure to continue the hearing date. See infra Section X.

95/ Dearlove argues that the journal entries for the January direct placement had been "corrected" long before Deloitte began its audit of Adelphia's books, so there is no evidence that "any record of journal entries made many months earlier would have emerged at year end." This argument is unclear. To the extent Dearlove refers to the alleged misposting of $368 million to UCA-Adelphia and the subsequent journal entries Adelphia made allegedly to correct the mistake, for the reasons discussed in the text, this argument is irrelevant to our analysis.

transaction as a stock sale, although the receivable was not collected in cash. That violated GAAP.

Statement of Accounting Standards No. 57 ("FAS 57") requires disclosure of material related party transactions. 96/ Such disclosures must include the nature of the relationship involved, a description of the transactions (including the amounts thereof), and amounts due from or to related parties as of the date of the balance sheet.

The disclosure of the January direct placement in the notes to Adelphia's 2000 financial statements was incomplete because it did not disclose that a stock subscription was involved, or that co-borrowed funds drawn by an Adelphia subsidiary had been used to fund the direct placement. The disclosure, therefore, failed to comply with FAS 57.

As for the GAAS violations charged, Dearlove knew that both direct placements had occurred; the dates and amounts of both transactions had been disclosed in Adelphia's quarterly and annual reports. Dearlove testified, however, that the engagement team did not bring to his attention the mechanics of the two direct placements, and neither Caswell nor Hofmann recalled discussing the direct placements with Dearlove during the audit. 97/ With respect to the January direct placement, Dearlove understood that $368 million in cash went to Adelphia and that equity was issued to the Rigases, but he did not understand "the misposting and the directing issues and the netting," which were not brought to his attention. Similarly, with respect to the July direct placement, Dearlove understood that Highland Holdings-Rigas paid Adelphia $145 million for the Class B shares, but he was not aware "that the $145 million was borrowed by [Highland Prestige-Rigas] and lent to an entity that we didn't have visibility to so that they could make that payment."

As was true with respect to the issues discussed above, GAAS required Dearlove to consider the "much greater than normal" risk of the audit in determining the extent of procedures, assigning staff, and requiring appropriate levels of supervision. 98/ Additionally, he was required to direct the efforts of assistants working under his supervision and to evaluate their work as it pertained to accomplishing the objectives of the audit. 99/ He was required to exercise

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96/ FAS 57 ¶ 2.

97/ The record contains conflicting testimony as to whether Brown and Werth discussed with Caswell and Hofmann the question whether one or both of the direct placements discussed above should be recorded as stock subscriptions rather than stock sales. The law judge credited the testimony of Brown and Werth that such conversations took place.

98/ AU § 312.17.

99/ AU § 311.11.

professional skepticism, 100/ to obtain sufficient competent evidential matter to provide reasonable support for his conclusions, 101/ and, after identifying related party transactions, to apply necessary procedures to obtain satisfaction concerning the purpose, nature, and extent of these transactions and their effect on the financial statements. 102/

The direct placements involved many of the factors that Deloitte recognized had contributed to the high risk level assigned to the audit: they were significant transactions involving related parties, including affiliates that Deloitte was not auditing. The transactions were unusual in that the co-borrowers that drew down the funds were not the entities that received the Class B shares. Moreover, they were large transactions, totaling more than half a billion dollars, and the sources of funds paid for the shares were unclear. Both auditing standards and Deloitte's own audit plan required the engagement team to understand the impact of such transactions on Adelphia's financial statements and to investigate the sources of financial resources supporting significant or unusual transactions. Yet Dearlove failed to question the facts that underlay the direct placements, accepting as adequate the superficial explanation that Adelphia got $368 million and issued $368 million in equity without seeking to understand the transactions involved. In doing so, he acted at least unreasonably.

With respect to the direct placements, as in other areas, Dearlove needed to do more than wait for other Deloitte personnel to inform him of potential issues. He had a duty to inquire in more detail about the direct placements, or to direct his staff to do so, rather than rely on his assistants to make the judgment on their own. While Dearlove could appropriately delegate much of the hands-on work of the Adelphia audit to his team, he was nonetheless bound by his duty to supervise that work, and he retained responsibility for doing so. Under the circumstances present here, we find that Dearlove violated his obligation under GAAS to supervise.

The record shows that the engagement team was aware that Adelphia had recorded the direct placements as stock purchases rather than stock subscriptions, but the team did not test this decision, nor did it take steps to ascertain the source of funds used for the stock purchases. The large amount of money involved and the fact that the transactions involved related parties (including ones that Deloitte would not be auditing) rendered Dearlove's acceptance of the transactions at face value unreasonable. In failing to probe further into the facts pertaining to the direct placements and their accounting treatment, Dearlove failed to employ the increased professional skepticism that the known risks of the audit required, and thus violated GAAS. 103/

100/ AU § 230.07.

101/ AU § 326.22.

102/ AU § 334.09.

103/ Although we have found that the accounting treatment of the January direct placement violated FAS 57, see text accompanying note 96, supra, we decline to find that Dearlove's (continued...)

VIII. Analysis of Liability and Appropriate Sanction Under Rule 102(e)

A. Liability

Rule of Practice 102(e)(1)(iv) provides that the Commission may discipline a person licensed to practice as an accountant if we find that the accountant has engaged in any of three types of improper professional conduct. 104/ However, as applied to this case, we need determine only whether Dearlove engaged in "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." 105/ We have already discussed our findings that Dearlove repeatedly engaged in at least unreasonable conduct during his audit of four critical areas of Adelphia's financial statements and that his conduct resulted in violations of GAAS. We must now determine whether Dearlove's conduct, though only negligent, nonetheless demonstrates a lack of competence to practice before the Commission.

