

1 BEFORE THE BOARD OF ACCOUNTANCY

2
3 In the Matter of:)
4 Certified Public Accounting Firm)
5 Registration No. 964-B) No. 00A-98230-ACY
6 Issued to:)
7) DECISION AND ORDER
8) (By Consent)
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9 I. INTRODUCTION AND JURISDICTION

10 1. On December 4, 2000, the Arizona State Board of Accountancy (the "Board")
11 filed a Notice of Hearing and Public Complaint ("Notice") against Certified Public
12 Accountants Jay Steven Ozer, Ann M. McGrath, and Alan Proctor Hague, and Certified
13 Public Accounting Firm Arthur Andersen LLP (hereinafter referred to as "Andersen" or
14 "Respondent") regarding services Andersen provided to the Baptist Foundation of Arizona
15 ("BFA"). The Board and Andersen have agreed to a full and final settlement of the matters
16 alleged in the December 4, 2000 Notice. This Decision and Order (By Consent) ("Consent
17 Order") represents a compromise with regard to contested matters and is the result of good
18 faith settlement negotiations regarding issues that are vigorously argued and disputed by all
19 parties. The Findings of Fact and Conclusions of Law set forth herein are for settlement
20 purposes only. The Board has made no determination on the merits of the matters contained
21 herein. Andersen denies, on behalf of itself and each of its present and former partners and
22 employees, any wrongdoing with regard to the matters set forth herein and denies that any
23 violations of professional standards have occurred.

24 2. The Board is the agency authorized pursuant to A.R.S. § 32-701, *et seq.*, to
25 regulate the profession of certified public accountants in the State of Arizona. The
26 December 4, 2000 Notice was issued pursuant to A.R.S. § 32-701, *et seq.*, and A.R.S. § 41-
1061, *et seq.* Separate consent orders have been entered with the other named respondents
in Docket Nos. 00A-98230B-ACY; 00A-98230C-ACY; 00A-98230D-ACY.

3. The Board has issued consent orders on two other Board investigations of
audits conducted by Andersen with the same engagement partner, Jay Steven Ozer ("Ozer"),
under Docket Nos. 2001.134 and 2002.056.

4. The Board hereby makes the following Findings of Fact and Conclusions of
Law and issues the following Order.

1 **II. FINDINGS OF FACT**

2 **A. Background**

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4 5. The conduct described herein occurred between 1992 and 1998. From October
5 1960 until September 1994, Arthur Andersen & Co. was a general partnership engaged in the
6 practice of public accounting in Arizona under Arizona Certified Public Accountant Firm
7 Registration No. 00009-P. In September 1994, the firm reorganized as a limited liability
8 partnership under the name of Arthur Andersen LLP and Registration No. 964-B.
References to "Andersen" shall encompass Registration Nos. 00009-P and 964-B and shall
include the individual accountants employed by Andersen who engaged in the particular
conduct described in this Consent Order.

9 **B. Background**

10 **1. Overview of the Baptist Foundation of Arizona**

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12 6. BFA was an Arizona religious non-profit 501(c)(3) organization that was
13 incorporated in 1948 for the purpose of providing financial support for Southern Baptist
14 causes. BFA was an institution of the Arizona Southern Baptist Convention ("Convention")
15 which elected BFA's Board of Directors. BFA's senior management consisted of William
16 Crotts ("Crotts"), President; Thomas Grabinski ("Grabinski"), Vice President and Legal
Counsel; and Donald Deardoff, CPA ("Deardoff"), Treasurer and Controller. In this Consent
Order, "BFA Senior Management" will refer to these three individuals who directed the
operations of BFA.

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18 7. Since 1984¹, BFA engaged Andersen as its independent auditor. From 1984
19 to 1997², Andersen issued unqualified audit opinions on BFA's combined financial
20 statements. Also, during these years, Andersen was engaged by BFA or its attorneys to
21 perform other accounting and auditing, management consulting and tax services. The
engagements that are the subject of this Consent Order include: (1) the audits of BFA's 1992-
1997 combined financial statements and (2) a special risk assessment review or "shadow
audit" in 1997 and 1998 ("Tax Risk Assessment").

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24 ¹When years are used in this Consent Order, the reference is to the calendar year ending December 31 and
25 the audit performed on that year by Andersen.

26 ²Andersen was engaged to conduct the 1998 audit, but did not issue an opinion on BFA's combined financial
statements. Andersen issued, but later withdrew, unqualified opinions on the separate 1998 financial statements of
certain entities within the BFA combined group.

1 8. Ozer was a Certified Public Accountant ("CPA") holding Arizona Certificate
2 No. 4669-R. For the 1992-1998 audit engagements, Ozer was the Andersen partner with the
3 ultimate responsibility for the conduct of the audits. As the audit partner, Ozer was required
4 to know, understand and consider any other information about BFA gathered in connection
5 with Andersen's Tax Risk Assessment and to determine if such information should be
6 included in or materially affected BFA's financial statements.

7 9. Ann M. McGrath ("McGrath") was a CPA holding Arizona Certificate No.
8 5789-E. McGrath was on the BFA audit engagement team from 1988-1998. Commencing
9 in 1991, she was the manager on the audit engagements with knowledge and familiarity with
10 the operations of BFA and its affiliates and subsidiaries. For audit years 1992-1998,
11 McGrath had primary responsibility for planning and supervising the audits.

12 10. Alan Proctor Hague ("Hague") is a CPA who holds Arizona Certificate No.
13 8406-R. Hague was a tax partner who provided advice and consulting services to BFA,
14 regarding various real estate transactions. Hague engaged in discussions with the Andersen
15 audit engagement team who looked to him for guidance on tax issues. He was the
16 engagement partner on Andersen's Tax Risk Assessment.

17 11. BFA's structure included a complex maze of for-profit subsidiary corporations
18 and controlled non-profit affiliates through which it engaged in investment activities and the
19 sale of securities. BFA operated a trust department and was authorized to serve as a non-
20 bank passive trustee for individual retirement accounts ("IRAs"). BFA managed related
21 affiliates and their subsidiaries including Arizona Southern Baptist New Church Ventures,
22 Inc. ("New Church Ventures"), and A.L.O., Inc. ("ALO").

23 12. BFA invested directly in real estate. BFA raised funds through the sale of
24 securities investment agreements ("IAs") and mortgage backed notes ("MBNs"), and invested
25 those funds in real estate loans, real property, and operating businesses. BFA claimed to be
26 exempt from Arizona statutes requiring registration of securities. BFA's 501(c)(3) tax-
exempt status supported the availability of such an exemption. In 1997, the IAs and MBNs
were sold through offering circulars and supplements thereto which included BFA's
"unaudited" financial statements which were identical to the 1997 financial statements,
complete with footnotes, that Andersen audited. Andersen's name did not appear in these
offering circulars, but investors may have had access to Andersen's audit reports.

13 13. As Andersen acknowledged in its workpapers, BFA operated in a manner
14 similar to a financial institution in some respects. Andersen planned its audit approach to
15 consider these similarities.

1 14. Because of its bank-like operations and products, BFA faced several risks that
2 affect banks and savings institutions such as liquidity and asset quality. BFA claimed an
3 exemption from Arizona banking regulations. Because of the lack of regulatory oversight
4 of BFA's operations and sales of securities, BFA's offerings were not subject to the same
5 scrutiny as a financial institution's products.

6 2. New Church Ventures

7 15. New Church Ventures was a not-for-profit organization with several for-profit
8 subsidiaries and controlled not-for-profit affiliates. Former BFA director and owner of ALO,
9 Jalma Hunsinger ("Hunsinger"), was a director, and president of New Church Ventures since
10 1987. New Church Ventures' stated purpose was to finance new Southern Baptist churches.
11 As reflected in Andersen's workpapers, New Church Ventures raised most of its funds
12 through the sale of IAs and MBNs. Its investment activities were similar to those of BFA.

13 16. New Church Ventures had no employees. Pursuant to management
14 agreements, for a fee, BFA provided accounting, administrative, marketing and other support
15 services which, for many years, included the preparation of unaudited financial statements.
16 New Church Ventures' two main sources of funding were money from IRA investors and
17 loans from BFA. IRA investors purchased New Church Ventures' debt products (IAs and
18 MBNs) which BFA marketed and managed for a fee. Substantially all of the IRAs were
19 invested in New Church Ventures' IAs and MBNs. While some of the IRA funds were
20 directed by investors to loans for specific new churches, most of New Church Ventures' IRA
21 funds flowed to ALO. The majority of New Church Ventures' assets were receivables from
22 ALO.

23 17. New Church Ventures had two principal controlled entities: New Church
24 Ventures Credit Corporation, ("NCVCC") a wholly owned for-profit subsidiary, and Valley
25 Asset Management, Inc. ("VAMI"), a not-for-profit affiliate. NCVCC borrowed money from
26 BFA and loaned it to ALO. VAMI held the collateral for the IRA investor loans, which
consisted primarily of loans to ALO. Beginning in 1996, BFA sold IRA investments through
Christian Financial Partners, Inc. ("CFPI"), a newly formed not-for-profit affiliate controlled
by New Church Ventures. The collateral for these investments was held by Christian Asset
Management, Inc. ("CAMI"), another controlled affiliate. In this Consent Order, references
to "New Church Ventures" shall include the aforementioned affiliated companies. Neither
New Church Ventures nor any of its subsidiaries were audited by Andersen.

24 3. ALO

25 18. ALO was a for-profit company owned by Hunsinger and engaged in real estate
26 investment activities for which it had numerous subsidiaries. Like New Church Ventures,

1 ALO had no employees. ALO paid BFA a fee to provide accounting, administrative,
2 marketing and other support services which, for many years, included the preparation of
3 unaudited financial statements. One of ALO's purposes was to buy BFA's non-producing
4 real estate investments so that BFA could avoid recording losses (writedowns) on its real
5 estate. ALO was the owner of many of the real estate investments that were utilized as
6 collateral for IRA investor loans. ALO was not audited by Andersen.

7 19. Until 1997, limited financial information on ALO was a matter of public record
8 and could be found in ALO's annual reports on file with the Arizona Corporation
9 Commission. ALO incurred operating losses every year since its inception in 1988. ALO's
10 financial statements show most of ALO's liabilities were notes payable to New Church
11 Ventures and BFA. By year-end 1997, ALO's total liabilities of \$275.6 million were over
12 two times its assets, leaving a negative net worth of \$138.9 million. At year end 1997, ALO
13 owed New Church Ventures \$173.6 million and BFA \$70.3 million. ALO's relationship
14 with New Church Ventures was not disclosed in any of BFA's financial statements.

15 4. Common Trust Funds and the Trusts

16 20. BFA served as a trustee for a number of Trusts, including the IRA accounts
17 marketed by BFA on behalf of New Church Ventures. BFA was subject to U.S. Treasury
18 regulations governing its fiduciary conduct as a non-bank passive trustee of IRAs. The
19 Trusts' assets were not audited. They were disclosed in a footnote to BFA's audited financial
20 statements but were not marked "unaudited". This footnote disclosed that the assets of
21 various Trusts may be invested in several different investment vehicles.

22 21. BFA also created and administered Common Trust Funds ("CTF") that were
23 invested principally in notes receivable from ALO and New Church Ventures. Trusts were
24 invested in the CTF. BFA also was named as the irrevocable beneficiary of certain trusts
25 which were invested in the CTF. These amounts appeared in BFA's balance sheet as assets.
26 BFA's financial statements did not disclose that substantially all of the receivables of the
CTF were loans to New Church Ventures and ALO.

27 C. Andersen's Responsibility as the Auditor of BFA's Financial Statements

28 22. BFA's Senior Management was responsible for the preparation of BFA's
29 financial statements in conformity with Generally Accepted Accounting Principles
30 ("GAAP"). GAAP are the conventions, rules and procedures necessary to define accepted
31 accounting practices at a certain time. The primary source of GAAP is the Financial
32 Accounting Standards Board ("FASB").³ Andersen was required to conduct its audits of

³FASB pronouncements are referenced as "SFAS No."

1 BFA's financial statements in accordance with Generally Accepted Auditing Standards
2 ("GAAS") and to report its compliance with GAAS in its opinion. GAAS are the standards
3 promulgated by the American Institute of Certified Public Accountants ("AICPA").⁴ GAAS
4 required Andersen to state whether, in its opinion, BFA's financial statements were presented
5 in conformity with GAAP and to identify those circumstances in which GAAP had not been
6 observed in BFA's preparation of its financial statements. AU §110.01.

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8 23. GAAS consists of three General Standards, three Standards of Field Work and
9 four Standards of Reporting, AU §150.02. In performing its audits of BFA's 1992-1997
10 financial statements, the Third General Standard of Due Professional Care imposed a
11 responsibility on Andersen to plan and perform its audits with due care and to observe the
12 standards of field work and reporting, AU § 230.02.

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D. Andersen's Conduct 1992-1997

1. 1992-1997: BFA's Conduct as a Non-Bank Passive Trustee of IRAs

24. Since 1983, BFA was authorized by the IRS to act as a non-bank passive trustee of IRAs. In this capacity, BFA could not manage or direct the investment of IRA funds. Treasury regulations⁵ governing the conduct for non-bank passive trustees of IRAs required BFA to conduct its affairs as a fiduciary, to maintain the appropriate minimum net worth, and to subject itself to an audit that would determine if it is in compliance with Treasury regulations.

25. Andersen's 1992-1997 workpapers indicate that its audit objectives include determining that BFA was properly fulfilling its fiduciary role and was in compliance with all regulatory measures. Andersen did not perform sufficient procedures to determine if BFA was in compliance with the applicable Treasury regulations. Andersen's workpapers do not contain any documentation to corroborate BFA Senior Management's representation that BFA was in compliance with Treasury regulations. BFA managed the IRA investments and collected a management fee from New Church Ventures. At all material times, BFA violated the Treasury regulations by actively managing the IRAs and collecting a fee to do so.

26. The State contends and Andersen disputes that (1) BFA breached its fiduciary duties by directing IRA money to a related party, ALO, which had a large negative net worth; (2) collateral for the IRA products was mostly junior positions subordinated to the collateral

⁴The AICPA has promulgated Statements on Auditing Standards ("SAS") which are codified in provisions cited as "AU §".

⁵26 C.F.R. § 1.408-2 (previously numbered 26 C.F.R. § 1.401-12(n)).

1 on notes payable to BFA; and (3) because BFA's net worth was actually negative, BFA was
2 in violation of the Treasury regulations' minimum net worth requirements. In such cases,
3 Treasury regulations prohibit a trustee from accepting IRAs and require the relinquishment
4 of existing accounts. The State contends and Andersen disputes that these acts exposed BFA
5 to contingencies that should have been disclosed in its financial statements.

6 2. Related Parties Disclosure

7 27. As BFA's auditors since 1984, Andersen had the responsibility to identify and
8 consider relationships and transactions with related parties. As reflected in the workpapers,
9 Andersen identified ALO and New Church Ventures and their numerous affiliates and
10 subsidiaries to be related parties. Because related party transactions are not at arms length,
11 they inherently pose an increased risk that purported gains on these transactions may be
12 overstated and, therefore, not reported in accordance with GAAP. Andersen was required
13 to determine if the transactions with ALO and New Church Ventures, and any resulting
14 gains, were adequately disclosed and appropriately reported in BFA's financial statements.

15 a. 1992-1994 Related Parties Disclosure

16 28. During the years 1992-1994, BFA engaged in significant related party
17 transactions with ALO and New Church Ventures, particularly at year-end. Andersen's
18 1992-1994 audit workpapers contained detailed notes receivable listings which show the
19 balances owed to BFA by ALO and New Church Ventures and their increase from 1992
20 through 1994. BFA's 1992-1994 financial statements neither identified nor disclosed the
21 notes receivable between BFA, ALO and New Church Ventures as related party transactions.

22 29. Except for information about New Church Ventures in 1994, the transactions
23 and balances due from the following individuals and companies were not disclosed as related
24 parties in BFA's 1992-1994 financial statements: (1) Dwain Hoover, BFA Board member;
25 (2) Harold Friend, former BFA Board member; (3) Jalma Hunsinger; (4) ALO; and (5) New
26 Church Ventures.

27 b. 1995-1997: Related Parties Disclosure

28 i. 1995 Financial Statement

29 30. Footnote (13) of BFA's 1995 financial statements, entitled "Related Parties,"
30 disclosed that "a substantial portion of BFA's transactions involve individuals or companies
31 associated with Southern Baptist causes." BFA's related parties were identified as "Director

1 A and his companies", "Benefactor A and his companies" or "Benefactor B and his
2 companies". By reviewing Andersen's workpapers, one could decipher that: (1) "Director
3 A" = Hoover; (2) "Benefactor A" = Friend; (3) "Benefactor B" = Hunsinger; (4) "Benefactor
4 B company" = ALO; and (5) "A company associated with Southern Baptist causes" = New
5 Church Ventures.

6 31. As of December 31, 1995, the total notes receivable owed to BFA from ALO
7 and New Church Ventures, accounted for 63% of BFA's total notes receivable and 30% of
8 BFA's total assets. This concentration of credit to ALO and New Church Ventures is
9 described in Footnote (2) in a subsection entitled "Concentration of Credit Risk," which does
10 not disclose that the credit risk is with related parties and states:

11 "Concentration of credit risk with respect to notes receivable are
12 limited due to the fact that BFA requires notes receivable to be
13 adequately collateralized. BFA establishes an allowance for
14 doubtful notes based on factors surrounding the credit risk of
15 specific borrowers historical trends and other information."

16 Andersen did not perform any testing on the collateral on performing notes owed by ALO
17 and New Church Ventures.

18 **ii. 1996 Financial Statements**

19 32. In connection with its 1996 audit of BFA, Andersen issued a "Memorandum
20 on Internal Control Structure" ("Internal Control Memorandum") in which it commented on
21 BFA's lack of review, analysis and proper documentation of related party transactions and
22 criticized the fact that the collateral on related party notes receivable was not adequately
23 monitored.

24 33. In the 1996 Internal Control Memorandum, Andersen noted that "certain of the
25 notes receivable from individuals and companies affiliated with Southern Baptist causes had
26 outstanding balances in excess of the current value of the underlying collateral." Andersen
did not require BFA to take a reserve or writedown on its notes receivable. BFA's 1996
financial statements, Footnote (2) in a subsection entitled "Concentration of Credit Risk"
discloses:

"Approximately \$4 million of the notes receivable due from
related parties are unsecured, and certain other notes have
outstanding balances that may be in excess of the underlying
collateral. The related parties have made all principal and

1 interest payments required under the terms of the note
2 agreements. Based on the payment history and BFA's
3 relationship with these parties, management believes the
associated credit risk has been mitigated."

4 BFA's 1996 financial statements do not disclose the total amount of related party notes
5 receivable that "may have outstanding balances in excess of current underlying collateral,"
6 which is an amount in addition to the \$4 million of unsecured notes receivable.

7 **iii. 1997 Financial Statements**

8 34. In connection with its 1997 audit, Andersen, again, assessed BFA's internal
9 controls and criticized BFA for lack of review, analysis and documentation of related party
10 transactions and for failing to adequately monitor collateral on related party notes receivable.
11 The 1997 Internal Control Memorandum notes that the 1996 recommendations had not been
12 fully implemented.

13 35. The 1997 Internal Control Memorandum repeated Andersen's observation "that
14 certain of the notes receivable from individuals and companies affiliated with Southern
15 Baptist causes had outstanding balances which appeared to be in excess of the current value
of the underlying collateral." Andersen issued an unqualified opinion on BFA's 1997
financial statements without requiring adequate disclosures of the nature and extent of the
relationships with ALO and New Church Ventures.

16 36. In BFA's 1996 and 1997 financial statements Footnote (2) states that the
17 current payment status of the notes receivable from related parties and BFA's relationship
18 with those related parties is evidence of collectibility. (See paragraph 32) The State contends
19 and Andersen disputes that to conclude that Footnote (2) was accurate, Andersen had to
20 understand the relationships of the related party entities, especially, when verifiable,
21 empirical evidence to support BFA's Senior Management's estimates was not available. The
22 State contends and Andersen disputes that Andersen should have reviewed ALO's and New
Church Ventures' financial statements to evaluate the ability of the related companies to pay
the notes receivable owed to BFA. BFA denied Andersen access to these financial
statements in 1996 and 1997.

23 **3. 1992-1997: Net Realizable Value Analysis of Collateral Securing**
24 **Notes Receivable From ALO and New Church Ventures**

25 37. BFA's notes receivable were "collateral dependent" because in the event ALO
26 or New Church Ventures could not pay the amounts due on the notes receivable, the only

1 source of repayment for the debt was the collateral. As a result of BFA Senior
2 Management's refusal to provide the detailed financial statements of ALO and New Church
3 Ventures, Andersen performed alternative procedures to determine the collectibility or the
4 "net realizable value" ("NRV") of the collateral. The purpose of Andersen's NRV analysis
5 was to determine whether BFA could report the full amount of the notes receivable or should
6 be written down or take an allowance for doubtful accounts. Because BFA's notes receivable were
7 collateral dependent, Andersen was required to address (1) whether the notes receivable were
8 impaired and (2) whether the NRV of the collateral equaled or exceeded the carrying values
9 of the individual notes receivable owed to BFA. SFAS No. 114, *Accounting by Creditors*
10 *for Impairment of a Loan*.

11
12 38. Based upon information available to Andersen in public filings with the
13 Arizona Corporation Commission, ALO had a large negative net worth making its ability to
14 pay its debt to BFA or New Church Ventures doubtful. To the extent New Church Ventures'
15 receivables from ALO were uncollectible, then, New Church Ventures could not meet its
16 obligations to BFA.

17
18 39. It was common practice for BFA to "recast" notes receivable owed by ALO
19 and New Church Ventures at the time the principal amount of the notes was due to mature.
20 Rather than identify a note as delinquent, the note was "recast," primarily by extending the
21 notes' maturity dates. This practice of recasting notes receivable is an indication that the
22 notes may be impaired.

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24 a. 1992-1994 NRV Analysis

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26 40. For audit years 1992-1993, Andersen's testing of notes receivable consisted
primarily of determining whether the notes were current by confirming balances due,
maturity dates, and the status of interest payments. For audit years 1992-1993, Andersen did
not test the NRV of the underlying collateral of any notes receivable.

41. In 1994, Andersen performed subsequent cash receipts testing on BFA's notes
receivable due from ALO and New Church Ventures and concluded the notes were current.
Andersen did not identify that ALO's primary source of cash to pay its interest and principal
payments to BFA was loans from BFA and New Church Ventures.

42. In 1994, for the first time, Andersen performed NRV testing of the collateral
for notes receivable identified as past due or on a "stop accrual" status. Andersen obtained
a detailed listing of the \$70 million in notes receivable owed to New Church Ventures as of
December 31, 1994 in order to analyze whether New Church Ventures could pay off its notes

1 due to BFA. Through this testing, Andersen knew that ALO owed New Church Ventures
2 the majority of \$70 million in notes receivable.

3 **b. 1995-1997 NRV Analysis**

4 43. As of December 31, 1995, BFA had notes receivable from ALO and New
5 Church Ventures totaling \$91 million, which were material to BFA's financial condition and
6 made up 63% of BFA's notes receivable and 30% of BFA's total assets. As of December
7 31, 1996, the notes receivable owed to BFA from ALO and New Church Ventures totaled
8 \$98.3 million, constituting 62% of all notes receivable owed to BFA and 27% of BFA's total
9 assets. As of December 31, 1997, the notes receivable owed to BFA from ALO and New
10 Church Ventures totaled \$131.5 million and made up 71% of all notes receivable owed to
11 BFA and 31% of BFA's total assets. As of December 31, 1997, New Church Ventures had
12 liabilities to IRA holders totaling \$96.1 million and also owed the CTF \$25.3 million. As
13 of December 31, 1997, ALO owed New Church Ventures \$173.6 million.

14 44. The State contends and Andersen disputes that an evaluation of the financial
15 condition of ALO and New Church Ventures was necessary to determine the collectibility
16 of BFA's notes receivable. For the audits of BFA's 1995, 1996 and 1997 financial
17 statements, Andersen requested but BFA refused to produce the detailed financial statements
18 of ALO and New Church Ventures. Rather than deem the denial a scope limitation,
19 Andersen performed NRV analysis on the real estate interests and other assets collateralizing
20 BFA's notes receivable. For 1995, Andersen did not perform a NRV analysis on New
21 Church Ventures and ALO notes receivable. For 1996 and 1997, Andersen's workpapers
22 indicate that there was insufficient verifiable information to determine that the collateral was
23 adequate.

24 45. Andersen's 1996 workpapers include an April 24, 1997, memorandum
25 analyzing "the net worth of the collateral pledged on notes receivable" from ALO and New
26 Church Ventures as of December 31, 1996. The memo emphasized BFA's "inability" to
provide specific appraised values for the assets assigned as collateral and the speculative
nature of BFA's representations to Andersen, concluding that the notes "are not adequately
collateralized." The disclosure in Footnote (2) of BFA's 1996 financial statements (under
caption "Concentration of Credit Risk") states that "certain other notes have outstanding
balances that may be in excess of the underlying collateral."

46. Andersen did not address the impairment of the ALO and New Church
Ventures notes receivable pursuant to SFAS No. 114. Instead of appropriate writedowns,
BFA's 1996-1997 financial statements included Footnote (2) (under "Concentration of Credit
Risk") which stated "certain other notes have outstanding balances that may be in excess of

1 the underlying collateral." The State contends and Andersen disputes that this disclosure was
2 not adequate given ALO's poor financial condition and the subjective nature of the estimated
3 values for certain collateral for the notes receivable from ALO. Based on the financial
4 statements for ALO and New Church Ventures and the lack of independent appraisals or
5 other external competent evidential matter, Andersen did not have an objective basis to
conclude that BFA's notes receivable balances were fairly stated in accordance with GAAP
as of December 31, 1995-1997.

6 4. Year-End Transactions

7 47. It was essential for BFA to maintain an adequate net worth to meet the
8 fiduciary requirements under U.S. Treasury regulations governing non-bank passive trustees
9 of IRAs. Since it was critical to BFA to report a positive net worth, Andersen was required
10 to plan its audit to assess BFA's motivation to report positive results, to overstate assets, to
not recognize losses or to not take appropriate writedowns on its assets.

11 48. Based upon Andersen's 1992-1997 workpapers, Andersen knew that BFA
12 operated with a decrease in net assets each year and that in November and December of each
13 year, BFA structured year-end transactions with related parties to recognize income so that
14 BFA could report an increase in net assets at year-end. These related party transactions were
not disclosed in BFA's 1992-1994 financial statements and were inadequately disclosed in
BFA's 1995-1997 financial statements.

15 49. For each year, 1995-1997, December transactions involving related parties
16 Friend, Hoover, New Church Ventures or ALO allowed BFA to change its financial
17 condition from a decrease to an increase in net assets of \$1.6 million for 1995, \$1.2 million
18 for 1996, and \$2.5 million in 1997. Andersen's 1996 and 1997 workpapers contain letters
19 from a previous Andersen employee and an MAI appraiser ("the Appraiser"), that Andersen
20 hired to consult on the fair market value of the land transferred in some of these year-end
21 related party transactions. Andersen's 1996 and 1997 workpapers contain the Appraiser's
letters to McGrath raising several concerns about BFA's valuations of several properties
transferred in these year-end transactions and opining that the properties were worth
substantially less.

22 50. The Appraiser's opinions raised questions as to the true value of the gifts.
23 Andersen accepted BFA Senior Management's representations as to value, in spite of the
24 Appraiser's concerns, and without performing sufficient audit procedures to support the
25 valuation. For example, regarding BFA's 1996 financial statements, Andersen permitted
26 BFA to record a \$1.6 million additional gain on the Hoover Colorado Property gift
transaction and an additional \$3.6 million gain on the Palo Verde gifts.

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2 51. Andersen's 1997 audit workpapers contain the Appraiser's January 5, 1998
3 letter to McGrath, which raises concerns regarding the FATCO trusts transaction. The
4 Appraiser believed that there should be a substantial reduction in the value of the FATCO
5 Trusts. According to Andersen's audit workpapers, after Andersen discussed the Appraiser's
6 concerns with BFA's Senior Management, Andersen concluded that the recorded value of
7 \$4.88 million was reasonable.

8 a. 1995-1997 Field Work: Warning Signs

9 i. 1995-1996 Field Work: Exodus of BFA Accountants
10 and the McGrath/Paetz Meeting

11 52. From April 1996 through September 1996, several BFA internal accountants
12 and one attorney resigned. One of these internal BFA accountants who resigned was Karen
13 Paetz, who, for several years, supervised the preparation of the detailed financial statements
14 of ALO and New Church Ventures. Paetz' misgivings about ALO, New Churches Ventures
15 and BFA prompted her to resign in July 1996.

16 53. In February 1997, seven months after Paetz resigned and during the field work
17 for Andersen's 1996 audit of BFA, Paetz contacted McGrath and set up a lunch meeting with
18 McGrath for the purpose of voicing her concerns. McGrath admits that Paetz told her that
19 BFA was selling overvalued assets to New Church Ventures and ALO, but disputes the
20 specificity of Paetz' remarks. Paetz has testified that she told McGrath that ALO's deficit
21 was in excess of \$100 million; that ALO was losing over \$2 million per month, and that
22 money from BFA and New Church Ventures was used to service ALO's debt to BFA.
23 Knowing that Andersen was performing the 1996 audit, Paetz advised McGrath to ask BFA
24 for ALO's and New Church Ventures' detailed financial statements. After the meeting,
25 McGrath reported the event to Ozer. There is no documentation in Andersen's files
26 memorializing the meeting between McGrath and Paetz or the subsequent meeting between
McGrath and Ozer. Both Ozer and McGrath considered the meeting a "non-event."
McGrath testified that Paetz did not provide information of substance beyond vague
references to improper transactions. There is no mention of McGrath's meeting with Paetz
in the 1996 or 1997 audit workpapers.

ii. 1997 Field Work: SAS No. 82 Analysis

54. SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AU §
316.02), was issued in February 1997 and applied to Andersen's 1997 audit of BFA. SAS
No. 82 provides guidance and reiterates the auditor's longstanding requirement to identify

1 and respond to indications of possible fraudulent acts by a client's management that could
2 cause material misstatements in the financial statements. SAS No. 82 provides categories
3 of "fraud risk factors" to be considered in Andersen's analysis.

4 55. The Andersen audit team utilized an Andersen standardized program, "Form
5 AP-125, Fraud Risk Practice Aid", ("Form AP-125") which incorporated many of the fraud
6 risk factors discussed in SAS No. 82. Form AP-125 contains a checklist of ninety-eight
7 fraud risk factors that would indicate possible fraudulent activity. Form AP-125 requires
8 Andersen to document its response to any identified fraud risks and to consider modifying
9 the audit plan or resigning. Andersen identified several fraud risk factors but did not modify
10 its audit plan.

11 56. Andersen identified eight of the possible ninety-eight fraud risk factors in Form
12 AP-125. Andersen initially considered but erased additional fraud risk factors which
13 considered (1) known sensitive or unsupported transactions; (2) frequent disputes with the
14 auditors or lack of open, complete and timely communication of significant matters; (3)
15 acceptance of unusually high business risks, including very aggressive expansion/acquisition
16 plans; (4) ineffectiveness of personnel due to excessive or unusual turnover, in accounting
17 positions; or (5) last minute adjustments that significantly affect results. Andersen's
18 engagement team believed that these factors were covered by the initial eight.

