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# SEC NEWS DIGEST

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## COMMISSION ANNOUNCEMENTS

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### COMMISSIONER HUNT TO TESTIFY

Commissioner Isaac C. Hunt, Jr. will testify before the House Committee on Financial Services on June 20 concerning the Public Utility Holding Company Act of 1935 and the Current Energy Situation in California. The hearing will begin at 10:00 a.m. in room 2128 of the Rayburn House Office Building.

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## ENFORCEMENT PROCEEDINGS

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### ARTHUR ANDERSEN LLP AND THREE PARTNERS SETTLE CIVIL INJUNCTIVE ACTION

The Commission announced today that Arthur Andersen LLP and three of its current and former partners settled a civil injunctive action, charging violations of antifraud provisions of the federal securities laws, as well as related administrative proceedings brought pursuant to Rule 102(e) of the Commission's Rules of Practice (Rule 102(e)). In a related action, a fourth Andersen partner, a regional practice director, settled administrative proceedings brought pursuant to Rule 102(e) in which the Commission found that he engaged in improper professional conduct. These proceedings arise out of one or more of Andersen's audits of Waste Management, Inc.'s (Waste Management or the Company) financial statements during the period 1992 through 1996.

Andersen and the individual defendants and respondents, without admitting or denying the allegations or findings in the Commission's complaint and orders, consented to the following sanctions:

- Arthur Andersen LLP (Andersen or Firm), a national accounting firm, consented (1) to the entry of a permanent injunction enjoining it from violating Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder; (2) to pay a civil money penalty in the amount of \$7 million; and (3) in related administrative proceedings, to the

entry of an order pursuant to Rule 102(e) censuring it based upon the Commission's finding that it engaged in improper professional conduct and the issuance of the permanent injunction;

- Robert E. Allgyer (Allgyer), the partner responsible for the Waste Management engagement, consented (1) to the entry of a permanent injunction enjoining him from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act of 1933 (Securities Act); (2) to pay a civil money penalty in the amount \$50,000; and (3) in related administrative proceedings pursuant to Rule 102(e), to the entry of an order denying him the privilege of appearing or practicing before the Commission as an accountant, with the right to request his reinstatement after five (5) years;
- Edward G. Maier (Maier), currently a partner and then the risk management partner for Andersen's Chicago office and the concurring partner on the Waste Management engagement, consented (1) to the entry of a permanent injunction enjoining him from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act; (2) to pay a civil money penalty in the amount \$40,000; and (3) in related administrative proceedings pursuant to Rule 102(e), to the entry of an order denying him the privilege of appearing or practicing before the Commission as an accountant, with the right to request his reinstatement after three (3) years;
- Walter Cercavschi (Cercavschi), currently a partner and then a partner on the Waste Management engagement, consented (1) to the entry of a permanent injunction enjoining him from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act; (2) to pay a civil money penalty in the amount \$30,000; and (3) in related administrative proceedings pursuant to Rule 102(e), to the entry of an order denying him the privilege of appearing or practicing before the Commission as an accountant, with the right to request his reinstatement after three (3) years;
- Robert G. Kutsenda (Kutsenda), currently a partner and then the Central Region Audit Practice Director responsible for Andersen's Chicago, Kansas City, Indianapolis, and Omaha offices (Practice Director), consented in administrative proceedings pursuant to Rule 102(e), to the entry of an order, based on the Commission's finding that he engaged in improper professional conduct, denying him the privilege of appearing or practicing before the Commission as an accountant, with the right to request reinstatement after one (1) year.

The Commission alleged in its complaint, or found in its Orders, as follows:

## Andersen

- Andersen knowingly or recklessly issued false and misleading unqualified audit reports on Waste Management's annual financial statements for the years 1993 through 1996. The audit reports stated that the Company's financial statements were presented fairly, in all material respects, in conformity with generally accepted accounting principles (GAAP) and that Andersen's audits were conducted in accordance with generally accepted auditing standards (GAAS). These representations were materially false and misleading.
- In February 1998, Waste Management announced that it was restating its financial statements for the five-year period 1992 through 1996 and the first three quarters of 1997 (Restatement). To date, the Restatement is the largest in the Commission's history. In the Restatement, the Company admitted that through 1996 it had materially overstated its reported pre-tax earnings by \$1.43 billion and that it had understated certain elements of its tax expense by \$178 million.
- Andersen audited the Restatement and issued an unqualified audit report on it. The Restatement addressed misstatements that resulted from accounting practices that improperly increased reported operating income primarily by understating operating expenses. In most instances, the Company had improperly deferred recognition of current operating expenses to future periods in order to inflate its current period income. The Company admitted that it had misstated expenses relating to, among other things, vehicle, equipment and container depreciation, capitalized interest, asset impairments, purchase accounting related to environmental remediation reserves and other liabilities.
- In one or more audits during the period 1993 through 1996, Andersen, through Allgyer, Maier, and Cercavschi, identified and documented numerous accounting issues giving rise to the misstatements and likely misstatements that the Restatement ultimately addressed, and brought certain of the issues to the attention of Andersen's Practice Director, the firm's Managing Partner and the Audit Division Head for the firm's Chicago office (Audit Division Head). The engagement team also consulted with and relied upon Andersen's waste industry expert in its Accounting Principles Group (a unit within Andersen available for consultation on significant accounting issues) concerning certain of the Company's improper accounting practices discussed herein.
- With respect to many of the non-GAAP accounting practices, Andersen failed to quantify and estimate all known and likely misstatements resulting from the accounting issues that the engagement team identified. During the years in question, Andersen quantified only certain of the misstatements. For example, in its 1993 audit, the engagement team quantified current and prior period misstatements of \$128 million, which, if recorded, would have reduced net

income before special items by 12%. The engagement team also identified, but did not quantify and estimate, accounting practices that gave rise to other known and likely misstatements. Allgyer and Maier consulted with the Practice Director and the Audit Division Head and informed them of the quantified misstatements and "continuing audit issues," and Allgyer consulted with the Firm's Managing Partner and informed him of the quantified misstatements and "continuing audit issues." The partners determined that the misstatements were not material and that Andersen could issue an unqualified audit report on the Company's 1993 financial statements.

- In connection with the 1993 audit, following the consultations noted above, and prior to the Company's announcement of its 1993 earnings, Allgyer presented a "plan" – known as the "Summary of Action Steps" (Action Steps) – to the Company's Chief Executive Officer (later signed and initialed by the Company's Chief Financial Officer and Chief Accounting Officer) to reduce, going forward, the cumulative amount of the quantified misstatements and to change, among other things, the accounting practices that gave rise to the quantified misstatements and to the other known and likely misstatements. According to an internal memorandum that Allgyer distributed, the Action Steps were the "minimum changes we have concluded are necessary for WMX to implement immediately" and concluded that the Company's compliance with the "must do" items [in the Action Steps] "brings the Company to a minimum acceptable level of accounting . . . ." The Action Steps also evidenced the fact that Andersen had identified the non-GAAP accounting practices that gave rise to numerous misstatements in the Company's 1993 through 1996 financial statements.
- In 1994, the Company continued to engage in the accounting practices that gave rise to the quantified misstatements and the other known and likely misstatements. As in 1993, the Practice Director, the Firm's Managing Partner and the Audit Division Head were consulted, and they again concurred in the issuance of an unqualified audit report on the Company's 1994 financial statements.
- In 1995, in many instances, the Company did not implement the Action Steps and continued to utilize accounting practices that did not conform with GAAP. Andersen monitored the Company's compliance or lack of compliance with the Action Steps. In its 1995 financial statements, the Company used a \$160 million gain that it realized on the exchange of its interest in an entity known as ServiceMaster to offset \$160 million in unrelated operating expenses and misstatements that, in most instances, had been identified as misstatements in 1994 and earlier. The Company offset the misstatements and expenses against the gain in Sundry Income, Net. The amount netted represented 10% of 1995 pre-tax income before special charges. The Company made no disclosure of the netting.
- After reaching a preliminary determination that the amounts being netted were not material to the financial statements taken as a whole, two of the partners on the





















