UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 49678 / May 11, 2004

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2008 / May 11, 2004

ADMINISTRATIVE PROCEEDING
File No. 3-11483

In the Matter of **PricewaterhouseCoopers LLP,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING A CENSURE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against PricewaterhouseCoopers LLP ("PwC" or "Respondent") pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") that the Commission has determined to accept.[2] Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent

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1 Rule 102(e)(1)(iii) provides, in relevant part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found …[t]o have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

2 Simultaneously with this proceeding, the Commission has instituted or filed the following settled actions: *In the Matter of The Warnaco Group, Inc.*, Rel. No. 34-49675 (May 11, 2004); *SEC v. William S. Finkelstein*, 04 CV 3574 (May 11, 2004 S.D.N.Y.) (SS); *In the Matter of Linda J. Wachner*, Rel. No. 34-49677 (May 11, 2004); and *In the Matter of Stanley P. Silverstein*, Rel. No. 34-49676 (May 11, 2004).

consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing a Censure ("Order"), as set forth below.[3]

III.

On the basis of this Order and Respondent's Offer, the Commission finds[4] that:

A. Respondent & Other Relevant Entities

PricewaterhouseCoopers LLP is a national public accounting firm with its headquarters in New York, New York. PwC audited the financial statements of The Warnaco Group, Inc. and provided various consulting services for the company during the period 1995 through 1998. It also performed quarterly reviews of Warnaco's financial results for the period 1996 through the third quarter of 1999.

The Warnaco Group, Inc. ("Warnaco") is a Delaware corporation with its headquarters in New York, New York. During the relevant period, Warnaco was one of the largest apparel manufacturers in the United States, reporting net revenue of $2 billion. Warnaco's common stock is registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"). During the relevant period, Warnaco was a Fortune 500 company that traded on the New York Stock Exchange, Inc. under the symbol "WAC." Warnaco filed for bankruptcy on June 11, 2001. In February 2003, Warnaco emerged from bankruptcy under new management and began trading on the NASDAQ National Market under the symbol "WRNC."

B. Summary

On April 2, 1999, Warnaco filed with the Commission an annual report on Form 10-K for fiscal 1998 that contained a material $145 million restatement of the prior three years' financial results. The restatement decreased 1998 net income by $49 million; turned a $23 million net profit in 1997 into a $12 million net loss; and increased the company's net loss for 1996 from $8.2 million to $31 million. In its annual report, Warnaco misled investors about the reason for the restatement. Warnaco stated that the restatement involved the write-off of previously-deferred "start-up related" costs identified in connection with the company's adoption of a new accounting pronouncement. Because the restatement resulted from a material inventory overstatement caused by an antiquated and defective accounting system at one of the company's largest divisions, Warnaco's description in its annual report was misleading.

PwC audited the financial statements contained in Warnaco's fiscal 1998 Form 10-K and issued an audit report containing an unqualified opinion dated March 2, 1999. During its audit, PwC concluded that the inventory overstatement identified by the company was not an

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3 In a separate civil action filed simultaneously with this proceeding, PwC consented to the entry of a judgment by the U.S. District Court for the Southern District of New York pursuant to Section 21(d) of the Securities Exchange Act of 1934 ordering PwC to pay a $2.4 million civil penalty. *SEC v. PricewaterhouseCoopers LLP*, 04 CV 3573 (May 11, 2004 S.D.N.Y.) (HB).

4 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

accumulation of deferred start-up costs that could be written off pursuant to Warnaco's adoption of a new accounting pronouncement.[5] PwC also concluded as part of its audit that the inventory overstatement most likely resulted from a series of internal control deficiencies and accounting errors that failed to reduce inventory properly over a period of years. PwC failed to object to Warnaco's mischaracterization of the inventory overstatement as "start-up related costs." PwC also incorporated the misleading description of the restatement into its own audit report. By doing so, PwC aided and abetted Warnaco's violation of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.

C. Facts

On April 2, 1999, Warnaco filed its annual report on Form 10-K for the year ended January 2, 1999 (fiscal year 1998). In this annual report, Warnaco reported revised financial results for the previously-reported periods 1996, 1997 and the first three quarters of fiscal 1998. Warnaco described the revisions as involving "start-up related production and inefficiency costs that had previously been deferred." Warnaco also asserted that these costs had been identified in connection with the company's early adoption of SOP 98-5, which required that pre-operating costs relating to the start-up of new manufacturing facilities or businesses be expensed as incurred. The disclosure misleadingly suggested that Warnaco was revising its previously reported financial statements as part of its write off of previously deferred "start-up related" costs in connection with the company's adoption of SOP 98-5.

PwC issued an audit report containing an unqualified audit opinion that the financial statements contained in Warnaco's fiscal 1998 Form 10-K "present fairly, in all material respects, the financial position of The Warnaco Group, Inc. and its subsidiaries at January 2, 1999 and January 3, 1998, and the results of their operations and their cash flows for each of the three fiscal years in the period ended January 2, 1999 in conformity with generally accepted accounting principles." The audit report also stated that "[a]s described in Note 1 [to the financial statements], pursuant to the adoption of SOP 98-5 the Company changed its accounting for deferred start-up costs effective the beginning of fiscal 1998 and revised its fiscal 1997 and 1996 consolidated financial statements with respect to accounting for other start-up related production and inefficiency costs."

PwC knew at the time it issued its report that the $145 million restatement was not caused by Warnaco's adoption of SOP 98-5 or Warnaco's write-off of deferred start-up or start-up related costs. PwC's audit report was misleading.

[5] American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 98-5, which was issued on April 3, 1998, required companies to expense start-up costs in the period in which they were incurred, rather than capitalizing them as had been previously permitted. Companies were required to write-off any previously deferred start-up costs on their books at the time of adoption. SOP 98-5 became effective in fiscal 1999, although companies were permitted to adopt the SOP early. Warnaco adopted SOP 98-5 at the end of its fiscal 1998 year.

1. PwC's Audit Risk Assessment of Warnaco

PwC was engaged as Warnaco's independent auditor in 1995. PwC viewed Warnaco as an important client, in part because it was a Fortune 500 company with a high-profile chief executive officer.

As early as its first audit of Warnaco in 1995, PwC considered Warnaco to be a high-risk client that employed aggressive accounting practices. As part of its 1998 audit, PwC's audit risk assessment form included a section relating to management's characteristics and control over the company. In that category, PwC internally assessed the risk of Warnaco engaging in fraudulent accounting as a 5 out of 6 (with 6 being the highest risk) and identified a number of significant risk factors, including:

- Warnaco's management had a practice of committing to analysts and others to achieve unduly aggressive or unrealistic forecasts, including quarterly earnings;

- Warnaco's management was dominated by a single person or small group without counterbalancing controls, such as effective oversight by the board;

- Warnaco's management had an "excessive interest" in maintaining or increasing the price of the company's stock through "unusually aggressive accounting practices;" and

- Warnaco's management had an "excessive interest" in delaying the recognition of losses.

2. PwC Had Identified Significant Apparent Errors In Warnaco's Inventory Accounts in Prior Audits

As early as its 1996 and 1997 audits, PwC had identified a number of potential errors in Warnaco's inventory accounting. PwC realized early in its tenure as Warnaco's auditors that the accounting systems at Warnaco's then-largest division, the Intimate Apparel Division ("IAD"), were antiquated and prone to error. The standard costs used by IAD's inventory system no longer approximated the division's actual costs, leading to significant and increasing variances that needed to be allocated between inventory and cost of goods sold in order to estimate actual costs for GAAP reporting purposes.[6] PwC questioned Warnaco's method for allocating the variances between inventory and cost of goods sold and questioned the appropriateness under GAAP of Warnaco's capitalization of certain overhead costs. PwC identified potential audit adjustments of

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6 Variances are the difference between standard and actual costs (e.g., the difference between what a company expects labor or raw materials to cost and the actual cost of such items). Under GAAP, companies must report the actual costs of inventory and cost of goods sold on their financial statements, even if they use a standard cost system internally. In order to determine actual costs, each quarter, Warnaco was required to determine what portion of the variances related to goods that had been sold and what portion related to goods still in inventory. The variances were then allocated accordingly between inventory and cost of goods sold. By the end of 1997, IAD's standard costs were so far below actual costs that its variances added to inventory ("capitalized") exceeded $42 million, more than 40 percent of the total value of the inventory on the division's books.

$20 million to IAD's inventory accounts during the 1996 audit. During the 1997 audit, PwC identified $52 million in potential audit adjustments to IAD's inventory. These apparent errors did not relate to start-up costs or start-up activities; they were simply accounting errors caused by system flaws at IAD or accounting decisions made by Warnaco that were not in accordance with GAAP.

PwC did not require Warnaco to make adjustments relating to these apparent errors in either year. At the conclusion of the 1996 audit, PwC recommended that Warnaco examine its cost accounting system at IAD. PwC also recommended in its management report to Warnaco that the company improve its internal controls, establish more accurate standard costs, and reconsider its classification of certain costs in inventory.

3. PwC Consultants Identified Apparent Errors of $60 Million Or More In IAD's Inventory Accounts

In late 1997, at PwC's recommendation, Warnaco's senior management hired PwC consultants to review, update, and correct IAD's standard cost system (the "Standard Cost Project"). As part of the Standard Cost Project, the PwC consultants examined IAD's inventory accounts. Shortly after beginning their review, the PwC consultants determined that Warnaco's standard costs failed to include certain actual production costs and that IAD was capitalizing too much of its variance amounts and overhead costs into inventory. This conclusion was similar to the conclusions reached by the 1996 and 1997 PwC audit teams.

By the Spring of 1998, the PwC consultants preliminarily concluded that IAD's inventory accounts were overvalued by $60 million. The consultants conveyed their preliminary findings to Warnaco's senior management and to PwC's audit team during a meeting on March 31, 1998. However, no adjustment was made to the inventory accounts at this time.

4. PwC Knew That Warnaco's Senior Management Wanted To Delay Or Avoid Correcting The Inventory Errors

In June 1998, after Warnaco informed PwC that the company internally estimated that inventory was overstated by $80 million or more, PwC recommended that Warnaco begin amortizing the overstatement over an arbitrary four-year period (a recommendation not in accordance with GAAP). PwC also informed Warnaco's senior management that, if the overstatement was material, it would require the company to restate prior years' financial results. Warnaco refused to begin recording the adjustment until the Standard Cost Project was completed and the total amount of the overstatement was determined. PwC acceded to this request.

In July 1998, the PwC engagement partner for the Warnaco account retired and was replaced by another PwC partner. The new engagement partner believed that Warnaco's audit committee should be informed about the potential inventory overstatement. After the engagement partner informed the audit committee of the potential overstatement at the August 1998 board meeting, Warnaco's CEO expressed dissatisfaction with the partner's failure to raise the issue with management prior to the meeting and requested that PwC address the issue. PwC assigned a new audit team, including another new engagement partner. That partner ultimately insisted upon the restatement of Warnaco's previously issued financial statements as a result of the inventory overstatement.

5. PwC's Expanded Audit Work In 1998 Confirmed That Flaws In IAD's Outdated Standard Cost System Caused The Overstatement

In the Fall of 1998, IAD completed its annual physical inventory count and attempted to reconcile the value of the physical inventory to the inventory value on the division's books and records. The reconciliation process was consistent with the size of the potential adjustment identified in the Standard Cost project: the value of the actual physical inventory was $60 million to $80 million ***less*** than the inventory value recorded on IAD's internal records and publicly reported in Warnaco's periodic reports. In late October or early November, Warnaco informed the new PwC audit team of these facts. Warnaco's chief financial officer claimed to the new PwC team that Warnaco could not explain the cause of the apparent inventory overvaluation.

Given the magnitude of the inventory discrepancy, PwC immediately informed Warnaco's senior management that the audit firm could not rely upon Warnaco's own accounting and internal control systems at IAD. Instead, the PwC audit team engaged some of the same PwC consultants who had worked on the Standard Cost Project to create a new model to value IAD's inventory. PwC also required that Warnaco complete another physical inventory count at year-end, observed by the PwC auditors, to ensure that the inventory discrepancy was a valuation problem and not a physical inventory problem. The physical inventory confirmed that the problem was not one of missing inventory, but rather was due to an overvaluation of existing inventory.

In the course of this work, PwC identified numerous flaws in IAD's cost accounting system – including missing cost data and improper capitalization of costs – that had prevented the system from properly reducing the value of inventory recorded on Warnaco's books as inventory was sold. These findings were consistent with the potential errors PwC had previously identified in the 1996 and 1997 audits and in the Standard Cost Project. None of the flaws identified by PwC indicated that deferred start-up costs had been improperly recorded in the inventory accounts or were the source of the inventory overstatement. During a meeting in December 1998 and in subsequent discussions, PwC notified Warnaco's senior management of its findings.

6. PwC Knew Warnaco Was Unable To Provide Sufficient Evidence of Its Claim That The Inventory Overstatement Was Caused By Misrecorded Start-Up Costs

PwC knew that Warnaco's senior management was very resistant to recording the inventory overstatement as the correction of an error that would require a restatement of previously reported financial results. When Warnaco's CFO first informed PwC of the reconciliation problem in late October, he asked whether Warnaco could write off the inventory overstatement as part of the restructuring costs the company planned to recognize in the fourth quarter of 1998. After consulting with the concurring partner, the audit team correctly advised the CFO that GAAP did not permit such accounting treatment.

Warnaco's senior management then asserted that the overstatement was attributable to start-up costs that had been improperly recorded in inventory accounts. Warnaco's management wanted to write off the overstatement as part of the company's adoption of a new accounting pronouncement SOP 98-5 later that year.[7] However, Warnaco's management was unable to support this assertion with sufficient evidence. Moreover, as PwC knew, Warnaco had already identified and recorded more than $71 million in deferred start-up costs in a separate account on its books. Given the size of the start-up balance already on Warnaco's books, and the fact that this balance had been audited by PwC in prior years, PwC was skeptical Warnaco had incurred an additional $60-$80 million in deferred start-up costs that had been mistakenly recorded in IAD's inventory accounts.

In February 1999, PwC completed its audit work and determined that the inventory accounts at IAD were overvalued by a total of $159 million. Moreover, PwC concluded there was no evidence to support Warnaco's assertion that the overstatement was due to misplaced start-up costs. In late February, PwC advised Warnaco's senior management of both of these findings and warned the company that it would have to restate its prior years' financial statements.

Warnaco's CEO and CFO did not accept PwC's conclusion and sought one final meeting to persuade PwC that the overstatement could properly be written off as start-up costs under SOP 98-5. PwC agreed to the meeting, but warned Warnaco that PwC would require sufficient competent, auditable evidence before it would change its conclusion.

Over the course of a two-day meeting in February 1999, senior Warnaco management tried to persuade PwC to allow Warnaco to write off the inventory overstatement as start-up costs under SOP 98-5. Although PwC had repeatedly asked Warnaco to provide evidence supporting the proposed accounting treatment of the overstatement as "start-up" costs, the company had produced none. At the start of the two-day meeting, Warnaco's CFO gave the auditors a two-page schedule attributing nearly the entire overstatement to start-up costs.

After reviewing the schedule, PwC concluded that it could not rely upon it to support the company's proposed accounting treatment, because the costs on the schedule could not be traced back to Warnaco's books and records or came from factories that had been open for many years and thus did not qualify as start-up costs under the company's start-up policy. PwC determined that, at most, only $14 million of the overstatement could be reclassified and accounted for as a current year write-off of start-up costs. The remaining inventory overstatement – $145 million – could not be written off under SOP 98-5. Accordingly, PwC told Warnaco that: (i) the overstatement must be accounted for as the correction of an error, thus necessitating a restatement

[7] "Start-up costs" are those costs associated with one-time activities related to opening a new facility or introducing a new product or service. Historically, GAAP allowed companies to capitalize their start-up costs, and amortize those costs over a period of years. However, SOP 98-5 required companies to record start-up costs at the time they were incurred. All public companies were required to adopt SOP 98-5 and write off their start-up costs by no later than fiscal 1999.

of previously reported financial statements; and (ii) PwC would not certify financial statements that accounted for the overstatement as part of the change in accounting to adopt SOP 98-5.

PwC's workpapers confirmed this analysis. The final memorandum to the audit file summarized PwC's conclusions:

> Factors Contributing to Overstatement of Inventories: The audit team performed necessary procedures through the end of February 1999 … to try to understand the cause of the inventory cost accumulation issue and the reasons why the Company's internal controls were not effective in identifying the inventory valuation issue in a timely manner.
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> * * *
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> On the basis of the work we performed, we believe that the inventory cost accumulation issue most likely resulted from not properly relieving inventory over a period of years.[8]

By the end of the two-day meeting, Warnaco acceded to PwC's conclusion that it would have to restate its 1997 and 1996 financial statements. The following day, March 1, 1999, PwC reiterated to Warnaco's board of directors the firm's conclusion that the inventory overstatement could not be written off under SOP 98-5.

The "revisions" had a material downward impact on Warnaco's previously-reported inventory, cost of goods sold, net income, and earnings per share, as set forth in the table below:

	Inventory ($ in thousands)			***Net Income ($ in thousands)***			***EPS (diluted)***		
	Prev. Reported	***Restated***	***%***	***Prev. Reported***	***Restated***	***%***	***Prev. Reported***	***Restated***	***%***
1998†	625,545	492,827	-21%	94,352	69,948*	- 26%	1.48	0.72	- 51%
1997	526,185	431,185	-18%	23,032	(12,319)	-154%	0.42	(0.23)	-155%
1996	387,318	349,335	- 10%	(8,239)	(31,409)	-281%	(0.16)	(0.61)	-281%

† Cumulative results from the first three quarters of 1998
* Adjusted to exclude $23,976 related to adoption of SOP 98-5 effective beginning of fiscal 1998

7. PwC Reviews Warnaco's Draft Press Release

On the afternoon of March 1, 1999, Warnaco's CFO gave the PwC engagement partner a draft of a press release that Warnaco intended to issue the following day. In the draft release, Warnaco touted "record" earnings results. The draft release falsely characterized the inventory error as a part of Warnaco's write-off of deferred start-up costs pursuant to SOP 98-5. After consulting with PwC's National Office regarding the press release, the PwC engagement partner informed Warnaco's CFO that the press release was inconsistent with the manner in which the company's financial results would be presented in the Form 10-K and that Warnaco should seek advice of counsel before issuing the release. Despite this, Warnaco issued the press release, substantially unchanged, the following day.

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[8] As inventory is sold, the costs associated with manufacturing that inventory are deducted (or "relieved") from the inventory accounts on the balance sheet and recorded in the cost of goods sold account on the income statement. This process decreases the inventory balance and increases the cost of goods sold.

8. Warnaco's 1998 Annual Report on Form 10-K

Also in March 1999, Warnaco began preparing its annual report on Form 10-K for fiscal 1998. As a result of Warnaco's issuance of the misleading March 2 press release, there were extensive discussions between Warnaco and PwC regarding the scope of the necessary disclosures in the company's annual report. According to a PwC partner, Warnaco's press release had characterized the inventory adjustment as a write-off of deferred start-up costs, and PwC's view was "very inconsistent with that, and so there were a lot of discussions going back and forth [regarding] how to get the disclosures to . . . an acceptable level."

On April 2, 1999, Warnaco filed its annual report on Form 10-K for fiscal 1998. In this report, the company revised its financial results for fiscal 1996-1998 to reduce inventory and increase cost of goods sold by $145 million, as required by GAAP. Warnaco continued, however, to insist misleadingly that the restatement was related to the company's adoption of SOP 98-5. In the notes to the audited financial statements, Warnaco explained the restatement to its investors as an inventory "revision" that was the result of "start-up related and production inefficiency costs" identified as part of the company's adoption of new accounting standard SOP 98-5. Specifically, the notes to the financial statements stated:

> *Adjustments, Reclassifications and Revisions:* As noted above, the Company early adopted SOP 98-5 in fiscal 1998. <u>In connection with the adoption of the new accounting standard, an extensive effort was undertaken to identify all start-up related production and inefficiency costs that had previously been deferred.</u> Over the last six years, the Company has opened or expanded 10 manufacturing facilities. In addition, to support anticipated future growth, the Company opened 2 new manufacturing facilities during 1998 for a total of 12 new facilities. <u>This resulted in the Company's incurring plant inefficiencies and other start-up related costs resulting from high turnover and related training and other costs.</u> <u>Such start-up related production and inefficiency costs have been classified in other assets and inventories</u>. <u>Because certain such costs identified in this process related to fiscal 1997 and 1996 activities, such prior year consolidated financial statements have been revised to reflect additional costs of goods sold[.]</u> (Emphasis added.)

The Form 10-K was misleading. The restatement was not the result of "previously deferred" start-up costs and was not related to the company's adoption of SOP 98-5. Rather, the restatement was precipitated by a material failure of Warnaco's inventory accounting system. The annual report did not clearly explain to investors that Warnaco had restated its financial results for a three-year period to correct a $145 million inventory overvaluation, and did not disclose that this restatement was caused by the failure of the company's accounting system to properly deduct costs from inventory as goods were sold.

PwC's workpapers confirmed that the audit firm viewed the inventory restatement as an error caused by material flaws in Warnaco's cost accounting system. Despite this, PwC acceded to Warnaco's insistence that these costs be disclosed in the annual report as "start-up related production and inefficiency costs." PwC issued a report containing an unqualified opinion and adopted Warnaco's characterization of the restatement in its report. After stating that the company's financial statements "present fairly, in all material respects, the financial position of The Warnaco Group . . . in conformity with generally accepted accounting principles," PwC's report contained the following explanatory paragraph:

> As described in Note 1, pursuant to the adoption of SOP 98-5, the Company changed its accounting for deferred start-up costs effective the beginning of fiscal 1998 and revised its fiscal 1997 and 1996 consolidated financial statements with respect to accounting for other start-up related production and inefficiency costs. (Emphasis added.)

At the time the Form 10-K was filed, there was no reasonable basis for either Warnaco or PwC to describe the inventory restatement as the write-off of "start-up related" costs identified in connection with Warnaco's adoption of SOP 98-5. PwC knew that there was not sufficient and competent audit evidence to support Warnaco's claim that the restatement was due to deferred "start-up" or "start-up related" costs. The only analysis performed by Warnaco in support of that position was the CFO's two-page analysis, which PwC had rejected because it was unverifiable. Both Warnaco and PwC were aware as a result of the Standard Cost Project that the inventory was overvalued on Warnaco's books by at least $60-$80 million. Furthermore, during both the Standard Cost Project and the 1998 audit, PwC had discovered defects in IAD's inventory systems that caused IAD's inventory to be overvalued, and had concluded at the end of the 1998 audit that the overstatement was due to the failure of the system to properly deduct costs from inventory as that inventory was sold. Warnaco mischaracterized the inventory restatement to conceal a material weakness in its cost accounting and internal control systems, and PwC's audit opinion aided and abetted this misleading disclosure.

Warnaco did not correct the disclosure until May 16, 2000, over a year later, when it filed an amended 1998 Form 10-K. In its amended report, Warnaco revised the discussion of the restatement to remove all references to "start-up related production and inefficiency costs" and the adoption of SOP 98-5. For the first time, Warnaco informed investors that the restatement resulted from flaws in the company's inventory costing control system:

> *Reclassifications and Restatement:* . . . Prior to fiscal 1998, the Company rapidly expanded its manufacturing capacity, hiring and training over 15,000 new employees. This resulted in the Company incurring plan inefficiencies and higher than anticipated manufacturing costs characteristic of new manufacturing operations resulting from high labor turnover and related training and other costs. The Company's infrastructure personnel and systems were overburdened by the size and scope of this rapid expansion and by the increased manufacturing volume. Manufacturing related costs, which were significantly higher than anticipated, were added to inventories when incurred. In connection with the fiscal 1998 year-end closing, the Company determined that in fiscal 1996, 1997 and the first three quarters of 1998, as merchandise was sold, inventories were relieved at less than actual cost per unit, leaving an accumulation of inventory costs. As a result, costs related to [those periods] have been restated to reflect additional costs of goods sold[.] . . . This restatement resulted from flaws in the Company's Intimate Apparel Division inventory costing control system that have since been addressed. (Emphasis added.)

At the same time, PwC issued an amended audit opinion that stated:

> As described in Note 1, pursuant to the adoption of SOP 98-5 the Company changed its accounting for deferred start-up costs effective the beginning of fiscal 1998. Also as described in Note 1, the Company restated its fiscal 1997 and 1996 consolidated financial statements with respect to accounting for inventory production and inefficiency costs. (Emphasis added.)

D. Violations

Section 13(a) of the Exchange Act and Rule 13a-1 thereunder require that annual reports filed by issuers must accurately reflect the financial condition and operating results of the issuer in all material respects. Rule 12b-20 further requires that, in addition to the information expressly required to be included in such a report, the issuer must include such additional material information as may be necessary to make the required statements, in light of the circumstances under which they were made, not misleading. *See*, *e.g.*, *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Information is material where there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). The issuer's legal obligation "extends not only to accurate quantitative reporting of the required items in its financial statements, but also to other information, qualitative as well as quantitative, needed to enable investors to make informed decisions." *In re Sony Corp. and Sumio Sano*, 67 SEC Docket 1609, 1998 WL 439898, at *4 (Aug. 5, 1998).

Warnaco issued a materially misleading fiscal 1998 Form 10-K annual report on April 2, 1999 that mischaracterized the reason for the company's restatement of its 1996 to 1998 financial results. The annual report inaccurately stated that the restatement involved the write-off of previously-deferred start-up or "start-up related" costs that related to the growth of the company's business and that were discovered in connection with Warnaco's adoption of SOP 98-5. It also failed to disclose the true reason for the restatement: that cost accounting and internal control systems at Warnaco's Intimate Apparel Division were materially deficient and caused a $145 million inventory overstatement. By this conduct, Warnaco violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.

By issuing an audit report containing an unqualified audit opinion that incorporated the company's misleading disclosures and yet stated that the company's financial statements "presented fairly, in all material respects" Warnaco's financial condition and results of operations, PwC willfully aided and abetted Warnaco's violations of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.[9]

E. Findings

Based on the foregoing, the Commission finds that PwC willfully aided and abetted Warnaco's violation of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.

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9 "Willfully" as used in this Order means knowingly committing the act which constitutes the violation, *see Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent PwC's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that PwC is censured pursuant to Rule 102(e)(iii) of the Commission's Rules of Practice.

By the Commission.

Jonathan G. Katz
Secretary