**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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| **SECURITIES AND EXCHANGE COMMISSION,**<br><br>**Plaintiff,**<br>**v.**<br><br>**WILLIAM S. FINKELSTEIN,**<br><br>**Defendant.** | **Civil Action No. 04 CV 3574 (SAS)**<br><br>**COMPLAINT** |

Plaintiff Securities and Exchange Commission (the "Commission") alleges as follows:

## SUMMARY

1. On March 2, 1999, Warnaco issued a false and materially misleading press release reporting its earnings for the fourth quarter and fiscal year 1998. The press release, which reported "record results," failed to disclose that Warnaco would be restating its financial results for the prior three years to correct a $145 million inventory overstatement. Instead, Warnaco hid the true reason for the write-down of inventory. In the press release, Warnaco characterized the inventory write-down as part of the company's write-off of deferred start-up costs under a new accounting pronouncement, American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 98-5. At the time that it issued the press release, Warnaco knew that it could not account for the inventory overstatement as part of its adoption of SOP 98-5, because the error did not involve deferred start-up costs. In fact, the overstatement had been caused by material defects in Warnaco's inventory accounting and internal control systems that had allowed inventory to become overstated by more than twenty percent over a period of years.

2. On April 2, 1999, Warnaco filed a misleading fiscal 1998 annual report with the Commission. The report disclosed that Warnaco had restated its 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 Warnaco's net loss for 1996 from $8.2 million to $31 million. However, the annual report did not disclose the true cause of the $145 million restatement. As it had done in the press release, Warnaco claimed in the annual report that the restatement resulted from the write-off of previously-deferred "start-up related" costs identified in connection with Warnaco's adoption of SOP 98-5.

3. In the fall of 2000, Warnaco issued a misleading and inaccurate quarterly report for the third quarter of 2000. Warnaco improperly offset its reported debt and cash balances in order to create the appearance that Warnaco was in compliance with certain financial covenants in its largest licensing agreement. This offsetting of cash against debt was improper under generally accepted accounting principles ("GAAP") and necessitated a restatement in April 2001. As CFO, Finkelstein directed the offsetting of cash against debt. He also reviewed and signed the quarterly report.

## JURISDICTION

4. This Court has jurisdiction over this matter pursuant to Sections 21(d), 21(e) and 27 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

## DEFENDANT

5. William S. Finkelstein, age 55, is a resident of Fairfield, Connecticut. From May 1995 until February 2001, he was the senior vice president and chief financial officer ("CFO") of Warnaco.

## OTHER ENTITIES

6. The Warnaco Group, Inc. 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 a voluntary petition for protection under Chapter 11 of the U.S. Bankruptcy Code 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."

7. PricewaterhouseCoopers LLP ("PwC") is an international 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. Warnaco dismissed PwC as its auditor on November 18, 1999.

## FACTUAL ALLEGATIONS

### 1. Inventory Restatement

#### a. Background

8. 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.

9. During the period from 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 did not have a reliable perpetual inventory system or other means for accurately determining the value of its inventory on 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.

10. Like many manufacturing companies, Warnaco used a "standard cost system" to value its inventory internally. The standard costs were based on the estimated cost to produce inventory. GAAP permits a company to use a standard cost system for internal accounting. However, the company must adjust the value of the inventory to actual cost 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; 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 assets) and decreases the company's expenses (thus increasing its net income).

11. However, IAD's standard cost system was old and prone to error. Many of the components of the standard costs had not been updated in years. In some instances, the standard costs were missing entirely, meaning that Warnaco treated some items as if it had cost nothing to produce them and relied on a manual system to cost these items. Because much of the data in

IAD's standard cost system was outdated or missing during the period 1996-1998, the division experienced large variances between standard and actual costs each year. The larger the variances, the greater the risk that Warnaco was not accurately reporting its inventory. Indeed, as a result of the shortcomings in the standard cost system, capitalized variances accounted for $42 million of IAD's inventory by 1997, more than 40 percent of the total value of the division's inventory.

12. Members of Warnaco's senior management, including its chief financial officer, William Finkelstein, knew that IAD's accounting and internal control systems were antiquated and prone to error. However, Warnaco did not take sufficient measures to correct the errors in a timely manner. Warnaco's independent auditors, PwC, had warned Warnaco as part of its 1996 and 1997 audits that the standard cost system needed to be updated to eliminate the large variances.

### b. <u>Discovery of the Inventory Overstatement</u>

13. In mid-1997, on PwC's recommendation, Warnaco hired consultants from PwC to update and correct IAD's standard cost system ("the Standard Cost Project"). As part of the Standard Cost Project, PwC consultants examined IAD's inventory accounts and preliminarily concluded by the spring of 1998 that the inventory accounts were potentially overstated by at least $60 million. The consultants conveyed their findings to Warnaco's senior management during a meeting on March 31, 1998. By June 1998, IAD personnel working with the PwC consultants confirmed these findings and identified another $23 million in improperly recorded inventory. Senior management at the company was informed that the potential overstatement could be as high as $83 million. However, no adjustments were made at that time.

14. In June 1998, after Warnaco informed PwC that the company internally estimated that its inventory was overvalued by at least $80 million, PwC recommended that Warnaco begin amortizing the adjustment over a period of years. Warnaco declined to record the adjustment until the Standard Cost Project was completed and the total amount of the overstatement was determined. PwC acceded to this request.

**c. <u>PwC's Audit Work Confirms the Overstatement</u>**

15. In the fall of 1998, IAD completed its annual physical inventory count and attempted to reconcile the physical inventory to the value of the inventory recorded on IAD's books. The reconciliation process resulted in a book to physical inventory difference: 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. This result was consistent with the findings of the Standard Cost Project.

16. After being informed of the results of the physical inventory reconciliation, Finkelstein directed IAD's controller to examine the division's cost accounting system for defects that could have caused the inventory overstatement. In early October 1998, IAD's controller delivered to Finkelstein a memorandum detailing significant defects in IAD's cost accounting system, including the improper capitalization of variances and missing or incomplete cost data in the system. The controller advised that these defects caused at least part of the overstatement. However, Finkelstein dismissed the controller's findings as "preliminary" and did not take sufficient action to investigate the flaws identified by the controller.

17. In late October or early November 1998, Finkelstein informed PwC of the significant discrepancy identified in the IAD reconciliation process. Finkelstein advised PwC that Warnaco could not explain the cause of the reconciliation discrepancy, and asked PwC

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 PwC's National Office, the audit team advised Finkelstein that GAAP did not permit such accounting treatment.

18. Finkelstein and Warnaco's then-CEO asserted to PwC that the overstatement must be due to "start-up costs" that had been erroneously recorded into inventory. Finkelstein proposed writing off the inventory discrepancy as part of Warnaco's early adoption of a new accounting principle, AICPA Statement of Position ("SOP") 98-5, which required companies to record start-up costs as they were incurred, rather than amortizing them over time. However, Finkelstein did not provide sufficient evidence to support this claim at that time.

19. "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 the expense over a period of years. However, 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.

20. Warnaco had a very expansive start-up policy that deemed all new or expanded plants to be in start-up phase for up to three years from the time they began operating. During this phase, Warnaco classified all of the plant's operating expenses above the standard cost as start-up, and recorded them each quarter into a separate "start-up account" on its books. Finkelstein oversaw this process; PwC audited the start-up accounts each year. As of year-end 1998, Warnaco had over $71 million recorded in its start-up accounts that would be written off under SOP 98-5.

21. Given the magnitude of the inventory discrepancy, PwC informed Finkelstein and Wachner that PwC could not rely upon Warnaco's books and records or internal control systems in determining the correct value of IAD's inventory. Instead, after Finkelstein conceded that the company had neither the personnel nor the expertise to complete the reconciliation or correctly value inventory, the audit team engaged some of the same consultants who had worked on the Standard Cost Project to create a new system for valuing IAD's inventory. PwC also required Warnaco to complete another physical inventory count, overseen 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.

