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UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

PAUL W. MIKUS and JOHN V. CRACCHIOLO,

Defendants.

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

COMPLAINT

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

JURISDICTION AND VENUE

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

2. Venue is proper in this district pursuant to Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because certain of the transactions, acts, practices, and courses of conduct constituting violations of the federal securities laws occurred within this district.

SUMMARY

3. This action involves a financial fraud perpetrated on the investing public by Paul W. Mikus, the former chief executive officer and chairman of the board of Endocare, Inc. ("Endocare"), and John V. Cracchiolo, Endocare's former chief financial officer and chief operating officer. At the time of the violations, Endocare developed and distributed medical devices for use in the treatment of various types of cancers and urological ailments. Endocare generated most of its revenue from the sale of a cryocare surgical system (referred to as a "box") and disposable probes that were used with the box to treat prostate cancer.

4. Throughout 2001 and 2002, Mikus and Cracchiolo significantly overstated Endocare's revenue and income by booking false sales, engaging in improper revenue recognition practices, and improperly understating or delaying the recognition of expenses in order to inflate Endocare's earnings. In addition, during conference calls with Wall Street securities analysts, Mikus and Cracchiolo misled investors about the number of procedures that were performed using Endocare-owned boxes, a significant metric because Endocare received revenue from the fees that were generated by the procedures that were performed using Endocare's boxes, and because the procedure numbers reflected the marketplace's acceptance of Endocare's products.

5. Public companies, like Endocare, report the financial results of their operations in periodic reports filed with the Commission. Endocare reported its financial results in quarterly reports on Form 10-Q, and in annual reports on Form 10-K. Endocare reported current events on Form 8-K.

6. As a result of the financial fraud, Endocare overstated its net revenue

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

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

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

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

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

THE DEFENDANTS

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

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

BACKGROUND

A. Endocare's Reporting Obligations

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

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

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

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

B. Applicable Accounting Rules

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

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

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

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

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

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

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

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

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

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

C. Endocare's Revenue Recognition Policies And "Record Revenue" Trend

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

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

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

THE FRAUDULENT SCHEMES TO OVERSTATE REVENUE IN 2001 AND 2002

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

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

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

A. Endocare's False Sales to Inflate Revenue

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

47. By orchestrating and approving these contingent sales arrangements,

Mikus and Cracchiolo facilitated Endocare's inappropriate recognition of revenue. Under GAAP, Endocare should not have recognized revenue on these contingent transactions. These transactions failed the CON 5 requirement that revenue should not be recognized before merchandise is exchanged for cash or claims to cash. Several of these transactions also failed to meet the criteria in FAS 48. FAS 48 provides that revenue should not be recognized when the buyer's obligation to the seller is contingent on resale of the product. In addition to the resale agreement that Cracchiolo approved in the Focus Surgery transaction, Focus Surgery paid for the Endocare box with Endocare's own money, making the exchange of assets between the companies inappropriate for revenue recognition under APB 29. Mikus and Cracchiolo knew, or were reckless in not knowing, that Endocare improperly booked revenue on these transactions.

D. Endocare Induced Customers with Undisclosed Financial Incentives

48. In an effort to sell more boxes, Mikus and Cracchiolo provided a range of financial incentives to their customers that varied from consulting fees, to partnership development fees, to guaranteed procedure revenue. Because these incentives were not disclosed in the box purchase orders, they were not properly reflected in Endocare's books and records. As a result, Endocare improperly recognized revenue on these transactions.

49. In December 2001, Endocare sold two boxes for $500,000 to Biotechnology Integration Management ("BIM"), which was a business wholly owned by a member of the board of managers of Bay Area Mobile Medical ("BAMM"). BAMM had previously purchased an Endocare box in September 2001. BIM's owner, who was in Chapter 11 bankruptcy, signed two purchase orders for BIM in December 2001. In order to reduce the owner's downside risk, Quilty signed a side letter, pursuant to which Endocare agreed to provide BIM's owner with guaranteed minimum procedure revenue of three procedures per month, worth $15,000 for each box for six months, for a total commitment of

$180,000. Endocare also agreed to pay BIM's owner a consulting fee of $5,000 per month for an indeterminate amount of time, beginning January 1, 2002. By June 2002, Cracchiolo and Quilty knew that BIM's owner could not pay for these boxes. Quilty proposed that if BAMM obtained financing to purchase both the BIM and BAMM boxes, Endocare would extend the minimum procedure payments for forty-eight months, and include a minimum procedure guarantee for all three boxes. Cracchiolo was personally involved in the June negotiations and knew about the minimum procedure guarantees. Because Cracchiolo knew about the minimum procedure guarantees, he should have ensured that Endocare not book revenue on the transaction. The purchase orders, which Mikus approved, did not include or reflect any of the side agreements and financial incentives. Given Mikus's knowledge of other instances in which Endocare improperly booked revenue and made misleading statements to securities analysts, Mikus knew or was reckless in signing the purchase order without further investigating the transaction.

50. In late June 2002, Cracchiolo approved recognition of $300,000 in revenue from the sale of another box to BIM on June 28, 2002. Concurrently with the sale, Endocare received a $500,000 check from BIM's owner to pay for the two boxes purchased in December 2001, and recorded the cash receipt on June 28, 2002. Cracchiolo agreed to hold the check until financing was completed to cover the check. Cracchiolo was notified around July 9, 2002 that the check bounced. BIM did not submit a new check, and BIM's owner made no payments on the three boxes he "purchased" from Endocare. Cracchiolo, however, continued to approve the consulting fees to BIM's owner.

51. Endocare also recorded $1,000,000 in revenue from the sale of boxes to Theratech Ventures LLC, even though Endocare had provided hundreds of thousands of dollars in financial incentives to Theratech. For example, in November 2001, Quilty proposed that Theratech "develop" five cryotherapy partnerships and, in a written proposal, offered Theratech $20,000 per month in

development fees beginning January 1, 2002, as well as expenses related to the development of the partnerships. Theratech then signed a purchase order for its first box in December 2001, and Endocare began paying the $20,000-per-month fee and expenses to Theratech. Cracchiolo approved the Theratech purchase order, which was dated December 17, 2001. Cracchiolo also began signing monthly checks and approving invoices to Theratech for "development fees" beginning in February 2002. At the time he was approving payments to Theratech, Cracchiolo knew about Quilty's deal with Theratech and understood Endocare's ongoing obligation to pay Theratech $20,000 each month.

52. In June 2002, Quilty extended Endocare's agreement with Theratech to pay the monthly development fees for another six months. Cracchiolo, in turn, continued to pay Theratech its $20,000 fees consistently each month. Moreover, as reflected in an email dated July 12, 2002, Quilty again guaranteed Theratech a minimum of two procedures per month, worth $2,500 each, for 40 months, in an attempt to assist Theratech in obtaining financing for its December 2001 "purchase." Cracchiolo approved some of these payments, as well as the development fees. Endocare even invested $36,000 in a Theratech-developed partnership in September 2002, and guaranteed a minimum of $5,000 per month in procedure revenue for 24 months. Cracchiolo signed the subscription agreement and the corresponding check through which Endocare invested in the Theratech-developed partnership.

53. In September and the first two days of October 2002, Mikus and Quilty negotiated the sale of three more boxes to Theratech for $750,000. Endocare offered Theratech a $500,000 equity investment, a $750,000 loan, a $100,000 fee for each partnership developed, and an extension of the $20,000 per month development fee, plus expenses, through December 2003. Knowing of all the payments to Theratech throughout 2002, Cracchiolo approved Theratech's September 30, 2002 purchase order for the three additional boxes. The final side

letter, executed concurrently with the purchase order received electronically by Endocare on October 2, 2002, included the $750,000 loan, a $100,000 fee for each partnership developed by Theratech, and the extension of the $20,000 monthly development fee. Notwithstanding all the financial inducements Endocare gave to Theratech, Endocare recorded revenue on the sales to Theratech in December 2001 ($250,000), and for three boxes on September 30, 2002 ($750,000), despite the fact that the final agreement for the latter sale was not received at Endocare until October 2, 2002. On December 12, 2002, Theratech rescinded the purchase of the three September 2002 boxes.

54. Mikus's and Cracchiolo's above-described financial inducements to Endocare's customers, coupled with the lack of reasonable assurances to collect any remaining balance purportedly due to Endocare, rendered revenue recognition inappropriate under GAAP. For example, one accounting guideline, Accounting Research Bulletin No. ("ARB") 43, Chapter 1A ¶ 1, states that "profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured." In this instance, Mikus and Cracchiolo knew that BIM had a tenuous payment history, and that without providing cash in the form of consulting and guaranteed payments, the BIM and BAMM companies had little chance of paying their invoices from Endocare. Similarly, Mikus and Cracchiolo knew that Endocare was paying Theratech to establish its business with no guarantee that Theratech would ever be able to pay for its purchases from Endocare. Under GAAP, recognition of revenue on these transactions was improper. Mikus and Cracchiolo knew, or were reckless in not knowing, that Endocare should not have recognized revenue on these contingent sales transactions.

E. Endocare Improperly Recognized Revenue From a Non-Cash Swap Transaction

55. In March 2002, Mikus and Cracchiolo orchestrated Endocare's improper revenue recognition from a non-cash swap transaction with AKSM. A non-cash swap transaction is a transaction in which a non-monetary asset is exchanged for another non-monetary asset. In Endocare's non-cash swap transaction with ASKM, Endocare accepted a competitor's device, which was previously acquired by AKSM, in exchange for AKSM receiving an Endocare box. Endocare recorded the full sale price of the box, $250,000, as revenue even though the competitor's device that was received as "payment" was valued at only about $70,000. Endocare's accounting records reflect that the receivable was "washed" against the payable to AKSM. Both Mikus and Cracchiolo approved the non-cash swap. Before Cracchiolo signed the purchase order, Quilty made Cracchiolo aware of the fact that Endocare had committed to purchase a competitor's device from AKSM. Cracchiolo, in fact, approved the invoice from AKSM, which obligated Endocare to purchase the competitor's equipment from AKSM. The purchase order did not reflect that this was a non-cash swap transaction. Endocare also failed to disclose this swap transaction in its public filings.

56. Mikus and Cracchiolo used the AKSM transaction to inflate Endocare's revenue. APB 29 directs that the cost of a non-monetary asset acquired in exchange for another non-monetary asset is the fair value of the asset surrendered. Because Endocare was only able to collect about $70,000 (the fair value of the competitor machine received from AKSM) in assets from the sale of one box, Endocare's revenue from the sale of that box likewise should have been limited to $70,000, instead of the $250,000 in revenue it recorded. APB 29 also requires that material, non-monetary transactions, like the transaction with AKSM, be disclosed in a company's public filings. Mikus and Cracchiolo knew, or were reckless in not knowing, that (1) Endocare should have disclosed the non-cash

swap transaction; and (2) Endocare should not have recognized $250,000 in revenue from the transaction.

ADDITIONAL IMPROPER TACTICS USED TO INFLATE ENDOCARE'S OVERALL WORTH

A. Mikus and Cracchiolo Caused Endocare To Understate Its Expenses, Thereby Inflating Earnings

57. In addition to their improper revenue recognition practices described above, Mikus and Cracchiolo delayed approving payments, which caused Endocare to understate expenses in the first two quarters of 2002, and thereby overstate its pre-tax earnings. Specifically, Mikus and Cracchiolo delayed recording almost $470,000 in first and second quarter 2002 expenses until the third quarter of 2002. None of the entries were appropriate under GAAP.

58. In late May 2002, Endocare received a $230,000 invoice from a vendor who developed marketing materials for Endocare, for services rendered in April and May 2002. Mikus did not approve payment of the expense, however, until some time in late July 2002. Endocare should have accrued for the expense in the second quarter of 2002, which is when the expense was incurred, but Endocare did not do so. Instead, Endocare posted the expense as of July 31, 2002, which was in the third quarter of 2002, and issued a check to the vendor on August 5, 2002. Furthermore, although Mikus approved payment and expense recognition in late July 2002 – well before Endocare filed its Form 10-Q for the second quarter on August 15, 2002 – the expenses were not reflected in the financial statements that were included in Endocare's second quarter Form 10-Q.

59. Also in July 2002, Cracchiolo approved payment of $65,000 to another vendor for printing services rendered in the first and second quarters of 2002, and $171,000 in legal expenses for services rendered by a law firm through June 30, 2002. Endocare should have accrued for these significant expenses in the first and second quarters of 2002, when they were incurred, but did not do so.

Instead, Endocare recorded the expenses in the third quarter of 2002.

60. Because Mikus and Cracchiolo knowingly delayed approval of and/or recording the payments, none of the above expenses were properly recorded under GAAP. GAAP requires that such expenses be recognized in the same period in which liabilities are incurred for goods and services that are rendered either simultaneously with the purchase or soon after. Here, Endocare had the benefit of the marketing, legal, and printing services at the time the expenses were incurred, which was during the first and second quarters of 2002. By failing to appropriately accrue for these expenses, Endocare overstated its pre-tax earnings for the second quarter of 2002 by at least 62%. Mikus and Cracchiolo knew, or were reckless in not knowing, that Endocare should have recorded these expenses in the first and second quarters of 2002.

B. Mikus and Cracchiolo Misled the Market about Procedure Numbers

61. In addition to the accounting improprieties described above, Mikus and Cracchiolo misled the market about Endocare's procedure numbers. Endocare received significant revenue from fees generated by procedures performed using Endocare-owned boxes. Procedure volume was critical to Endocare because it reflected the present and future market acceptance and growth for Endocare's cryotherapy business. Mikus and Cracchiolo led analysts and investors to believe that Endocare's procedure numbers were higher than they actually were, thus creating the perception that Endocare had greater overall worth.

62. For example, on February 19, 2002, Mikus misrepresented Endocare's procedure volume for the 2001 year-end in an analyst conference call. During the call, Mikus told analysts and investors that 2,200 cryotherapy procedures were performed in 2001 using Endocare boxes. This materially overstated Endocare's true procedure volume, which was closer to 1,500 procedures. Mikus knew this representation was misleading because he received weekly updates regarding procedure numbers from Quilty.

63. In addition, on July 24, 2002, Mikus misrepresented Endocare's procedure volume for the second quarter of 2002 in an analyst conference call. During the conference call, Mikus misled analysts that 1,300 cryotherapy procedures were performed in the quarter ended June 30, 2002, using Endocare's box. Endocare's true procedure volume, however, was less than half the reported amount – less than 600 for the quarter. Mikus knew that this representation was misleading because he had received internal reports of procedure volume before the conference call that showed that Endocare's actual procedure volume was less than 600.

64. Cracchiolo was present on the February 19 and July 24, 2002 analyst calls. During the calls, Cracchiolo provided overviews of the company's operational and financial status. With respect to the 2001 year-end call, Cracchiolo, like Mikus, knew that Endocare's procedure volume was significantly lower than 2,200. Cracchiolo also knew that the actual procedure volume was significantly lower than 1,300 for the second quarter of 2002. Quilty provided regular updates on procedure volume to Endocare's senior management, including Cracchiolo.

65. Furthermore, throughout 2001 and 2002, Mikus and Cracchiolo misled analysts regarding Endocare's procedure volume. The analysts relied on these misrepresentations. Mikus and Cracchiolo knew, or were reckless in not knowing, that the analysts relied on Endocare's false procedure volumes, but Mikus and Cracchiolo did not correct their inflated numbers.

C. Endocare Failed to Disclose Related Party Transactions

66. Mikus and Cracchiolo failed to disclose related party transactions, which increased Endocare's revenue. Endocare's largest customer in 2001 and 2002 was U.S. Medical Development Ltd. ("USMD"), which was a division of a large urologic group of physicians that operating under the name U.S. Therapies LLC. In 2001, Endocare and USMD entered into a distribution agreement that

gave USMD the exclusive right to market Endocare's box in a specific region, in exchange for USMD's commitment to purchase at least six boxes per quarter that would be sold to end-users. Pursuant to the distribution agreement, from June 2001 through March 2002, Endocare sold 21 boxes to USMD, for a total of $4,305,000. As a result, USMD quickly began to build-up an inventory of boxes in storage with no specific end users identified. Endocare advanced $900,000 to USMD, so that USMD could use the money as a partial payment for the boxes back to Endocare. The advance was made under the guise of an earnest money payment as part of a letter of intent dated April 8, 2002, in which Endocare expressed interest in acquiring USMD.

67. Although the letter of intent requiring the $900,000 earnest money payment to USMD was dated April 8, 2002, Mikus approved a requisition for a $900,000 check to USMD on March 27, 2002. The check requisition contained instructions to date the check April 1, 2002 – effectively making it a second quarter expenditure. Both Mikus and Cracchiolo signed the post-dated check to USMD, which was credited to USMD's bank account on March 29, 2002. At the same time that Endocare issued its check to USMD, USMD issued a $410,000 check, dated March 28, 2002, to Endocare for boxes purchased in September 2001. Although Endocare posted the $410,000 check from USMD to its cash receipts journal on March 29, 2002, it did not deposit the check to its bank account until April 12, 2002. Endocare's files contained a note from USMD's chief financial officer requesting that the $410,000 check not be deposited until Endocare received confirmation that funds were available, with a notation "ask John on Friday."

68. Endocare's $900,000 payment to USMD was not disclosed to KPMG during its review of Endocare's first quarter 2002 financial statements, and it was not disclosed in Endocare's Form 10-Q for that period. The acting controller disclosed the existence of the $900,000 payment to KPMG during KPMG's review

of Endocare's second quarter 2002 financial statements. When Cracchiolo learned that the acting controller had told KPMG about the $900,000 payment to USMD, Cracchiolo told the acting controller, among other things, that he should not have disclosed the $900,000 payment to KPMG.

69. The negotiations between Endocare and USMD about Endocare's potential acquisition of USMD continued into late June 2002. At that time, USMD was supposed to purchase another six boxes under the distribution agreement. USMD also owed Endocare $2 million for the boxes that it purchased from Endocare as early as November 2001. USMD did not have enough money to make the $2 million payment that it owed to Endocare. Endocare and USMD agreed that USMD would purchase $1 million worth of disposable probes, instead of purchasing more boxes. Before issuing a purchase order for the probes, however, USMD wanted Endocare to guarantee that it would acquire USMD. In response, Mikus offered to give the head of USMD a consulting agreement, pursuant to which he would receive a salary of $650,000 per year, for three years, and 200,000 shares of Endocare common stock, all of which was worth about $3 million. On June 27, 2002, USMD issued a purchase order for $1 million worth of probes. Endocare's acquisition of USMD was completed on September 30, 2002.

70. Mikus and Cracchiolo failed to disclose these related party transactions in Endocare's financial statements. FAS No. 57 (Related Party Disclosures) requires that a company's financial statements disclose related party transactions that are material. Endocare and USMD were related parties. USMD was not only Endocare's major customer, but USMD was a related party because Endocare also had an investment interest in USMD's parent company, U.S. Therapies. The above transactions with USMD were not fully disclosed in Endocare's public filings. Mikus and Cracchiolo knew, or were reckless in not knowing, that the USMD transactions should have been more fully disclosed.

ENDOCARE'S CEO AND CFO KNOWINGLY SIGNED FALSE MANAGEMENT REPRESENTATION LETTERS TO KPMG

71. In connection with Endocare's year-end 2001 audit and KPMG's reviews of the Endocare's financial statements for the second and third quarters of 2001 and the first and second quarters of 2002, Mikus and Cracchiolo provided KPMG with management representation letters that they knew, or were reckless in not knowing, were materially false and misleading. As part of an audit and/or quarterly review, auditors obtain letters that contain the written representations of management, to support whether a company's financial statements are presented fairly in conformity with GAAP.

72. Among other things, the letters that Mikus and Cracchiolo signed falsely represented that (1) Endocare's financial statements were fairly presented in conformity with GAAP; (2) Endocare properly recognized revenue in accordance with SAB 101; (3) there had been no material transactions that were not properly recorded in Endocare's accounting records underlying the financial information; and (4) all financial records and related data were made available to the auditors. In addition, the April 19, 2002 management representation letter to KPMG, which was signed by Mikus and Cracchiolo, falsely represented that there were no subsequent events or undisclosed related party transactions requiring disclosure for the period ended March 31, 2002.

ENDOCARE INITIATES AN INTERNAL INVESTIGATION AND PUBLICLY DENIES ANY WRONGDOING

73. In February 2002, the acting controller joined Endocare, initially as the general manager of a company that Endocare had acquired. In July 2002, he began acting as Endocare's controller. As such, he helped close Endocare's books in the second and third quarters of 2002. At that time, the acting controller discovered a June 4, 2002 email from Endocare's director of sales for the Southeastern region to Quilty and Endocare's former controller, which contained a

status report on several outstanding receivables for boxes that were purportedly sold by Endocare that were sitting in warehouses. The acting controller told Mikus and Cracchiolo that sending product to warehouses and calling it revenue was fraud. He warned Mikus and Cracchiolo that if he discovered information to suggest this was not an isolated incident, he would resign and "go out loud."

74. In addition, the acting controller, who was involved in responding to the due diligence inquiries of a potential acquirer of Endocare, learned that Cracchiolo had provided the potential acquirer misleading information about the status of receivables from box sales. Specifically, Cracchiolo represented to the potential acquirer that Endocare's receivables were being paid, even though no payments had been received. The acting controller told the potential acquirer that he found some of Cracchiolo's representations about the outstanding receivables to be wrong. On October 18, 2002, the potential acquirer offered to acquire Endocare at a price significantly less than anticipated, thereby effectively ending the merger discussions between the two companies. On October 24, 2002, the acting controller contacted a member of the board of directors and alleged accounting improprieties at the company. The board member referred the allegations to the audit committee of the board.

75. In late October 2002, the audit committee retained a law firm to perform an initial investigation. KPMG was not satisfied that the law firm's investigation was sufficient to allay concerns of fraud, and notified the audit committee that KPMG's review of Endocare's third quarter 2002 financial statements was incomplete. KPMG also requested further investigation into the challenged transactions and suggested that the audit committee hire independent counsel and an independent forensic accountant to conduct the investigation.

76. Endocare delayed the release of its third quarter 2002 financial results, which were previously scheduled for October 30, 2002. Endocare also delayed the filing of its quarterly report for the period ended September 30, 2002.

On October 30, 2002, when Endocare announced that its third quarter results would be delayed, its stock price dropped from a close of $5.20 on October 30, to a close of $2.83 on October 31, more than 45%.

77. On October 31, at KPMG's insistence, the audit committee retained a forensic accountant. On November 13, 2002, after considering the results of the forensic accountant, KPMG informed the audit committee that it was not prepared to complete its quarterly review until an expanded investigation of the acting controller's allegations was performed. KPMG was concerned about the possible role of management in the transactions and the intent of the parties in engaging in the transactions.

78. On December 11, 2002, KPMG informed the audit committee that it had reached the conclusion that it could no longer rely on the representations of Endocare's management and withdrew its report on Endocare's financial statements for the year ended December 31, 2001. KPMG also indicated that the company's financial statements for the quarters ended March 31, 2002 and June 30, 2002 should not be relied upon. Endocare announced these facts in a press release on December 12, 2002.

79. On December 19, 2002, the company announced the termination of the acting controller for "misconduct" that was "demonstrably and materially injurious to the company," in a Form 8-K and press release (the "December 19 Form 8-K"). Mikus and Cracchiolo both approved the final press release, which was attached as an exhibit to the Form 8-K. By highlighting the acting controller's alleged misconduct and failing to disclose that Mikus and Cracchiolo were members of management upon whom KPMG could not rely, the December 19 Form 8-K was misleading in light of the press release that Endocare had issued a week before, reporting that KPMG had concluded that it could not rely on the representations of management.

80. On March 11, 2003, Endocare issued a press release, which Mikus

and other board members approved, announcing the completion of the audit committee's investigation. The press release stated that "an independent review and investigation of [Endocare's] accounts and accounting practices [had] been completed" and that the "audit committee and its advisors" had concluded that there was "no indication of fraud or intentional wrongdoing by management." The March 11, 2003 press release was false and misleading in two respects. First, the investigation by the law firm was not independent. Second, the press release claimed that there was "no indication of fraud or intentional wrongdoing." To the contrary, there was substantial evidence of fraud or intentional wrongdoing. For example, in investigating Anderson's false box sales, which had been shipped to a warehouse at the close of the third quarter of 2002, the forensic accountant received an obviously back-dated rental agreement from the purported purchaser of the boxes. In fact, Anderson, with Mikus's knowledge, recruited a front man to represent the entities that purportedly purchased the equipment. During the internal investigation, when the forensic accountant asked to see a rental agreement for the boxes, Anderson had the front man obtain a back-dated rental agreement. This back-dated rental agreement was suspect because its electronic date of November 6, 2002 was the very day on which the forensic accountant requested the agreement from the supposed box purchaser. In addition, the phony purchaser later refused to speak to the forensic accountant about the back-dated agreement and then rescinded the order.

81. On March 14, 2003, Endocare filed a Form 8-K announcing that the audit committee had concluded its investigation, that the audit committee disagreed with KPMG that KPMG could not rely on the representations of senior management, and that the audit committee "concluded there had been no fraud or intentional wrongdoing by the company's management." Endocare also announced that it was dismissing KPMG in the Form 8-K. Mikus approved the Form 8-K. Like the March 11, 2003 press release, the March 14 Form 8-K was

misleading in light of the evidence of fraud before the audit committee and the fact that no investigation of management's role was performed.

ENDOCARE'S RESTATEMENT OF 2000, 2001, AND THE FIRST TWO QUARTERS OF 2002

82. On December 3, 2003, Endocare filed its annual report on Form 10-K for the period ended December 31, 2002, which included restatements of its consolidated financial statements for the years ended December 31, 2001, and December 31, 2000. For the year ended December 31, 2001, Endocare reversed $2,684,523 of its revenues that were improperly recognized during that period. Thus, Endocare overstated its revenues by more than 20%, and understated its loss from operations by more than 40% during that one-year period. Endocare also reversed $1 million (17%) in revenue that Endocare previously recognized for the quarter ended March 31, 2002, and $2,590,000 (29%) in revenue that Endocare previously recognized for the quarter ended June 30, 2002. In total, Endocare reversed more than $6 million in revenue that it had recognized in 2001 and the first two quarters of 2002. Much of the revenue that Endocare reversed was related to the sale of its boxes and its disposable probes. Further, several sales of Endocare's boxes and probes that were recorded in the quarter ended September 30, 2002, were reversed in Endocare's books, or rescinded by the customers during the internal investigation. Finally, in its definitive proxy statement, which was also filed on December 3, 2003, Endocare announced that, in view of its subsequent investigation and the totality of the available information, it did not now disagree with KPMG's conclusion in December 2002 that KPMG could not rely on management's representations.

MIKUS AND CRACCHIOLO PROFITED FROM THE FINANCIAL FRAUD

83. Mikus and Cracchiolo profited from their participation in the fraud. During the relevant period, Mikus and Cracchiolo received salaries, bonuses,

severance payments, and other compensation. Mikus also received consulting payments.

84. In 2001 and 2002, Endocare paid Mikus salaries of $200,000 and $239,583, respectively. Cracchiolo received a salary of $95,000 in 2001, and a salary of $210,833 in 2002. In addition to their salaries, Mikus and Cracchiolo received bonuses for 2001 and 2002 totaling at least $138,860 and $60,715, respectively.

85. Also, on August 7, 2001, Mikus received approximately $2,119,000 under a prepaid forward sale of 150,000 shares of Endocare stock, which amounted to approximately 88% of the value of the stock, which was trading in the $15 to $16 per share range at the time. On September 15, 2003, Mikus settled the prepaid forward transaction for $4.285 per share, or $642,750, for a net profit from the transaction of $1,476,240.

FIRST CLAIM FOR RELIEF

FRAUD IN THE OFFER OR SALE OF SECURITIES

Violations of Section 17(a) of the Securities Act

86. The Commission realleges and incorporates by reference paragraphs 1 through 85 above.

87. Defendants Mikus and Cracchiolo, by engaging in the conduct described above, directly or indirectly, in the offer or sale of securities by the use of means or instruments of transportation or communication in interstate commerce or by use of the mails:

a. with scienter, employed devices, schemes, or artifices to defraud;

b. obtained money or property by means of untrue statements of a material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

c. engaged in transactions, practices or courses of business which operated or would operate as a fraud or deceit upon the purchaser.

88. By engaging in the conduct described above, defendants Mikus and Cracchiolo violated, and unless restrained and enjoined will continue to violate, Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a).

SECOND CLAIM FOR RELIEF

FRAUD IN CONNECTION WITH THE PURCHASE OR SALE OF SECURITIES

Violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

89. The Commission realleges and incorporates by reference paragraphs 1 through 85 above.

90. Defendants Mikus and Cracchiolo, by engaging in the conduct described above, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter:

a. employed devices, schemes, or artifices to defraud;

b. made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

c. engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

91. By engaging in the conduct described above, defendants Mikus and Cracchiolo violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

THIRD CLAIM FOR RELIEF

VIOLATIONS OF COMMISSION PERIODIC REPORTING REQUIREMENTS

Aiding and Abetting Violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder

92. The Commission realleges and incorporates by reference paragraphs 1 through 85 above.

93. Endocare violated Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rules 12b-20, 13a-1, 13a-11, and 13a-13, 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13 thereunder, by filing with the Commission materially false and misleading periodic reports for the second and third quarters of 2001, the year end 2001, and the first and second quarters in 2002, and registration statements filed on November 14, 2001 and March 26, 2002. Endocare also issued misleading press releases and Forms 8-K in December 2002 and March 2003.

94. Defendants Mikus and Cracchiolo, and each of them, knowingly provided substantial assistance to Endocare's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

95. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), defendants Mikus and Cracchiolo aided and abetted Endocare's violations, and unless restrained and enjoined will continue to aid and abet violations, of Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder, 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13.

FOURTH CLAIM FOR RELIEF

RECORD-KEEPING VIOLATIONS

Aiding and Abetting Violations of Section 13(b)(2)(A) of the Exchange Act and Violations of Rule 13b2-1 thereunder

96. The Commission realleges and incorporates by reference paragraphs 1

through 85 above.

97. Endocare violated Section 13(b)(2)(A) of the Exchange Act by failing to make or keep books, records, and accounts that in reasonable detail accurately and fairly reflected its transactions and disposition of its assets.

98. Defendants Mikus and Cracchiolo knowingly provided substantial assistance to Endocare's violations of Section 13(b)(2)(A) of the Exchange Act.

99. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), defendants Mikus and Cracchiolo aided and abetted Endocare's violations, and unless restrained and enjoined will continue to aid and abet violations, of Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(A).

100. By engaging in the conduct described above, defendants Mikus and Cracchiolo violated Exchange Act Rule 13b2-1 by, directly or indirectly, falsifying or causing to be falsified Endocare's books, records, and accounts subject to Section 13(b)(2)(A) of the Exchange Act. Unless restrained and enjoined, defendants will continue to violate Rule 13b2-1, 17 C.F.R. § 240.13b2-1.

FIFTH CLAIM FOR RELIEF

INTERNAL CONTROLS VIOLATIONS

Aiding and Abetting Violations of Section 13(b)(2)(B) of the Exchange Act

101. The Commission realleges and incorporates by reference paragraphs 1 through 85 above.

102. Endocare violated Section 13(b)(2)(b) of the Exchange Act by failing to have sufficient internal controls to assure that it accounted for its revenue and expenses correctly.

103. Defendants Mikus and Cracchiolo knowingly provided substantial assistance to Endocare's violations of Section 13(b)(2)(B) of the Exchange Act.

104. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), defendants Mikus and Cracchiolo

aided and abetted Endocare's violations, and unless restrained and enjoined will continue to aid and abet violations, of Section 13(b)(2)(B) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(B).

SIXTH CLAIM FOR RELIEF

BOOKS AND RECORDS VIOLATIONS

Violations of Section 13(b)(5) of the Exchange Act

105. The Commission realleges and incorporates by reference paragraphs 1 through 85 above.

106. By engaging in the conduct described above, defendants Mikus and Cracchiolo violated Section 13(b)(5) of the Exchange Act, which prohibits any person from circumventing or failing to implement a system of internal accounting controls, or from knowingly falsifying any book, record, or account described in Section 13(b)(2) of the Exchange Act. Unless restrained and enjoined, defendants Mikus and Cracchiolo will continue to violate Section 13(b)(5) of the Exchange Act, 15 U.S.C. § 78m(b)(5).

SEVENTH CLAIM FOR RELIEF

FALSE STATEMENTS TO AUDITORS

Violation of Exchange Act Rule 13b2-2

107. The Commission realleges and incorporates by reference paragraphs 1 through 85 above.

108. By engaging in the conduct described above, defendants Mikus and Cracchiolo violated Rule 13b2-2 of the Exchange Act by directly or indirectly making or causing to be made materially false or misleading statements to accountants and omitting to state, or causing another person to omit to state to accountants, material facts necessary in order to make statements made to the accountants, in light of the circumstances under which such statements were made, not misleading. Unless restrained and enjoined, defendants Mikus and Cracchiolo will continue to violate Exchange Act Rule 13b2-2, 17 C.F.R. § 240.13b2-2.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

I.

Issue findings of fact and conclusions of law that the defendants committed the alleged violations.

II.

Issue judgments, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, permanently enjoining defendants Mikus and Cracchiolo, and their officers, agents, servants, employees, and attorneys, and those persons in active concert or participation with them, who receive actual notice of the order by personal service or otherwise, from violating Section 17(a) of the Securities Act and Sections 10(b) and 13(b)(5) of the Exchange Act, and Rules 10b-5, 13b2-1, and 13b2-2 thereunder, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

III.

Order defendants Mikus and Cracchiolo to disgorge all ill-gotten gains from their illegal conduct, together with prejudgment and post-judgment interest thereon.

IV.

Order defendants Mikus and Cracchiolo to pay civil penalties under Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).

V.

Enter an order, pursuant to Section 20(e) of the Securities Act, 15 U.S.C. § 77t(e), and Section 21(d)(2) of the Exchange Act, 15 U.S.C. § 78u(d)(2), prohibiting defendants Mikus and Cracchiolo from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the

Exchange Act, 15 U.S.C. § 781, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d).

VI.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

VII.

Grant such other and further relief as this Court may determine to be just and necessary.

DATED: August 9, 2006

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