This case presents to us the first litigated proceeding in which a respondent's conduct is being judged solely against Rule 102(e)'s third definition of improper professional conduct. We are guided in our analysis by the 1998 release accompanying the amendments to Rule 102(e), which explained that

> [t]he term "unreasonable," as distinguished from the term "highly unreasonable" used in subparagraph B(1), connotes an ordinary or simple negligence standard. The lower standard of culpability is justified in this instance because the repetition of the unreasonable conduct may show the

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103/ (...continued)
failure to include the appropriate disclosure regarding that direct placement in the notes to the financial statements was a separate violation of GAAS. Moreover, because we believe the OIP was somewhat ambiguous in identifying the other transactions that are alleged to have been inadequately disclosed under FAS 57, we decline to consider whether any of the other three accounting areas at issue in this case (i.e., netting, co-borrowed debt, and debt reclassifications) involve violations of FAS 57. Although we find that the OIP provided adequate notice to Dearlove that he was charged with failing to review Adelphia's disclosure under FAS 57 of the common treasury system it used to manage its own accounts and the accounts of its subsidiaries and the Rigas Entities, it is not clear to us that such disclosure was necessary under FAS 57. Given the several examples in this case of accounting presentations that depart from GAAP, as well as the several examples of conduct that already form a basis for finding that Dearlove departed from GAAS, we decline to decide whether disclosure of the common treasury system was necessary or whether Dearlove gave appropriate consideration to the issue.

104/ See supra note 1.

105/ Commission Rule of Practice 102(e)(1)(iv)(B)(2); see supra note 2.

> accountant's lack of competence to practice before the Commission. If an accountant fails to exercise reasonable care on more than one occasion, the Commission's processes may be threatened. More than one violation of applicable professional standards ordinarily will indicate a lack of competence. 106/

The Commission distinguished such conduct from, for example, "two isolated violations of applicable professional standards . . . that may not pose a threat to the Commission's processes." 107/ Upon review of the totality of the circumstances of this case, we conclude that the frequency and gravity of Dearlove's negligent failures on the Adelphia audit demonstrate that he engaged in improper professional conduct under this standard.

As discussed above, Dearlove approved Adelphia's net presentation of over $1 billion each in related party payables and receivables without devoting any attention to the matter, despite his admitted inexperience with the issue and despite knowing that management sought to reduce the net balance to improve its financial picture. He also summarily approved Adelphia's accounting for $1.6 billion in related party contingent debt while failing to test any of several assumptions underlying his conclusion that Adelphia was unlikely to have to repay that debt. Dearlove also approved the company's obfuscatory disclosure of that obligation; despite audit plan warnings about aggressive management accounting positions, he acquiesced in management's formulation of the disclosure without probing its reasons for rejecting Deloitte's proposed language, and he took no steps to confirm with Deloitte's risk or reviewing partners that the disclosure was GAAP compliant. Dearlove did not himself review, or ensure that his team reviewed, three significant reclassifications of related party debt that did not comply with GAAP and that should have been subject to careful attention as post-closing journal entries. He approved the accounting treatment for two sizeable direct placements of Adelphia stock with related parties involving unspecified sources of funds without inquiring about, or instructing his audit team to inquire about, the specifics of those transactions. Dearlove conducted his review of Adelphia's financial statements with these serious failings despite the need for heightened scrutiny called for generally by the high-risk engagement, and despite the special care with which GAAS required Dearlove to review these significant, related party transactions.

These repeated failures, taken together, evidence a troubling disregard of some of the most basic auditing principles. GAAS require auditors to adequately plan the audit and to

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106/ Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,166 (Oct. 26, 1998).

107/ Id.

properly supervise any assistants, 108/ to exercise due professional care, 109/ maintain an attitude of professional skepticism, 110/ and obtain sufficient competent evidential matter to afford a reasonable basis for an opinion with respect to the financial statements under review. 111/ As audit risk increases, so does the need for care and skepticism. 112/ Although there may be room for debate among auditors regarding the best way to tailor an audit to satisfy these requirements, no reasonable auditor could conclude that Dearlove satisfied them here, where Dearlove, in a high-risk audit environment, neglected to ask what gross dollar amounts were behind the net related party receivables presented on Adelphia's balance sheet, relied on media reports as evidence of the Rigases' financial status, made no inquiry into post-closing journal entries that were specifically identified by Deloitte as requiring attention, and made no effort to ensure his team identified the source of funds used for multi-million-dollar stock placements to affiliated companies. Dearlove repeatedly ignored rudimentary audit principles not just with respect to one auditing area, but several: his failures were extensive. We conclude, therefore, that Dearlove engaged in repeated instances of conduct that were at least unreasonable, that departed from GAAS in fundamental respects, and that indicate a lack of competence to practice before the Commission.

Dearlove argues that the record contains evidence of Dearlove's "overall diligence and competence," including that Dearlove was involved in Deloitte's risk identification process, and that Dearlove was an active, engaged, and accessible supervisor who reviewed and signed off on numerous workpapers. Dearlove contends that it would be unreasonable to hold him to a standard that would require him "to have personally reviewed over 32,000 pages of the audit documentation and to have participated in all conversations that related to any audit conclusions." We believe that Dearlove's argument misapprehends the requirements of GAAS. We agree that GAAS do not require engagement partners to review every workpaper, analyze every transaction, or supervise every task, and our findings in this opinion are not intended to suggest otherwise. However, in deciding which audit areas deserve more of his or her attention, the auditor must be mindful of the GAAS requirement to exercise special care in high-risk audit environments 113/ and to ensure that the staff devotes appropriate attention to all audit

108/ AU §§ 311.01, 311.11.

109/ AU § 230.01.

110/ AU §§ 230.07-08.

111/ AU § 326.22.

112/ AU §§ 312.17, 316.27.

113/ AU §§ 312.17, 316.27.

areas. 114/ In any audit, areas that present more risk will demand more attention. We find fault with Dearlove not because he failed to review every workpaper but because he failed to devote enough care and attention to certain significant audit issues that presented him with clear, previously-identified risks of fraud, misstatement, or error. Evidence that Dearlove spent substantial time and effort on some auditing areas does not insulate him from liability for his failure to spend enough time and effort on others that were so material to Adelphia's financial statements.

We find, therefore, that Dearlove engaged in repeated instances of at least unreasonable conduct during his audit of four critical areas of Adelphia's financial statements, that his conduct resulted in violations of GAAS, and that his conduct indicates a lack of competence to practice before the Commission.

B. Denial of the Privilege of Appearing or Practicing Before the Commission

In determining the appropriate sanction, we are mindful of the remedial nature of Rule 102(e) and our purpose in promulgating the rule to ensure that the Commission's "processes continue to be protected, and that the investing public continues to have confidence in the integrity of the financial reporting process." 115/ In the Commission's release adopting the 1998 amendments to Rule 102(e), we recognized that

> [i]nvestors have come to rely on the accuracy of the financial statements of public companies when making investment decisions. Because the Commission has limited resources, it cannot closely scrutinize every financial statement. Consequently, the Commission must rely on the competence and independence of the auditors who certify, and the accountants who prepare, financial statements. In short, both the Commission and the investing public rely heavily on accountants to assure corporate compliance with federal securities law and disclosure of accurate and reliable financial information. 116/

Further, we stated that "a negligent auditor can do just as much harm to the Commission's processes as one who acts with an improper motive." 117/ We thus recognized that, under some circumstances, unreasonable conduct is not necessarily a less egregious discplinary matter than either intentional or reckless conduct, or highly unreasonable conduct in circumstances warranting heightened scrutiny. The requirement that we make a finding that an auditor's

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114/ AU §§ 311.01, 311.11.

115/ Amendment to Rule 102(e), 63 Fed. Reg. at 57,164; see also Robert W. Armstrong, III, Exchange Act Rel. No. 51920 (June 24, 2005), 85 SEC Docket 3011, 3041.

116/ Id. at 57,165.

117/ Amendment to Rule 102(e), 63 Fed. Reg. at 57,167.

negligent conduct indicates a lack of competence to practice before us would justify, under appropriate circumstances, permanently barring the auditor from doing so.

Here, Dearlove violated fundamental principles of auditing. He failed to exercise due care and appropriate professional skepticism. He also failed to collect sufficient competent evidential matter to provide the basis for the expression of an audit opinion with respect to several significant related party transactions despite the clear need for heightened scrutiny presented by the Adelphia audit. The frequency of Dearlove's failures far exceed the minimum threshold established by Rule 102(e)(1)(iv)(B)(2): he engaged in many instances of unreasonable conduct resulting in several GAAS violations in each of four auditing areas. Unreasonable failures to comply with auditing standards that so pervasively compromise an audit, such as those of Dearlove, "jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors." 118/ Moreover, Dearlove's lengthy audit experience makes his failure to conduct the Adelphia audit in accordance with applicable professional standards all the more troubling. 119/ Dearlove's repeated, substantial departures from his professional duties establish that the Commission cannot, at present, rely upon him to perform diligently and with reasonable competence his audit responsibilities.

We have determined under these circumstances to deny Dearlove the privilege of appearing or practicing before the Commission coupled with a right to apply for reinstatement after four years. We conclude that this sanction is necessary to protect the integrity of the Commission's processes and encourage more rigorous compliance with auditing standards both by Dearlove and by other independent auditors, without being punitive. 120/

118/ Touche Ross & Co. v. SEC, 609 F.2d 570, 581 (2d Cir. 1979).

119/ See, e.g., McCurdy v. SEC, 396 F.3d at 1265 (upholding Commission's finding that respondent's "'signficant experience in audit work'" rendered his audit failures "'particularly troublesome,'" and affirming sanction based on its demonstrated remedial purpose to "protect the public from his demonstrated capacity for recklessness in the present, and presumably to encourage his more rigorous compliance with GAAS in the future"); Marrie, 56 S.E.C. at 799 (finding respondent's lengthy audit experience made his failure to conduct audit in accordance with generally accepted auditing standards particularly troublesome).

120/ Cf. McCurdy v. SEC, 396 F.3d at 1265 (recognizing that, where auditor departed from GAAS in the audit of one asset during the audit of one year's financial statements, order suspending auditor from practice before the Commission for one year served remedial purpose of encouraging more rigorous compliance with generally accepted auditing standards in future); Marrie, 56 S.E.C. at 798-99 (imposing permanent bar on auditors who failed to conduct an adequate review of three critical audit areas during the audit of one year's financial statements and noting that "substantial departures from their

(continued...)

IX. Causing Violations of the Reporting, Recordkeeping, and Internal Accounting Control Provisions of the Exchange Act

A. Liability

Section 13(a) of the Exchange Act and Exchange Act Rule 13a-1 require issuers of securities to file annual reports with the Commission. 121/ The reports must comply with Commission Regulation S-X, 122/ which in turn requires that financial statements be prepared in conformity with GAAP. 123/ The obligation to file these reports includes an obligation that the filings be accurate. 124/ Under Exchange Act Rule 12b-20, an issuer has a duty to provide any additional material information necessary to make the required statements, in the light of the

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120/ (...continued)
professional duties establish[ed] that the Commission [could] not rely upon Marrie and Berry to perform diligently and with reasonable competence their audit responsibilities in the future"), rev'd on other grounds, 374 F.3d 1196, see supra note 13; Russell Ponce, 54 S.E.C. 804, 825 (2000) (imposing on auditor bar with right to reapply after five years for failing, during audit of one year's financial statements, to adequately review two critical audit areas and maintain auditor independence), aff'd, 345 F.3d 722 (9th Cir. 2003).

121/ 15 U.S.C. § 78m(a) and 17 C.F.R. § 240.13a-1.

122/ 17 C.F.R. Part 210. Title 17 C.F.R. Section 249.310 requires generally that a Form 10-K be used for annual reports pursuant to Exchange Act Section 13. Form 10-K (Item 8) in turn requires issuers to furnish financial statements meeting the requirements of Regulation S-X, including the requirement in Rule 2-02 that an accountant's report (defined in 17 C.F.R. § 210.1-02(a) as a document in which an "independent" public or certified public accountant sets forth certain information) state whether the audit was made in accordance with GAAS. See also Rule 1-01(a)(2) of Regulation S-X, 17 C.F.R. 210.1-01(a)(2) (directing that Regulation S-X govern "the form and content of and requirements for financial statements required to be filed as part of" annual reports, among other filings).

123/ Rule 4-01(a)(1) of Regulation S-X, 17 C.F.R. § 201.4-01(a)(1) ("Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.").

124/ See, e.g., SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1165 (D.C. Cir. 1978) ("The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports") (citing SEC v. IMC Int'l, Inc., 384 F. Supp. 889, 893 (N.D. Tex.), aff'd mem., 505 F.2d 733 (5th Cir. 1974).

circumstances under which they are made, not misleading. 125/ No showing of scienter is necessary to establish a violation of Section 13(a) and Rules 13a-1 and 12b-20. 126/

Under Section 21C(a) of the Exchange Act, 127/ the Commission may impose a cease-and-desist order on a person who is a cause of another's violation. Being a cause of another's violation under Section 21C(a) requires findings that: (1) a primary violation occurred; (2) the respondent engaged in an act or omission that contributed to the violation; and (3) the respondent knew, or should have known, that his or her conduct would contribute to the violation. 128/ Negligence is sufficient to establish "causing" under Section 21C(a) where the underlying primary violation does not require scienter. 129/ Negligence is the failure to exercise reasonable care. 130/ Here, as discussed above in Section III, GAAS establish the standard of care against which we measure Dearlove's conduct.

As discussed above, we find that the financial statements included in Adelphia's 2000 Form 10-K contained several violations of GAAP. The lack of conformity with GAAP rendered the annual report misleading. Adelphia's filing of the Form 10-K, together with the financial

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125/ 17 C.F.R. § 240.12b-20; see also Armstrong, 85 SEC Docket at 3029 & n.58; Ponce v. SEC, 345 F.3d 722, 735 (9th Cir. 2003).

126/ SEC v. McNulty, 137 F.3d 732, 740-41 (2d Cir. 1998); SEC v. World-Wide Coin Inv., Ltd., 567 F. Supp. 724, 751 (N.D. Ga. 1983); SEC v. Wills, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

127/ 15 U.S.C. § 78u-3.

128/ See, e.g., Gateway Int'l Holdings, Inc., Exchange Act Rel. No. 53907 (May 31, 2006), 88 SEC Docket 430, 444; Armstrong, 85 SEC Docket at 3029; Robert M. Fuller, 56 S.E.C. 926, 984 (2003), petition denied, 95 Fed. Appx. 361 (D.C. Cir. 2004); Erik W. Chan, 55 S.E.C. 715, 725-33 (2002).

129/ See, e.g., Gateway Int'l Holdings, 88 SEC Docket at 444-45 & n.48; KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175 & n.100 (2001), petition denied, 289 F.3d 109 (D.C. Cir. 2002); see also KPMG Peat Marwick, LLP v. SEC, 289 F.3d 109, 120 (D.C. Cir. 2002) ("[T]he Commission was virtually compelled by Congress' choice of language in enacting Section 21C to interpret the phrase 'an act or omission the person knew or should have known would contribute to such violation' as setting a negligence standard.") (emphasis in original).

130/ IFG Network Sec., Inc., Exchange Act Rel. No. 54127 (July 11, 2006), 88 SEC Docket 1374, 1389 (citing SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997)).

statements and Deloitte's audit report, was a primary violation of Exchange Act Section 13(a) and Rules 13a-1 and 12b-20 thereunder. 131/

By signing the audit report, Dearlove engaged in an act that contributed to Adelphia's primary violation. 132/ Because of the requirement in Regulation S-X that financial statements filed with annual reports be prepared in conformance with GAAP, without an unqualified audit opinion, Adelphia could not have filed its Form 10-K. Thus, Dearlove should have known that his conduct of the audit (which, as noted above, failed to satisfy GAAS in a variety of ways) and his signature on the unqualified audit opinion contributed to the violation by allowing Adelphia to proceed to file the Form 10-K and the non-GAAP-compliant financial statements. In the high-risk auditing environment presented by the circumstances attending Deloitte's audit of Adelphia's 2000 financial statements, with the array of potential problem areas discussed above, it is likely that an audit conducted in accordance with GAAS would have brought to Dearlove's attention some, if not all, of the GAAP violations we have found. Dearlove, whose departures from GAAS were at least negligent, should have known that his deficient audit would contribute to Adelphia's primary violation. For these reasons, we find that Dearlove was a cause of Adelphia's violations of Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and 12b-20. 133/

B. Cease-and-Desist Order

Exchange Act Section 21C(a) authorizes the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate" any provision of the Exchange Act or any rule or regulation thereunder, or against any person who "is, was, or would be a cause of [a] violation, due to an act or omission the person knew or should have known

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131/ Armstrong, 85 SEC Docket at 3029; KPMG, 54 S.E.C. at 1173-74 & n.97. For the reasons discussed above, we reject Dearlove's arguments that the financial statements complied with GAAP and that there was therefore no primary violation of Exchange Act Section 13(a) and Rules 13a-1 and 12b-20 thereunder by Adelphia.

132/ See KPMG, 54 S.E.C. at 1174-83 (holding that accounting firm's negligent conclusion that it was independent from audit client was a cause of audit client's violation of Exchange Act Section 13(a) and Rule 13a-1 thereunder based on filing of annual report that included financial statements that were not, as required, audited by independent accountants).

133/ Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(A), requires issuers to make and keep books, records, and accounts that, in reasonable detail, accurately and fairly reflect their transactions and dispositions of assets. The OIP charged, and the law judge found, that Adelphia violated Exchange Act Section 13(b)(2)(A) and that Dearlove was a cause of Adelphia's violation. As a discretionary matter, we decline to reach the question whether Dearlove engaged in an act or omission that was a cause of an Exchange Act Section 13(b)(2)(A) violation within the meaning of Exchange Act Section 21C(a).

would contribute to such violation." 134/ To determine whether a cease-and-desist order is an appropriate sanction for Dearlove's role in Adelphia's violations of the reporting requirements contained in Exchange Act Section 13(a) and related rules, we must look to whether there is some risk of future violations. 135/ The existence of a violation raises an inference that the violation will be repeated, and where the misconduct that results in the violation is egregious, the inference is justified. 136/ We also consider whether other factors demonstrate a risk of future violations. Beyond the seriousness of the violation, these may include the isolated or recurrent nature of the violation, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, the respondent's state of mind, the sincerity of assurances against future violations, the opportunity to commit future violations, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions sought in the proceeding. 137/ Not all of these factors need to be considered, and none of them, by itself, is dispositive.

The law judge declined to impose a cease-and-desist order because, having imposed a permanent bar on Dearlove's ability to appear or practice before the Commission that would have effectively precluded Dearlove from serving in any position in which he might cause future violations of Exchange Act Section 13(a) and related rules, the law judge concluded that the Division did not meet the minimum threshold required to impose a cease-and-desist order, i.e., that there exists some risk of future violations. Because we are permitting Dearlove to apply for reinstatement after four years, that sanction does not obviate the need for a cease-and-desist order. Dearlove may resume appearing or practicing before the Commission should he apply for, and be granted, reinstatement. Dearlove may eventually, therefore, be once again in a position to violate or cause violations of the reporting requirements of the Exchange Act.

The violations Dearlove caused were serious and of substantial import to investors. His signature on Deloitte's unqualified audit opinion was a cause of Adelphia's filing of financial statements that were inaccurate in a number of ways and that masked the true financial condition of Adelphia as well as the company's interdependency with the Rigas Entities. Revelation of the accounting deficiencies in Adelphia's financial statements would eventually result in harm to

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134/ 15 U.S.C. § 78u-3(a).

135/ KPMG Peat Marwick LLP, 54 S.E.C. at 1185. The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction. Id. at 1191; see also KPMG, 289 F.3d at 124 (finding that the plain language of Exchange Act Section 21C and its legislative history support the Commission's issuance of a cease-and-desist order on the basis of a lower risk of future violation than that required for an injunction).

136/ See Geiger v. SEC, 363 F.3d 481, 489 (D.C. Cir. 2004) and cases cited therein.

137/ KPMG, 54 S.E.C. at 1192.

investors estimated to be at least $715 million, the amount of cash and stock Adelphia agreed to pay into a victims' restitution fund to help recompense harmed investors. 138/ Dearlove signed his unqualified opinion despite having conducted an audit that was seriously deficient in the face of numerous and obvious risk factors that called for increased professional care. Although Dearlove's audit encompassed only one year's financial statements, the failures on this one audit were several and occurred in several auditing areas, the responsibility for which Dearlove consistently attempts to shift to others. Moreover, while several years have elapsed since Dearlove completed the audit of Adelphia, this case is not so aged as to give comfort that the conduct will not be repeated, and, in any event, the other factors weigh strongly in favor of imposing a cease-and-desist order. 139/ We believe that the issuance of a cease-and-desist order will serve the important remedial purpose of encouraging Dearlove to discharge his responsibilities with more care in the future, thereby contributing to the integrity of, and investor confidence in, the financial reporting process.

We find that the record as a whole, especially the evidence with regard to the gravity of the violations and the harm to the marketplace and the regulatory scheme, establishes a sufficient risk that Dearlove would commit future violations to warrant imposition of a cease-and-desist order. Based on all of these factors, we find a cease-and-desist order against Dearlove to be in the public interest. 140/

X. Dearlove's Due Process Argument

We conclude this opinion by addressing Dearlove's argument that the proceedings against him are defective because he was denied due process. As explained in detail below, we reject his argument and find no basis for relief.

138/ See supra note 9 and accompanying text.

139/ See Armstrong, 85 SEC Docket at 3040 (imposing cease-and-desist order based on conduct that occurred more than twelve years prior to the issuance of the Commission's opinion, noting that, although the age of the violations militated against imposition of the order, "this consideration [was] outweighed by the other factors" discussed in the opinion); Rita J. McConville, Exchange Act Rel. No. 51950 (June 30, 2005), 85 SEC Docket 3127, 3152 (imposing cease-and-desist order based on "relatively recent" conduct that occurred more than five years prior to issuance of the Commission's opinion), aff'd, 465 F.3d 780 (7th Cir. 2006).

140/ See McConville, 85 SEC Docket at 3151-52 (imposing cease-and-desist order on corporate officer for causing Section 13 violations based on, among other things, the significance of the violations, harm caused to investors, and denial of responsibility for violations charged), aff'd, 465 F.3d 780 (7th Cir. 2006).

A. Facts

We issued the Order Institutuing Proceedings ("OIP") in this matter on September 30, 2005. The OIP directed, pursuant to Commission Rule of Practice 360(a)(2), 141/ that the law judge issue an initial decision in this proceeding within 300 days from the date of service of the OIP. The OIP was served on October 5, 2005, giving the law judge until August 5, 2006, to issue his initial decision.

On November 1, 2005, the law judge entered a scheduling order setting a January 23, 2006, hearing date. 142/ On December 8, 2005, Dearlove moved for a sixty-day postponement of the hearing date on the ground that he did not have adequate time to prepare for the hearing. Dearlove argued that if he had to go forward on January 23, 2006, he would be prejudiced in his ability to defend himself, in violation of his Fifth Amendment right to due process.

Under Commission Rule of Practice 161(a), 143/ a law judge may, for good cause shown, postpone a hearing, consistent with Commission Rule of Practice 161(b). Rule 161(b) states that a law judge must adhere to a policy of strongly disfavoring postponement motions, except in circumstances where the moving party makes a "strong showing" that denial of the motion would "substantially prejudice" its case. 144/ In determining whether to grant a motion for a postponement, the law judge should consider, in addition to any other relevant factors: (1) the length of the proceeding to date; (2) the number of postponements already granted; (3) the stage of the proceeding at the time of the request; (4) the impact of the request on the law judge's ability to complete the proceeding in the time specified by the Commission; and (5) such other matters as justice may require. 145/ The law judge weighed these factors and found that Dearlove failed to make the required "strong showing of substantial prejudice" to warrant a postponement.

141/ Under Rule 360(a)(2), we must specify in the OIP a deadline for completion of the hearing and issuance of the initial decision. 17 C.F.R. § 201.360(a)(2). This deadline will be either 120, 210, or 300 days, in our discretion, "after consideration of the nature, complexity, and urgency of the subject matter, and with due regard for the public interest and the protection of investors." Id.

142/ The order also recited that the parties had agreed to this schedule.

143/ 17 C.F.R. § 201.161(a).

144/ 17 C.F.R. § 201.161(b)(1).

145/ 17 C.F.R. § 201.161(b)(1)(i)-(v).

Dearlove petitioned for interlocutory review of the law judge's denial of a postponement. We denied the petition, finding no "extraordinary circumstances." 146/

The hearing commenced on January 23, 2006, as scheduled, and extended over nine days. Dearlove was represented by counsel of his choice and submitted evidence about the merits of the allegations against him. After the hearing, Dearlove renewed his argument that the denial of a sixty-day postponement deprived him of due process. He also argued that the Commission's Rules of Practice, and Rule 360(a)(2) in particular, violated his right to due process.

In the initial decision, the law judge ruled that the denial of a sixty-day postponement did not violate Dearlove's due process rights. The law judge declined to rule on Dearlove's claim that the Rules of Practice are unconstitutional. He asserted that "any claim that the Rules of Practice are unconstitutional must be addressed to the Commission."

B. Dearlove's Contentions on Appeal

1. Dearlove argues that the denial of a sixty-day postponement deprived him of due process because he did not have adequate time to prepare for the hearing. He cites the complexity of the case, as well as the large size of the investigative file, which "prevented effective preparation and caused exculpatory material to lie unreviewed." Dearlove argues that he was given "less than four months" to prepare for the hearing, whereas the Division had "over three and a half years" to investigate the case. He points to Helms's testimony, which was provided by the Division along with "millions of pages" of other documents in advance of the hearing, as "[t]he clearest example of undiscovered, and therefore unpresented, exculpatory evidence." 147/ Dearlove contends that, had he been afforded adequate time to prepare, he would have uncovered Helms's testimony among the mass of material provided to him, which would have refuted the law judge's finding, in connection with the January 2000 direct placement of stock, that "the $368 million loan [directed to Adelphia] was originally intended for UCA."

Dearlove additionally contends that the task of preparing for the hearing "was made more difficult by the Division's late production of adequate witness and exhibit lists, and its eleventh-hour inclusion of allegations not specified in the OIP." The failure of third parties, i.e., Adelphia, PricewaterhouseCoopers, and other Adelphia advisors, to produce documents in response to his subpoenas assertedly compounded the prejudice to his case.

146/ Gregory M. Dearlove, CPA, Order Denying Application for Interlocutory Review, Admin. Proc. File No. 3-12064 (Jan. 6, 2006) (citing 17 C.F.R. § 201.400(a) (providing that "[t]he Commission will not review a hearing officer's ruling prior to its consideration of the entire proceeding in the absence of extraordinary circumstances")).

147/ See discussion supra at note 94 and accompanying text.

Dearlove uses the United States Supreme Court's due process analysis in Mathews v. Eldridge 148/ to argue that the denial of a sixty-day postponement deprived him of due process. In Mathews, the Supreme Court spoke of a balancing of three factors to determine what process is due in a given case: (1) the nature of the private interest affected by the official action; (2) the risk of erroneous deprivation of such an interest through the procedures used and the probable value of additional or substitute procedural safeguards; and (3) the government's interest, including the "function involved and the fiscal and administrative burdens that the additional or substitute procedural safeguards would entail." 149/ Dearlove characterizes the private interest at stake as his protected property interest in appearing and practicing before the Commission. 150/ He asserts that, "[b]ecause of the private interest at stake, the risk of an erroneous deprivation of the interest, and the Government's interest in the accurate determination of this matter, Dearlove was entitled to sufficient time to prepare his defense, and therefore to a continuance."

2. Dearlove argues, without citation to any authority, that Rule of Practice 360(a)(2) violates due process. He characterizes the hearing schedules in Commission administrative proceedings as "rigid" and "inflexible." Dearlove argues that Rule 360(a)(2) takes "a one-size-fits-all approach [that] does not adequately safeguard an individual's due process rights." Dearlove finds support for his constitutional challenge to Rule 360(a)(2) in the law judge's finding that his argument "echoed" some of the public comments submitted during the rulemaking proceeding that led to Rule 360(a)(2)'s adoption. 151/

148/ 424 U.S. 319 (1976).

149/ Id. at 335.

150/ Dearlove cites various licensing cases, as well as the Ninth Circuit Court of Appeals' decision in Sartain v. SEC, 601 F.2d 1366 (9th Cir. 1979), to support his claim of a protected property interest. In Sartain, the court held that due process entitled a broker-dealer's registered representative to a fair hearing before the Commission and the right to be represented by independent counsel where the registered representative stood to lose the "valuable privilege" of being employed in the securities industry. Id. at 1375; see also Michael J. Crane, Note, Disciplinary Proceedings Against Accountants: The Need for a More Ascertainable Improper Professional Conduct Standard in the SEC's Rule 2(e), 53 Fordham L. Rev. 351 (1984) (stating that an accountant has a property interest in his right to practice before the Commission that may not be terminated without due process).

151/ See Letter from the District of Columbia Bar, Corporation, Finance and Securities Law Section to the Commission (Mar. 21, 2003); Letter from the American Bar Association, Section of Business Law, Committee on Federal Regulation of Securities to the Commission (May 13, 2003), available at http://www.sec.gov/rules/proposed/s70403.html.

C. Denial of Sixty-Day Extension

In Ungar v. Sarafite, 152/ the Supreme Court articulated the standard for analyzing a due process challenge to the denial of a continuance:

> The matter of a continuance is traditionally within the discretion of the trial judge, and it is not every denial of a request for more time that violates due process even if the party fails to offer evidence or is compelled to defend without counsel. Contrariwise, a myopic insistence upon expeditiousness in the face of a justifiable request for delay can render the right to defend with counsel an empty formality. There are no mechanical tests for deciding when a denial of a continuance is so arbitrary as to violate due process. The answer must be found in the circumstances present in every case, particularly in the reasons presented to the trial judge at the time the request is denied. 153/

We have consistently followed the principles articulated in Ungar. We have recognized that the trier of fact has discretion in deciding whether to grant a motion for a postponement or continuance. 154/ We have stated that our inquiry on review of a denial of a postponement or continuance is whether the denial constituted "an unreasoning and arbitrary insistence upon expeditiousness in the face of a justifiable request for delay." 155/

152/ 376 U.S. 575 (1964).

153/ Id. at 589-90; accord Morris v. Slappy, 461 U.S. 1, 11-12 (1983) ("[B]road discretion must be granted trial courts on matters of continuances; only an unreasoning and arbitrary 'insistence upon expeditiousness in the face of a justifiable request for delay' violates the right to assistance of counsel.") (citing Ungar).

154/ See, e.g., Underhill Sec. Corp., 42 S.E.C. 689, 699 (1965) (stating that "[t]he determination whether to grant a continuance was a matter resting in the sound discretion of the [hearing] examiner"; examiner's denial of one-month adjournment to give counsel more time to prepare his defense was a proper exercise of that discretion where any lack of preparation by respondents' counsel was a result of their own dilatory conduct, and where counsel conducted a vigorous defense in the course of the hearings which extended over many weeks and was afforded the opportunity to recall any witness and to request additional time).

155/ See, e.g., Richard W. Suter, 47 S.E.C. 951, 963 (1983) (holding that law judge's refusal to grant further postponements of hearing was not an abuse of discretion or "unreasoning and arbitrary insistence upon expeditiousness" where hearing already had been delayed for a long period of time); Gary L. Jackson, 48 S.E.C. 435, 441 (1986) (holding that law judge's refusal to permit respondent's various requests for postponement of the hearing was not an abuse of discretion or "unreasoning and arbitrary insistence upon

(continued...)

A review of our precedent applying this standard reveals that most cases have held that the trier of fact's denial of a postponement was not an abuse of discretion and did not violate due process. 156/ In the "rare" cases where the denial was deemed to be improper, we have found that there were "extraordinary circumstances" supporting a postponement, i.e., the respondent was left without assistance of counsel at or near the hearing date. 157/

155/ (...continued)
expeditiousness"; "[w]hile a respondent has the right to be represented by counsel, the law does not require endless postponements of judicial proceedings while respondents attempt to secure legal representation").

156/ See, e.g., Falcon Trading Group, Ltd., 52 S.E.C. 554, 560-61 (1995) (finding no due process violation in NASD's denial of applicants' motions for continuance and adherence to the previously-scheduled hearing date where applicants were given six weeks' notice of the hearing date, and they had sufficient time to obtain new counsel after discovering that joint counsel had potential conflict of interest), aff'd, 102 F.3d 579 (D.C. Cir. 1996); Alexander V. Stein, 52 S.E.C. 296, 300-01 (1995) (finding no due process violation in law judge's denial of a postponement where respondent had well over a month to prepare any defense to the allegations in the OIP, he failed to claim that he could not defend himself without certain materials or witnesses, and he failed to specify those materials that he claimed to need); Michael Markowski, 51 S.E.C. 553, 558-59 (1993) (finding no due process violation in NASD's refusal to grant an additional continuance of the second hearing date where hearing panel had already granted counsel a continuance of the second hearing date, and attorneys gave no indication to panel prior to rescheduled hearing that they would not be ready to go forward at that time), aff'd, 34 F.3d 99 (2d Cir. 1994).

157/ See, e.g., Philip L. Pascale, CPA, Order Granting Postponement of Administrative Hearing, Admin. Proc. File No. 3-11194 (Nov. 24, 2003) (holding, on interlocutory review of a law judge's denial of a postponement request, that respondent demonstrated substantial prejudice warranting a short postponement of the hearing where the medical condition of respondent's counsel was incapacitating, and counsel learned about this condition so close to the hearing that substitute counsel could not be obtained; the Commission acknowledged that "[t]he substantial prejudice test is a difficult one to meet," but found, in this "rare" case, that respondent's request presented "extraordinary circumstances"); Carleton Wade Fleming, Jr., 52 S.E.C. 409, 415 (1995) (holding that NASD's refusal to grant a continuance was improper where counsel had withdrawn and respondent was required to proceed and present his case for three days of hearing, without assistance of counsel, despite NASD Code of Procedure provision granting a right to be heard by counsel); James Elderidge Cartwright, 50 S.E.C. 1174, 1178 (1992) (holding that NASD's refusal to grant a continuance was unreasonable where respondent was ill on the hearing date and demonstrated his inability to proceed, and NASD Code of Procedure gave the respondent the right to be heard in person and by counsel).

This proceeding is not one of those "rare" cases. Dearlove received notice of the charges no later than October 5, 2005, when he was served with the OIP, and had three and a half months to prepare for the hearing. The schedule here provided 121 days from service of the OIP to completion of the hearing; 82 days for the parties to review the transcript and submit post-hearing briefs; and 92 days for the law judge to prepare and file an initial decision. 158/ This schedule was consistent with the guidelines in Rule 360(a)(2). In fact, it afforded the parties more time than allotted. Moreover, at a pre-hearing conference on October 28, 2005, Dearlove's counsel agreed with the law judge's statement that this case did not "just drop[] on [counsel's] desk" for the first time on October 5, 2005, when Dearlove was served with the OIP. Dearlove's counsel acknowledged that he had been formally involved in this proceeding since at least 2003 when the Division took Dearlove's investigative testimony. In Dearlove's counsel's words, he was no "stranger[]" to any of the issues raised in the proceeding.

On appeal, Dearlove cites his failure to find and review Helms's testimony prior to the hearing as the only evidence that the denial of a postponement prejudiced his case. 159/ Any prejudice resulting from the omission of this evidence has been cured by our admission of this testimony under Rule 452. In any event, our review of Helms's testimony leads us to conclude that this testimony is irrelevant to the issues of Dearlove's liability. 160/

In our order denying Dearlove's motion for interlocutory review, we rejected Dearlove's claim that the complexity of the case and large size of the investigative file justified a postponement. Observing that many Commission proceedings involve complicated issues resulting in voluminous files, we stated that we already had considered the complexity of the case when, pursuant to Rule 360(a)(2), we selected the 300-day timeline for issuing the initial decision. We considered and rejected Dearlove's argument that the law judge believed the only "barrier" to his postponement request was the 300-day deadline, stating that "[t]he deadlines for issuing initial decisions are not [absolute] 'barriers' to requests for postponements." 161/ The law judge considered the 300-day deadline as one of several factors in determining whether to grant a request for a postponement and denied the postponement request only after weighing all of the

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158/ For a 300-day timeline, Rule 360(a)(2) provides that there should be 120 days from the date of service of the OIP to completion of the hearing, 60 days for the parties to obtain the transcript and submit post-hearing briefs; and 120 days after briefing for the law judge to prepare and file an initial decision. 17 C.F.R. § 201.360(a)(2).

159/ Cf. DWS Sec. Corp., 51 S.E.C. 814, 822-23 (1993) (finding no due process violation in NASD's refusal to grant applicants' requests for a continuance; applicants, who had approximately two months to prepare for their initial hearing before NASD, failed to explain how they were specifically prejudiced by the denial of their requests).

160/ See supra note 92 and accompanying text.

