I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against LSB Industries, Inc. (“LSB”), and pursuant to Sections 4C and 21C of the Exchange Act and Rule 102(e) of the Commission’s Rules of Practice against Jimmie Dean Jones, CPA (“Jones”) (collectively, “Respondents”).

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1 Section 4C provides, in relevant part, that: “The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(iii) provides, in pertinent part, that: “The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.”
II.

In anticipation of the institution of these proceedings, each Respondent has submitted an offer of settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondents’ Offers, the Commission finds that:

Summary

These proceedings arise out of LSB’s and Jones’ failures to comply with Generally Accepted Accounting Principles (“GAAP”) in connection with LSB’s change in inventory pricing methodology from LIFO to FIFO. When LSB changed from LIFO to FIFO during the first quarter of fiscal year 2004, the value of its LIFO reserve was material to its net income. LSB, however, failed to comply with GAAP by disclosing its change from LIFO to FIFO and by restating its prior financial results. Instead, to avoid a restatement, Jones (LSB’s then Chief Accounting Officer and Controller) directed his subordinates to eliminate the LIFO reserve by improperly “bleeding it down” over four quarters in 2004. Consequently, Jones caused LSB to issue three quarterly reports and one annual report for fiscal year 2004 that failed to comply with GAAP. In addition, Jones caused two of the quarterly reports issued in fiscal year 2004 to falsely represent that LSB still maintained LIFO inventory. In December 2005, after the Commission’s Division of Corporation Finance questioned how LSB’s change from LIFO to FIFO was in compliance with GAAP, LSB disclosed the change and restated its financial results.

3 The findings herein are made pursuant to Respondents’ offers of settlement and are not binding on any other person or entity in this or any other proceeding.

4 LIFO is an inventory pricing method whereby a company values the cost of the products it sells at the price paid for its most recently purchased inventory. Under FIFO, a company values the cost of the products it sells at the price paid for its oldest purchased inventory. GAAP requires issuers with LIFO inventory to maintain a reserve that represents the difference between the carrying value of their inventory using LIFO and what the carrying value of that inventory would be if they used FIFO instead. GAAP requires companies to track their inventory costs in order to maintain a LIFO reserve.
Respondents

1. LSB Industries, Inc. is a Delaware corporation, based in Oklahoma City, Oklahoma. It is a diversified holding company with two primary subsidiaries. Its Climate Control Business manufactures and sells products used in commercial and residential air conditioning systems. LSB’s Chemical Business manufactures and sells chemical products for agricultural, varied industrial, and mining markets. LSB’s securities are registered with the Commission pursuant to Section 12(b) of the Exchange Act and are listed on the New York Stock Exchange.

2. Jimmie Dean Jones, age 66, is a Certified Public Accountant licensed to practice in Oklahoma. Jones served as the Chief Accounting Officer, Corporate Controller, Treasurer and a Senior Vice President of LSB, from the early 1980s until he resigned from these positions in 2008. He is currently a Senior Vice President and Treasurer at LSB. Prior to joining LSB, Jones worked in public accounting for seven years at Arthur Young & Co.

Facts

1. Prior to and during its fiscal year 2003, LSB valued the inventory of its Climate Master subsidiary using the LIFO (last in, first out) inventory pricing method. LSB also tracked its inventory costs to maintain a LIFO reserve which, under GAAP, is required to reflect the difference between the carrying value of a company’s inventory under LIFO and what the carrying value would be if the company instead used the FIFO (first in, first out) inventory pricing method.

2. In May 2003, LSB’s independent auditor, Ernst & Young (“E&Y”), suggested to LSB that it change the inventory pricing method for its Climate Master subsidiary from LIFO to FIFO for tax purposes. E&Y suggested this change because LSB was no longer deriving any tax benefit from maintaining this pricing methodology, yet was incurring the cost of tracking its LIFO inventory as required by GAAP. LSB agreed and, at Jones’ direction, changed from LIFO to FIFO for tax purposes in October 2003.

3. For financial reporting purposes, however, LSB did not change from LIFO to FIFO at that time to avoid having to restate its financial results. Under GAAP, if the value of an issuer’s LIFO reserve is material to its net income when it changes from LIFO to FIFO, then the issuer must disclose the change and eliminate its LIFO reserve by restating its financial statements to reflect what the company’s results would have been in prior periods had it not maintained a LIFO reserve.5 Accounting Principles Board Opinion No. 20, “Accounting Changes” (“APB 20”). At the end of fiscal year 2003, LSB’s LIFO reserve was $503,000, which represented 16 percent of its 2003 reported net income of $3,111,000. However, the LIFO reserve was forecast to decline to $250,000 by the end of fiscal year 2004 in the ordinary course of business. In December 2003, an E&Y senior manager advised Jones that if LSB were to delay the change from LIFO to FIFO for financial reporting purposes until its LIFO reserve became immaterial, the company could write the reserve off without having to restate.

5 Alternatively, if an issuer’s LIFO reserve is not material to its net income in the period of the change, an issuer changing from LIFO to FIFO may eliminate its LIFO reserve by releasing the value of the reserve into current net income and disclosing the change in the notes to its financial statements.
4. To avoid filing a restatement, Jones told an E&Y audit principal on January 5, 2004, that LSB would delay the change from LIFO to FIFO for financial reporting purposes until the end of 2004 to ensure that E&Y would not consider the impact of the change on LSB’s net income to be material. The E&Y audit principal agreed with this plan and confirmed to Jones that he would not consider a restatement to be necessary if LSB were to change from LIFO to FIFO when the LIFO reserve fell to $250,000, assuming that LSB’s financial condition did not change materially.

5. LSB ceased tracking inventory costs in January 2004. By not tracking its LIFO inventory costs, which GAAP requires for purposes of maintaining an accurate LIFO reserve, LSB effectively switched to FIFO for financial reporting purposes in January 2004. LSB did not disclose its change from LIFO to FIFO for financial reporting purposes at that time. Jones understood in the first quarter of fiscal year 2004 that LSB had ceased tracking inventory costs. Jones also understood at that time that LSB was required to track its inventory costs in order to remain on LIFO.

6. In April 2004, Jones learned that, due to rising costs, the value of LSB’s LIFO reserve was not declining in the normal course of business as expected. Whereas LSB had previously forecast that the LIFO reserve would decline to $250,000 in the normal course of business by the end of 2004, Jones learned in April 2004 that the reserve remained at $503,000 as of March 31, 2004, and was expected to decline by only $40,000 in fiscal year 2004 and was therefore still expected to be material to LSB’s net income.

7. To avoid having to file a restatement, Jones improperly directed his subordinates to make journal entries that artificially reduced LSB’s LIFO reserve by $125,000 in each quarter of 2004, so that the LIFO reserve account’s year-end balance was zero by December 31, 2004. These entries resulted in corresponding increases in LSB’s operating income by $125,000 in each quarter. The only justification for these entries was the elimination of the LIFO reserve to avoid restatement. Jones did not inform LSB’s chief financial officer of his decision to bleed down the LIFO reserve, even though LSB’s internal controls policies required Jones to note any item with a potential financial statement impact of at least $100,000 on a quarterly “Issues List” for the CFO to review. In fact, Jones did not inform LSB’s CFO of the bleed down at any point in 2004, even though LSB’s internal controls required him to do so.

8. By the time LSB filed its Form 10-Q for the first quarter of 2004 on May 14, 2004, it had effectively changed from LIFO to FIFO for financial reporting purposes. The change was material: the value of LSB’s LIFO reserve was $503,000 while its first quarter operating results were a $243,000 net loss. Had LSB instead released the entire amount of the LIFO reserve in that quarter, it would have reported $260,000 net income. Nevertheless, LSB failed to comply with APB 20’s restatement and disclosure requirements in its Form 10-Q for the quarter ended March 31, 2004. Not only did LSB fail to disclose its change from LIFO to FIFO in this filing, but it falsely disclosed in this Form 10-Q that it was continuing to price inventory using the LIFO methodology.
9. As a result of the decision to bleed down the LIFO reserve by $125,000 each quarter, LSB understated its net loss for the quarter ended March 31, 2004 by $125,000, a 51 percent understatement. LSB reported a net loss of $118,000; its actual (restated) net loss was $243,000. LSB also reported a loss per share of 1 cent instead of 2 cents for the quarter, a 50 percent understatement.

10. LSB continued to reduce its LIFO reserve by $125,000 each quarter throughout the remainder of 2004. This led LSB to overstate its income in its Form 10-Q for the quarter ended June 30, 2004 by $125,000, or 7.8 percent, and to overstate its income for the six-month period ended June 30, 2004 by $250,000, or 18.4 percent. LSB reported earnings per share of 8 cents instead of 7 cents for that quarter, a 12.5 percent overstatement, and earnings per share of 6 cents instead of 5 cents for the six-month period ended June 30, 2004, a 16.7 percent overstatement. Again, LSB disclosed that it was continuing to value inventory using the LIFO methodology in its Form 10-Q for the quarter ended June 30, 2004.

11. As a result of LSB’s decision to bleed down the LIFO reserve by $125,000 each quarter, LSB overstatement its income in its Form 10-Q for the quarter ended September 30, 2004 by $125,000, or 3.7 percent, and by $375,000, or 7.9 percent, for the nine-month period ended September 30, 2004. LSB also reported earnings per share of 19 cents instead of 18 cents for the quarter, a 5.6 percent overstatement, and 26 cents instead of 24 cents for the 9-month period ended September 30, 2004, an 8 percent overstatement.