22. In the course of its work, PwC identified certain flaws in IAD's cost accounting system, including missing or incomplete standard costs and the division's failure to update or maintain the standard cost files over the prior five years, 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 Finkelstein, of its findings.

23. In February 1999, PwC completed its work and determined that Warnaco's inventory was overvalued by $159 million. PwC also determined that this overstatement could not be written off under SOP 98-5 and informed Warnaco that it would have to restate its financial results for the preceding three years. Finkelstein and the company's then-CEO did not accept PwC's conclusion. Over the course of a two-day meeting held in late February 1999, Finkelstein and other members of senior management attempted to convince PwC that the overstatement should be written off under SOP 98-5.

24. At the start of the two-day meeting, Finkelstein gave PwC for the first time 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 position, 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 arguably could be reclassified as start-up costs. The remaining inventory overstatement – $145 million – could not be written off as deferred start-up costs under SOP 98-5.

25. Accordingly, at the conclusion of the two-day meeting, PwC told Finkelstein and the rest of the company's senior management that: (i) the overstatement must be accounted for as the correction of an error, thus necessitating a restatement of previously-reported financial statements; and (ii) PwC would not certify financial statements that attributed the overstatement to deferred start-up costs being written off under SOP 98-5.

26. The following day, PwC informed Warnaco's board of directors that the inventory error could not be written off under SOP 98-5 and would require the company to restate its financial results for a three-year period. As CFO, Finkelstein attended the board meeting and participated in the discussion of the problem. At the end of the meeting, the board agreed that Warnaco would restate its financial results.

27. 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

### d. Warnaco Issues a False and Misleading Press Release

28. On March 1, 1999, shortly after the board meeting concluded, Finkelstein gave PwC a draft press release announcing the company's fiscal 1998 results. In the draft release, Warnaco touted "record" earnings results and falsely characterized the inventory error as a part of Warnaco's write-off of deferred start-up costs pursuant to SOP 98-5, stating that:

> Included in this fiscal year is the <u>early adoption of the change in accounting for start-up costs that writes-off non-cash accumulated costs previously deferred, relating to the start-up of new and expanded manufacturing operations</u>. The amount of this charge in fiscal year 1998 is $104.8 million, net of tax. In connection with the inventory costs related to start-up activities and write-offs, $35.5 million, net of tax, and $23.2 million, net of tax, have been reflected in the statement of operations for fiscal years 1997 and 1996, respectively. (Emphasis added.)

29. The pro forma statement of operations attached to the press release also misleadingly combined both the 1998 portion of the inventory overstatement and Warnaco's actual write-off under SOP 98-5 into a single entry called "Write-off of Deferred Start-Up." Thus, Warnaco reported that it would be writing off, on a net of tax basis, start-up costs of $104.8 million. In fact, Warnaco wrote off only $72.6 million in start-up costs. The remaining amount written off by Warnaco, $90.7 million, ($32.1 million for 1998, plus the $35.5 million and $23.1 million identified in the press release as "inventory costs related to start-up activities and write-offs" for 1996 and 1997) was actually the correction of the inventory overstatement.

30. The draft press release gave no indication that Warnaco would be writing down its inventory by $145 million pre-tax (or $90.7 million after tax) to correct an inventory overstatement. Nor was there any indication that Warnaco had calculated its "record" earnings by ignoring the effect of the restatement. The press release failed to tell investors that the earnings reported in the press release were not presented in conformity with GAAP, and that Warnaco's annual report, which would be filed the following month, would report significantly lower net income and earnings, as indicated below:

| | ***3/1/99 Press Release ($ in thousands)*** | ***4/1/99 10-K ($ in thousands)*** |
|---|---|---|
| Operating Income | $ 282,758 | $ 85,575 |
| Pre-tax Income from Continuing Operations | $ 218,968 | $ 21,785 |
| Income before Charges and Accounting Change | $ 141,672 | $ 14,097 |

31. The PwC engagement partner advised Finkelstein that the press release was inconsistent with the way the financial statements would be presented in Warnaco's upcoming 1998 annual report. Despite these warnings, Finkelstein replied that Warnaco would nevertheless issue the press release. Warnaco issued the misleading press release, substantially unchanged, the following day.

32. Warnaco's stock traded slightly higher on the news of Warnaco's reported "record" results.

**e. <u>Warnaco's 1998 Annual Report</u>**

33. On April 2, 1999, Warnaco filed its annual report on Form 10-K for fiscal 1998. In this report, Warnaco restated its financial results for fiscal 1996-1998 to reduce inventory and increase cost of goods sold by $145 million, as required by GAAP. Warnaco misleadingly continued to claim, however, that the restatement related to the adoption of SOP 98-5. In the

notes to the audited financial statements, Warnaco explained the restatement as an inventory revision resulting from deferred "start-up related and production inefficiency costs" identified as part of Warnaco's adoption of new accounting standard SOP 98-5.

34. 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. 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 cost of goods sold[.]</u> (Emphasis added.)

35. The Form 10-K report was misleading. The restatement was not the result of previously-deferred start-up costs and was not related to Warnaco's adoption of SOP 98-5. Rather, the restatement was precipitated by a material failure of Warnaco's inventory accounting and internal control systems. 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 Warnaco's accounting system to properly deduct costs from inventory as goods were sold.

36. As Warnaco's CFO, Finkelstein oversaw the preparation of the annual report and approved the misleading disclosures. He also signed the annual report. Finkelstein knew or should have known that the annual report mischaracterized the cause of the restatement. He was aware that there were certain flaws in IAD's cost accounting and internal control systems. He also knew that, as early as March 1998, the PwC consultants had identified a potential inventory overvaluation of more than $60 million, due to the company's improper capitalization of inventory costs and that IAD personnel had subsequently uncovered a book to physical adjustment of $60 million or more.

He also knew that PwC had determined that the inventory overstatement could not be attributed to misclassified start-up costs, and was aware that the inventory overstatement was not related to Warnaco's adoption of SOP 98-5.

37. Warnaco did not correct the disclosure until May 16, 2000, over a year later, 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.

**f. Finkelstein's Bonus**

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

39. As CFO of Warnaco, Finkelstein oversaw the bonus calculations. In 1998, Warnaco met the 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, Finkelstein and others decided that Warnaco should calculate its EBIT without including the effect of the restatement. By doing so, Warnaco appeared to meet the EBIT target, resulting in larger bonuses for the senior executives, including Finkelstein, than they should have received.

40. As a result of the improper EBIT calculation, Finkelstein's bonus was $143,213 larger than it should have been.

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

41. In the summer of 2000, due to its deteriorating financial situation, Warnaco was faced with the possibility of being unable to meet the financial covenants of its long-term debt, which totaled nearly $2 billion. Warnaco 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. The negotiations culminated in an agreement between the banks and Warnaco that was signed on October 6, 2000.

42. 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 issued that day,, 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. In the conference call with investors held that day, Finkelstein reported that "[d]ebt net of cash was $1.644 billion."

43. Shortly after the press release was issued, Warnaco's lenders contacted Warnaco to inquire whether, based upon the numbers reflected in the press release, the company was in compliance with the financial covenants in Warnaco's 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.

44. After Finkelstein confirmed that the lenders' calculations were correct, he consulted with the company's new auditors to determine whether there was any provision of GAAP that would permit the company to offset cash against debt. After consulting with the

auditors, Finkelstein decided to retroactively offset Warnaco'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. In order to convince Warnaco's auditors that the cash against debt set-off was proper under GAAP, at the request of Warnaco's auditors, Finkelstein asked Warnaco's general counsel to send a letter to the auditors stating 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. The general counsel sent the letter without ascertaining whether a legally enforceable agreement had been reached by that date. Finkelstein knew or should have known that there was no legally enforceable agreement requiring Warnaco to repay the money to its banks.

45. On November 12, 2000, Warnaco filed its quarterly report on Form 10-Q for the third quarter of fiscal 2000. At Finkelstein's direction, Warnaco offset its cash on hand as of September 30 against its long-term debt to prepare the consolidated balance sheet for the report. The balance sheet reported cash of $36.5 million and long-term debt of $1.6 billion. By using the revised amounts, Warnaco's debt-to-equity ratio appeared to be slightly less than 5-to-1, indicating that Warnaco remained in compliance with the Calvin Klein licensing agreement. The quarterly report did not disclose that the reported cash and long-term debt amounts 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 CFO, Finkelstein approved and signed the quarterly report.

46. 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.

47. 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; there was no legally enforceable agreement between Warnaco and its banks to repay the $190.5 million that was setoff; and Warnaco never repaid the full $190.5 million. Therefore, under GAAP, Warnaco was not permitted to offset the $190.5 million against debt. As a result, the quarterly report was misleading.

## FIRST CLAIM FOR RELIEF

### Violation of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. 240.10b-5]

### Finkelstein Aided and Abetted Warnaco's Issuance of a False and Misleading Press Release

48. Paragraphs 1 through 47 are hereby realleged and incorporated herein by reference as if set forth fully.

49. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit materially false or misleading statements or omissions made in connection with the purchase or sale of securities.

50. Warnaco issued a false and misleading press release on March 2, 1999 that materially misrepresented Warnaco's financial results. The press release reported "record" earnings results without informing investors that these results were substantially greater than the audited results Warnaco would report the following month in its annual report. It obscured the material information that Warnaco's inventory was overstated by $145 million (more than 20 percent), and failed to disclose this overstatement had been caused by materially deficient accounting and internal control systems at Warnaco's largest division. Instead, Warnaco claimed that the inventory write-down was part of the write-off of start-up costs under new accounting pronouncement SOP 98-5, making it appear that these were costs incurred in growing the business when in fact Warnaco would be restating its financial results to correct the $145 million overstatement of its inventory. As a result of these acts and omissions, Warnaco violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder [15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5].

51. Finkelstein prepared and reviewed the press release that Warnaco issued on March 2, 1999. Finkelstein knew or was reckless in not knowing that the press release he prepared, reviewed, and allowed Warnaco to issue contained materially false and misleading statements. By his actions, Finkelstein provided substantial assistance to Warnaco and enabled Warnaco to issue the fraudulent press release.

52. By engaging in the conduct described above, Finkelstein aided and abetted Warnaco's violation of Section 10(b) and Rule 10b-5 of the Exchange Act.

## SECOND CLAIM FOR RELIEF

### Violation of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12-20, 13a-1, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240. 13a-1, 240.13a-13]

### Finkelstein Aided and Abetted Warnaco's Issuance of Misleading and Inaccurate Financial Statements

53. Paragraphs 1 through 47 are hereby realleged and incorporated herein by reference as if set forth fully.

54. Section 13(a) of the Exchange Act and Rule 13a-1 require that a public company file with the Commission annual reports that are factually accurate in all material respects. Exchange Act Rule 12b-20 requires that, in addition to the information expressly required to be included in a report, a public company must include such further material information as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.

55. Warnaco filed a misleading and inaccurate fiscal 1998 Form 10-K annual report on April 2, 1999 that falsely attributed Warnaco's $145 million restatement to "previously deferred" start-up related costs identified in connection with Warnaco's adoption of SOP 98-5. Warnaco failed to disclose that the restatement was precipitated by a material failure of Warnaco's inventory accounting and internal control systems and 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.