161/ Dearlove, Order Denying Application for Interlocutory Review, supra note 146, at 3-4 n.10.

relevant factors. 162/ Moreover, under Rule 360(a)(3), a law judge who decides that it will not be possible to issue an initial decision within the time specified in the OIP should consult with the chief law judge who, in turn, may submit a motion to us requesting an extension. 163/ Rule 360(a)(3) states that the motion should "explain[] why circumstances require an extension and specify[] the length of the extension." It further provides that we may authorize an extension if we determine that "additional time is necessary or appropriate in the public interest." Although the law judge did not avail himself of these procedures, the option to do so provided some flexibility if he decided that the case required more than 300 days to complete.

The record does not support Dearlove's contention that his hearing preparation was frustrated by the Division's late production of adequate witness and exhibit lists. The law judge required the Division to amend its witness and exhibit lists because those lists were deficient. 164/ To minimize any possible prejudice, the law judge modified his scheduling order to give Dearlove several extra weeks to identify his proposed exhibits and fact witnesses. Although Dearlove also complains about what he characterizes as the Division's "eleventh-hour" inclusion of allegations not specified in the OIP, the law judge refused to entertain those allegations. Dearlove cannot now claim that they caused him any harm.

The record shows that the delays Dearlove encountered in obtaining documents from third parties were foreseeable. The law judge encouraged Dearlove to submit his applications for document subpoenas at an early date, but Dearlove delayed doing so for one month.

Furthermore, we reject Dearlove's use of the balancing test in Mathews. The Supreme Court has stated that it has "never viewed Mathews as announcing an all-embracing test for deciding due process claims." 165/ As discussed above, Ungar supplies the proper analytical framework. We, as well as the federal courts, have used Ungar's principles in assessing a due process challenge to the denial of a postponement. Dearlove has not offered any grounds to justify a departure from this well-established practice, and we perceive no basis for doing so.

162/ See Rule 161(b)(1), 17 C.F.R. § 201.161(b)(1) (setting forth several factors the decisionmaker must consider in determining whether to grant an extension of time).

163/ 17 C.F.R. § 201.360(a)(3). See, e.g., Raymond James Fin. Serv., Inc., Securities Act Rel. No. 8597 (July 29, 2005), 85 SEC Docket 4318, 4320 (granting forty-five-day extension "[i]n light of the complexity of the case, the scheduling conflict identified by the Chief Administrative Law Judge, and the reasonableness of the requested extension").

164/ Gregory M. Dearlove, CPA, Order Following Prehearing Conference, Admin. Proc. File No. 3-12064 (Dec. 9, 2005).

165/ Dusenbery v. United States, 534 U.S. 161, 168 (2002).

Even if we were to find that Mathews supplies the proper analysis, we believe application of Mathews' three-factor balancing test also leads to the conclusion that the process provided to Dearlove was adequate. Although the nature of the private interest affected, i.e., Dearlove's right to practice before the Commission, militates in Dearlove's favor, the other factors do not. As demonstrated above, the risk that Dearlove was erroneously deprived of his right to practice was negligible: he received notice of the allegations against him, a full administrative hearing, the opportunity to respond to the allegations, and the opportunity for our review of the proceedings. In addition, the government's interest in the timely resolution of its administrative hearings was balanced against Dearlove's need for a meaningful process, as evidenced by the many concessions made by the law judge in Dearlove's favor detailed above. Mathews does not require us to provide more process than Dearlove received. 166/

D. Commission Rule of Practice 360

In the June 2003 release adopting Rule 360(a)(2), we rejected a "one-size-fits-all" approach to timely disposition of administration proceedings. 167/ As a result, we established three different deadlines for the completion of administrative proceedings. Moreover, as discussed above, Rule 360(a)(3) allows for the possibility of an extension of time where circumstances warrant. Although it is true that two of eleven commenters suggested that the proposed timeline implicated due process concerns, neither one offered any case authority holding that an agency's establishment of deadlines for the timely disposition of cases violates due process, and our research has uncovered no such authority. In response to these commenters' concerns, we amended Rule 230(d) to provide for the earlier production of the investigative record to respondents. Under Rule 230(d), the Division of Enforcement is required to make its investigative file available to a respondent within seven days after service of the OIP, or, in this case, by October 12, 2005. The Division notified Dearlove that the investigative file was available for his review on October 5, 2005, one week before it was required to do so by Rule 230(d). In sum, we find Dearlove's due process challenge to these proceedings to be without merit.

166/ See Mathews, 424 U.S. at 333 ("The fundamental requirement of due process is the opportunity to be heard at a meaningful time and in a meaningful manner.") (internal quotations omitted).

167/ See Rules of Practice, Securities Act Rel. No. 8240 (June 11, 2003), 80 SEC Docket 1463.

XI. Conclusion

We find that Dearlove engaged in improper professional conduct within the meaning of Rule of Practice 102(e)(1)(iv)(B)(2) and that he caused Adelphia's violations of Exchange Act Section 13(a) and related rules. We therefore deny Dearlove the privilege of appearing or practicing before the Commission with a right to reapply after four years, and we order him to cease and desist from causing violations of Exchange Act Section 13(a) and related rules.

An appropriate order will issue. 168/

By the Commission (Chairman COX and Commissioners ATKINS, NAZARETH, and CASEY).

Nancy M. Morris
Secretary

168/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57244 / January 31, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 2779 / January 31, 2008

Admin. Proc. File No. 3-12064

In the Matter of

GREGORY M. DEARLOVE, CPA

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that, effective immediately:

A. Gregory M. Dearlove cease and desist from causing any violation of the reporting provisions of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 12b-20.

B. Gregory M. Dearlove is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After four years from the date of this order, Dearlove may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. A preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Dearlove's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. An independent accountant. Such an application must satisfy the Commission that:

(a) Dearlove, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Dearlove, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision or, if the Board has not conducted an inspection, has received an unqualified report relating to his, or the firm's, most recent peer review conducted in accordance with the guidelines adopted by the former SEC Practice Section of the American Institute of Certified Public Accountants Division for CPA Firms or an organization providing equivalent oversight and quality control functions;

(c) Dearlove has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Dearlove acknowledges his responsibility, as long as Dearlove appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews, and quality control standards.

D. The Commission will consider an application by Dearlove to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Dearlove's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary