

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54994 / December 21, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2528 / December 21, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12515

In the Matter of	:	
	:	ORDER INSTITUTING CEASE-AND-
Interstate Bakeries Corporation,	:	DESIST PROCEEDINGS, MAKING
	:	FINDINGS, AND IMPOSING A CEASE-
Respondent.	:	AND-DESIST ORDER PURSUANT TO
	:	SECTION 21C OF THE SECURITIES
	:	EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Interstate Bakeries Corporation (“Respondent,” “IBC,” or “the Company”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) 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 it and over the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:¹

RESPONDENT

1. Interstate Bakeries Corp. ("IBC"), a Delaware corporation headquartered in Kansas City, Missouri, is one of the nation's largest wholesale bakers and distributors of fresh baked breads and snack cakes, selling Wonder, Dolly Madison, Hostess, and other well-known brands. On September 22, 2004, IBC voluntarily filed a bankruptcy petition seeking relief under chapter 11 of title 11 of the United States Bankruptcy Code, and currently is planning to reorganize.²

IBC's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act until it was delisted from the NYSE in September 2004, after the Company filed the bankruptcy petition. Since that time, IBC's stock has been deemed registered under Section 12(g). It currently is quoted in the Pink Sheets.

OVERVIEW

2. As described below, IBC violated the record-keeping, internal controls and reporting provisions of the Exchange Act in connection with its financial reporting of its workers' compensation reserves and, consequently, its earnings during the second and third quarters of fiscal 2004.³ During those periods, IBC's then principal financial officer disregarded the estimates of its future workers' compensation liabilities provided by its insurance consultant, on which IBC historically had relied for this critical piece of its workers' compensation reserve analysis. Instead of recording the \$30 to \$32 million in additional workers' compensation reserves that IBC's insurance consultant had estimated and confirmed with an independent actuarial firm, the principal financial officer set IBC's quarterly workers' compensation reserve for the fiscal 2004 second and third quarters using obsolete information and estimates derived from a methodology that he had been advised was no longer considered reliable.

3. The principal financial officer, whose quarterly reserve determinations were not reviewed by other IBC personnel, failed to disclose to IBC's accountants, its board, its Audit Committee, its auditor, and the public that IBC had disregarded its consultant's estimates in

¹ 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.

² *In re Interstate Bakeries Corporation*, Case No. 04-45814-jwv11 (W.D. Mo.).

³ IBC ends its fiscal year on the Saturday closest to the last day of May. Most of IBC's reporting years contain 52 weeks of operating results, while every fifth or sixth year includes 53 weeks. In addition, each quarter of its fiscal year represents a period of 12 weeks, except the third quarter, which covers 16 weeks, and the fourth quarter of any 53-week year, which covers 13 weeks.

setting the second and third quarter 2004 reserves. As a result, IBC's financial statements contained in its Forms 10-Q for the fiscal second and third quarters 2004 understated the Company's reserves by at least \$30 million. Because IBC failed to record the expense necessary to increase the reserve, the Company materially overstated its fiscal second quarter pre-tax income in its Form 10-Q for the period ended November 15, 2003, and its cumulative fiscal third quarter pre-tax income in its Form 10-Q for the period ended March 6, 2004.⁴

BACKGROUND

4. IBC historically has self-insured for its estimated workers' compensation liabilities. As a self-insurer, IBC is required to accrue a reserve for the potential losses associated with its workers' compensation self-insurance program when the loss contingency is probable and the Company can estimate the amount of the loss. *See* Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, ("FAS 5"). The nature of the contingency, the amount of the accrual, and, if appropriate, the possibility of further losses should be disclosed if doing so is necessary to prevent the financial statements from being misleading. Even if the loss contingency is reasonably possible, rather than probable, FAS 5 requires IBC to disclose in its financial statements the possibility of the additional loss, the nature of the loss contingency, and an estimate of the possible loss or range of loss.⁵

5. From at least the mid-1990s through fiscal 2004, IBC's principal financial officer, or *de facto* chief financial officer,⁶ set IBC's workers' compensation reserve quarterly relying upon an actuarially-based estimate from the Company's insurance consultant. No one at IBC substantively reviewed the principal financial officer's quarterly workers' compensation reserve determination, or the methodology or rationale for his reserve determination.

6. Toward the end of fiscal 2003, in early May 2003, IBC's insurance consultant advised the principal financial officer that because of recent anomalies in IBC's loss experiences, the insurance consultant's methodology for estimating IBC's future liability for workers' compensation claims potentially was no longer reliable. The insurance consultant further advised that even under this possibly unreliable methodology, IBC likely had a \$16 million deficit in its reserve accrual, and that, if other methodologies were used to calculate the reserve, IBC's reserve deficit could be substantially higher.

⁴ On December 20, 2006, the Commission filed a district court action against IBC's former principal financial officer seeking a permanent injunction, civil penalties and additional relief. *See* Litigation Rel. No. 19951 (December 20, 2006).

⁵ A loss is probable if it is likely to occur, and it is reasonably possible if the chance of the loss occurring is more than remote but less than likely. FAS 5, ¶3.

⁶ Despite financial challenges in fiscal 2003, IBC postponed hiring a new CFO until fiscal 2005 after its former CFO retired in May 2003, in part because a qualified CFO would be expensive and would skew the Company's compensation scale.

