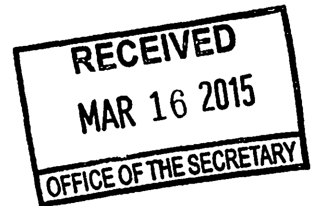
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16293

In the Matter of LAURIE BEBO, and JOHN BUONO, CPA, Respondents.	THE DIVISION OF ENFORCEMENT'S LIST OF POTENTIAL WITNESSES

Pursuant to the Court's January 12, 2015 Prehearing Scheduling Order, and Rule 222(a)(4) of the Commission's Rules of Practice, the Division of Enforcement intends to call each of the following individuals to testify at the evidentiary hearing in this matter:[1]

1. John Barron
   Marks Paneth LLP
   685 Third Avenue
   New York, NY 10017

The Division expects that Mr. Barron will testify about his professional background; his retention as the Division of Enforcement's expert witness; his analysis of ALC's financial statements, financial accounting, internal controls, and the Ventas lease covenant calculations; the conclusions contained in his expert report; the analysis and underlying materials supporting the conclusions in his expert report; and his knowledge of other facts alleged in the Order Instituting Proceedings.

2. Laurie Bebo
   c/o Mark Cameli, Esq.
   Reinhart Boerner Van Deuren S.C.
   1000 North Water Street, Suite 1700
   Milwaukee, WI 53202

The Division expects that Ms. Bebo will testify about her professional background; her role as ALC's chief executive officer and member of the board of directors; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; her communications with Mr. Buono and his staff, members of management and/or the board of directors, and ALC's attorneys and

[1] The Division submits this list without waiving its right to call as a witness any person who appears on the Respondent's list of witnesses. The Division also reserves its right to call additional witnesses for purposes of rebuttal, or as unforeseen circumstances arise and the Court deems appropriate.

auditors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; facts related to the sale of ALC; the materiality of ALC's compliance with the Ventas lease covenants; her understanding of the inclusion of employees in the Ventas lease covenant calculations, including ALC's accounting related to the covenant calculations; her understanding of certain employees' and family members' attendance at the Ventas facilities; her role in selecting the names of non-residents for inclusion in the Ventas covenant calculations; her compensation; her prior statements; and her knowledge of other facts alleged in the Order Instituting Proceedings.

3. Alan Bell
c/o Eric Sussman, Esq.
Paul Hastings LLP
191 N. Wacker Drive, Thirtieth Floor
Chicago, IL 60606

The Division expects that Mr. Bell will testify about his professional background; his role as a member of ALC's board of directors and audit committee; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; his communications with Ms. Bebo, Mr. Buono and his staff, members of management and/or the board of directors, and ALC's attorneys and/or auditors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; facts related to the sale of ALC; the materiality of ALC's compliance with the Ventas lease covenants; his understanding of the inclusion of employees in the Ventas lease covenant calculations; Ms. Bebo's compensation; and his knowledge of other facts alleged in the Order Instituting Proceedings.

4. Kathy Bucholtz
c/o Pravin Rao, Esq.
Perkins Coie LLP
131 South Dearborn Street
Chicago, Illinois 60603-5559

The Division expects that Ms. Bucholtz will testify about her professional background, including her role as ALC's vice president of sales and marketing; her communications with Ms. Bebo, Mr. Buono and his staff, and other members of management and/or the board of directors; her understanding of certain employees' and family members' attendance at the Ventas facilities; her understanding of the inclusion of employees in the Ventas lease covenant calculations; and her knowledge of other facts alleged in the Order Instituting Proceedings.

5. John Buono
c/o Patrick S. Coffey, Esq.
Whyte Hirschboeck Dudek S.C.
161 N. Clark St., Suite 4700
Chicago, IL 60601

The Division expects that Mr. Buono will testify about his professional background; his role as ALC's chief financial officer; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; his communications with his staff, Ms. Bebo, members of management and/or the board of directors, and ALC's attorneys and auditors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; facts related to the sale of ALC; the materiality of ALC's compliance with the Ventas lease covenants; his understanding of the inclusion of employees in the Ventas lease covenant calculations, including ALC's accounting related to the covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

6. Joy Butora
c/o Roger H. Stetson, Esq.
Barack Ferrazano Kirschbaum & Nagelberg LLP
200 West Madison Street, Suite 3900
Chicago, IL 60606

The Division expects that Ms. Butora will testify about her professional background; her role as a Ventas asset manager; Ventas' relationship, communications, and interactions with ALC; Ventas' internal communications regarding ALC; facts related to ALC's lease of the Ventas facilities; her communications with Ms. Bebo and Mr. Buono; Ventas' review and analysis of information provided by ALC; Ventas' understanding of occupancy and coverage ratio covenants included in its tenant leases; and her knowledge of other facts alleged in the Order Instituting Proceedings.

7. Timothy Doman
c/o Roger H. Stetson, Esq.
Barack Ferrazano Kirschbaum & Nagelberg LLP
200 West Madison Street, Suite 3900
Chicago, IL 60606

The Division expects that Mr. Doman will testify about his professional background; his role as a Ventas vice president; Ventas' relationship, communications, and interactions with ALC; Ventas' internal communications regarding ALC; facts related to ALC's lease of the Ventas facilities; his communications with Ms. Bebo and Mr. Buono; Ventas' review and analysis of information provided by ALC; Ventas' understanding of occupancy and coverage ratio covenants included in its tenant leases; and his knowledge of other facts alleged in the Order Instituting Proceedings.

8. Anthony Ferreri
c/o Junaid A. Zubairi, Esq.
Vedder Price P.C.
222 N. LaSalle St.
Chicago, IL 60601

The Division expects that Mr. Ferreri will testify about his professional background; his role as ALC's assistant treasurer; his communications with Ms. Bebo, Mr. Buono and his staff, other members of management, and ALC's auditors; his understanding of the inclusion of employees in the

Ventas lease covenant calculations, including ALC's accounting related to the covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

9. Eric Fonstad
c/o John F. Hartmann, Esq.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, Illinois 60654

The Division expects that Mr. Fonstad will testify about his professional background; his role as ALC's general counsel; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; his communications with Ms. Bebo, Mr. Buono, and members of management and/or the board of directors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; his understanding of the inclusion of employees in the Ventas lease covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

10. Daniel Grochowski
c/o William J. Schwartz, Esq.
Cooley LLP
The Grace Building
1114 Avenue of the Americas
New York, NY 10036-7798

The Division expects that Mr. Grochowski will testify about his professional background; his roles as ALC's director of tax and director of treasury; his communications with Ms. Bebo, Mr. Buono and his staff, other members of management and/or ALC's board of directors, and ALC's auditors; ALC's relationship, communications, and interactions with Ventas; his understanding of the inclusion of employees in the Ventas lease covenant calculations, including ALC's accounting related to the covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

11. David Hennigar
c/o Theodore T. Chung, Esq.
Jones Day
77 W. Wacker Dr.
Chicago, IL 60601

The Division expects that Mr. Hennigar will testify about his professional background; his role as chairman of ALC's board of directors; ALC board meetings; materials submitted to ALC's board; his communications with Ms. Bebo, Mr. Buono and his staff, members of management and/or the board of directors, and ALC's attorneys and/or auditors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; facts related to the sale of ALC; the materiality of ALC's compliance with the Ventas lease covenants; his understanding of the inclusion of employees in the Ventas lease covenant calculations; Ms. Bebo's compensation;

and his knowledge of other facts alleged in the Order Instituting Proceedings. Mr. Hennigar is a citizen of Canada and does not reside in the United States. If Mr. Hennigar is not willing to voluntarily appear for testimony, and remains outside of the United States, the Division intends to move to introduce prior sworn statements of Mr. Hennigar pursuant to Rule of Practice 235(a)(2).

12. Robin Herbner
c/o Junaid A. Zubairi, Esq.
Vedder Price P.C.
222 N. LaSalle St.
Chicago, IL 60601

The Division expects that Ms. Herbner will testify about her professional background; her role as ALC's field accounting manager; her communications with Ms. Bebo, Mr. Buono and his staff, other members of management and/or ALC's board of directors, and ALC's auditors; ALC's relationship, communications, and interactions with Ventas; her understanding of the inclusion of employees in the Ventas lease covenant calculations, including ALC's accounting related to the covenant calculations; and her knowledge of other facts alleged in the Order Instituting Proceedings.

13. Jared Houck
c/o Pravin Rao, Esq.
Perkins Coie LLP
131 South Dearborn Street
Suite 1700
Chicago, Illinois 60603-5559

The Division expects that Mr. Houck will testify about his professional background; his roles as ALC's regional director of operations, division vice president, and senior vice president; his communications with Ms. Bebo and other members of management and/or ALC's board of directors; his understanding of certain employees' attendance at the Ventas facilities; and his knowledge of other facts alleged in the Order Instituting Proceedings.

14. Sitalakshmi Natarajan
c/o Asheesh Goel, Esq.
Ropes & Gray LLP
191 North Wacker Dr.
Chicago, IL 60606

The Division expects that Ms. Natarajan will testify about her professional background; her role as ALC's payroll manager; her review, analysis and compilation of ALC payroll information; the preparation of documents bearing the control numbers ALC_SEC00056289-56302 and ALC_SEC00527117; and her knowledge of other facts alleged in the Order Instituting Proceedings.

15. Sara Renardo
Securities and Exchange Commission
175 West Jackson, Suite 900
Chicago, IL 60604

The Division expects that Ms. Renardo will testify about her professional background; her role as a Division paralegal; her review of prior sworn statements and ALC payroll materials; and her preparation of summary exhibits.

16. Sean Schelfout
c/o Junaid A. Zubairi, Esq.
Vedder Price P.C.
222 N. LaSalle St.
Chicago, IL 60601

The Division expects that Mr. Schelfout will testify about his professional background; his role as ALC's treasury manager; his communications with Ms. Bebo, Mr. Buono and his staff, other members of management and/or ALC's board of directors, and ALC's auditors; ALC's relationship, communications, and interactions with Ventas; his understanding of the inclusion of employees in the Ventas lease covenant calculations, including ALC's accounting related to the covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

17. Joseph Solari
c/o Roger H. Stetson, Esq.
Barack Ferrazano Kirschbaum & Nagelberg LLP
200 West Madison Street, Suite 3900
Chicago, IL 60606

The Division expects that Mr. Solari will testify about his professional background; his role as a Ventas managing director; Ventas' relationship, communications, and interactions with ALC; Ventas' internal communications regarding ALC; facts related to ALC's lease of the Ventas facilities; his communications with Ms. Bebo and Mr. Buono; Ventas' review and analysis of information provided by ALC; Ventas' understanding of occupancy and coverage ratio covenants included in its tenant leases; and his knowledge of other facts alleged in the Order Instituting Proceedings.

18. Mary Zak-Kowalczyk
c/o James W. Ducayet, Esq.
Sidley Austin LLP
One South Dearborn St.
Chicago, IL 60603

The Division expects that Ms. Zak-Kowalczyk will testify about her professional background; her role as ALC's vice president – legal; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; her communications with Ms. Bebo, Mr. Buono and his staff, and members of management and/or the board of directors; ALC's relationship,

communications, and interactions with Ventas; her understanding of the inclusion of employees in the Ventas lease covenant calculations; her understanding of certain employees' attendance at the Ventas facilities; and her knowledge of other facts alleged in the Order Instituting Proceedings.

* * *

The Division further states that, in addition to the foregoing individuals, it may call any or all of the following individuals to testify at the evidentiary hearing in this matter, either in the Division's case-in-chief or as a rebuttal witness:

19. Derek Buntain
    c/o Chris Niewoehner, Esq.
    Steptoe & Johnson LLP
    115 South LaSalle Street
    Chicago, IL 60603

The Division expects that Mr. Buntain may testify about his professional background; his role as a member of ALC's board of directors and audit committee; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; his communications with Ms. Bebo, Mr. Buono, members of management and/or the board of directors, and ALC's attorneys and/or auditors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; facts related to the sale of ALC; his understanding of the inclusion of employees in the Ventas lease covenant calculations; Ms. Bebo's compensation; and his knowledge of other facts alleged in the Order Instituting Proceedings. Mr. Buntain is a citizen of Canada and does not reside in the United States. If Mr. Buntain is not willing to voluntarily appear for testimony, and remains outside of the United States, the Division may move to introduce prior sworn statements of Mr. Buntain pursuant to Rule of Practice 235(a)(2).

20. Bruce Davidson
    c/o Eric J. Van Vugt, Esq.
    Quarles & Brady LLP
    411 East Wisconsin Avenue, Suite 2400
    Milwaukee, Wisconsin 53202

The Division expects that Mr. Davidson may testify about his professional background; his role as a partner at Quarles & Brady; his communications with Ms. Bebo, Mr. Buono, members of ALC management and/or the board of directors; ALC's relationship, communications, and interactions with Ventas; his understanding of the inclusion of employees in the Ventas lease covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

21. Matthew Flynn
c/o Eric J. Van Vugt, Esq.
Quarles & Brady LLP
411 East Wisconsin Avenue, Suite 2400
Milwaukee, Wisconsin 53202

The Division expects that Mr. Flynn may testify about his professional background; his role as a partner at Quarles & Brady; his communications with Ms. Bebo, Mr. Buono, members of ALC management and/or the board of directors; ALC's relationship, communications, and interactions with Ventas; his understanding of the inclusion of employees in the Ventas lease covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

22. Jeannine Hiatt

The Division expects that Ms. Hiatt may testify about her professional background as an ALC employee and her attendance at the Ventas facilities.

23. Melissa Koeppel
c/o Gary A. Orseck, Esq.
Robbins, Russell, Englert, Orseck, Untereiner & Sauber LLP
1801 K Street, N.W., Suite 411 L
Washington, D.C. 20006

The Division expects that Ms. Koeppel may testify about her professional background; her role as a partner at Grant Thornton; Grant Thornton's audits and reviews of ALC's financial statements; Grant Thornton's communications with Ms. Bebo, Mr. Buono and his staff, members of management and/or the board of directors; ALC's relationship, communications, and interactions with Ventas; her understanding of the inclusion of employees in the Ventas lease covenant calculations; and her knowledge of other facts alleged in the Order Instituting Proceedings.

24. Ryan Morrison
c/o Eric J. Van Vugt, Esq.
Quarles & Brady LLP
411 East Wisconsin Avenue, Suite 2400
Milwaukee, Wisconsin 53202

The Division expects that Mr. Morrison may testify about his professional background; his role as a partner at Quarles & Brady; his communications with Ms. Bebo, Mr. Buono, members of ALC management and/or the board of directors; ALC's relationship, communications, and interactions with Ventas; his understanding of the inclusion of employees in the Ventas lease covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

25. Malen Ng
c/o John Kocoras, Esq.
McDermott Will & Emery LLP
227 West Monroe
Chicago, IL 60606

The Division expects that Ms. Ng may testify about her professional background; her role as a member of ALC's board of directors and chair of ALC's audit committee; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; her communications with Ms. Bebo, Mr. Buono and his staff, members of management and/or the board of directors, and ALC's attorneys and/or auditors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; facts related to the sale of ALC; her understanding of the inclusion of employees in the Ventas lease covenant calculations; Ms. Bebo's compensation; and her knowledge of other facts alleged in the Order Instituting Proceedings. Ms. Ng is a citizen of Canada and does not reside in the United States. If Ms. Ng is not willing to voluntarily appear for testimony, and remains outside of the United States, the Division may move to introduce prior sworn statements of Ms. Ng pursuant to Rule of Practice 235(a)(2).

26. Lynette Nichols-Newman
Securities and Exchange Commission
175 West Jackson, Suite 900
Chicago, IL 60604

The Division expects that Ms. Nichols-Newman may testify about her professional background; her role as a Division paralegal; and statements made by John Buono.

27. Charles H. Roadman II, M.D.
c/o Matthew Crowl, Esq.
Schiff Hardin LLP
233 South Wacker Dr.
Chicago, IL 60606

The Division expects that Dr. Roadman may testify about his professional background; his roles as ALC's interim CEO and a member of ALC's board of directors and audit committee; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; his communications with Ms. Bebo, Mr. Buono and his staff, members of management and/or the board of directors, and ALC's attorneys and/or auditors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; facts related to the sale of ALC; the materiality of ALC's compliance with the Ventas lease covenants; his understanding of the inclusion of employees in the Ventas lease covenant calculations; Ms. Bebo's compensation; the retention of documents following Ms. Bebo's termination; and his knowledge of other facts alleged in the Order Instituting Proceedings.

28. Melvin Rhinelander
c/o Mark Rotert, Esq.
Stetler, Duffy & Rotert, Ltd.
10 S. LaSalle, Suite 2800
Chicago, IL 60603

The Division expects that Mr. Rhinelander may testify about his professional background; his role as vice chairman of ALC's board of directors; ALC board and audit committee meetings; materials submitted to ALC's board and audit committee; his communications with Ms. Bebo, Mr. Buono and his staff, members of management and/or the board of directors, and ALC's attorneys and/or auditors; ALC's relationship, communications, and interactions with Ventas; facts related to the sale of ALC; facts related to ALC's lease of the Ventas facilities; the materiality of ALC's compliance with the Ventas lease covenants; his understanding of the inclusion of employees in the Ventas lease covenant calculations; Ms. Bebo's compensation; and his knowledge of other facts alleged in the Order Instituting Proceedings.

29. Jeffrey Robinson
c/o Gary A. Orseck, Esq.
Robbins, Russell, Englert, Orseck, Untereiner & Sauber LLP
1801 K Street, N.W., Suite 411 L
Washington, D.C. 20006

The Division expects that Mr. Robinson may testify about his professional background; his role as a partner at Grant Thornton; Grant Thornton's audits and reviews of ALC's financial statements; Grant Thornton's communications with Ms. Bebo, Mr. Buono and his staff, members of management and/or the board of directors; ALC's relationship, communications, and interactions with Ventas; his understanding of the inclusion of employees in the Ventas lease covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

30. Michael Zeka
c/o Eric J. Van Vugt, Esq.
Quarles & Brady LLP
411 East Wisconsin Avenue, Suite 2400
Milwaukee, Wisconsin 53202

The Division expects that Mr. Zeka may testify about his professional background; his role as a partner at Quarles & Brady; his communications with Ms. Bebo, Mr. Buono, members of ALC management and/or the board of directors; ALC's relationship, communications, and interactions with Ventas; facts related to ALC's lease of the Ventas facilities; his understanding of the inclusion of employees in the Ventas lease covenant calculations; and his knowledge of other facts alleged in the Order Instituting Proceedings.

*   *   *

The Division further states that, in addition to the foregoing individuals, pursuant to the Court's February 6, 2015 Order, the Division will introduce the prior sworn statements of the following individuals: Linda Abel, Gale Bebo, Bill Bell, William Bowen, Amber Brake, Kristin Cherry, Stacy Cromer, Sara Hamm, Mike Jacksic, Sean Lahr, Joshua Lindsey, Susan Martin, Rick Parker, Mike Reed, Jennifer Schertz, Io Schug, Kevin Schweer, Nicholas Welter, and Lynn Wolfgram. The prior sworn statements of Gale Bebo, Kevin Schweer, and Nicholas Welter that the Division will introduce are portions of their deposition transcripts that address their attendance at the Ventas facilities.

Respectfully submitted:

Dated: March 13, 2015

Benjamin J. Hanauer
Daniel J. Hayes
Timothy J. Stockwell
Scott B. Tandy
Division of Enforcement
U.S. Securities and Exchange Commission
175 West Jackson Blvd, Suite 900
Chicago, IL 60604
Phone: 312-353-8642
Email: hanauerb@sec.gov

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16293

In the Matter of

LAURIE BEBO, and
JOHN BUONO, CPA,

Respondents.

CERTIFICATE OF SERVICE

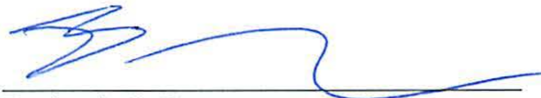
Benjamin J. Hanauer, an attorney, certifies that on March 13, 2015, he caused a true and correct copy of the foregoing The Division of Enforcement's List of Potential Witnesses to be served on the following by overnight delivery and email:

Honorable Cameron Elliot
Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2557

Mark Cameli, Esq.
Reinhart Boerner Van Deuren S.C.
1000 N. Water Street, Suite 1700
Milwaukee, WI 53202

Patrick S. Coffey, Esq.
Whyte Hirschboeck Dudek S.C.
161 N. Clark St., Suite 4700
Chicago, IL 60601

Dated: March 13, 2015



Benjamin J. Hanauer
Division of Enforcement
U.S. Securities and Exchange Commission
175 West Jackson Blvd, Suite 900
Chicago, IL 60604
Phone: 312-353-8642
Fax: 312-353-7398
Email: hanauerb@sec.gov

Preliminary Report

of

John Barron, CPA, CFE

SECURITIES AND EXCHANGE COMMISSION

In the matter of Laurie Bebo, Administrative Proceeding File No. 3-16293

March 13, 2015

Table of Contents

I. Scope of the engagement 1
II. Qualifications 2
III. Overview 2
A. Assisted Living Concepts 2
B. Summary of findings 3
IV. Ventas Lease 6
A. Parties to the lease 6
B. Summary of the Ventas lease 6
C. ALC's accounting for the lease transaction 6
D. Properties subject to the lease 7
E. Financial covenants of the lease, Section 8.2.5 7
F. Financial Statements and Reporting requirements, Section 25 8
G. Events of default 9
H. Remedies available to Ventas upon the occurrence of an event of default 9
I. ALC disclosed that it was in compliance with the Ventas occupancy and coverage ratio covenants and that it did not believe there was a reasonable likelihood of breaching those covenants in the foreseeable future 10
J. ALC's statements on the impact of non-compliance with lease covenants on its operations 10
V. ALC's process for inclusion of employees in Ventas lease covenant calculations 10
A. Summary of ALC's procedures 10
B. The number of employees added was determined based on what was needed to comply with the Ventas lease covenants 12
C. Ms. Bebo provided the names of the employees needed to meet the covenants 13
D. Recording of revenue related to employees added to occupancies 14
E. Declaration of John Buono 15
VI. Materiality of the potential consequences of a default on the Ventas lease 16
A. Professional and regulatory guidance on materiality 16
B. Quantitative materiality thresholds 17
C. Grant Thornton's materiality calculations 18
D. Effect of default under the Ventas lease on ALC's reported net income 18
E. Effect of default on other financial statement measures 19
F. Conclusions with respect to materiality 20
VII. Effect of excluding employee occupancy and revenues on covenant compliance 23
A. My methodology 23
B. Number of employees added 23
C. Minimum average occupancies at quarter end 24

D. Minimum average occupancies for the trailing twelve months 25
E. Number of employees that were needed to meet the occupancy covenants 26
F. Coverage ratios 26
VIII. Failure to provide GAAP-compliant financial information 27
A. Requirement to provide financial information in accordance with GAAP 27
B. GAAP revenue recognition criteria 27
C. Employee revenue failed to meet the GAAP criteria for revenue recognition 28
IX. ALC's failure to maintain effective internal controls 29
A. ALC management reported that its internal controls over financial reporting were effective 29
B. SEC rules regarding record keeping and internal controls 29
C. The COSO internal control framework (the "COSO framework") 30
D. Internal controls deficiency with respect to inclusion of employees in covenant calculations 31
X. Summary of opinions 32
EXHIBIT A 33

I. Scope of the engagement

1. I have been retained by the Division of Enforcement of the United States Securities and Exchange Commission ("SEC") in connection with the SEC's administrative proceedings instituted against Laurie Bebo in her role as Chief Executive Officer of Assisted Living Concepts, Inc. ("ALC").

