UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 49676 / May 11, 2004

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2007 / May 11, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-11481

	:	**ORDER INSTITUTING PUBLIC**
	:	**ADMINISTRATIVE AND CEASE-AND-**
In the Matter of	:	**DESIST PROCEEDINGS PURSUANT TO**
	:	**SECTION 21C OF THE SECURITIES**
STANLEY P. SILVERSTEIN,	:	**EXCHANGE ACT OF 1934 AND RULE**
	:	**102(e) OF THE COMMISSION'S RULES**
Respondent.	:	**OF PRACTICE, MAKING FINDINGS,**
	:	**AND IMPOSING REMEDIAL SANCTIONS**
	:	**AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Stanley P. Silverstein ("Silverstein" or "Respondent") pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

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.[1] 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 him and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-And-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Rule 102(e) of

[1] 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); *In the Matter of PricewaterhouseCoopers LLP,* Rel. No. 34-49678 (May 11, 2004).

the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-And-Desist Order ("Order"), as set forth below.[2]

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:[3]

A. Respondent and Related Parties

Stanley P. Silverstein, age 51, was Vice President, General Counsel, and Secretary of The Warnaco Group, Inc. during all relevant periods. He is currently Chief Administrative Officer and Senior Vice President, Corporate Development for Warnaco. Silverstein is a resident of Englewood, New Jersey. He is licensed to practice law in the state of New York.

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 revenues of $2 billion. Warnaco's common stock is registered with the Commission pursuant to Section 12(b) of the 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, the company emerged from bankruptcy under new management and began trading on the NASDAQ National Market under the symbol "WRNC."

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

B. Summary

During the period from at least 1996 through early 1999, Warnaco's inventory accounts were materially overstated in its books and records and, as a result, the value of its inventory was overstated in reports filed with the Commission and disseminated to the public. The inventory overstatement was caused by serious and pervasive flaws in the company's cost accounting systems at its largest division. As a result, by early 1999, inventory at the division was overstated by more than 100 percent, and the company's entire inventory balance was overstated by more than twenty percent. Warnaco had to restate its financial results for a three-year period, 1996 through the first three quarters of 1998.

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[2] 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.

[3] 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.

On April 2, 1999, Warnaco filed with the Commission its annual report on Form 10-K for the year ended January 2, 1999 (fiscal 1998), which "revised" the company's previously-reported financial results for the years 1996 through the first three quarters of 1998. Warnaco did not disclose in its annual report that it had restated to correct an inventory overstatement caused by flaws in the company's cost accounting systems. Instead, Warnaco improperly attributed the "revision" to the write-off of "start-up related production and inefficiency costs" identified in connection with the adoption of a new accounting pronouncement. Accordingly, the annual report contained material misstatements.

Silverstein and other members of Warnaco's senior management knew or should have known that it was improper to attribute the inventory restatement to the write-off of start-up related costs in the company's annual report. Nevertheless, Silverstein approved the misleading annual report. As a result, Silverstein caused the company's reporting violation.

In an unrelated matter, in the third quarter of 2000, Warnaco filed a quarterly report on Form 10-Q that improperly offset $190.5 million in cash against long-term debt. Such an offset was not permitted under generally accepted accounting principles ("GAAP"). Silverstein reviewed and signed Warnaco's Form 10-Q, when he knew or should have known that the company's offset of cash against long-term debt in its quarterly report was improper and not in conformity with GAAP.

C. Facts

1. Inventory Restatement

a. Discovery of Inventory Overstatement

Warnaco is one of the largest manufacturers and distributors of apparel in the United States. It designs and manufactures a broad line of intimate apparel, sportswear, swimwear and other clothing under a variety of well-known brand names. Warnaco's Intimate Apparel Division ("IAD") is a leading supplier of intimate apparel to department and specialty stores in the United States.