7. At the same time, IBC's auditors scrutinized the reserve and developed their own estimates as part of the fiscal 2003 audit. This action ultimately prompted IBC to add \$15 million to its workers' compensation reserve in the fourth quarter of fiscal 2003, which brought the total to approximately \$103.6 million, or the low end of the range that the auditor had determined was acceptable. In July 2003, IBC announced that it would report \$.61 per share earnings in fiscal 2003, down substantially from the prior year's earnings of \$1.36 per share, due in part to the workers' compensation reserve increase. IBC's stock price fell more than 10% after the July 14 announcement.

IBC UNDERSTATES ITS WORKERS' COMPENSATION RESERVE

8. In late July or early August 2003, the insurance consultant, in conjunction with discussing its estimate of IBC's workers' compensation liability for the fiscal first quarter 2004, reiterated its concerns about the reliability of the methodology it was using. The report itself continued its reliance on the same methodology, but the insurance consultant again advised IBC's principal financial officer that it was considering changing methodologies, and indicated that if a different methodology was used, IBC's workers' compensation liability could be considerably higher than the then current reserve.

9. In early November 2003, IBC's insurance consultant advised IBC's principal financial officer that, consistent with the concerns it had expressed in the two prior quarterly meetings, it had changed the methodology it used to estimate IBC's workers' compensation reserve. The insurance consultant indicated that it estimated IBC's workers' compensation reserve should be within a range from \$134 million to \$152.2 million. The low end of this estimate was approximately \$32 million higher than IBC's fiscal first quarter 2004 reserve. The principal financial officer did not accept the insurance consultant's report for the quarter, in part because of concerns about the impact of the estimate on IBC. Instead, the insurance consultant and the principal financial officer agreed that the insurance consultant would hire an actuarial firm to substantiate its estimate.

10. By at least early December 2003, the insurance consultant informed the principal financial officer that it had confirmed its new, much higher estimate with an independent actuarial firm. The principal financial officer failed to disclose the insurance consultant's change of methodology, its new, much higher workers' compensation reserve estimate, or the independent confirmation of the consultant's new estimate to IBC accountants, the Company's board, its Audit Committee, or its auditor. As a result, IBC failed to disclose these material facts or contingencies to the investing public in its fiscal second quarter 2004 Form 10-Q or in its second quarter earnings releases, which were filed with the Commission on a Form 8-K.

11. Instead, IBC set its workers' compensation reserve at approximately \$101.6 million, or \$32 million below the low end of the insurance consultant's estimate range. If, consistent with the consultant's estimate, IBC had recorded a current period expense to increase its reserve by the additional \$32 million, the Company's pretax earnings for the period would have been reduced by a corresponding amount. Consequently, IBC reported fiscal second quarter 2004 pretax income of \$11.25 million when it should have reported a substantial loss.

12. In early February 2004, during IBC's fiscal third quarter 2004, IBC's insurance consultant, after updating the numbers to reflect the most recent quarter, advised the Company's principal financial officer that its workers' compensation reserve estimate essentially had not changed. Later in February 2004, the insurance consultant provided IBC with a reserve estimate of \$137 million. The principal financial officer again failed to disclose the insurance consultant's change of methodology, its new, much higher workers' compensation reserve estimate, or the independent confirmation of the consultant's new estimate to IBC's accountants, its board, its Audit Committee, or its auditor. As a result, IBC again failed to disclose these material facts or contingencies to the investing public in its fiscal third quarter 2004 Form 10-Q or in its third quarter earnings releases, filed on Form 8-K.

13. IBC instead set the third quarter fiscal 2004 workers' compensation reserve at \$107 million, approximately \$30 million below the low end of the most recent estimate provided by its insurance consultant. As a result, IBC materially understated its workers' compensation reserve, and the company reported pre-tax income of \$15,394,000 for the 40 weeks ended March 6, 2004, when it should have reported a substantial loss.

14. During the fiscal second and third quarters of 2004, IBC was close to violating its debt covenants, and likely would have violated those covenants had it used its insurance consultant's workers' compensation reserve estimate in setting its reserve for those periods.

15. In early May 2004, IBC's principal financial officer advised IBC's Audit Committee that management was reviewing the workers' compensation reserve for a possible year-end charge in the fourth quarter, without disclosing the potential magnitude of the issue. In late May 2004, IBC management advised the board, the Audit Committee, and IBC's auditor of the workers' compensation reserve issue and the magnitude of the anticipated reserve increase. Upon learning this information, the IBC board reacted by directing disclosure of the issue to the public and commencing an internal investigation, first by company counsel and then by the Audit Committee, as advised by independent counsel. On June 3, 2004, IBC announced that it had increased its workers' compensation reserve during fiscal 2004 with a charge to pretax income of approximately \$40 million, and that it was reviewing whether all or part of the charge related to earlier quarters, thus necessitating a restatement of fiscal 2004 quarterly results of operations.

16. IBC has failed to timely file Forms 10-K for fiscal 2004, 2005, and 2006, and has failed to timely file Forms 10-Q for each of its fiscal 2005 and fiscal 2006 quarters.

VIOLATIONS

17. As a result of the conduct described above, IBC violated Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder. Section 13(a) of the Exchange Act requires issuers to file periodic reports with the Commission containing such information as the Commission prescribes by rule. Exchange Act Rules 13a-1 and 13a-13 require issuers to file annual and quarterly reports, respectively, and Rule 13a-11 requires issuers to file current reports. Under Exchange Act Rule 12b-20, such

reports must contain, in addition to disclosures expressly required by statute and rule, such other information as is necessary to ensure that the statements made are not materially misleading under the circumstances. Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act require issuers to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer and to maintain an adequate system of internal controls, respectively.

IV.

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

Accordingly, it is hereby ORDERED that Respondent IBC cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary