

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59594 / March 18, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2951 / March 18, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13411

In the Matter of

Allion Healthcare, Inc. and
James G. Spencer,

Respondents.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against Allion Healthcare, Inc. (“Allion”) and James G. Spencer (“Spencer”) (collectively, “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds¹ that:

Summary

1. This matter concerns Allion's failure to properly record and report two significant warrant grants made during the second quarter of 2005. Because Allion failed to recognize interest expense for the warrants in conformity with Generally Accepted Accounting Principles ("GAAP"), the company materially overstated its net income and understated its loss per share when reporting results for the second quarter of 2005 and the nine months ended September 30, 2005. Allion restated its results in March 2006 after the company's independent auditor inquired about the errors. In its restatement, the company reduced its net income by 1372% for the second quarter of 2005, from net income of \$70,431 to a net loss of \$895,569, and increased its loss per share for this period by 77%, from \$0.31 to \$0.55 per share. Allion also reduced its net income for the nine months ended September 30, 2005 by 97%, from \$932,517 to \$26,517, and increased its loss per share for this period by 233%, from \$0.06 to \$0.20 per share. Allion violated the federal securities laws by filing materially inaccurate periodic reports with the Commission, failing to make and keep accurate books and records, and failing to devise and maintain an adequate system of accounting controls.

2. Allion's former chief financial officer, James G. Spencer, was a cause of the company's violations and certified the company's inaccurate Form 10-Qs for the second and third quarters of 2005. Spencer knew the warrants had potentially significant value, and was aware of the potential impact on the company's earnings associated with the larger of the two grants. Nevertheless, he failed to ensure that the company properly recorded and reported the warrant transactions.

Respondents

3. Allion, a Delaware corporation with its headquarters in Melville, New York, is a national provider of specialty pharmacy and disease management services focused on HIV/AIDS patients. During all relevant times, Allion's common stock has been registered with the Commission pursuant to Section 12(g) of the Exchange Act and traded on the NASDAQ National Market under the symbol "ALLI."

4. Spencer, 40, a resident of Baltimore, Maryland, served as Allion's chief financial officer ("CFO") from May 2004 to July 2007. Spencer worked for Allion as an independent consultant for approximately seven months before becoming CFO. Since July 2007, Spencer has been senior vice president and CFO for a privately-held company. Spencer has never been a certified public accountant ("CPA").

Facts

Director's Personal Guarantee of Allion's Line of Credit

5. In late 1999 or early 2000, an Allion director agreed to personally guarantee a \$1.5 million line of credit for Allion and Allion granted the director a warrant to purchase 375,000

¹ The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

shares of common stock as consideration for his guarantee. The warrant expires in March 2010 and the shares are exercisable at \$1.00 per share. In June 2002, Allion issued another warrant to purchase 150,000 shares of common stock to the director as consideration for extending his guarantee of the loan. This warrant had a ten year life and an exercise price of \$3.50 per share.² Allion issued these warrants prior to the time Spencer began working at the company.

Allion's Second Quarter 2005 Warrant Grants

6. Allion's line of credit was due to expire in March 2005, by which time the company was preparing to file a registration statement for its initial public offering ("IPO"). Because Allion did not have sufficient cash available to repay the line of credit, it needed to extend it to continue operating until the company could raise funds through the IPO. The bank that had issued the line of credit agreed to extend it for six months contingent upon, among other things, the director maintaining his personal guarantee.

7. The director asked Allion for a warrant to purchase additional shares of Allion stock in return for extending his guarantee. Allion's board had numerous discussions regarding the value of the warrant grant. During these discussions, Spencer told Allion's chief executive officer ("CEO") and two members of the board that the estimated value of such a warrant grant would be \$1.75 to \$2 per share, based on the calculations performed by an independent valuation firm that Allion had used when valuing warrants issued in connection with two acquisitions it made during early 2005.

8. On April 13, 2005, Allion's board of directors held a special meeting to grant the director a warrant to purchase 100,000 shares of Allion common stock at an exercise price equal to the IPO price or, if no IPO were to occur by April 20, 2006, at \$6.26 per share (the "Director Warrant"). As anticipated at the time the Director Warrant was granted, Allion publicly filed its registration statement for the IPO with the Commission two days later, and the IPO took place approximately two months later at a price of \$13 per share. Consequently, the exercise price of the Director Warrant became \$13 per share. The Director Warrant has never been exercised, and expires on April 15, 2015.

9. During the evening of April 14, Spencer received an e-mail from an assistant to the director who had been granted the Director Warrant, asking "what is earnings hit for these warrants??" Spencer replied that the value of warrants recently issued by the company in connection with a March 2005 acquisition had been approximately \$1.65 per share; however, he also noted that if the company were to go public there was a "good chance" the company's auditor would want to reassess the volatility factor used in the Black-Scholes model.³

² At the time of the grants, Allion recognized an insufficient expense for the 2000 grant and disclosed, but did not recognize any expense for, the 2002 grant. In 2006, Allion calculated the expense for these grants and determined the associated increases were immaterial when recognized over the term of the loan. The director exercised the 2002 warrant and sold the shares at \$12.83 in Allion's January 2006 secondary offering.

³ Although GAAP does not require its use, the Black-Scholes model is commonly used to estimate the fair value of stock options and other equity instruments, including warrants. The inputs to the Black-Scholes model include: (a) the exercise price of the warrant; (b) the expected life of the warrant; (c) the current price of the underlying stock; (d) its expected volatility; (e) expected dividends; and (f) the risk-free interest rate for the expected term of the warrant.

10. In response, the director's assistant asked Spencer for a Black-Scholes model to estimate the value of the Director Warrant. Later that evening, Spencer e-mailed the assistant and Allion's CEO the results of his Black-Scholes model, which showed that a ten-year warrant with an exercise price of \$10 would be valued at \$3.74 per share and a ten-year warrant with an exercise price of \$12 would be valued at \$4.49 per share.⁴ The valuations produced by Spencer's model were higher than the estimates he previously had communicated to Allion's CEO and two directors during the board of directors' discussions regarding the grant. Furthermore, Spencer did not consult the company's auditor or the independent valuation firm Allion previously had used regarding the correct volatility factor or any other aspect of the Black-Scholes model he used to produce these valuations.

11. Allion disclosed the issuance of the Director Warrant in its IPO registration statement filed with the Commission on April 15, 2005. A few days later, on April 21, Allion again disclosed the issuance of the Director Warrant in a Form 8-K filing that attached the warrant agreement as an exhibit. Also on April 21, the director himself filed a Form 4 disclosing his receipt of the Director Warrant.

12. In mid-May 2005, Allion issued a \$2 million note to an investor. As partial consideration for the note, Allion granted the investor a warrant to purchase 40,000 shares of Allion common stock at an exercise price equal to the price per share of a successful IPO (the "Investor Warrant"), which as noted above turned out to be \$13.00 per share. The Investor Warrant has never been exercised, and expires on May 15, 2010.

13. On May 18, 2005, Allion disclosed the issuance of the Investor Warrant in its Form 10-Q for the first quarter of 2005, and attached the warrant agreement as an exhibit to that filing. Allion also disclosed the issuance of the Director Warrant in the same Form 10-Q.

Allion's June 22, 2005 IPO

14. On June 22, 2005, Allion conducted its IPO, selling four million shares of common stock at \$13 per share. Allion disclosed the issuance of the Director and Investor Warrants in its registration statements and prospectus for the IPO. Allion used proceeds from the offering to repay the bank line of credit and the \$2 million note prior to June 30, 2005.

Allion Failed to Properly Record and Report the Director and Investor Warrants in its Second Quarter Form 10-Q

15. GAAP provides that when a company grants warrants in connection with the issuance of debt, it should value the warrants and generally record a non-cash interest expense for these warrants over the life of the debt. Allion, however, failed to record any expense for the Director or Investor Warrants in its Form 10-Q for the second quarter of 2005.

16. Neither the Director Warrant nor the Investor Warrant was properly recorded in the company's books and records for the second quarter of 2005. At the time, Allion had no written procedures in place for recording equity-based transactions. As CFO, Spencer was responsible for ensuring that the warrants were properly recorded in Allion's financial statements, yet failed to do so. Spencer did not verify that the warrants were recorded in the company's accounting records, nor did he provide his valuation model to anyone else to enable them to properly record the

⁴ Spencer's Black-Scholes models assumed the exercise price of the warrant equaled the market price of Allion's common stock, which Spencer's models assumed would be the IPO price per share.

expense. In addition, notwithstanding his lack of experience accounting for equity issued in connection with debt, Spencer did not consult with the company's auditor, other accountants, or any other specialist regarding how properly to value or record the Director or Investor Warrants.

17. Allion was scheduled to release its second quarter results and host an investor conference call after the market closed on August 11, 2005. Prior to that date and after reviewing the Investor Warrant disclosure in the company's draft Form 10-Q, Allion's auditor had asked Spencer whether an expense for the Investor Warrant had been recorded in the company's financial statements. On the morning of August 11, Spencer informed the auditor that the company had not recorded an expense for the Investor Warrant. One of the auditors responded by e-mail that "if there was no accounting for these warrants, which there should have been, we just need to know what was/should be the value attached to those warrants."

18. Spencer subsequently used the Black-Scholes model and valued the Investor Warrant at \$60,000. He e-mailed the model to the auditor early in the afternoon on August 11. However, Spencer's calculation underestimated the fair value of the Investor Warrant by more than \$150,000 because he incorrectly used an estimated term of exercise that was only half of the warrant's life, rather than the full term, and he used a stock price volatility that was too low because it did not reflect the increased volatility of Allion's stock price after the stock became publicly traded.

19. Later that day, Allion's auditor advised the chairman of the company's Audit Committee and Spencer that it was proposing an adjustment of \$60,000 to the company's second quarter interest expense, an amount the auditor and the company collectively deemed to be immaterial to the second quarter results. Allion recorded the \$60,000 interest expense in its third quarter financial statements.

20. Notwithstanding his multiple communications regarding the accounting for the Investor Warrant, Spencer did not alert Allion's auditor to the possibility that the company similarly might have failed to recognize an expense for the much larger Director Warrant grant.

21. Allion's second quarter Form 10-Q, which was certified by Spencer and filed on August 15, 2005, included financial statements that were materially incorrect because they did not reflect any interest expense for the Director Warrant or Investor Warrant.

Allion Failed to Properly Record and Report the Director or Investor Warrants in Its Form 10-Q for the Third Quarter of 2005 and January 2006 Secondary Offering Documents

22. Allion's third quarter Form 10-Q, which was filed on November 14, 2005 and certified by Spencer, included financial statements that materially overstated Allion's net income and earnings per share for the first nine months of 2005 because they understated the interest expense for the Investor Warrant and did not reflect any interest expense for the Director Warrant.⁵

23. Allion conducted a follow-on offering of common stock on January 26, 2006. The company sold 1.8 million shares and selling stockholders sold an additional 2,636,454 shares at \$12.83 per share. The company's registration statements and final prospectus for the offering included the company's financial results through the first nine months of 2005, and thus contained the same warrant-related inaccuracies as the third quarter Form 10-Q described above. These

⁵ As noted above, Allion recorded \$60,000 of interest expense for the Investor Warrant in its third quarter financial statements.

filings, however, did contain disclosures concerning the issuance of the Director Warrant and Investor Warrant.

Allion's March 2006 Restatement

24. Allion was scheduled to release its 2005 annual results and conduct an earnings call after the market closed on March 9, 2006. On March 8, Allion's auditor, after reviewing the disclosure regarding the Director Warrant grant in the draft Form 10-K, asked Spencer whether the company had recognized an expense for that warrant. After checking the company's accounting books and records, Spencer informed the auditor that Allion had not recorded an expense for the Director Warrant, and Spencer and the auditor agreed that the company needed to do so. Spencer then prepared a Black-Scholes model valuing the Director Warrant at approximately \$150,000. Allion's auditor, however, independently prepared a Black-Scholes model that valued the Director Warrant at approximately \$700,000 - \$900,000.

25. The discrepancy prompted Allion's auditor to review Spencer's Black-Scholes calculation. Based on this review, the auditor determined that Spencer incorrectly had used an expected term of half of the Director Warrant's life, rather than the full life, and used a volatility factor that was too low.

26. Following the market close on March 9, Allion filed a Form 8-K and issued a related press release announcing its intention to restate results for the three and six months ended June 30, 2005 and the nine months ended September 30, 2005 to correct the failure to record a non-cash interest expense for the Director Warrant. The press release stated that Allion expected the non-cash interest expense to be approximately \$700,000 - \$900,000 recorded in the second quarter of 2005. Prior to issuing its press release, Allion self-reported the matter to the Commission staff.

27. The following day, Allion's auditor sent an e-mail to Spencer questioning whether the company had "the same issues" with respect to its accounting for the Investor Warrant. Spencer subsequently recalculated the fair value of both the Director and Investor Warrant. Based on advice from Allion's auditor and an independent valuation expert, Spencer used the full contractual term of the warrants as the expected term of exercise and a volatility factor of 40%, which was based on the closing prices of Allion's stock and other health care companies' stocks during the eight and a half months since Allion's June 2005 IPO. Using these revised inputs to the Black-Scholes model, Spencer valued the Director Warrant at \$752,563 and the Investor Warrant at \$213,747.

28. On March 15, Allion filed a Form 8-K disclosing its prior failure to record the correct non-cash interest expense for the Investor Warrant and stating that the total non-cash interest expense to be recorded in the second quarter of 2005 for both warrants would be restated to \$966,000. The effect of the restatement is summarized in the charts below:

	THREE MONTHS ENDED JUNE 30, 2005		DOLLAR CHANGE	PERCENT CHANGE
	Original	Restated		
Interest income (expense)	(\$451,634)	(\$1,417,634)	(\$966,000)	214%
Net income (loss)	\$70,431	(\$895,569)	(\$966,000)	1372%
Net income (loss) available to common shareholders	(\$1,267,616)	(\$2,233,616)	(\$966,000)	76%
Earnings (loss) per share	(\$0.31)	(\$0.55)	(\$0.24)	77%

	NINE MONTHS ENDED SEPT. 30, 2005		DOLLAR CHANGE	PERCENT CHANGE
	Original	Restated		
Interest income (expense)	(\$359,419)	(\$1,265,419)	(\$906,000) ⁶	252%
Net income (loss)	\$932,517	\$26,517	(\$906,000)	97%
Net income (loss) available to common shareholders	(\$405,530)	(\$1,311,530)	(\$906,000)	223%
Earnings (loss) per share	(\$0.06)	(\$0.20)	(\$0.14)	233%

Allion Stated that a Material Weakness Existed in its Internal Controls

29. Allion's 2005 Form 10-K, filed on March 16, 2006, stated that, after consultation with its auditor, the company's management had concluded that a material weakness existed in the company's internal controls over financial reporting relating to its failure to properly record non-cash interest expense for the Director Warrant and Investor Warrant.

30. Allion has since taken steps to address this material weakness, including retaining an independent consultant to review and improve its internal procedures and controls relating to the recording of equity-based and related party transactions, adding two certified public accountants to its board of directors and audit committee, one of whom was appointed chairman of the audit committee and later became the company's CFO after Spencer voluntarily left Allion in July 2007. The company also sent its controller for additional training.

Spencer was Responsible for Allion's Improper Accounting and Internal Controls

31. Spencer, as CFO, was responsible for Allion's false financial statements and inadequate internal controls described above. Spencer knew that the Director Warrant had potentially significant value, and was aware of the potential "earnings hit" associated with the warrant. Nevertheless, he failed to ensure that the Director or Investor Warrants were recorded

⁶ Allion's restated interest expense for the nine months ended September 30, 2005 was \$60,000 less than its restated interest expense for the three months ended June 30, 2005 because the company recognized \$60,000 of interest expense for the Investor Warrant in its Form 10-Q originally filed for the third quarter of 2005.

properly in the company's accounting records. He did not verify that the warrants were recorded, nor did he provide his valuation model to anyone else to enable them to properly record the expense. In addition, notwithstanding his lack of experience accounting for equity issued in connection with debt, Spencer did not consult with the company's auditor, other accountants, or any other specialist regarding how properly to value or record the Director or Investor Warrants. Instead, Spencer unreasonably relied upon Allion's auditor to detect and remedy the company's accounting errors. Even after the company's auditor inquired about the omission of the Investor Warrant from the company's financial statements shortly before Allion filed its second quarter Form 10-Q, Spencer failed to inquire whether the company's accounting for the Director Warrant raised a similar issue or raise the issue with the auditor.

Spencer Made Inaccurate Certifications Under Section 302 of the Sarbanes-Oxley Act

32. As Allion's CFO, Spencer signed certifications for Allion's Forms 10-Q for the second and third quarters of 2005 stating that, among other things, he had evaluated the effectiveness of the company's internal controls over financial reporting, and had disclosed to the company's auditor and audit committee all significant deficiencies and material weaknesses in the design or operation of these internal controls. Spencer should have known that the company's internal controls relating to the recording of warrant transactions were deficient, and that these certifications therefore were inaccurate.

Violations

33. Section 13(a) of the Exchange Act and Rule 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act to file quarterly reports with the Commission. Exchange Act Rule 12b-20 requires that an issuer's periodic reports contain such further material information as may be necessary to ensure that the required statements made in them are not misleading. It is implicit in these requirements that the information in the reports be accurate. *See SEC v. IMC International, Inc.*, 384 F. Supp. 889, 893 (N.D. Texas), *aff'd mem.*, 505 F.2d 733 (5th Cir. 1974), *cert. denied sub nom., Evans v. SEC*, 420 U.S. 930 (1975).

34. Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP.

35. Exchange Act Rule 13a-14 requires principal executive and financial officers to certify in quarterly Commission filings that, among other things, the certifying officers have reviewed the filing and, based on their most recent evaluation of the company's internal controls over financial reporting, have disclosed to the audit committee and auditors all significant deficiencies and material weaknesses in these internal controls.

36. As a result of the conduct described above, Allion violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

37. As a result of the conduct described above, Spencer was a cause of Allion's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder, and violated Exchange Act Rule 13a-14.

Allion's Remedial Efforts

38. In determining to accept the Offers, the Commission considered remedial acts undertaken by Allion and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the cease-and-desist order agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Allion cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder; and

B. Pursuant to Section 21C of the Exchange Act, Respondent Spencer cease and desist from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder, and cease and desist from committing or causing any violation and any future violation of Exchange Act Rule 13a-14.

By the Commission.

Elizabeth M. Murphy
Secretary