

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57211 / January 28, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2776 / January 28, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12939

In the Matter of

THOMAS H. BAUER, CPA,

Respondent.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO RULE 102(e) OF THE
COMMISSION'S RULES OF
PRACTICE, MAKING FINDINGS,
AND IMPOSING REMEDIAL
SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Thomas H. Bauer, CPA ("Bauer" or "Respondent"), pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.¹

II.

In anticipation of the institution of these proceedings, Bauer has submitted an Offer of Settlement ("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 him and the subject matter of these proceedings, which are admitted, Bauer consents to the entry of this Order Instituting Public Administrative Proceedings

¹ Rule 102(e)(1)(ii) provides that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . to have engaged in . . . improper professional conduct.

Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds² that:

A. SUMMARY

Enron Corp.'s ("Enron") senior executives engaged in a wide-ranging scheme to defraud the investing public by materially overstating the company's earnings and cash flows, and concealing debt in periodic reports filed with the Commission.³ The fraudulent scheme was carried out through a variety of complex structured transactions, related party transactions, misleading disclosures, and a widespread abuse of generally accepted accounting principles ("GAAP").

Arthur Andersen LLP ("Andersen") served as Enron's auditor, and for each year during the relevant time period, issued an auditor's report falsely stating that Enron's financial statements were presented fairly, in all material respects, in conformity with GAAP, and that Andersen had conducted its audit of those financial statements in accordance with generally accepted auditing standards ("GAAS"). Bauer served as one of the partners on the Enron engagement team and was responsible for the auditing of Enron's largest division. As specified in this Order, Bauer engaged in improper professional conduct by failing to design and implement auditing procedures adequate to address the known risk of fraud inherent in the Enron engagement in violation of GAAS.

B. RESPONDENT

Thomas H. Bauer, 54, served as one of the partners on the Enron engagement and was a CPA licensed in the state of Texas at all relevant times.

C. OTHER PARTIES

Enron Corp. was an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, Enron's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. Among other operations, Enron was the nation's largest natural gas and electric marketer, with reported annual revenue of more than \$100 billion. In 2000, Enron rose to number seven on the *Fortune 500* list of public companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped over the course of a year from more than \$80 per share to less than \$1.

² 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.

³ In connection with this fraudulent scheme, several former Enron executives either pleaded guilty or were convicted of felonies, including Enron's former Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer.

Arthur Andersen LLP once was one of the so-called “Big Five” accounting firms in the United States and had its headquarters in Chicago, Illinois. Andersen personnel performed work for Enron during the relevant time period in several cities, including Chicago, Houston and London.⁴

D. FACTS

1. Andersen Identified Enron as a Maximum Risk Client

Bauer was aware that the risk of fraudulent financial reporting at Enron was high. In accordance with applicable professional standards, Andersen assessed the risk of fraud at Enron (AU §316, *Consideration of Fraud in a Financial Statement Audit*), and Bauer should have known that Enron possessed many of the risk factors that should be considered in making that assessment. For example, Fraud Risk Assessment questionnaires prepared by the audit engagement team documented that Enron placed an “undue emphasis on meeting earnings targets;” used “highly aggressive accounting;” utilized “unusual” year-end transactions that posed difficult “substance over form” questions; possessed a “philosophy of significantly managing (maximizing or minimizing) earnings;” and had a “high dependence on debt, difficulty in meeting debt payments or vulnerability to interest rate changes.” In addition, an internal Andersen document prepared each year by the engagement team consistently classified the Enron engagement as involving “maximum risk” and noted that Enron’s use of complex “form over substance” and “related party” transactions created an “extreme” or “very significant” financial reporting risk. This document, called a “SMART,” was prepared each year to assist with the annual decision whether to retain Enron as an audit client. Bauer reviewed the SMART documents and also attended annual client retention meetings during which the risks identified above were discussed.

2. JEDI/Chewco Transaction

In May 1993, Enron teamed with the California Public Employees’ Retirement System (“CalPERS”) to form the Joint Energy Development Investments Limited Partnership (“JEDI”) to invest in natural gas assets. CalPERS contributed \$250 million and Enron funded its share of the joint venture with \$250 million of its own stock. Enron did not consolidate JEDI into its financial statements. Rather, it accounted for JEDI using the equity method and recorded its share of gains and losses from JEDI in its financial statements.

In 1997, Enron proposed to CalPERS that a new, larger partnership be formed – JEDI II. CalPERS representatives were hesitant to enter into JEDI II because they felt that CalPERS’ board of directors would not approve the increased exposure to Enron. Thus, Enron offered to buy out

⁴ David B. Duncan served as the global engagement partner for Andersen’s audits of Enron from 1997 until December 2001. Contemporaneously with the filing of this Order, the Commission filed a settled civil injunctive action in the U.S. District Court for the Southern District of Texas, Houston Division, against Duncan, in which Duncan consented to be permanently enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Upon entry of the injunction by the Court, Duncan has also offered to settle an administrative proceeding by the Commission in which he agrees to be permanently barred from appearing or practicing before the Commission as an accountant.

CalPERS' interest in JEDI. CalPERS agreed and a \$383 million purchase price was negotiated. Because Enron did not want to bring JEDI's debt onto its balance sheet, Enron formed a special purpose entity ("SPE") named Chewco Investments L.P. ("Chewco") to step into the shoes of CalPERS. An Enron employee, Michael Kopper ("Kopper"), managed Chewco's business affairs and also invested personally in Chewco.

To properly treat Chewco as an off-balance sheet SPE, GAAP required the partnership to have independent outside investors who had at least a three percent equity investment in Chewco. These investors also needed to control the SPE and have the substantive risks and rewards of ownership associated with the SPE. The transaction, however, did not satisfy these requirements. Because Barclays Bank ("Barclays"), which contributed \$11.4 million of purported equity, was not comfortable providing the funds backed solely by the assets held by JEDI, it wanted additional credit support. To satisfy Barclays, reserve accounts controlled by Barclays were set up and funded in the amount of \$6.5 million upon the closing of the transaction. The funding of the reserve accounts was accomplished by a special distribution from JEDI to Chewco that was agreed to in an undisclosed side letter signed by Kopper on behalf of Chewco, and an Enron employee on behalf of JEDI. The funding of the reserve accounts meant that the requisite three percent equity was not actually at risk. Thus, the structure did not comply with applicable accounting rules.

Andersen spent considerable time working with Enron on the Chewco transaction. Bauer advised Enron about the three percent equity capital requirement and also on governance issues. Bauer also performed audit procedures to determine whether Chewco and JEDI were required to be consolidated into Enron's financial statements.

However, despite numerous red flags associated with this transaction, Bauer failed to exercise due professional care, did not exhibit professional skepticism, and failed to obtain sufficient competent evidential matter to support his analysis of either the control issue or the three percent independent equity requirement (AU §230, *Due Professional Care in the Performance of Work* and AU §326, *Evidential Matter*). Instead, Bauer placed an undue reliance on oral representations from Enron's management (AU §333, *Management Representations*). Bauer asked for, but was denied access to, documents related to the funding of Chewco. Bauer should have insisted on seeing the relevant documents rather than relying solely on management representations. Bauer also violated professional standards by failing to sufficiently document in the audit workpapers his planning and supervision of audit procedures and the nature and extent of the audit evidence obtained in reaching his conclusions (AU §339, *Working Papers*).

3. Violations

Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission in any way to any person who is found by the Commission to have engaged in improper professional conduct. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

As applicable here, improper professional conduct means a violation of applicable standards that resulted from “repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.” (Rule 102(e)(1)(iv)(B)(2)). As a result of the conduct described above, Bauer repeatedly acted unreasonably in failing to conduct or supervise the audit of Enron’s JEDI/Chewco transaction in accordance with GAAS.

4. Findings

Based on the foregoing, the Commission finds that Bauer engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent’s Offer.⁵

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Bauer is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After three years from the date of this order, Bauer may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

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

2. an independent accountant. Such an application must satisfy the Commission that:

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

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms

⁵ In determining to accept Bauer’s Offer, the Commission considered Bauer’s cooperation with the Department of Justice and his testimony at the criminal trial of Enron’s former top two executives.

of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

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

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

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

By the Commission.

Nancy M. Morris
Secretary