2. On January 1, 2008, ALC entered into an agreement with Ventas Realty Limited Partnership ("Ventas") in which ALC leased a portfolio of eight facilities from Ventas. The lease required ALC to meet certain covenants related to occupancy and the ratio of cash flow to certain fixed obligations ("coverage ratio"). In the fourth quarter of 2008, ALC began including employees in its covenant calculations both with respect to occupancy and coverage ratio.

3. From the inception of the lease through December 31, 2011, ALC reported to Ventas and in its SEC filings that it was in compliance with the lease covenants.

4. I have been asked to specifically assess the following matters:

    - Whether a default by ALC on its lease with Ventas was material to ALC's financial statements for the years ended December 31, 2009, 2010, and 2011, and for each of the quarters in 2009, 2010, and 2011;

    - The effects that ALC's inclusion of employees as occupants had on ALC's covenant calculations under the Ventas lease;

    - Whether the financial information furnished by ALC to Ventas, including the statements of income of the individual tenant entities, was prepared and presented in accordance with generally accepted accounting principles ("GAAP"); and

    - The sufficiency of internal controls maintained by ALC in connection with its determinations of compliance with the Ventas lease covenants, including ALC's inclusion of employees in the covenant calculations.

5. The Division of Enforcement has provided me with the audit working papers prepared by Grant Thornton for the years ended December 31, 2009, 2010 and 2011, transcripts of investigative testimony of ALC, Ventas, and Grant Thornton personnel, and related exhibits, emails, and other correspondence. In addition, I have reviewed filings by ALC with the SEC. The principal documents I relied upon in forming my opinions are cited throughout my preliminary report. This preliminary report contains my opinions based on information known to me as of the date of the report.

II. Qualifications

6. I am a graduate of the University of Florida with a Bachelor's Degree in Business Administration and a major in Accounting. Upon graduation I joined the Atlanta office of the firm of Haskins & Sells which later became Deloitte & Touche ("Deloitte"). I left Deloitte in 1976 and joined a private real estate investment firm as chief financial officer and later became chief operating officer. I rejoined the Atlanta office of Deloitte in 1987 as a senior audit manager and was admitted to the partnership in 1990. I transferred to the New York office of Deloitte in 1998 and retired from the firm in 2003.

7. During my career at Deloitte, I served as the engagement partner on numerous audits and interim reviews of SEC registered entities and oversaw the auditing services related to several securities registrations and initial public offerings. I served as a member of Deloitte's national practice office review team and the accounting industry peer review team, prior to the establishment of the PCAOB inspection process.

8. In 2003, I joined the firm of Marks Paneth where I served as a Director in the Litigation and Corporate Advisory Services Group until April 2014. Since April 2014, I have served as a Senior Advisory Consultant at Marks Paneth. Marks Paneth is a firm of approximately 350 professionals providing accounting, auditing, income tax, and consulting services. In addition to my work in the litigation services group at Marks Paneth, I have supervised several audit engagements and provided consulting in technical accounting areas to other audit engagements.

9. From 2008 through 2012, I was an adjunct professor of accounting and auditing at the Zicklin School of Business of Baruch College, City University of New York, teaching undergraduate courses in auditing, financial reporting and managerial accounting.

10. Exhibit A is a list of the proceedings in which I have provided testimony.

III. Overview

A. Assisted Living Concepts

11. Assisted Living Concepts, Inc. ("ALC" or the "Company") was formed in 1994 and became an independent publicly traded entity on November 10, 2006. ALC's shares were listed on the New York Stock Exchange. The Company's headquarters were located in Menomonee Falls, Wisconsin. At December 31, 2011, ALC operated 211 senior living centers located in 20 states totaling 9,325 units.[1]

12. The Company's consolidated statements of operations for the three years ended December 31, 2009, 2010, and 2011 are summarized below (in thousands of dollars):

[1] 2011 Form 10-K.

	2009	2010	2011
Revenues	228,723	233,128	234,452
Expenses:			
Operations	142,048	139,689	136,659
General and adminstrative	13,515	15,080	13,361
Residence lease expense	20,044	19,846	17,686
Depreciaation and amoritization	21,219	22,806	23,103
Goodwill impairment	16,315		
Interest expense	7,343	7,782	8,151
Other than temporary impairement		2,026	
Other - net	94	(34)	(968)
Total expenses	220,578	207,195	197,992
Income before income taxes	8,145	25,933	36,460
Income tax expense	7,343	9,449	12,100
Loss from discontinued operations	957		
Net income (loss)	(155)	16,484	24,360

13. The Company's consolidated balance sheets at December 31, 2009, 2010, and 2011 are summarized below (in thousands of dollars):

	2009	2010	2011
Total current assets	21,380	33,256	20,271
Property and equipment, net	415,454	437,303	430,733
Intangible assets, net	11,812	10,193	9,028
Other assets	6,723	4,352	4,021
Total assets	455,369	485,104	464,053
Current liablities	35,958	34,060	36,005
Long-term debt	119,914	129,661	85,703
Deferred income taxes	13,257	20,503	23,961
Other long-term liablities	13,269	11,621	10,664
Total liabilities	182398	195845	156333
Total stockholders's equity	272,971	289,259	307,720
Total liabilities and stockholders' equity	455,369	485,104	464,053

B. Summary of findings

14. The remedies available to Ventas in the event of a default by ALC included: (1) termination of the lease including termination of ALC's right to continue to operate the properties, and (2) a requirement for ALC to make a payment to Ventas equal to the present value of the remaining lease payments. If Ventas were to have terminated the lease, ALC would also have been required to immediately write-off any remaining unamortized intangible assets associated with the lease.

15. The effects of the remedies available to Ventas on ALC's financial statements for the years ended December 31, 2009, 2010, and 2011 compared with reported amounts were approximately as follows (in millions of dollars):

	2009	2010	2011
Effect of default on income statements			
Present value of lease payments[2]	24.7	20.9	16.7
Unamortized intangible assets[3]	10.3	9.6	8.9
Total before income taxes	35.0	30.5	25.6
Income tax effect[4]	(15.9)	(11.9)	(9.9)
Decrease in net income	19.1	18.6	15.7
Amounts reported by ALC[5]			
Net income (loss)[6]	(0.16)	16.5	24.4
Cash flows from operating activities	44.0	46.2	54.67
Total stockholders' equity	272.9	289.3	307.7

16. Typically, for publicly held entities an effect on net income of between 5% and 10% is considered material to the financial statements taken as a whole. The effects of the remedies available to Ventas in the event of default represented approximately 112% and 64% of ALC's reported net income for 2010 and 2011, respectively. After adjusting ALC's reported net loss of $155,000 in 2009 for the goodwill impairment charge of $16.3 million taken in that year, the effect of the remedies available to Ventas represented approximately 118% of the adjusted net income amount.[7]

17. The effects of the remedies on ALC's net income represented from 5% to 7% of ALC's total stockholders' equity at the end of each year. In my experience, an amount from 1% to 2% of stockholders' equity is normally considered to be material to the financial statements.

---

[2] These amounts were disclosed in the Future Liquidity and Capital Resource sections of the Company's annual reports on Form 10-K

[3] Notes to financial statements for the years ended December 31, 2009, 2010, and 2011. These amounts are approximate and exclude the residency relationship and non-compete agreement intangibles.

[4] The statutory federal income tax rate for all three years was 35%. The statutory state income rate, net of the federal income tax benefit, was 10.4% in 2009 and was 4% in both 2010 and 2011. Accordingly, a combined rate of 45.4% was applied for 2009 and a combined rate of 39% was applied for 2010 and 2011. 2011 Form 10-K, page F-27.

[5] Financial statements included in ALC's Form 10-K for the years ended December 31, 2009, 2010, and 2011.

[6] The net loss reported by ALC for the year ended December 31, 2009 included a $16.3 million goodwill impairment charge. Without this charge, ALC would have reported net income of approximately $16.1 million. 2011 Form 10-K, page F-4.

[7] Net loss of $155,000 with impairment charge of $16.3 million added back equals approximately $16.1 million compared with the decrease in net income of $19.1 million.

18. From the standpoint of the effect on cash flows, the payment of the present value of the remaining lease obligation would have represented from 30% to 56% of the cash flows from operating activities reported by ALC during the years ended December 31, 2009, 2010, and 2011.

19. Based on my professional experience and the relevant professional and SEC guidance on the subject, it is my opinion that an event of default resulting from a failure by ALC to meet the covenants of its lease with Ventas was material to ALC's financial statements for each of the years ended December 31, 2009, 2010, and 2011, and for each of the fiscal quarters included in those years.

20. Without the inclusion of employees in the lease covenant calculations, ALC failed certain of the occupancy and coverage ratio covenants in every quarter during each of the three years ended December 31, 2009, 2010, and 2011.

21. The number of employees added to the covenant calculations was determined based on what was needed to satisfy the lease covenants. Generally, ALC accounting personnel calculated the number of employees and associated revenue needed each quarter to satisfy the covenants. The names of the employees to be added were determined by ALC's CEO Laurie Bebo.

22. Pursuant to the lease, on a quarterly basis, ALC provided Ventas with quarterly and trailing twelve-month income statements for each of the eight tenant entities (the Ventas facilities) as well as combined amounts for the portfolio as a whole. Along with the income statements, ALC management provided certifications to Ventas that the income statements had been prepared in accordance with GAAP. The amounts reported in these income statements included revenues associated with employees that had been added for purposes of meeting the covenant calculations. These revenues failed to meet the GAAP requirements for revenue recognition.

23. I understand that whether and to what extent Ventas agreed to the inclusion of employees in the occupancy and coverage ratio covenant calculations is in dispute. Assuming that Ventas had not agreed to the inclusion of employees, there was an absence of internal controls in place that would have been effective in preventing or detecting the inclusion of employees without Ventas's approval or agreement.

24. Assuming that Ventas had agreed that ALC could include employees in the lease covenant calculations, there was an absence of effective internal controls in place to provide reasonable assurance that the employees and associated revenue included in the covenant calculations were accurate based on actual or anticipated employee attendance at the facilities, or some other criteria.

25. As a result, the Company failed to maintain a system of internal controls that provided reasonable assurance that ALC's financial statements were fairly presented in accordance with GAAP as required by Exchange Act Section 13(b)(2).

IV. Ventas Lease

A. Parties to the lease

26. The lease dated January 1, 2008 was between Ventas Realty, Limited Partnership, as Landlord, and the following separate legal entities, all of which were ALC subsidiaries or affiliates, as "Tenants:" ALC CVMA, LLC; ALC GGMG, LLC; ALC HTIF, LLC; ALC PEDG, LLC; ALC TPCG, LLC; ALC TISSC, LLC; ALC TSKG, LLC; and ALC WRWG, LLC.

B. Summary of the Ventas lease

27. ALC purchased the operations of a prior Ventas lessee, the company previously doing business as CaraVita, which had been the operator of what are referred to as the eight CaraVita properties.[8] In connection with the purchase, Ventas and ALC entered into a new lease agreement.[9] Properties subject to the Lease are referred to herein either as the CaraVita properties, Ventas facilities, tenant facilities, or properties subject to the Ventas lease.

28. The lease agreement was described in ALC's 2008 financial statements as follows:

> *CaraVita lease agreement*
>
> On January 1, 2008, a wholly owned subsidiary of ALC acquired the operations of eight assisted and independent living residences consisting of a total of 541 leased units for a purchase price including fees and expenses of $14.8 million. The lease has an initial term expiring in March 2015 with three five-year renewal options. Aggregate minimum rent payments for the remainder of the initial lease term (years 2009 through 2015) are $5.1 million, $5.2 million, $5.3 million, $5.5 million, $5.6 million, $5.7 million and $1.4 million (three months), respectively. ...
>
> In connection with the lease, ALC guarantees certain performance and payment obligations, including minimum occupancy, net worth, and capital expenditures per residence levels and minimum fixed charge coverage ratios. Failure to comply with these covenants could result in events of default under the lease and the guaranty. At December 31, 2008, ALC was in compliance with all covenants.[10]

C. ALC's accounting for the lease transaction

29. ALC allocated the $14.8 million purchase price of CaraVita's operations as follows:[11]

- Operating lease intangible - $11.6 million

---

[8] January 7, 2008 Form 8-K.
[9] Amended and restated master lease agreement, Investigative Testimony Ex. ("Test. Ex.") 172 at VSEC0008706
[10] Form 10-K, year ended December 31, 2008, *Lease Commitments* Note to financial statements.
[11] 2008 Form 10-K. page F-20.

- Resident relationship intangible - $2.4 million
- Non-compete agreements - $0.3
- Vehicles and other - $0.5 million

D. Properties subject to the lease

30. The properties subject to the lease included the following:[12]

		Units[13]
CaraVita Village	Montgomery, AL	163
Greenwood Gardens	Marietta, GA	60
Highland Terrace	Inverness, FL	44
Peachtree Estates	Dalton, GA	61
Tara Plantation	Cumming, GA	62
The Inn at Seneca	Seneca, SC	43
The Sanctuary	Acworth, GA	56
Winterville Retirement Ctr.	Winterville, GA	51
		540

E. Financial covenants of the lease, Section 8.2.5

31. The lease required ALC to meet the following financial covenants throughout the term of the lease:

> <u>Coverage Ratio</u>. Tenant shall maintain a Coverage Ratio[14] with respect to each Facility for the 12 month period ending as of the end of each fiscal quarter of not less than 0.8 to 1.0.
>
> <u>Portfolio Coverage Ratio</u>. Tenant shall maintain a Portfolio Coverage Ratio[15] for the 12 month period ending as of the end of each fiscal quarter of not less than 1.0 to 1.0.

---

[12] Lease agreement, VSEC0008699-0008869; GT-SEC 020134.

[13] The ALC Portfolio Coverage Compliance Worksheet, prepared as of September 30, 2008, indicated that CaraVita Village had 164 available units and that the Cara Vita properties were comprised of a total of 541 available units. Test Ex. 22, ALC00073644.

[14] The term Coverage Ratio is defined to mean the ratio of (i) Cash Flow of any Facility for the applicable period, to (ii) the sum of the Fixed Rent payments allocated to the Facility, and all other debt service of the Tenant which owns the Facility and lease payments (other than Fixed Rent) payable by such Tenant relating to the Facility, for the applicable period. Cash Flow is defined as net income reflected in the income statement of the Tenant, plus the provisions for: (i) depreciation and amortization; (ii) management fees; (iii) income taxes; (iv) Fixed Rent and interest and lease payments; minus (v) an imputed management fee equal to 6% of gross revenues of such Facility, and minus (vi) a replacement reserve of $300 per licensed bed at such Facility per year. Test. Ex. 172. "Exhibit B, Definitions."

Minimum Average Occupancy. As of the end of each fiscal quarter, the minimum average occupancy rate (i) for the quarter then ended for each Facility shall be greater than or equal to 65%, (ii) for the trailing 12 months then ended (1) for each Facility shall be greater than or equal to 75% and (2) for all Facilities in aggregate shall be greater than or equal to 82%.

F. Financial Statements and Reporting requirements, Section 25

32. ALC was required to maintain books and records in accordance with GAAP "reflecting the financial affairs of each Tenant and the results of each Facility"[16] and to provide Ventas with annual statements of income for each Tenant on a property-by-property basis.[17] The Lease provided that "all accounting terms not otherwise defined herein have the meanings assigned to them in accordance with GAAP."[18]

33. ALC was required, on a quarterly basis, to furnish Ventas with the covenant calculations and statements of income for each tenant on a property-by-property basis, as well as:[19]

- "a breakdown of Patient Revenues[20] and other revenues itemized by payor type and a reasonably detailed breakdown of operating expenses;"[21]
- "patient census information by payor type;"
- "a statement in reasonable detail showing the calculation of Net Operating Income for each Facility for the trailing four fiscal quarters ...;"
- "a then current occupancy report for each 'Facility;'" and
- "a report describing in reasonable detail the occurrence during such quarter of any event that is reasonably likely to result in a material adverse effect on the ability of Tenant to perform any material provision of this Lease ..."

34. Together with the delivery of the information described in the above paragraph, ALC was required to provide an "Officer's Certificate" to Ventas certifying the covenant

---

[15] Portfolio Coverage Ratio is defined as the ratio of (i) the Cash Flow for all Facilities to (ii) the sum of Fixed Rent and all other debt service of the Tenants, and lease payments (other than Fixed Rent) payable by any Tenant relating to the Facilities. Id.

[16] Id., Section 25.1, "Maintenance of Books and Records."

[17] Id., Section 25.2, "Annual Financial Information."

[18] Id., Section 2.1, "Definitions".

[19] Id., Section 25.3, "Quarterly Financial Information".

[20] The lease defines Patient Revenues as "primarily derived from services provided to patients (including, without limitation, revenues received or receivable for the use of or otherwise by reason of all rooms, beds, and other facilities provided ...) ...." Id., EX. B.

[21] Operating Expenses include all costs and expenses related to the operation, maintenance, repair, use and management of the leased properties but excluding. (i) Fixed Rent, (ii) depreciation amortization and other non-cash expenses, and (iii) capital expenditures. Id.

calculations and stating that the financial statements of each "Tenant"[22] had been prepared in accordance with GAAP.[23] The following is an example of paragraph 1 of an Officer's Certificate:

> The attached quarterly financial statements of Tenant have been prepared in accordance with GAAP (except as the absence of notes) and are complete and accurate to the best of the Tenant's knowledge, subject to normal year end adjustments, and show the separate operations of each Leased Property, including without limitation, (a) a breakdown of Patient Revenues and other revenues itemized by payor type and a reasonably detailed breakdown of Operating Expenses and (b) patient census information by payor type.[24]

G. Events of default

35. The lease provided that the occurrence of either of the following constituted and event of default:[25]

- Failure to observe covenants or agreements pursuant to sections 8.1.1, 8.2.5 (Financial Covenants), or Section 8.3; or

- Failure to observe or perform reporting obligations set forth in section 25.

H. Remedies available to Ventas upon the occurrence of an event of default

36. Ventas's remedies in the event of default by ALC included the following:

- Termination of the Lease including termination of ALC's right of possession;[26] and

- Payment by ALC to Ventas of: (1) any unpaid rent due at the time of lease termination, and (2) the net present value of the rent for the remaining term of the lease.[27]

37. ALC's 2008 Form 10-K included the following description of default and cross-default provisions in its lease agreements:

> In addition, our leases contain financial and operating covenants and cross default provisions. Breaches of certain lease covenants could give the landlord the right to require us to pre-pay future lease payments, write off our related assets and replace us

[22] The Lease had eight separate tenants, one for each property. In this case, the term "Tenant" referred collectively to each of the individual tenants. See for example, the Officer's Certificate dated July 11, 2008. (ALC00070490-00070492)
[23] Test. Ex. 172, Section 25.4 and Exhibit D.
[24] ALC00070491.
[25] Test. Ex 172, Section 17, "Default."
[26] Id., Section 17.2.1, "Remedies Generally."
[27] Id., Section 17.4, "Damages."

with new operators. The realization of any of these scenarios could have an adverse effect on our financial condition and capital structure. Further, because our mortgages and leases generally contain cross-default and cross-collateralization provisions, a default by us related to one residence could affect a significant number of residences and their corresponding financing arrangements and leases. (Emphasis added)

I. ALC disclosed that it was in compliance with the Ventas occupancy and coverage ratio covenants and that it did not believe there was a reasonable likelihood of breaching those covenants in the foreseeable future

38. Throughout 2009, 2010 and 2011 ALC disclosed in the MD&A[28] sections of its annual filings on Form 10-K and quarterly filings on Form 10-Q that it was in compliance with the occupancy and coverage ratio covenants in the Ventas lease. ALC included the same disclosure in the Notes to its financial statements included in its filings on Forms 10-K during this three year period.

39. In addition, the MD&A section of the Company's annual report on Form 10-K for the year ended December 31, 2011 and the Form 10-Q for the second and third quarters of 2011 contained the following statement regarding the risk of breaching the Ventas lease covenants:

> Based upon current and reasonably foreseeable events and conditions, ALC does not believe that there is a reasonably likely degree of risk of breach of the CaraVita covenants.[29]

J. ALC's statements on the impact of non-compliance with lease covenants on its operations

40. For each period in 2009, 2010, and 2011, the MD&A sections of ALC's annual reports on Form 10-K and quarterly reports on Form 10-Q disclosed the present value of the remaining lease obligations that ALC would be required to pay Ventas in the event of default and included the following statement:

> ... The acceleration of the remaining obligation and loss of future cash flows from operating those properties could have a material adverse impact on our operations. ... (Emphasis added)

V. ALC's process for inclusion of employees in Ventas lease covenant calculations

A. Summary of ALC's procedures

41. The quarterly packages ALC submitted to Ventas included the Officer's Certificate of compliance; financial statements of the Company and each of the facilities (including

---

[28] MD&A refers to "Management's Discussion and Analysis of Financial Condition and Results of Operations."

[29] Page 43 of 2011 Form 10-K.

income statements), schedules of average occupancies, and covenant calculations.[30] The assemblage of the packages, including the covenant calculations contained therein, was performed by ALC accounting personnel: Robin Herbner (from 2008 through August 2009),[31] Sean Schelfout (from August 2009 through December 2010),[32] Daniel Grochowski (From December 2010 to November 2011), and John Buono (November 2011 to February 2012).[33]

42. Information in the packages sent to Ventas was reviewed by John Buono who signed the officer's certificates.[34]

43. ALC used a system called TIPS to track occupancies. The standard practice for calculating occupancy for the covenant calculations was to take the information from TIPS with respect to the number of occupied units at each property adjusted for "companions or cut outs"[35] and divide the adjusted number of occupants by the number of units from the lease agreement. The calculation was based on a weighted average of the number of days for each quarter.[36]

44. Grant Thornton's audit working papers described the following occupancy and patient revenue related controls:

> Maintain a current resident roster on file that accurately reflects occupancy in a house at any given time.[37]
>
> Residency agreements are on file and signed by the residents ... Rate update letters are on file to support the current rates being charged to residents ... Invoicing of residents, application of payments, and issuance of credits are functions which are processed and controlled at Corporate.[38]

45. Beginning with the fourth quarter of 2008, when ALC began experiencing difficulties meeting the Ventas lease covenants, ALC began including employees in the occupancy and coverage ratio calculations.[39] Ms. Herbner, Mr. Schelfout, and Mr. Grochowski generally determined the number of additional occupants (employees) and revenues

---

[30] Herbner Test. Tr. 48:17-49:13. Test. Ex 13.
[31] Ms. Herbner took maternity leave in August 2009 and "never really came back to ALC." (Herbner, 53:23-54:3).
[32] Schelfout Test. Tr. 22:6-23:15.
[33] John Buono took over the responsibilities from Mr. Grochowski after November 2011. Grochowski Test. Tr., 12:25-13:6, 15:5-22, 30:24-31:5, 55:2-18.
[34] Herbner Test. Tr. 49:1-51:5; Grochowski Test. Tr. 23:24-24:8.. Ms. Herbner's successor, Sean Schelfout, testified that no one other than John Buono reviewed the packages before it went to Ventas. Schelfout Test. Tr. 22:6-23:15.
[35] The companion and cut out adjustments are not at issue in this case.
[36] Herbner Test. Tr. 147:16-148:6.
[37] GT-SEC 025233.
[38] GT-SEC 025234.
[39] Ms. Herbner testified that ALC first began having difficulties complying with the Ventas lease covenants toward the end of 2008. The difficulties began with the occupancy covenants and later the coverage covenants also became problematic. (Herbner Test. Tr. 52:16-53:18)

needed to meet the covenants each quarter and communicated this information to either Mr. Buono or Ms. Bebo.[40]

46. It was generally Ms. Bebo who determined the names of employees to be added. (See paragraph 53 below)

47. Revenues were recorded for the employees added to the lease covenant calculations based on an average daily rate for each of the specific properties.[41] The employee revenue amounts were recorded by journal entries increasing revenue for each of the tenant facilities. The journal entries recorded an offsetting negative revenue amount in a corporate revenue account, thus eliminating the revenue from ALC's consolidated financial statements.[42]

B. The number of employees added was determined based on what was needed to comply with the Ventas lease covenants

48. Ms. Herbner testified that at the direction of John Buono, beginning late in 2008, she began including employees in the covenant calculations in order to meet covenant requirements and, over time, there "continued to be more and more employee stays"[43]

Q: Did the process for meeting the occupancy calculations change over time from picking up nickels to something else?
A: Yeah. So, in the beginning it was picking up nickels, and then it was the employee stays were introduced as, you know, meeting, as being a way to meet the covenants. And then, at my time at ALC, that continued to get, there just continued to be more and more employee stays.[44]

49. Ms. Herbner's testimony indicates that ALC "backed into" the number of employees to be included in the covenant calculations. Ms. Herbner would first determine how many additional employees were needed to meet the covenants with the names of employees to later be provided either directly by Laurie Bebo or from Ms. Bebo through Mr. Buono:

Q: How would they determine the number of people that needed to be added?
A: I was asked to do projections fairly routinely. And I would tell John how many people we needed to have in order to meet the requirements.[45]

Q: Was the process that you would say, we need this many employees and then John, or you would just tell John you need this many employees to meet the coverage requirements and John Buono would say, all right, let's book the revenue for those

[40] Schelfout Test. Tr. 26:13-17, 53:17-54:18, 150:15-151:4; Herbner Test. Tr. 69:20-70:1, 84:2-7, 88:11-15, 178:10-13; Grochowski Test. Tr. 31:19-25.
[41] Schelfout Test. Tr. 54:2-8.
[42] Ferreri Test. Tr. 9:7-11:21, 11:22-12:18, 16:18-18:9.
[43] Herbner Test. Tr. 53:9-57:15.
[44] Herbner Test. Tr. 54:5-13.
[45] Herbner Test. Tr. 57:4-13.

number of employees and we'll get the names from Laurie, something along those lines? Is that generally what happened?

A: Yeah, I would do the calculations, tell John how we were short. We would make revenue adjustments and then I would work with, I would either send an e-mail directly to Laurie to get the names or work with John. In some cases John sent the e-mail to Laurie to get the names."[46]

Q: Okay. And how did the topic arise?

A: In the May [2009] time frame, I was doing some projections where I knew that we would fall short of the covenants, and additional individuals would need to be put into the calculations. And so, I reached out to John to get names. And John had to, he had to turn around and ask Laurie for names. And there was an e-mail exchange where he was requesting names from Laurie for these additional, you know, individuals. ...[47]

(Emphasis added)

50. The testimony of Sean Schelfout, Ms. Herbner's successor, is consistent with that of Ms. Herbner:

Q: Did anyone ever explain to you the purpose of including employees?

A: When Robin transferred the process to me, you know I mean, it was pretty evident that it was, we were using it to back in to meet [the covenant] calculation.[48]

(Emphasis added)

51. Mr. Grochowski testified that he determined the number of employees needed to meet the covenants based on changes in actual occupancies and provided the information to Mr. Buono.[49]

52. Mr. Grochowski testified that he was directed to exclude from the package of information sent to Ventas the schedule he used in determining the employees included in the covenant calculation.[50]

C. Ms. Bebo provided the names of the employees needed to meet the covenants

53. Ms. Bebo testified that it was generally the accounting staff who determined the number of employees needed to meet the covenants and that she decided which names to add:

Q: Okay, but at the end of the day, you're the one that's providing the list of employee names to the accounting people for them to use in the occupancy calculations.

A: Most of the time, yes. I'm the one who provides new names most of the time.[51]

[46] Herbner Test. Tr. 256:4-16.

[47] Herbner Test. Tr. 111:18-112:5.

[48] Schelfout Test. Tr. 26:13-17. See also Schelfout, 150:15-151:4.

[49] Grochowski Test. Tr. 25:22-26:17, 28:7-17.

[50] Grochowski Test. Tr. 17:2-18:11, 21:9-20.

[51] Bebo Test. Tr. 698:16-21.

54. Ms. Herbner, Mr. Schelfout, Mr. Grochowski and Mr. Buono likewise stated that Ms. Bebo furnished the names for the employees needed to meet the covenant requirements.[52]

D. Recording of revenue related to employees added to occupancies

55. Mr. Grochowski testified that the amount of additional revenue needed to meet the lease covenants was determined as follows:

> Q: And so after you received the names back and the number for the month from John Buono, the spreadsheet that said ALC 177088 would calculate the amount of revenue that each facility would need to have recognized, or need to have booked for the month in association with the employees included in the covenant calculations?
> A: Correct.[53]
>
> Q: And when you saw the list of names such as the one in Exhibit 297 it was your understanding that the employees listed were to be included as occupants for the purpose of the covenant calculations?
> A: Correct, and occupants in terms of the occupancy covenants and <u>there was also a revenue allocation that was associated with those employees that went into the journal entry which inflated the revenue from these facilities, which helped make the coverage ratios.</u>[54] (Emphasis added)

56. ALC Assistant Comptroller, Anthony Ferreri, was instructed to post journal entries prepared by the ALC accounting staff recording revenue associated with the employees included in the covenant calculations.[55] The journal entries recorded revenue for the employees at the individual facility level and an offsetting negative revenue amount at a corporate level account commonly referred to as the "997 account."[56]

57. Mr. Ferreri testified that the revenue was recorded for internal purposes only and eliminated in connection with ALC's public financial reporting:

> Q: And generally speaking, how did those journal entries operate? What was their purpose?
> A: The purpose was to recognize revenue on the Ventas properties and there's a, a however to this in that the, the overall financial statements were not supposed to have recognized revenue in total. So there was an, an offsetting or negative revenue entry on a separate entity so that was reported, basically, as a, an inter-company transaction.

---

[52] Herbner Test. Tr. 111:18-112:5, 218:19-221:14, 256:4-16; Grochowski Test. Tr. 28:18-30:1; Schelfout Test. Tr. 73:3-10, 132:20-133:1; John Buono declaration, paragraph 10.
[53] Grochowski Test. Tr. 31:19-25.
[54] Grochowski Test. Tr. 25:12-21.
[55] Ferreri Test. Tr. 9:7-11:21.
[56] Ferreri Test. Tr. 16:18-18:9.

Q: So you called the Ventas journal entries would recognize revenue internally on the financial statements of the properties that were leased from Ventas?
A: That is correct.

Q: But, on an overall ALC level or in consolidation it would be eliminated through a negative revenue entry in some form of corporate account?
A: That is correct.

Q: Corporate reserve account?
A: Yes, sir.

Q: And was there a name for that account that people generally used to call it at ALC?
A: The, the entity or, or location was entity 997.[57]

58. Mr. Ferreri testified that the journal entry to record employee revenue was in the nature of an intercompany transaction, with revenue recognized on the financial statements of the tenants (the Ventas facilities). Normally, intercompany transactions between affiliates are recorded on the books (general ledger) of each entity with a two-sided entry. If this had been the case with ALC, the tenant entities would have recorded revenue and an intercompany receivable from ALC, while ALC would have recorded expense and an intercompany payable to the tenant entities. However, I have seen nothing to indicate that ALC maintained separate general ledgers for the tenant entities. This leads me to conclude that the journal entries described by Mr. Ferreri were recorded only on the books of ALC as revenue with offsetting negative revenue, without intercompany balances on the books of ALC or the tenant entities. As discussed below, this is significant with respect to one of the two GAAP criteria for revenue recognition requiring payment of cash or a claim to cash.

E. Declaration of John Buono

59. The following statements made by John Buono in his December 16, 2014 declaration are consistent with the testimony of Ms. Herbner, Mr. Schelfout, Mr. Grochowski, and Mr. Ferreri:

> On a quarterly basis, ALC accounting staff informed me of the number of personnel needed to be included in the calculations to remain in compliance with the Ventas financial covenants. Ms. Bebo determined the identity of the personnel to be added to the Ventas facilities for purposes of the covenant calculations.[58]
>
> Based on Ms. Bebo's instruction to include ALC personnel in the covenant calculations, I directed my staff, on a quarterly and/or monthly basis, to: (a) ascertain the number of additional occupants and the amount of additional revenue necessary to meet the financial covenants; (b) determine the number of ALC personnel (and the

[57] Ferreri Test. Tr. 11:22-12:18.
[58] Buono declaration, paragraph 10.

attendant revenue) to be included in the covenant calculations; and (c) prepare journal entries crediting revenue associated with the ALC personnel to the individual Ventas facilities and debiting revenue in the same amount in a corporate revenue account. On certain occasions, I initialed the journal entry before it was recorded.[59]

On multiple occasions, Ms. Bebo told me that ALC was not going to fail the occupancy covenants under any circumstances.[60]

VI. Materiality of the potential consequences of a default on the Ventas lease

A. Professional and regulatory guidance on materiality

60. The underlying principal of materiality with respect to financial statements is an item that would influence the decision making of persons relying on the financial statements. Specifically, the Financial Accounting Standards Board ("FASB") defines materiality as the "magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."[61] It is also understood that amounts that might not be material based on quantitative factors could be material based on qualitative considerations. The FASB has addressed the issue in two of its Statements of Financial Accounting Concepts:

> ... Materiality judgments are primarily quantitative in nature. They pose the question: Is this item large enough for users of the information to be influenced by it? However, the answer to that question will usually be affected by the nature of the item; items too small to be thought material if they result from routine transactions may be considered material if they arise in abnormal circumstances.[62] (Emphasis added)
>
> Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.[63] (Emphasis added)

61. The SEC has issued guidance on materiality in Staff Accounting Bulletin No. 99, *Materiality* ("SAB 99"). The SEC's guidance emphasizes that a quantitative benchmark

---

[59] Buono declaration, paragraph 11.
[60] Buono declaration, paragraph 19.
[61] FASB Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*, ("CON 2"), Glossary of Terms.
[62] CON 2, paragraph 123.
[63] FASB Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, ("CON 8"), paragraph QC11. CON 8 was issued September 2010 and superseded CON 2.

such as 5% of net income is a starting point before consideration of qualitative factors, pointing out that matters that are not material quantitatively may be material on a qualitative basis.

> The use of a percentage as a numerical threshold, such as 5%,[64] may provide the basis for a preliminary assumption that – without considering all relevant circumstances – a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material. The staff has no objection to such a "rule of thumb" as an initial step in assessing materiality. But quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations. Materiality concerns the significance of an item to users of a registrant's financial statements. A matter is "material" if there is a substantial likelihood that a reasonable person would consider it important. (Emphasis added)
>
> * * *
>
> As a result of the interaction of quantitative and qualitative considerations in materiality judgments, misstatements of relatively small amounts that come to the auditor's attention could have a material effect on the financial statements. (Emphasis added)
>
> Among the considerations that may well render material a quantitatively small misstatement of a financial statement item are – (Emphasis added)
>
> * * *
>
> - whether the misstatement changes a loss into income or vice versa[65] (Emphasis added)

B. Quantitative materiality thresholds

62. The effect on net income is generally considered the most relevant quantitative criteria in determining materiality for a public entity, with a range between 5% and 10% of net income the most commonly used quantitative threshold. In cases in which an entity is at or near breakeven, alternative measures such as the effect on stockholders' equity or operating cash flows may also be considered relevant. In addition, to the extent that the reported net income includes significant items that are considered to be unusual or infrequently occurring, the materiality calculation may be adjusted for such unusual items.

---

[64] This section of the interpretive response addressed a question raised about the materiality of a misstatement which resulted in a 4% overstatement of net income. The question was whether the registrant and the auditor could conclude that the misstatement was not material because it did not exceed 5% of net income.
[65] SAB 99, *Topic 1: Financial Statements, M. Materiality, 1. Assessing Materiality.*

63. In order to detect errors that are material to the financial statements based on a percentage of net income, auditors typically plan the audit based on income before income taxes. Then, if an error is detected it is adjusted for the income tax expense or benefit. Accordingly, if an item exceeds a materiality threshold on a pre-tax income basis, it will typically exceed the same materiality threshold on a net income basis.

C. Grant Thornton's materiality calculations

64. For audit planning purposes, Grant Thornton considered an entity's earnings (excluding abnormal or unusual items such as impairment write-downs) as the appropriate materiality benchmark for a public entity. Grant Thornton based its audit planning materiality calculations for ALC on 5% of reported income before income taxes after first adding back what it considered to be unusual charges.[66] To determine the effect on net income, any error detected by Grant Thornton would have been adjusted by the effective income tax rate, with the goal of detecting an error equal to or greater than 5% of net income. Based on this approach, Grant Thornton's materiality assessments for its audits of ALC's financial statements for the years ended December 31, 2009, 2010, and 2011, based on annualized pre-tax amounts adjusted for unusual items through the third quarter of each year, were as follows:[67]

- 2009 - $1,153,000[68]
- 2010 - $1,195,000[69]
- 2011 - $1,727,000[70]

65. Grant Thornton's approach for determining audit planning materiality with a goal of detecting errors equaling or exceeding 5% of net income is consistent with my experience as an audit partner. The potential effects of a default by ALC under the terms of the Ventas lease ranged from $35 million in 2009 to $25.6 million in 2011, which far exceeded Grant Thornton's planning materiality thresholds, indicating the materiality of the potential effects of a default to ALC's financial statements.

D. Effect of default under the Ventas lease on ALC's reported net income

66. The effects of the remedies available to Ventas on ALC's reported net income compared with reported net income or loss were approximately as follows for each of the years ended December 31, 2009, 2010, and 2011 (in millions of dollars):

[66] For the purposes of determining materiality, Grant Thornton added back impairments of goodwill, capital lease assets, and other than temporary impairment of investments. GT-SEC022505, 026450, 030822.

[67] Grant Thornton compared the interim calculations to amounts based on year-end balances and in each case the interim calculations were not changed as they were approximately the same as the annual amounts.

[68] GT-SEC 022505.

[69] GT-SEC 026450.

[70] GT-SEC 030822.

Effect of default on income statements	2009	2010	2011
Present value of lease payments[71]	24.7	20.9	16.7
Unamortized intangible assets[72]	10.3	9.6	8.9
Total before income taxes	35.0	30.5	25.6
Income tax effect[73]	(15.9)	(11.9)	(9.9)
Decrease in net income	19.1	18.6	15.7
Net income (loss) reported by ALC	(0.16)	16.5	24.4

67. The effects of the remedies available to Ventas in the event of default represented approximately 112% and 64% of ALC's reported net income for 2010 and 2011, respectively. After adjusting ALC's reported net loss of $155,000 in 2009 for the goodwill impairment charge of $16.3 million taken in that year, the effect of the remedies available to Ventas represented approximately 118% of the adjusted net income amount.[74]

68. Even if 100% of the all amounts considered by Grant Thornton to be unusual were added back to reported net income, the effect of a default would have ranged from approximately 64% to approximately 109% of adjusted net income.[75]

E. Effect of default on other financial statement measures

69. The effects of the remedies available to Ventas on ALC's reported net income represented from 5% to 7% of ALC's total stockholders' equity at the end of each year. In my experience, an amount from 1% to 2% of stockholders' equity is normally considered to be material to the financial statements (in millions of dollars):

[71] These amounts were disclosed in the Future Liquidity and Capital Resource sections of the Company's annual reports on Form 10-K.

[72] Notes to financial statements for the years ended December 31, 2009, 2010, and 2011. These amounts are approximate and exclude the residency relationship and non-compete agreement intangibles.

[73] The statutory federal income tax rate for all three years was 35%. The statutory state income rate, net of the federal income tax benefit, was 10.4% in 2009 and was 4% in both 2010 and 2011. Accordingly, a combined rate of 45.4% was applied for 2009 and a combined rate of 39% was applied for 2010 and 2011. 2011 Form 10-K, page F-27.

[74] Net loss of $155,000 with impairment charge of $16.3 million added back equals approximately $16.1 million compared with the decrease in net income of $19.1 million.

[75] Grant Thornton added back goodwill impairment of $16.3 million and a capital lease impairment of $1.4 million in 2009 and added back an other than temporary impairment of investments of $2 million in 2010. GT-SEC022505, 026450, 030822.

	2009	2010	2011
Total stockholders' equity	272.9	289.3	307.7
Decrease in net income	19.1	18.6	15.7
Percentage effect	7.00%	6.40%	5.10%

70. The effect of a payment of the present value of the remaining lease obligations would have represented from approximately 30% to 56% of cash flows from operating activities reported by ALC in each year (in millions of dollars):

	2009	2010	2011
Cash flows from operating activities	44.0	46.2	54.67
Present value of lease payments	24.7	20.9	16.7
Percentage effect	56%	45%	30%

F. Conclusions with respect to materiality

71. In my experience as an auditor, an item's effect on net income is generally considered the most relevant quantitative measure in determining its materiality to the financial statements of a public entity. A range from 5% to 10% of net income is the most commonly used threshold for determining materiality. In this case, the effect of a default on ALC's reported net income ranged from 64% to 109%, even if certain unusual charges against net income were first added back to net income.

72. In circumstances in which the effect of an item on net income or loss is considered less meaningful,[76] common alternative measures include the effect of an item on an entity's cash flows or its stockholders' equity. In this case, the effects of the cash payment of the present value of the remaining lease obligations would have ranged from 30% to 56% of the operating cash flows reported by ALC during the years ended December 31, 2009, 2010, and 2011. The effects of a default on net income, including both the present value of the remaining lease payments and the write-off of the intangible assets would have ranged from 5% to 7% of reported stockholders' equity. Both of these effects were well above a normal quantitative threshold for materiality.

73. As provided in the guidance discussed above in paragraphs 60 and 61 , matters whose impact on the financial statements is less than a quantitative threshold may, nevertheless, be material depending on their qualitative nature. For instance, in ALC's case, the potential losses associated with an event of default would have been material in 2009 and 2010 using qualitative, as well as quantitative, factors. In 2010, the potential losses from a default would have exceeded the net income reported in that year, which would have

[76] For example, this might be the case when an entity is reporting an amount at or near breakeven.

changed the reported profit in that year to a loss. For 2009, the potential loss from a default would have changed what was essentially a breakeven year to net loss of approximately $19 million.

74. From the perspective of the individual components of the potential loss, the effect of the smallest individual amount (the $8.9 million write-off of the unamortized intangible asset in 2011, adjusted for a 39% income tax effect), represented approximately 15% of reported net income ($5.4 million divided by $36.4 million). Moreover, the larger figures associated with the remaining lease payments ($16.7 - $24.7 million) would have represented an even greater percentage of reported net income. The individual components of the potential loss would also each have been material in relation to shareholder equity. Specifically, the write-off of the leasehold intangible assets of $8.9 million in 2011, adjusted for income taxes, was the smallest item individually and represented approximately 1.76% of stockholders' equity at December 31, 2011,[77] which is within the 1% to 2% range generally considered to be material to the financial statements. Accordingly, I consider these effects – in combination or in isolation – to be material to the financial statements.

75. Based on my professional experience and the professional and regulatory guidance on the issue, it is my opinion that the impact on ALC's financial statements of an event of default under the terms of the Ventas lease with respect to each individual component of loss (the present value of lease payments and the intangible asset write-off), and the total loss, was material to the Company's consolidated financial statements for each of the years ended December 31, 2009, December 31, 2010, and December 31, 2011 and for each of the quarters in the three years.[78]

76. The amounts discussed in paragraphs 66 through 68 above represent potential losses to ALC based on what Ventas was entitled to do under the terms of the lease in the event of default by ALC. It is my understanding that there are requirements in the law for persons who have suffered damages to take reasonable actions to mitigate the loss suffered. It is not possible for me to take such, or other, potential outcomes into account in reaching a conclusion with respect to the materiality of potential losses in accordance with the terms of the Ventas lease. It is, however, my opinion that an event of default was material to the financial statements of ALC even if all possible eventualities were uncertain. Due to the significance of the potential consequences, both individually and in combination, a reasonable person relying on ALC's financial statements would have considered an event

[77] $8.9 million minus the tax effect of $3.5 million would have represented approximately 1.76% of total stockholders' equity at December 31, 2011 of $307.7 million.

[78] I reviewed the quarterly financial information for each quarter during the three years ended December 31, 2011 and, with the exception of the first quarter of 2009, found the quarterly amounts of income to be significantly less than the annual amounts. Thus, the effects of a default as a percentage of the income statement amounts would have been greater in each of the quarters than for the annual amounts, and thus were material. The same is true with respect to cash flows from operating activities. Moreover, even for the first quarter of 2009, a default would have been material to that quarter's financial statements. The total potential loss from a default under the Ventas lease of December 31, 2010 of $30.5 million represented approximately 260% of ALC's Q1'09 pre-tax loss of $11.7 million. Form 10-Q, March 31, 2009.

of default important and influential. Thus, an event of default was material based on the guidance of the SEC and the FASB (see paragraphs 60 and 61 above).

77. As it turned out, ALC's settlement of Ventas' lawsuit in 2012 confirms the materiality of a default of the lease covenants. Specifically, after Ventas filed a claim against ALC in 2012 for alleged violations of the lease agreement,[79] the parties reached a settlement involving ALC's purchase of twelve properties.[80] In connection with that purchase, ALC recognized $47.2 million of losses in its 2012 financial statements which included: (1) $34.4 million based on the purchase price of the properties in excess of their appraised values; (2) the $3.1 million write-off of unamortized leasehold improvements; (3) the $8.7 million write-off of the unamortized leasehold intangible; and (4) transactions costs of $1 million.[81] The total losses recognized by ALC of $47.2 million (adjusted for the income tax effect of approximately $18.1 million[82]) reduced net income by approximately $29.1 million representing approximately 111% of ALC's reported net loss of $26.1 million for the year ended December 31, 2012.[83] With respect to the individual components of the loss, each was independently material to ALC's 2012 financial statements. Specifically, the $34.4 million loss associated with the purchase price in excess of fair value, adjusted for income taxes, represented approximately 80% of ALC's reported net loss for 2012.[84] The $8.7 million write-off of the leasehold intangible assets in 2012, adjusted for income taxes, represented approximately 20% of ALC's reported net loss for 2012,[85] and approximately 1.9% % of ALC's total stockholders' equity at December 31, 2012.[86]

---

[79] The Company's May 9, 2012 filing on Form 8-K disclosed that Ventas instituted a lawsuit on April 26, 2012 alleging that ALC had breached its obligations under the lease due to ALC's receipt of notices from state regulators revoking its licenses to operate three of the properties. The 8-K filing also disclosed that on May 9, 2012, ALC received a letter from Ventas asserting that ALC had "submitted fraudulent information by treating units leased to employees as bona fide rentals by third parties and, therefore, may not have been in compliance with the minimum occupancy covenant and coverage ratio covenants."

[80] ALC purchased the eight CaraVita properties from Ventas along with four other properties leased by ALC from MLD Delaware Trust ("MLD"). Based on ALC's May 9, 2012 filing on Form 8-K, ALC believed that Ventas had previously acquired the lease between MLD and ALC in connection with Ventas's merger with Nationwide Health Properties and that an event of default under the Ventas lease may have constituted an event of default under the MLD lease.

[81] In connection with its settlement of the complaint, ALC purchased twelve residences comprised of 696 units for a purchase price of $97 million in addition to a $3 million litigation settlement fee and payment of Ventas's litigation expenses. The twelve residences included eight residences purchased from Ventas subject to the January 1, 2008 lease and four residences subject to a January 1, 2002 lease with MLD Delaware Trust. The preliminary estimated value of the acquired properties totaled approximately $62.6 million, approximately $34.4 million less than the purchase price. (2012 Form 10-K, pages F-4, F-16, F-27, and F-28)

[82] ALC's statutory income tax rates for 2012 were 35% for federal and 3.4% for state, after the federal income tax benefit for a combined statutory rate of 38.4%. 2012 Form 10-K, page F-32.

[83] $47.2 - $18.1 = $29.1 / $26.1 net loss = 111%. 2012 Form 10-K, page F-4.

[84] $34.4 million less the 38.4% income tax effect of $13.2 million for an after tax effect of $21.2 million. $21.2 / $26.1 = 81%.

[85] $8.7 million less the 38.4% income tax effect of $3.3 million for an after tax effect of $5.4 million. $5.4 / $26.1 = 20.6%.

[86] After tax effect of $5.4 million divided by stockholders' equity at December 31, 2012 of $277.6 million. 2012 Form 10-K

VII. Effect of excluding employee occupancy and revenues on covenant compliance

A. My methodology

78. The Division of Enforcement provided me with the electronic worksheets with embedded formulas used by ALC to make the covenant calculations with respect to each quarter of 2009, 2010, and 2011. These worksheets included the following:[87]

- Monthly occupancy reconciliations, including employee and other adjustments, and calculations of quarterly average occupancies for each of the Ventas facilities;

- Detailed monthly and trailing twelve month income statements for each of the Ventas facilities including employee revenue reported for each facility; and

- Quarterly and trailing twelve month calculations of occupancy and coverage ratios as of the end of each fiscal quarter.

79. I copied each of the electronic worksheets used by ALC, deducted employees and employee related revenues from the worksheets, and recalculated the coverage ratios and occupancies to determine whether ALC met the covenant requirements.

B. Number of employees added

80. The following table shows the average number of employees included in the covenant compliance calculations each quarter.[88] For purposes of the covenant calculations, ALC's general practice was to consider each employee an occupant for every day of the quarter based on an average of the three months in the quarter:[89]

[87] ALC00044149, 00044263, 00044321, 00044406, 00044564, 00044766, 00044861, 00100613, 00103235, 00115506, 00121389, 00126317, 00140655; GT-SEC 00173593, 00493433.
[88] Blank spaces on the table indicate that employees were not included for the quarter at issue.
[89] The number of employees added for each quarter was based on an average of the monthly number of employees. For example, the 11.67 employees added for the Sanctuary at Northstar facility in Q2'10, was based on 14 employees in April, 12 employees in May, and 9 employees in June.

	Winterville Retirement	Greenwood Gardens	Highland Terrace	Peachtree Estates	Tara Plantation	The Inn at Seneca	CaraVita Village	Sanctuary at Northstar	Portfolio Total
Q1'09	10.00	1.00	-	10.00	-	-	3.00	-	24.00
Q2'09	10.15	1.02	-	10.15	-	-	3.05	-	24.37
Q3'09	10.00	5.32	8.32	10.00	11.00	3.26	7.33	8.32	63.53
Q4'09	14.00	12.00	10.00	12.00	14.00	15.00	12.00	14.00	103.00
Q1'10	14.00	11.00	10.00	12.00	14.00	15.00	12.00	14.00	102.00
Q2'10	10.35	11.00	10.00	12.00	14.00	15.00	12.99	11.67	97.01
Q3'10	4.00	6.00	7.35	12.00	10.00	11.00	15.00	4.00	69.35
Q4'10	4.00	6.00	3.00	12.00	12.00	7.67	16.33	-	61.00
Q1'11	4.00	5.34	1.03	9.69	12.03	9.00	22.00	-	63.10
Q2'11	9.00	5.00	0.67	8.00	10.66	8.33	34.00	-	75.66
Q3'11	14.96	5.00	-	8.00	12.35	4.67	38.30	-	83.28
Q4'11	21.00	5.00	-	8.00	11.00	4.00	43.00	-	92.00

C. Minimum average occupancies at quarter end

81. The lease required minimum average quarterly occupancy rates of 65% for each facility. As shown in the table below, without the employees that were included as occupants, ALC would have failed the requirements for at least one facility in every quarter of 2009, 2010, and 2011:[90]

[90] Blank spaces on the table indicate that, without the inclusion of employees, occupancy at the facility was not below the 65% threshold for the quarter at issue.

	Winterville Retirement	Highland Terrace	Peachtree Estates	Tara Plantation	The Inn at Seneca	CaraVita Village	Sanctuary at Northstar
Q1'09	62.6	-	-	-	-	-	-
Q2'09	58.5	-	-	-	-	-	-
Q3'09	54.3	63.2	-	-	-	-	-
Q4'09	50.8	56.9	-	57	60.2	-	64.1
Q1'10	59.3	58.4	-	62.8	58.4	-	-
Q2'10	-	-	64.8	64.6	60.2	-	-
Q3'10	-	-	62.1	-	60.4	-	-
Q4'10	-	-	64.8	60.9	-	63.9	-
Q1'11	-	-	-	60	-	62.8	-
Q2'11	-	-	-	-	-	55.5	-
Q3'11	50.4	-	-	-	-	55.3	-
Q4'11	45.4	-	-	-	-	54.2	-

D. Minimum average occupancies for the trailing twelve months

82. As of each quarter end, the lease required minimum average occupancy for the trailing twelve months of not less than 75% for each facility and not less than 82% for all facilities in the aggregate. As shown in the table below, without the employees that were included as occupants, ALC would have failed the individual facility requirement for at least two facilities in every quarter of 2009, 2010, and 2011, and failed the portfolio requirement for every quarter except the first quarter of 2009:[91]

	Winterville Retirement	Greenwood Gardens	Highland Terrace	Peachtree Estates	Tara Plantation	The Inn at Seneca	CaraVita Village	Sanctuary at Northstar	Portfolio Total
Q1'09	74.7	-	-	71.6	-	-	-	-	-
Q2'09	68.7	-	-	71.3	-	-	-	-	80.4
Q3'09	62.8	-	-	70.5	-	-	-	-	76.9
Q4'09	56.5	74.1	74.4	70	71.2	-	73.9	72.1	72.3
Q1'10	55.7	72.2	66.1	68.5	65.7	-	71.1	71.1	68.9
Q2'10	59.8	71	61.7	65.5	62.6	67	69.6	71.4	66.9
Q3'10	68.5	71.2	64.1	64.6	63.4	59.8	68.6	-	67.5
Q4'10	-	72	71.2	64.2	64.4	63.6	66.8	-	69.5
Q1'11	-	71.1	-	66.7	63.7	65.9	64.9	-	70.4
Q2'11	-	70.9	-	70	66.2	69.2	62.1	-	71.1
Q3'11	70	72.4	-	74.1	68.2	-	59.4	-	71.4
Q4'11	59.5	-	-	-	72.2	-	56.9	-	71

[91] Blank spaces on the table indicate that, without the inclusion of employees, occupancy at the facility was not below the 75% and 82% thresholds for the quarter at issue.

E. Number of employees that were needed to meet the occupancy covenants

83. The following table shows the shortfall in the number of occupants needed for each day of the current and prior three quarters to meet the trailing twelve month occupancy requirement for each facility (75%) and the portfolio (82%). In other words, without the inclusion of employees, ALC would have needed the following number of additional occupants, for *each day of the current and prior three quarters*, to satisfy the occupancy covenants. This table does not include the additional number of employees needed to meet the coverage ratio covenants.[92]

	Winterville Retirement	Greenwood Gardens	Highland Terrace	Peachtree Estates	Tara Plantation	The Inn at Seneca	CaraVita Village	Sanctuary at Northstar	Portfolio Total
Q1'09	0.16	-	-	2.09	-	-		-	-
Q2'09	3.23	-	-	2.23	-	-		-	8.85
Q3'09	6.24	-	-	2.75	-	-		-	27.64
Q4'09	9.44	0.54	0.27	3.02	2.38	-	1.73	1.64	52.19
Q1'10	9.86	1.70	3.91	3.94	5.80	-	6.33	2.20	70.82
Q2'10	7.75	2.37	5.84	5.77	7.69	3.45	8.77	1.99	81.44
Q3'10	3.32	2.29	4.81	6.32	7.17	6.53	10.39	-	78.30
Q4'10	-	1.83	1.69	6.57	6.56	4.92	13.38	-	67.41
Q1'11	-	2.35	-	5.04	7.00	3.91	16.43	-	62.40
Q2'11	-	2.46	-	3.03	5.47	2.50	21.02	-	58.97
Q3'11	2.54	1.55	-	0.55	4.20	-	25.49	-	57.42
Q4'11	7.89	-	-		1.76	-	29.47	-	59.20

F. Coverage ratios

84. With respect to the twelve month period ending as of the end of each fiscal quarter, the lease required ALC to maintain coverage ratios of 0.80 to 1.0 for each facility and 1.0 to 1.0 for the portfolio as a whole. As shown in the table below, without the revenue from employees, ALC would have failed the coverage ratio requirements for one or more properties in all four quarters of 2009, 2010, and 2011.[93] In addition, without the revenue

[92] Blank spaces on the table indicate that additional occupants were not needed to meet the covenants for the quarter at issue.

[93] Blank spaces on the table indicate that revenue associated with additional occupants was not needed to meet the covenants for the quarter at issue.

from employees, ALC would have failed the portfolio coverage ratio beginning with the fourth quarter of 2009 and each quarter in 2010 and 2011.

	Winterville Retirement	Highland Terrace	Peachtree Estates	Tara Plantation	Portfolio Total
Q1'09	0.69	-	0.7	-	-
Q2'09	0.58	-	0.77	-	-
Q3'09	0.49	-	-	-	-
Q4'09	0.39	0.76	-	-	0.97
Q1'10	0.32	0.57	-	0.65	0.86
Q2'10	0.3	0.33	-	0.59	0.77
Q3'10	0.38	0.32	-	0.59	0.77
Q4'10	0.49	0.55	-	0.59	0.84
Q1'11	0.61	0.66	-	0.55	0.89
Q2'11	0.62	-	-	0.53	0.93
Q3'11	0.49	-	-	0.51	0.92
Q4'11	0.37	-	-	0.57	0.91

VIII. Failure to provide GAAP-compliant financial information

A. Requirement to provide financial information in accordance with GAAP

85. For purposes of demonstrating compliance with the coverage ratio covenants, ALC submitted income statements for each of the eight facilities which included detailed breakdowns of revenues and operating expenses. As discussed in paragraph 32, the Ventas lease required that these statements be prepared in accordance with GAAP. As discussed below, the revenues reported by ALC to Ventas associated with employees failed to meet the revenue recognition criteria of GAAP.

B. GAAP revenue recognition criteria

86. The FASB Accounting Standards Codification (the "FASB Codification")[94] provides the following criteria for recognition of revenue: [95]

> The recognition of revenue and gains of an entity during a period involves consideration of the following two factors, with sometimes one and sometimes the other being the more important consideration:

[94] The Financial Accounting Standards Board (FASB) established the Codification as a source of authoritative GAAP, providing that "all guidance contained in the Codification carries an equal level of authority." The Codification became effective for financial statements of nongovernmental entities issued for interim and annual periods ending after September 15, 2009. However, it was the FASB's view that the Codification did not change GAAP. FASB Statement No 168, "The *FASB Accounting Standards Codification* and the Hierarchy of Generally Accepted Accounting Principles,"

[95] Codification section 605-10-25-1.

a. **Being realized or realizable.** Revenue and gains generally are not recognized until realized or realizable. Paragraph 83(a) of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, states that revenue and gains are realized when products (goods or services), merchandise, or other assets are exchanged for cash or claims to cash. That paragraph states that revenue and gains are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash.

b. **Being earned.** Paragraph 83(b) of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, states that revenue is not recognized until earned. This paragraph states that an entity's revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. That paragraph states that gains commonly result from transactions and other events that involve no earnings process, and for recognizing gains, being earned is generally less significant that being realized or realizable.

C. Employee revenue failed to meet the GAAP criteria for revenue recognition

87. I have been asked to address whether the income statements that were provided by ALC to Ventas, as they related to recognition of revenue, were prepared in accordance with GAAP. Ostensibly, the employee revenues reported to Ventas would have represented transactions between the individual tenant entities and ALC.

88. It is my understanding that the employee transactions reflected as revenues in the income statements of the tenants did not involve an exchange of cash between the tenant entities and ALC. Further, there is nothing to indicate that the transactions resulted in the tenant entities having a claim to cash or holding an asset readily convertible to cash. Although intercompany transactions might not always be settled in cash, I could find no evidence of an intercompany account receivable or payable recorded between the tenant entities and ALC which might have represented a claim to cash. Accordingly, the "realized or realizable" criterion discussed above was not satisfied.

89. Unlike the residency agreements between ALC and its tenants referred to in paragraph 44 above, I found no evidence of an oral or written arrangement between the tenant entities and ALC setting forth the specific nature and terms of the goods or services to be rendered in connection with employee revenues reported in the income statements of the tenant entities. As a result, there was no evidence to show that the tenant entities had substantially accomplished what they were required to do in order to be entitled to the benefits represented by the revenues. For this reason, ALC did not meet the "earned" criteria as defined in GAAP.

90. In order to comply with GAAP, the employee revenue transactions were required to meet both criteria for revenue recognition (being realized or realizable and being earned). The employee revenues reported by ALC to Ventas failed to satisfy either of these GAAP criteria.

91. ALC's inclusion of revenue associated with employees in the tenant financial statements furnished to Ventas in contravention of GAAP masked ALC's failure to satisfy the coverage ratio covenants.[96]

IX. ALC's failure to maintain effective internal controls

A. ALC management reported that its internal controls over financial reporting were effective

92. ALC's annual reports on Form 10-K disclosed that management, including the CEO and CFO, was responsible for establishing and maintaining adequate internal control over the Company's financial reporting as defined in Rules 13a-15(f) under the Securities Exchange Act. Management assessed the effectiveness of the Company's internal controls over financial reporting based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), *Internal Control—Integrated Framework*, concluding that as of December 31, 2009, 2010, and 2011, the Company's controls over financial reporting were effective.

B. SEC rules regarding record keeping and internal controls

93. Exchange Act Sections 13(b)(2)(B) and 13(b)(5) include the following provisions with respect to internal controls:

> §13(b)(2)(b) Every issuer which has a class of securities registered pursuant to section 781 of this title and every issuer which is required to file reports pursuant to section 780(d) of this title shall—
>
> (A) 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;
>
> (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—
>
> (i) transactions are executed in accordance with management's general or specific authorization;
> (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any

[96] The certifications required by the lease referred to coverage ratios "based upon Cash Flow for all of the Facilities ..." Test. Ex. 172. VSEC0008848.

other criteria applicable to such statements, and (II) to maintain accountability for assets;
(Emphasis added)

***

§13(b)(5) No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2).
(Emphasis added)

C. The COSO internal control framework (the "COSO framework")

94. The COSO framework upon which the Company's assessment of internal controls over financial reporting was based includes five components of internal control over financial reporting:

- *Control Environment* - The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors. (Emphasis added)

- *Risk Assessment* - ... Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. ...

- *Control Activities* - Control activities are the policies and procedures that help ensure management directives are carried out. ... Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties. (Emphasis added)

- *Information and Communication* - .... All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators and shareholders. (Emphasis added)

- *Monitoring* - Internal control systems need to be monitored-a process that assesses the quality of the system's performance over time. ... Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities ... Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.
  (Emphasis added)

95. With respect to the control environment and integrity and ethical values, the COSO framework provides that management's preferences and style "reflect management's integrity and its commitment to ethical values:"

    An entity's objectives and the way they are achieved are based on preferences, value judgments and management styles. Those preferences and value judgments, which are translated into standards of behavior, reflect management's integrity and its commitment to ethical values.

D. Internal controls deficiency with respect to inclusion of employees in covenant calculations

96. Information included in the TIPS system tracking patients and residents at each facility was reconciled with ALC's financial reporting system.[97] Occupancies reported in the TIPS system and financial reporting systems were supported by current resident rosters and residency agreements.[98]

97. Unlike the system-generated information related to patient and resident occupancies and revenues, employee occupancies and associated revenues included in ALC's lease covenant calculations were based upon what was needed to satisfy the covenants. The inclusion of employees as well as the determination of the names to be included and the number of days to be included was done under the direction of Ms. Bebo, the Company's president and CEO and without effective internal controls.

98. Even assuming that Ventas had agreed to the inclusion of employees, there were no controls in place that provided reasonable assurance that the number and names of employee additions were accurate. For example, there were no controls in place to determine: (a) that the employees added to the covenant calculations had stayed in the facilities or were anticipated to stay at the facilities for the periods indicated; (b) whether rooms had actually been set aside for the employees included in the calculations; or (c) whether Bebo's selection of names was appropriate under some other criteria.

99. Assuming that Ventas had not agreed to the inclusion of employees, in addition to the above control deficiencies, there was an absence of internal controls in place that would

[97] Unit information from the financial reporting system was reconciled with the TIPS system with differences generally related to move-ins and move-outs. (Herbner Test. Tr. 161:18-163:11)
[98] GT-SEC 025233-025234.

have been effective in preventing or detecting the inclusion of employees without Ventas's approval or agreement.

100. As discussed in section VI, the potential consequences of an event of default were material to the Company's financial statements and, as discussed in section VII, without the inclusion of employees in the covenant calculations, ALC would have failed to meet the occupancy and coverage ratio covenant requirements in each quarter of 2009, 2010, and 2011.

101. As a result, the absence of effective internal controls related to the inclusion of employees in the covenant calculations caused ALC to fail to maintain a system of internal controls as required by Exchange Act Section 13(b).

X. Summary of opinions

102. An event of default of the Ventas lease covenants was material to ALC's financial statements for each of the years ended December 31, 2009, 2010, and 2011 and for each of the quarters included in those years.

103. Without the inclusion of employees in the lease covenant calculations, ALC failed certain of the occupancy and coverage ratio covenants in every quarter during each of the three years ended December 31, 2009, 2010, and 2011.

104. The employee revenues included in the income statements provided by ALC to Ventas failed to meet the GAAP requirements for revenue recognition.

105. ALC failed to maintain a system of internal control that would provide reasonable assurance that ALC's financial statements were fairly presented in accordance with generally accepted accounting principles as required by Exchange Act Section 13(b).

John Barron, CPA CFE

EXHIBIT A

<u>Prior testimony of John Barron</u>

Confidential PCAOB proceeding in a matter involving the auditor's evaluation of management's conclusion regarding the need to record certain losses and management's conclusion concerning the going concern assumption, testified at hearing November 2013.

In the matter of John J. Aesoph, CPA and Darren M. Bennett, CPA, testified at SEC administrative proceeding October 2013.

Ohio Public Employees Retirement System and State Teachers Retirement System of Ohio, v. Federal National Mortgage Association, United States District Court, District of Columbia, testified at deposition February 1-2, 2011

In the matter of Gerard A. M. Oprins and Wendy McNeeley, CPA, testified at SEC Administrative Proceedings on July 28 and 29, 2010

Comet Systems, Inc. Shareholders' Agent P v. MIVA, Inc., Court of Chancery of Delaware, testified at deposition, February 27, 2008

CILP Associates L.P. and Cohen Pooled Assets L.P. v. Lipper Convertibles, L.P. and PriceWaterhouse Coopers, U.S. District Court, Southern District of New York, testified at deposition December 31, 2006

Richard P. Friedman and SIGS Publications, Inc. v. Ralph Anderson, Rockaway Partners, and Eisner LLP, State Supreme Court, State of New York, County of New York, testimony at deposition on March 8, 2006

MSDW 140 Broadway Property, L.L.C. v. Brown Brothers Harriman & Co.,
New York, New York American Arbitration Association, testimony at deposition on May 24, 2005

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16293

In the Matter of LAURIE BEBO, and JOHN BUONO, CPA, Respondents.	CERTIFICATE OF SERVICE

Benjamin J. Hanauer, an attorney, certifies that on March 13, 2015, he caused a true and correct copy of the foregoing Preliminary Report of John Barron, CPA, CFE to be served on the following by overnight delivery and email:

Honorable Cameron Elliot
Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2557

Mark Cameli, Esq.
Reinhart Boerner Van Deuren S.C.
1000 N. Water Street, Suite 1700
Milwaukee, WI 53202

Patrick S. Coffey, Esq.
Whyte Hirschboeck Dudek S.C.
161 N. Clark St., Suite 4700
Chicago, IL 60601

Dated: March 13, 2015

Benjamin J. Hanauer
Division of Enforcement
U.S. Securities and Exchange Commission
175 West Jackson Blvd, Suite 900
Chicago, IL 60604
Phone: 312-353-8642
Fax: 312-353-7398
Email: hanauerb@sec.gov

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
CHICAGO REGIONAL OFFICE
SUITE 900
175 WEST JACKSON BOULEVARD
CHICAGO, ILLINOIS 60604

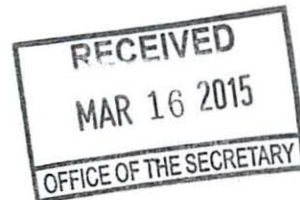
BENJAMIN J. HANAUER
SENIOR TRIAL COUNSEL
DIVISION OF ENFORCEMENT

TELEPHONE: (312) 353-8642
FACSIMILE: (312) 353-7398

March 13, 2015

VIA UPS NEXT DAY AIR

Brent J. Fields, Secretary
Office of the Secretary
Securities and Exchange Commission
100 F. Street, N.E.
Washington D.C. 20549



Re: ***In the Matter of Laurie Bebo and John Buono, CPA***
(AP File No. 3-16293)

Dear Mr. Fields:

Enclosed for filing in the above-referenced matter please find the original and three copies of *The Division of Enforcement's List of Potential Witnesses,* the *Preliminary Report of John Barron, CPA, CFE*, and the related Certificates of Service.

Sincerely,

Benjamin J. Hanauer

Enclosures

Copies to: Hon. Cameron Elliot, ALJ
Mark Cameli, Esq.
Patrick Coffey, Esq.