During the period at least 1997 through early 1999, the cost accounting and internal control systems at IAD were severely outdated and inadequate, given the size of the division's operations. IAD operated on a standard cost system that had not been updated in decades.[4] IAD did not have a perpetual inventory system or other means for accurately determining the value of its inventory on

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[4] IAD used a "standard cost system" to value its inventory internally. The standard costs were based on the estimated cost to produce the company's inventory. GAAP permits the use of a standard cost system for internal accounting. However, a company must adjust the value of the inventory to the actual cost of production before filing its financial statements. The company makes this adjustment by apportioning the difference (or "variance") between inventory (i.e., goods produced by the company but not yet sold), and the cost of goods sold. Inventory is carried as an asset on the balance sheet; the cost of goods sold is recorded as an expense item on the income statement. Capitalizing costs into inventory instead of recording them as an expense to cost of goods sold increases the inventory balance (thus increasing the company's recorded assets) and decreases the company's expenses (thus increasing its recorded net income).

a regular basis. The division valued its inventory accounts only once a year, when the physical inventory count was taken mid-year and reconciled to the general ledger. Further, out-of-date and missing standard costs led to large and increasing variances between actual and standard cost. By the end of 1997, capitalized variances accounted for forty-two percent of the value of inventory at the division.

As Warnaco's General Counsel, Silverstein became aware that IAD's accounting systems were antiquated. Silverstein also knew that, on the advice of its auditors, PwC, Warnaco hired PwC consultants to update and correct IAD's standard cost system ("the Standard Cost Project") in late 1997. In August 1998, PwC informed the board and management, including Silverstein, that the standard cost project had revealed that a material reduction in the value of IAD's inventory of $60 million or more might be required.

In the Fall of 1998, IAD completed its annual physical inventory count and attempted to reconcile the value of the physical inventory to the value of the inventory on IAD's books. The reconciliation process confirmed the findings of the standard cost project: the value of IAD's actual physical inventory was $60 million to $80 million ***less*** than the value recorded on IAD's internal records and publicly reported in Warnaco's periodic reports.

b. PwC's Audit Work Confirms the Overstatement

Warnaco informed PwC in late October or early November 1998 of the inventory discrepancy identified by the IAD reconciliation. Given the magnitude of the inventory discrepancy, the audit team informed Warnaco's senior management that PwC could not rely upon the company's books and records or internal control systems in determining the correct value of IAD's inventory. Instead, PwC created a new "valuation model" to revalue IAD's inventory, bypassing IAD's own accounting systems.

In the course of this work, PwC identified flaws in IAD's cost accounting system, including missing, incomplete and outdated standard costs, that had prevented the system from properly reducing the value of inventory recorded on Warnaco's books as inventory was sold. During a meeting in December 1998 and in subsequent discussions, PwC notified Warnaco's senior management, including Silverstein, of their findings. These findings were consistent with the errors the PwC consultants had identified in March 1998 during the Standard Cost Project.

In February 1999, the auditors completed their work and determined that Warnaco's inventory was overvalued by $159 million. Warnaco sought to treat the overstatement as start-up costs that would be written off as part of the company's adoption of new accounting pronouncement Statement of Position ("SOP") 98-5, which required companies to record start-up costs as they were incurred instead of amortizing them over time.[5] However, PwC determined that the inventory overstatement could not be written off as start-up costs and informed the company that it would have to restate its financial results for the preceding three years to correct the error.

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[5] "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, AICPA Statement of Position 98-5 ("SOP 98-5") required companies to record start-up costs as expenses 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.

Over the course of two days in late February 1999, Silverstein attended a series of meetings between PwC and Warnaco's senior management. During these meetings, senior management attempted to convince the auditors that Warnaco should be permitted to write off the overstatement as start-up costs under SOP 98-5. After reviewing the information provided by Warnaco in the light most favorable to the company, PwC determined that, at most, only $14 million of the overstatement arguably could be reclassified as start-up costs. The remaining $145 million could not be written off as start-up costs.

The auditors informed Silverstein and other members of Warnaco's senior management of this decision at the end of the day on Sunday, February 29, 1999. Silverstein and other members of senior management were also present the next day, March 1, 1999, when PwC informed Warnaco's board of directors that the inventory error could not be written off under SOP 98-5 and would require Warnaco to restate its financial statements for a three-year period.

As shown below, the restatement had a material impact upon the company's previously reported results for 1996, 1997, and the first three quarters of 1998:

	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

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

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 annual report, the notes to the audited financial statements explained the restatement by claiming that the inventory "revision" was the result of "start-up related and production inefficiency costs" identified by the company during its adoption of new accounting standard SOP 98-5. Specifically, 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>

> Such start-up related production and inefficiency costs have been classified in other assets and inventories. 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[.] *(emphasis added)*

The Form 10-K was misleading and inaccurate. 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.

As general counsel of Warnaco, Silverstein reviewed the fiscal 1998 Form 10-K and approved its filing. Silverstein knew or should have known that the disclosures contained in the Form 10-K mischaracterized the cause of the restatement. Silverstein knew or should have known that there were significant flaws in IAD's cost accounting and internal control systems. From his attendance at the meetings with PwC in late February and early March 1999, Silverstein knew or should have known that Warnaco's auditors had determined the inventory overstatement could not be attributed to misclassified start-up costs. Silverstein also knew or should have known that it was incorrect to imply that the restatement was related to the adoption of SOP 98-5.

Warnaco did not correct the misleading disclosure until May 16, 2000, when it filed an amended 1998 Form 10-K. The amended report removed all references to start-up related production and inefficiency costs and for the first time, informed investors that:

> *Reclassifications and Restatement:* . . . 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.

d. Silverstein's Bonus

As an executive of the company, Silverstein participated in Warnaco's Incentive Compensation Plan. The plan provided for bonuses of up to 100 percent of salary, based upon certain criteria. In 1998, executives at the company were eligible to receive a bonus if Warnaco met certain EBIT (earnings before interest and taxes), inventory turn, and cash flow targets.

Warnaco met the 1998 cash flow target, but did not meet the inventory turn target. Warnaco did not meet the EBIT target, either, due to the effect of the $145 million restatement upon the company's income. However, Warnaco calculated the company's EBIT as if the restatement had never occurred. By doing so, Warnaco appeared to meet the EBIT target, resulting in larger bonuses for the executives, including Silverstein, than they should have received. As a result of the improper EBIT calculation, Silverstein received an additional $125,305 in Incentive Compensation for 1998.

2. Improper Offset of Debt Against Cash in the Third Quarter of 2000

In the Summer of 2000, due to its deteriorating financial situation, Warnaco was unable to meet the financial covenants of its long-term debt, which totaled nearly $2 billion. The company sought and subsequently obtained waivers of the financial covenants from its banks. It then entered into a series of negotiations with its bank consortium to restructure its long-term debt. As Warnaco's general counsel, Silverstein participated in these negotiations as one of Warnaco's representatives. The negotiations culminated in an agreement between the banks and Warnaco that was signed on October 6, 2000.

On November 2, 2000, Warnaco publicly announced its earnings for the third quarter of 2000. In the consolidated balance sheet attached to the press release, Warnaco reported that it had shareholders' equity of $348 million, cash of $227 million, and debt of $1.79 billion as of the end of the third quarter on September 30, 2000.

Shortly after the press release was issued, Warnaco's lenders contacted Warnaco to inquire whether the company was in compliance with the financial covenants in its license agreement with Calvin Klein, Inc. The financial covenants in that license required Warnaco to maintain a debt-to-equity ratio of less than 5-to-1. The debt and equity amounts reported in the earnings release, however, revealed that Warnaco's debt-to-equity ratio had risen above 5-to-1. Under the terms of the licensing agreement, a violation of the covenant could result in termination of the license, which accounted for more than twenty-five percent of Warnaco's gross revenues.

After Warnaco's then-CFO confirmed that the lenders' calculations were correct, the CFO decided to retroactively offset the company's cash on hand as of September 30 against its debt, which would reduce Warnaco's debt on paper and create the appearance that Warnaco had remained in compliance with the debt-to-equity covenant as of the end of the quarter. The CFO asked Silverstein to send a letter to the auditors confirming that Warnaco and its lenders had entered into a legally enforceable agreement as of September 29, 2000 that Warnaco's cash on hand would be offset against its debt. Silverstein sent the letter without ascertaining whether a legally enforceable agreement had been reached by that date. No legally enforceable agreement existed as of September 30.

On November 12, 2000, Warnaco filed its quarterly report on Form 10-Q for the third quarter of fiscal 2000. At the CFO's direction, the company used the revised debt and cash amounts to prepare the consolidated balance sheet for the report. Using the revised amounts, Warnaco's debt-to-equity ratio was slightly less than 5-to-1, thereby creating the appearance that the company remained in compliance with the Calvin Klein licensing agreement. The quarterly report did not disclose that the cash and long-term debt amounts it reported differed from the amounts Warnaco had previously announced in its earnings release on November 2, 2000. Nor did the report disclose that Warnaco had offset $190.5 million in cash against long-term debt in order to reach the reported cash and debt amounts. As General Counsel of the company, Silverstein reviewed and signed Warnaco's Form 10-Q.

The revised cash and debt amounts that Warnaco reported in its Form 10-Q were not calculated in conformity with GAAP. Under Financial Accounting Standards Board ("FASB") Interpretation No. 39 ("FIN 39"), accounts can be offset only in certain limited instances:

> [T]he offset of assets and liabilities in the balance sheet is improper except where a right of setoff exists. . . . A right of setoff exists when all of the following conditions are met: (a) Each of *two* parties owes the other determinable amounts; (b) The reporting party has the right to set off the amount owed with the amount owed by the other party; (c) The reporting party intends to set off; and (d) The right of setoff is enforceable at law.

FIN 39 also states that cash cannot be treated as an amount owed to the depositor by the financial institution and cannot be subject to set-off.

None of the FIN 39 requirements were met. FIN 39 specifically prohibits the set off of cash held on deposit at a financial institution, and therefore Warnaco could not treat its cash deposits as a "debt" owed to it by the banks. Moreover, there was no legally enforceable agreement between the company and its banks to repay the $190.5 million that was setoff. Finally, Warnaco never repaid $190.5 million, indicating that there was no agreement to offset that amount. Therefore, under GAAP, Warnaco was not permitted to offset the $190.5 million against debt. As a result, the quarterly report was misleading.

D. Violations

Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers whose securities are registered with the Commission pursuant to Section 12 of the Exchange Act to file annual reports with the Commission. These reports must be complete and accurate in all material respects. *United States v. Bilzerian*, 926 F.2d 1285, 1298 (2d Cir. 1991). Rule 12b-20 of the Exchange Act requires that an issuer's periodic reports include any additional information "as necessary to make the required statements, in the light of the circumstances under which they are made, not misleading." 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).

By filing an fiscal 1998 Form 10-K annual report on April 2, 1999 that misleadingly and inaccurately described the reason for the restatement of the company's financial statements, Warnaco violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder. Silverstein willfully aided and abetted and caused Warnaco's violation of Section 13(a) and Rules 12b-20 and 13a-1 by approving the annual report that he knew or should have known contained a materially inaccurate and misleading description of the reasons for the company's restatement and the cause of the inventory overstatement.

By filing a third quarter 2000 Form 10-Q quarterly report on November 12, 2000 that improperly offset $190.5 million in cash against long-term debt, Warnaco violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder. Silverstein willfully aided and abetted and caused Warnaco's violation of Section 13(a) and Rules 12b-20 and 13a-13 thereunder by approving and signing a quarterly report that he knew or should have known did not accurately represent Warnaco's debt and cash.

E. Findings

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

F. Undertakings

Silverstein undertakes and agrees that, for a period of two years from the date of the issuance of the Order:

1. He will not sign any documents to be filed with the Commission, except for those filings made in his individual capacity that relate to his personal stock holdings; and

2. He will not participate in or be responsible for the preparation or review of any documents to be filed with the Commission, except for those filings made in his individual capacity that relate to his personal stock holdings. Although he may provide information to others, upon request, for inclusion into documents to be filed with the Commission by or on behalf of Warnaco or another public company, he must provide a copy of any such information to the Audit Committee of the Board of Directors of such company.

In determining whether to accept the Offer, the Commission has considered the undertakings set forth in the preceding paragraph.

IV.

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

ACCORDINGLY, IT IS HEREBY ORDERED, effective immediately,

A. Pursuant to Section 21C of the Exchange Act, Silverstein cease and desist from causing any violations and any future violations of Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 promulgated thereunder.

B. Pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, Silverstein is hereby censured.

C. IT IS FURTHERED ORDERED that Silverstein shall, within ten days of the entry of this Order, pay disgorgement and prejudgment interest in the total amount of $165,772 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies Stanley P. Silverstein as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 450 5th Street N.W., Washington, D.C. 20549-0801.

By the Commission.

Jonathan G. Katz
Secretary