56. Warnaco also filed a misleading and inaccurate third quarter 2000 Form 10-Q quarterly report on November 12, 2000 that improperly offset $190.5 million in cash against debt in order to create the appearance that Warnaco remained in compliance with the Calvin Klein

licensing agreement. Warnaco's senior management knew or should have known that this offset was not in conformity with GAAP.

57. By this conduct, Warnaco violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder [15 U.S.C. § 78m(a); 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13].

58. By allowing Warnaco to issue the 1998 Form 10–K with misleading disclosures, and by reviewing and signing that report, Finkelstein substantially assisted Warnaco in committing violations of the reporting provisions of the Exchange Act. Finkelstein also reviewed and signed Warnaco's third quarter 2000 Form 10–Q filed on November 14, 2000. By directing that Warnaco offset $190.5 million in cash against debt, and by reviewing and signing the Form 10–Q, Finkelstein substantially assisted Warnaco in committing violations of the reporting provisions of the Exchange Act.

59. By this conduct, Finkelstein aided and abetted Warnaco's violation of Exchange Act Section 13(a) and Rules 12b-20, 13a-1, and 13a-13 [15 U.S.C. § 78m(a); 17 C.F.R. §§ 240.12b-20, 240.13a-1].

## THIRD CLAIM FOR RELIEF

### Violations of Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)]

### Finkelstein Aided and Abetted Warnaco's Violations of the Books and Records Requirements of the Exchange Act

60. Paragraphs 1 through 47 are hereby realleged and incorporated herein by reference as if set forth fully.

61. Section 13(b)(2)(A) of the Exchange Act requires that a public company make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of its assets.

62. During the period 1996 through 2001, Warnaco's books and records did not accurately reflect Warnaco's transactions. Specifically:

- During the period from at least 1996 through the end of 1998, as a result of the weaknesses in the IAD inventory accounting and internal control systems, Warnaco's books and records overstated the actual value of the company's inventory by $145 million.
- In November 1999, as a result of Warnaco's decision to improperly offset cash against long term debt, the company's books and records understated long-term debt and cash on hand by $190.5 million.

63. As Warnaco's chief financial officer, Finkelstein was responsible for ensuring that the company's books and records were accurate and that the company's internal controls were functioning properly. Despite learning as early as 1997 that there were errors in the IAD inventory accounts, Finkelstein did not take adequate steps to ensure that Warnaco's books and records were accurate or that its accounting systems were functioning properly. By his conduct, Finkelstein aided and abetted Warnaco's violations of Sections 13(b)(2)(A) [15 U.S.C. § 78m(b)(2)(A)].

## FOURTH CLAIM FOR RELIEF

### Violation of Section 13(b)(2)(B) of the Exchange Act [15 U.S.C. § 78m(b)(2)(B)]

### Finkelstein Aided and Abetted Warnaco's Violations of the Internal Control Requirements of the Exchange Act

64. Paragraphs 1 through 47 are hereby realleged and incorporated herein by reference as if set forth fully.

65. During the period from 1996 through at least 2001, Warnaco's internal control systems were inadequate to ensure that Warnaco's financial statements would be prepared in accordance with GAAP, as required by Section 13(b)(2)(B) of the Exchange Act.

66. Finkelstein knew that IAD's accounting and internal control systems had not been upgraded or replaced for decades, but did not take adequate steps to ensure that Warnaco's books and records were accurate or that its accounting systems were functioning properly. By his conduct, Finkelstein aided and abetted Warnaco's violations of Sections 13(b)(2)(B) [15 U.S.C. § 78m(b)(2)(B)].

## PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court enter a final judgment:

a. Permanently restraining and enjoining Finkelstein from aiding and abetting future violations of Sections 10(b), 13(a) and 13(b) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, and 13a-13 thereunder;

b. Ordering Finkelstein to pay disgorgement and prejudgment interest in the amount of $189,464;

c. Ordering Finkelstein to pay a civil money penalty in the amount of $75,000;

d. Prohibiting Finkelstein pursuant to Section 21(d)(2) from acting as an officer or director of any public company for a period of four years.

Respectfully submitted,

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