12. The bleed-down plan also led LSB to overstate its net income for the annual period by $503,000, or 36.7 percent, in its Form 10-K for the year ended December 31, 2004. LSB reported net income of $1.873 million for the year; its actual (restated) net income was $1.370 million. LSB also reported earnings per share for this annual period of 1 cent instead of a loss per share of 3 cents.


14. Following a series of comment letters to LSB from the Commission’s Division of Corporation Finance that questioned how LSB’s change from LIFO to FIFO complied with APB 20, on December 30, 2005, LSB disclosed the change and filed an amended Form 10-K in which it restated its financials for the year ended December 31, 2004. The amended Form 10-K restated the financial statements and corrected the disclosure issues described in paragraphs 8-12 above.
Violations

1. Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13 require issuers with securities registered under Section 12 of the Exchange Act to file quarterly and annual reports with the Commission and to keep this information current. The obligation to file such reports also embodies the requirement that they be true and correct. See, e.g., SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1165 (D.C. Cir. 1978). Rules 13a-1 and 13a-13 also require issuers to file annual and quarterly financial statements that comply with Regulation S-X. Regulation S-X, Section 4-01(a) mandates that financial statements and the accompanying notes be presented in conformity with GAAP.

2. Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets.

3. Section 13(b)(5) of the Exchange Act provides that no person shall knowingly falsify any such book, record, or account or circumvent internal controls. Exchange Act Rule 13b2-1 also prohibits the falsification of any book, record, or account subject to Section 13(b)(2)(A).

4. By failing to comply with APB 20’s restatement and disclosure requirements, misstating its financial results during the first three quarters of fiscal year 2004 and the full fiscal year 2004 by bleeding down its LIFO reserve quarterly by $125,000, and falsely stating in its Forms 10-Q for the first and second quarters of 2004 that it maintained LIFO inventory, LSB violated Exchange Act Sections 13(a) and 13(b)(2)(A) and Rules 13a-1 and 13a-13.

5. Rather than comply with APB 20’s restatement and disclosure requirements, Jones directed his subordinates to bleed down LSB’s LIFO reserve during 2004. Jones also failed to comply with LSB’s requirement that he alert the company’s CFO to items with a financial statement impact exceeding $100,000. Moreover, Jones, as LSB’s Chief Accounting Officer, was responsible for LSB’s false disclosures in its Forms 10-Q for the first and second quarters of 2004 that it maintained LIFO inventory. Jones knew that LSB’s Forms 10-Q for the first three quarters of fiscal year 2004 and Form 10-K for the year ended December 31, 2004 materially overstated LSB’s reported net income. Jones also knew that LSB’s Form 10-Q for the quarter ended March 31, 2004 failed to comply with APB 20. Finally, Jones knew or should have known that LSB’s Forms 10-Q for the quarters ended March 31, 2004 and June 30, 2004 contained false disclosures that LSB maintained inventory using the LIFO pricing methodology. As a result of this conduct, Jones willfully violated Exchange Act Section 13(b)(5) and Rule 13b2-1 and caused and willfully aided and abetted LSB’s violations of Exchange Act Sections 13(a) and 13(b)(2)(A), and Rules 13a-1 and 13a-13.
Findings

1. Based on the foregoing, the Commission finds that LSB violated Exchange Act Sections 13(a) and 13(b)(2)(A), and Rules 13a-1 and 13a-13.

2. Based on the foregoing, the Commission finds that Jones willfully violated Exchange Act Section 13(b)(5) and Rule 13b2-1, and caused and willfully aided and abetted LSB’s violations of Exchange Act Sections 13(a) and 13(b)(2)(A), and Rules 13a-1 and 13a-13.

3. Based on the foregoing, the Commission finds that Jones willfully violated and willfully aided and abetted the violation of provisions of the federal securities laws and rules thereunder within the meaning of Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii) of the Commission’s Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Respondents’ Offers.

Accordingly, it is hereby ORDERED that:

A. LSB Industries, Inc. shall cease and desist from committing or causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Exchange Act Rules 13a-1 and 13a-13;

B. Jimmie Dean Jones shall cease and desist from committing or causing any violations and any future violations of Section 13(b)(5) of the Exchange Act and Exchange Act Rule 13b2-1, and from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) and Rules 13a-1 and 13a-13;

C. Respondent Jimmie Dean Jones is denied the privilege of appearing or practicing before the Commission as an accountant.

D. After two years from the date of this order, Respondent Jimmie Dean Jones may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company’s financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent’s work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or
2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent’s or the firm’s quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

E. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission’s review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent’s character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary