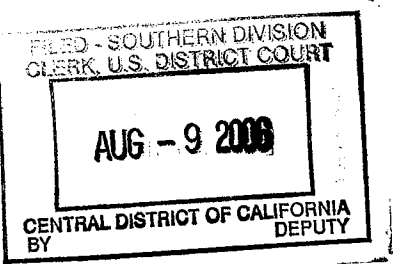


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9 **UNITED STATES DISTRICT COURT**
10 **FOR THE CENTRAL DISTRICT OF CALIFORNIA**

11 **SECURITIES AND EXCHANGE**
12 **COMMISSION,**

13 **Plaintiff,**

14 **vs.**

15 **PAUL W. MIKUS and JOHN V.**
16 **CRACCHIOLO,**

17 **Defendants.**

Case No. **SACV06-734 JVS (MLGx)**
COMPLAINT

18
19 Plaintiff Securities and Exchange Commission ("Commission") alleges:

20 **JURISDICTION AND VENUE**

21 1. The Court has jurisdiction over this action pursuant to Sections 20(b),
22 20(d)(1), and 22(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§
23 77t(b), 77t(d)(1), and 77v(a), and Sections 21(d)(3)(A), 21(e), and 27 of the
24 Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78u(d)(3)(A),
25 78u(e), and 78aa. Defendants have, directly or indirectly, made use of the means
26 or instrumentalities of interstate commerce, of the mails, or of the facilities of a
27 national securities exchange, in connection with the transactions, acts, practices,
28 and courses of business alleged in this Complaint.

1 by at least 16% for 2001, 17% for the first quarter of 2002, and 33% for the second
2 quarter of 2002 as reported in the financial statements included in its periodic
3 filings. Endocare's financial statements also understated its pre-tax loss for 2001
4 by 20%, and it falsely reported pre-tax earnings for the first two quarters of 2002,
5 rather than properly reporting substantial pre-tax losses. Endocare's financial
6 statements for the third quarter of 2002 would have similarly contained
7 misstatements, but Endocare never filed its Form 10-Q for the third quarter of
8 2002, because its acting controller raised serious questions about Endocare's
9 accounting practices. Endocare also included a misleading consolidated income
10 statement for the third quarter of 2001 in an amended Form S-3 registration
11 statement that Endocare filed on November 14, 2001 to register an offering of
12 common stock, from which Endocare realized gross proceeds of \$78.2 million.
13 Furthermore, Endocare incorporated its inflated third quarter 2001 financial results
14 into another registration statement that it filed in March of 2002 for the issuance of
15 additional common stock.

16 7. After Endocare's acting controller raised questions about Endocare's
17 accounting practices, Endocare committed further securities laws violations in the
18 course of investigating the allegations. The company made misleading disclosures
19 in its Forms 8-K and its press releases. First, on December 19, 2002, Endocare
20 announced in a Form 8-K and press release the termination of the acting controller
21 for conduct "materially injurious to the company." Both Mikus and Cracchiolo
22 approved the Form 8-K and press release. One week before issuing the December
23 19 Form 8-K and concurrent press release, Endocare had disclosed that the
24 company's independent auditors, KPMG LLP, had concluded that KPMG could no
25 longer rely on the representations of management. The December 19 Form 8-K
26 and press release falsely implied that Endocare had terminated the bad actors
27 responsible for KPMG's concerns. The bad actors, however, included Mikus and
28 Cracchiolo, who remained at the company and who approved Endocare's

1 December 19 disclosure regarding termination of the acting controller. Second, on
2 March 11, 2003, Endocare issued a press release in which it announced that after
3 an independent investigation, the audit committee had concluded that there “was
4 no indication of fraud or intentional wrongdoing by management.” This statement
5 was false because the company had not conducted an “independent” investigation,
6 and because an internal review, in fact, had uncovered evidence suggesting
7 intentional manipulation. The company then filed a Form 8-K containing a similar
8 false and misleading statement. Mikus approved both the misleading press release
9 and the Form 8-K.

10 8. Mikus authorized, reviewed and/or signed Endocare’s false and
11 misleading filings, including Forms 10-Q for the second and third quarters of 2001
12 and for the first and second quarters of 2002, the Form 10-K for 2001, the Form S-
13 3 filed on November 14, 2001, the Form S-8 filed on March 26, 2002, and the
14 Forms 8-K filed on December 19, 2002 and March 14, 2003. Cracchiolo prepared,
15 reviewed, and/or signed the false and misleading filings, including Forms 10-Q for
16 the second and third quarters for 2001 and for the first and second quarters of
17 2002, the Form 10-K for 2001, the Form S-3 filed on November 14, 2001, the
18 Form S-8 filed on March 26, 2002, and the Form 8-K filed on December 19, 2002.

19 9. As alleged more specifically below, Mikus and Cracchiolo each
20 violated the antifraud, record-keeping, false statements to the auditors, books and
21 records, and internal controls provisions of the federal securities laws, and aided
22 and abetted Endocare’s violations of the reporting, record-keeping, and internal
23 controls provisions of the federal securities laws. By this complaint, the
24 Commission seeks an order permanently enjoining Mikus and Cracchiolo from
25 future violations of the federal securities laws, directing them to disgorge all their
26 ill-gotten gains and to pay civil penalties, and prohibiting them from serving as
27 officers or directors of publicly-traded companies.

1 **THE DEFENDANTS**

2 10. Paul W. Mikus, age 40, is a resident of Irvine, California. Mikus was
3 Endocare's president and chief executive officer from November 1995 through
4 March 2003. Mikus served as the chief financial officer of Endocare when the
5 company's shares first began trading in February 1996, and continued in that
6 position through 1997. Mikus also served as the company's chairman of the board
7 from November 1995 until September 23, 2003, when he resigned from the board.

8 11. John V. Cracchiolo, age 50, is a resident of Gardnerville, Nevada.
9 Cracchiolo was Endocare's chief operating officer and chief financial officer from
10 the time he joined Endocare in June 2001, until March 3, 2003, when he resigned
11 from these positions and became the president of Endocare's radiological
12 intervention business. Endocare terminated Cracchiolo effective July 31, 2003.
13 Cracchiolo is a certified public accountant, although his license has been inactive
14 since 1982.

15 **BACKGROUND**

16 **A. Endocare's Reporting Obligations**

17 12. Endocare, Inc. is incorporated in Delaware, with its principal place of
18 business in Irvine, California. Endocare's common stock is registered with the
19 Commission pursuant to Section 12(g) of the Exchange Act and, at all relevant
20 times, was listed on the Nasdaq Stock Market. Endocare's common stock
21 currently trades in the Over-the-Counter Bulletin Board.

22 13. As a public company, Endocare was required to comply with federal
23 statutes, rules, and regulations to maintain public trading of its stock and to sell its
24 securities to the public. These statutes, rules, and regulations required Endocare to,
25 among other things: (a) make and keep books, records, and accounts, which, in
26 reasonable detail, accurately and fairly reflected its transactions and dispositions of
27 assets; (b) devise and maintain a system of internal accounting controls sufficient
28 to provide reasonable assurances that the transactions were recorded as necessary

1 to permit preparation of financial statements in conformity with Generally
2 Accepted Accounting Principles (“GAAP”), or any other criteria applicable to such
3 statements and to maintain accountability for assets; (c) file with the Commission
4 accurate annual, current, and quarterly reports on the appropriate forms including a
5 financial statement containing the company’s balance sheet and statements of
6 income and cash flows prepared in conformity with GAAP; and (d) file with the
7 Commission periodic reports that did not make any untrue statement of material
8 fact or omit to state a material fact necessary in order to make the statements made,
9 in the light of the circumstances under which they were made, not misleading.

10 14. Pursuant to the Commission’s rules and regulations, Endocare
11 reported sales revenue and income for specific periods, such as at the end of each
12 quarter and the end of its fiscal year. Endocare used a calendar year as its fiscal
13 year. In 2001, Endocare’s first quarter ended March 31; its second quarter ended
14 June 30; its third quarter ended September 30; and its fourth quarter ended
15 December 31. In addition to filing annual and quarterly reports with the
16 Commission, Endocare also periodically issued press releases announcing its
17 earnings and held conference calls with securities analysts and investors to discuss
18 its financial performance. The earnings releases and conference calls usually
19 occurred after the end of a quarter and before Endocare filed its periodic reports
20 with the Commission.

21 **B. Applicable Accounting Rules**

22 15. By improperly booking false sales, engaging in improper revenue
23 recognition practices, and improperly understating or delaying Endocare’s
24 recognition of expenses, Mikus and Cracchiolo violated, and caused Endocare to
25 violate, numerous accounting rules that Endocare was obligated to follow. These
26 accounting rules are designed to ensure that financial information is accurately
27 recorded and publicly disclosed.

28 16. Under GAAP, which are the accounting conventions, standards, and

1 rules required for preparing financial statements, and the Commission's rules and
2 regulations, Endocare could recognize revenue from a sale during a particular
3 reporting period only if (1) persuasive evidence existed of a sales arrangement with
4 a customer; (2) delivery of the product had occurred; (3) the price for the product
5 was fixed or determinable; (4) collectibility of the sales price was reasonably
6 assured; and (5) Endocare had substantially performed all of its obligations to the
7 customer.

8 17. One of the accounting standards that governs the criteria that
9 companies must meet to properly recognize revenue is Financial Accounting
10 Standards Board Statement of Concepts No. 5 ("CON 5"). GAAP and, in
11 particular, CON 5 provide that it is not appropriate for a company to recognize
12 revenue before merchandise is exchanged for cash or claims to cash.

13 18. Another accounting standard that governs the criteria for revenue
14 recognition is Accounting Principles Board Opinion No. 29 ("APB 29"). APB 29
15 directs that the amount of revenue that a company can recognize from a non-
16 monetary asset that the company acquires in exchange for another non-monetary
17 asset is the fair value of the asset that the company surrendered. APB 29 also
18 requires that a company disclose material, non-monetary transactions in the
19 company's public filings.

20 19. Another accounting standard is Financial Accounting Standards
21 Board Statement No. 57 ("FAS 57"). FAS 57 states that a company's financial
22 statements shall include disclosures of transactions with related parties, if the
23 transactions are material.

24 20. Financial Accounting Standards Board Statement No. 48 ("FAS 48")
25 provides that revenue should not be recognized when the buyer's obligation to the
26 seller is contingent on resale of the product. FAS 48 also does not normally permit
27 a company to recognize revenue on a sale with a right of return. The only
28 exception to this rule exists when there is a history of such sales to provide a basis

1 for estimating the amount of future returns and if income is reduced to reflect the
2 estimated future returns by establishing a reserve for returned goods.

3 21. Two other accounting standards that govern the criteria companies
4 must meet, Accounting and Auditing Enforcement Release (“AAER”) No. 108 and
5 Staff Accounting Bulletin (“SAB”) No. 101, set forth certain criteria that must be
6 met to recognize revenue from “bill-and-hold” sales. Under GAAP, in order to
7 recognize revenue from sales in which the seller maintains inventory of the sold
8 goods (otherwise referred to as “bill-and-hold” sales), the transaction must satisfy
9 the following requirements: (1) the risks of ownership for the goods must have
10 passed to the buyer; (2) the customer must have made a fixed commitment to
11 purchase the goods, preferably reflected in written documentation; (3) the buyer,
12 not the seller, must have requested that the transaction be on a bill-and-hold basis,
13 and the buyer must have had a substantial business purpose for ordering the goods
14 on a bill-and-hold basis; (4) there must have been a fixed schedule for delivery of
15 the goods that was reasonable and consistent with the buyer’s business purpose; (5)
16 the seller must not have retained any specific performance obligations such that the
17 earnings process was not complete; (6) the ordered goods must have been
18 segregated from the seller’s inventory and not have been subject to being used to
19 fill other orders; and (7) the equipment must have been complete and ready for
20 shipment.

21 22. Finally, GAAP also requires that a company recognize expenses in
22 the period in which the company incurs liabilities for goods and services that are
23 expended either simultaneously with the purchase or soon after.

24 **C. Endocare’s Revenue Recognition Policies And “Record Revenue”**

25 **Trend**

26 23. According to Endocare’s public filings in 2001 and 2002, the
27 company’s revenue recognition policy required that revenue, including revenue
28 generated by Endocare’s sales to distributors, could be recognized once the boxes

1 and disposable cryoprobes were shipped, provided that the buyer's acceptance of
2 the product was assured and collectibility was probable.

3 24. In July 1999, Endocare obtained Medicare coverage for use of its box
4 in cryosurgery. Shortly thereafter, Endocare began reporting a consistent history
5 of "record revenue" growth quarter after quarter in its public filings, during its
6 conference calls with stock analysts, and in its press releases. Endocare's reported
7 revenue began to rise more significantly beginning in the first quarter of 2001,
8 increasing from \$2.8 million for the quarter ended March 31, 2001, to \$11.4
9 million for the quarter ended June 30, 2002.

10 **THE FRAUDULENT SCHEMES TO OVERSTATE**

11 **REVENUE IN 2001 AND 2002**

12 25. Before Endocare recognized revenue from the sale of one of its boxes,
13 the sale was approved by either Mikus or Cracchiolo. Mikus and Cracchiolo
14 indicated their approval by initialing the customer's purchase order. After the
15 purchase order was approved, it was then forwarded to Endocare's finance
16 department, which recorded the sale in the company's books and records. Since
17 1999, Endocare employees were required to use a template purchase order to
18 ensure that there were clear, unconditional terms as required by GAAP. The policy
19 of Endocare's finance department was to record revenue only if (1) there was an
20 unconditional purchase order; (2) the delivery requirements had been met; and (3)
21 the customer was creditworthy.

22 26. Despite Endocare's policies, in 2001 and 2002, Mikus and Cracchiolo
23 caused Endocare to fraudulently record and/or report revenue from the sales of its
24 boxes. Mikus and Cracchiolo perpetrated this fraud by engaging in improper
25 revenue recognition practices, which included (1) booking false sales to inflate
26 Endocare's revenue; (2) recognizing revenue on various contingent transactions,
27 including bill-and-hold sales and side agreements with contingent sales terms;
28 (3) making agreements that contained undisclosed financial incentives for

1 customers to purchase boxes; and (4) booking revenue on an improper non-cash
2 swap transaction.

3 **A. Endocare's False Sales to Inflate Revenue**

4 27. Endocare fraudulently recognized \$1,450,000 in revenue on three
5 false sales transactions, all of which were orchestrated or approved by Mikus. In
6 December 2001, Mikus called a physician in Celebration, Florida and asked him to
7 sign a purchase order for a box, telling him that Endocare needed additional box
8 revenue before the end of the year. After contacting the physician, Mikus
9 instructed Endocare's Southeast regional sales director that he should forward a
10 purchase order and side-letter agreement to the physician-customer. Endocare's
11 sales director copied Mikus on a December 26 email in which the sales director
12 attached the side letter to the physician. The side letter said that the Florida
13 physician was purchasing the unit "on behalf of a physician-owned company, of
14 which he is an investor" and that the "company is in the process of formation."
15 The side letter also stated that "Endocare will assist in the formation and resale of
16 the system into existing targeted or future partnerships" and that "[w]hen the
17 company is formed, [the physician] may transfer some or all ownership of this
18 system to the company."

19 28. The contingencies, which were set forth in the side letter, were not
20 included on the purchase order that Mikus approved. The purchase order was
21 submitted to Endocare's finance department, which recorded revenue for the
22 transaction. Endocare then shipped the box to an Endocare-controlled storage
23 facility in Florida, where it remained until September 2002. During KPMG's
24 review of Endocare's financial statements for the third quarter of 2002, the
25 physician in Celebration, Florida received a confirmation request, which was a
26 document asking the physician to confirm, in writing, what the physician owed
27 Endocare for the box. The physician was to return the confirmation request
28 directly to KPMG. Before the physician received the confirmation request, Mikus

1 contacted the physician to explain to him how to fill it out. Mikus also warned the
2 physician that an auditor from KPMG might contact him and that it was important
3 for the physician to tell the auditor that the physician had instructed Endocare to
4 ship the box to Endocare's storage facility, which was not true. The physician
5 followed Mikus's instructions.

6 29. In a meeting in late August or early September 2002 at Endocare,
7 Jerry Anderson ("Anderson"), the head of Endocare's billing unit, informed Mikus
8 and Kevin Quilty ("Quilty"), Endocare's senior vice president of sales and
9 marketing, that he intended to leave Endocare. Anderson offered to purchase a box
10 and probes to start a mobile prostate therapy business. Mikus had previously told
11 Anderson that Endocare could not sell a box to an employee. About one week
12 before the close of the third quarter of 2002, however, Anderson again presented
13 his proposal to Mikus and Quilty. This time, Mikus suggested that Anderson
14 "purchase" multiple boxes and pay Endocare when his new business was
15 generating sufficient revenue. Mikus instructed Anderson to use familiar customer
16 names on the purchase orders so they would seem legitimate and not raise
17 suspicion.

18 30. Following Mikus's direction, Anderson instructed his subordinate to
19 create two purchase orders in the names of Florida Medical Systems and
20 Southwest Urology, two business names that Anderson had previously registered.
21 Anderson also instructed the subordinate to sign the purchase orders using the
22 names of real employees who worked for known Endocare customers, and then fax
23 the purchase orders to Quilty. Anderson's subordinate forged the signatures of
24 Endocare's customers on the purchase orders.

25 31. When the Southwest Urology purchase order came in, Cracchiolo
26 asked whose name was on the document. Upon hearing the name, Cracchiolo
27 responded that he did not want to sign off on the purchase order and that Mikus
28 needed to approve it. Despite his suspicions, Cracchiolo did not investigate the

1 transaction or take steps that would have prevented Endocare from booking
2 revenue for the transaction. Mikus did approve the purchase order, and Endocare
3 booked \$1.2 million in revenue. Shortly after the forged purchase orders were
4 signed, Endocare's internal investigation ensued, and the third quarter financials
5 were delayed.

6 32. Through their involvement in these transactions, Mikus and
7 Cracchiolo facilitated Endocare's improper revenue recognition. Pursuant to
8 GAAP and CON 5, revenue recognition is not appropriate until merchandise is
9 exchanged for cash or claims to cash. In the above transactions, Mikus knew, or
10 was reckless in not knowing, that Endocare had no claims to cash in connection
11 with these false and contingent sales transactions. With respect to the purported
12 sale to Southwest Urology, Cracchiolo knew or was reckless in not knowing that
13 Endocare had no claims to cash because Cracchiolo did not investigate the
14 transaction.

15 **B. Endocare Improperly Recognized Revenue On Box Sales Involving Bill-**
16 **And-Hold Sales**

17 33. Mikus and Cracchiolo approved Endocare's improper revenue
18 recognition on box sales that involved bill-and-hold sales. A bill-and-hold sale is a
19 transaction where the seller maintains the inventory of the goods that were sold.

20 34. Endocare improperly recognized \$200,000 in revenue from
21 Endocare's Southeast regional sales director's sale of a box in December 2001 to
22 an entity called South Florida Partnership, which was going to be formed by a
23 businessman in the area. The box was shipped to Endocare's storage facility in
24 Florida and remained there through April 2002. The representative and managing
25 partner of the South Florida venture partnership never developed a physician
26 partnership for the box, and in fact still owed Endocare \$150,000 for a box that he
27 purchased three months earlier. Cracchiolo approved the purchase order for this
28 box. Given Cracchiolo's knowledge of other instances where Endocare improperly

1 booked revenue or made misleading statements to securities analysts, Cracchiolo
2 was reckless in signing the purchase order without further investigating the
3 transaction. Mikus knew that the box remained in storage without an end user as
4 late as February 12, 2002, which was six weeks after Endocare's year end and
5 before Endocare filed its Form 10-K reporting this revenue in its year-end financial
6 statements.

7 35. In March 2002, Endocare's Southeast regional sales director sold
8 another box to the same representative partner of the South Florida venture
9 partnership. The Endocare sales director negotiated and executed a side agreement
10 that was approved by Quilty. The side agreement stated that the box was intended
11 for another physician and that Endocare would pay the representative of the
12 venture partnership a \$25,000 commission once he resold the unit to the end-user
13 physician. Endocare agreed to this side agreement because it allowed Endocare to
14 book a sale in the first quarter of 2002. Endocare's sales director did not include
15 this side letter with the purchase order. Cracchiolo approved the purchase order,
16 which was forwarded to Endocare's finance department. Given Cracchiolo's
17 knowledge of other instances where Endocare improperly booked revenue or made
18 misleading statements to securities analysts, Cracchiolo was reckless in signing the
19 purchase order without further investigating the transaction. The side letter,
20 however, was not forwarded to the finance department for purposes of recording
21 the sale. Endocare then shipped the box to the Endocare storage facility in Florida
22 and recognized \$250,000 in revenue from the transaction. The partnership's
23 representative never paid for the March 2002 box.

24 36. Endocare also improperly recognized revenue from the sale of three
25 boxes to American Kidney Stone Management ("AKSM") in March 2002.
26 Endocare shipped the boxes to AKSM, but AKSM refused delivery, citing space
27 concerns. Cracchiolo approved the purchase order of the sale of the three boxes to
28 AKSM. Upon AKSM's refusal to accept delivery, an Endocare salesman, with

1 Quilty's approval, leased a storage unit under his own name and paid for the unit
2 with an Endocare corporate credit card. Endocare reimbursed the salesman for the
3 charge on the credit card. AKSM took possession of one of the boxes in May
4 2002, while the other box remained in storage until January 20, 2003. Mikus and
5 Cracchiolo knew that the AKSM boxes were sitting in storage. AKSM never paid
6 for the two boxes.

7 37. Through their involvement in these transactions, Mikus and
8 Cracchiolo approved Endocare's improper revenue recognition for these bill-and-
9 hold sales. The bill-and-hold transactions failed to meet the revenue recognition
10 criteria of CON 5 because the sales were contingent and did not meet the
11 requirement that merchandise be exchanged for claims to cash. These transactions
12 also failed to meet revenue recognition criteria under Accounting and Auditing
13 Enforcement Release No. 108 and the guidance under Staff Accounting Bulletin
14 No. 101 for bill-and-hold sales, because there was no fixed delivery schedule, and
15 the AKSM boxes were put into a storage unit paid for by an Endocare salesman.
16 Mikus and Cracchiolo knew, or were reckless in not knowing, that Endocare
17 should not have recorded revenue for these bill-and-hold sales.

18 **C. Endocare Entered Into Undisclosed Side Agreements to Improperly**
19 **Inflate Revenue**

20 38. For many customers, Endocare allowed the customer's payment for a
21 box to be contingent upon the successful formation of a business, the box
22 generating a minimum number of procedures, and/or the resale of the box to an end
23 user. Because these side agreements and payment terms were not reflected in the
24 purchase orders that Mikus and/or Cracchiolo approved, Endocare improperly
25 recognized revenue from the sales in its books and records.

26 39. In a box sale for \$250,000 to Innovative Medical Technologies
27 ("IMT") in December 2001, although the purchase order and invoice indicated that
28 IMT had 90 days to pay the invoice, Quilty agreed and confirmed in a written side

1 agreement that IMT's payment would not be due until the box generated a
2 minimum number of procedures. Mikus approved the minimum procedure
3 guarantee. In addition, in an unexecuted letter from Quilty to IMT dated
4 December 20, 2001, Endocare promised that it would assist IMT in forming an
5 organization around the box, such as a physician practice group, or in reselling the
6 unit. IMT never paid for the box despite ordering another unit in June 2002.

7 40. In June 2001, Endocare recognized \$250,000 in revenue on a box sale
8 to a New York physician, whose purchase of the box was contingent upon the
9 successful formation of his physician partnership. After executing the purchase
10 order, Quilty and another salesman offered to "incentivize" the New York
11 physician to form the partnership and obtain financing to pay for the box by
12 crediting the physicians for procedures that were performed on equipment that was
13 not owned by these physicians. Through this arrangement, Endocare gave the New
14 York physician a \$64,500 check in July 2002 for procedures that other physicians
15 performed. Cracchiolo and Mikus approved this payment one year after Endocare
16 recognized revenue from the sale of the box to the New York physician.

17 41. In September 2001, Mikus and Endocare's Southeast regional sales
18 director asked a physician in Gainesville, Florida to take delivery of a box for
19 \$250,000, pending the ultimate sale of the box to the eventual end user. The end
20 user was an associate of the Gainesville physician who was interested in forming a
21 physician partnership to purchase a box. The Gainesville physician, who had
22 already purchased his own box in June 2001, but still had not paid for it, agreed to
23 assist in the sale to his associate. The Gainesville physician, however, was
24 unsuccessful in helping Endocare sell the box to his associate by the end of the
25 third quarter of 2002. Mikus then called the Gainesville physician and told him
26 that "it would really help Endocare" if he would take the box pending its eventual
27 sale to his associate.

28 42. The Gainesville physician asked Endocare's sales director for written

1 confirmation that Endocare would resell the unit if his associate decided not to
2 purchase the box, and requested that the sales director's supervisor, Quilty, sign the
3 letter agreement. In response, Quilty called the physician and confirmed that
4 Endocare would resell the unit if the associate refused to purchase the box. Quilty
5 sent the Gainesville physician a side-letter agreement, which Mikus reviewed,
6 affirming the commitment. The box was shipped to Endocare's storage facility in
7 Florida in September 2001, where it remained through October 2002. Endocare
8 improperly recognized revenue from this transaction in the third quarter of 2001.

9 43. In March 2002, Endocare improperly recognized revenue from a
10 transaction with Focus Surgery, Inc. Endocare purchased \$450,000 in equipment
11 from Focus Surgery, and agreed to pay \$250,000 for the development of a software
12 program to make the Focus Surgery equipment compatible with Endocare's box.
13 In a March 12, 2002 email from an Endocare salesman to Focus Surgery, the
14 Endocare salesman confirmed that Endocare would purchase equipment from
15 Focus Surgery. In that March 12 email, which was sent two weeks before the date
16 of the transaction, the Endocare salesman requested that Focus Surgery purchase
17 one box from Endocare, and promised to help Focus Surgery resell the box if no
18 procedure revenue materialized from the venture. Both entities' representatives
19 understood that Focus would use Endocare's \$250,000 payment for the
20 development of the software program to pay for the \$250,000 box it purchased
21 from Endocare.

22 44. During a telephone conversation on or about June 25, 2002, Focus's
23 representative and Endocare's salesman agreed that Focus's check to Endocare
24 would be dated June 28, 2002, and that Endocare's check to Focus would be dated
25 July 1, 2002. These selected dates had the intended effect of pushing Endocare's
26 expense into the third quarter of 2002, as well as providing Focus Surgery with the
27 funds to pay Endocare before the end of the second quarter of 2002. Cracchiolo
28 approved the \$250,000 expenditure to Focus Surgery and signed the July 1, 2002

1 post-dated check, which was actually issued on June 28, 2002. Cracchiolo also
2 approved the purchase order for Focus Surgery to acquire a box from Endocare.
3 At the time he approved the purchase order, Cracchiolo knew that Endocare was
4 buying software from Focus Surgery at the same price that Endocare was selling its
5 box to Focus Surgery. The purchase order stated that Focus Surgery was required
6 to pay for the box in 90 days, without reference to the fact that Endocare was
7 simultaneously obligated to pay for the software program within the same time.

8 45. In June 2002, Endocare's Southeast regional sales director negotiated
9 the sale of a box to Tri-States Cryotherapy ("Tri-States") in a transaction that
10 included a side letter committing Endocare to help resell the box. Quilty, who
11 approved the side letter, discussed its terms with Mikus and Cracchiolo.
12 Cracchiolo authorized the transaction, including the side letter. The purchase order
13 did not include or reflect the side agreement. Endocare improperly recognized
14 \$250,000 in revenue from this transaction.

15 46. In June 2002, Mikus participated in negotiations that led to the sale of
16 three boxes and accessories for \$900,000 to a physician in California. As part of
17 the sale, Endocare agreed, with Mikus's knowledge, that no payment was due for
18 six months and that the physician could withdraw from the deal if the number of
19 procedures generated by the units did not meet projections. In a written proposal
20 that Mikus reviewed, the California physician was offered a \$45,000 "marketing
21 contribution," no equipment costs for six months, a possible extension of the six
22 month payment terms, assistance in securing an outside investor for a physician
23 partnership, and assistance in reselling at least one of the boxes. Despite the
24 existence of these various contingent terms and despite Endocare's continuing
25 performance obligations, Endocare recognized \$900,000 in revenue in June 2002.
26 The purchase order, which Cracchiolo approved, did not reflect the contingent
27 terms or Endocare's continuing performance obligations.

28 47. By orchestrating and approving these contingent sales arrangements,