19 57. The State contends and Andersen disputes that Andersen should have included
20 several other fraud risk factors identified in Form AP-125 which considered: (1) possible
21 significant irregularities or illegal acts resulting from non-compliance with laws and
22 regulations; (2) participation or unusual interest by non-financial management in selection
23 of accounting methods or the determination of significant accounting estimates;⁶ (3)
24 domination of management by a single person or a small group without compensating
25 controls such as effective oversight by the board of directors or audit committee;⁷ and (4)
26 denial of (or delays in allowing) access to records.⁸

21 ⁶ Andersen did not address the active involvement of Grabinski, BFA's legal counsel, in providing
22 estimates of values for significant real estate that was either collateralizing BFA's notes receivable or was sold in
23 year-end transactions. Andersen relied upon his valuations, giving them greater weight than the opinions of
24 independent, outside appraisers or Andersen's own expert.

23 ⁷ Paetz claims that she warned McGrath during Andersen's 1996 audit of the lack of accountability over the
24 conduct of BFA's Senior Management. As auditors for the previous thirteen years, the domination of BFA's Senior
25 Management and the lack of effective oversight was apparent to Andersen.

25 ⁸ BFA denied Andersen access to the detailed financial statements of ALO and New Church Ventures in
26 connection with the 1995, 1996 and 1997 audits of BFA's financial statements which could be characterized as a
fraud risk factor pursuant to AU § 316.17

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2 58. Form AP-125 included fraud risk factor Item 85: "Tips or Complaints about
3 fraud received from employees, vendors or others." Andersen's 1997 audit workpapers and
4 its SAS No. 82 analysis do not reference McGrath's meeting with Paetz in February 1997.

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iii. 1997 Field Work: SAS 82 Analysis of the Anonymous
Call to Chicago Legal Group

59. Andersen indicated in a February 24, 1998 memo included with Form AP-125
in its workpapers, that "During 1997, an individual contacted the AA Legal Group in World
Headquarters [Chicago] regarding misappropriation of assets. The firm's Risk Management
Group reviewed these claims, however no evidence was found which supported these
allegations." Neither McGrath, Ozer, nor the accountant that authored the memo, could
identify the source of the information in the memo.⁵

60. One month later, in a memorandum dated March 24, 1998, McGrath
documented Grabinski's speculation that Tom Church was responsible for a "call (from an
anonymous caller) that was placed to the firm's Legal Group in Chicago alleging a Ponzi
scheme, and the illegal sale of securities." This memorandum was not in Andersen's audit
workpapers, but rather was contained on the hard drive of McGrath's computer. McGrath
denies ever hearing the term "Ponzi Scheme" before her meeting with Grabinski.

61. Another March 24, 1998 memo drafted by McGrath was found in the SAS No.
82 workpapers, documenting McGrath's meeting with Grabinski in which he declared that
he was "unaware of any fraudulent reporting, misappropriation of assets, or other illegal acts
involving BFA that have occurred or are currently occurring."

62. The "anonymous call" to Andersen's Chicago Legal Group described in
McGrath's memo was actually a phone call, which occurred several months earlier in July
1997, from an Andersen Regional Practice Director in Houston, Texas ("Houston Regional
Practice Director") to Andersen's Senior Counsel in Chicago, Illinois. The purpose of the
July 1997 phone call to the Senior Counsel was to convey the concerns about BFA raised by
the CFOs of two Andersen clients in Dallas, Texas: Allen Jordan ("Jordan") and Roger Hall
("Hall"). The CFOs had met with their Andersen audit partner ("Dallas Andersen Audit
Partner") in June 1997 to show him BFA's 1995 financial statements and to convey

⁵According to AU § 316, two types of misstatements in financial statements are relevant to Andersen's
consideration of fraud: (1) misstatements arising from fraudulent financial reporting (such as a "Ponzi scheme") and
(2) misappropriation of assets (such as embezzlement). There are no allegations whatsoever of conduct falling
under category #2 as mentioned in the February 24 memo. A "Ponzi scheme" allegation would be characterized as
"fraudulent financial reporting".

1 information they learned from a BFA insider. This information included the fact that BFA
2 needed a continuous stream of new money from investors to remain in business. Jordan and
3 Hall do not recall using the specific term "Ponzi scheme."¹⁰

4 63. The Dallas Andersen Audit Partner called the Houston Regional Practice
5 Director to convey the concerns of Jordan and Hall.

6 64. The Houston Regional Practice Director called the Senior Counsel to convey
7 the concerns of Jordan and Hall. After the discussion between the Houston Regional Practice
8 Director and the Senior Counsel, the Senior Counsel called the Pacific Region Practice
9 Director who is responsible for oversight of the Andersen Phoenix Office. The Pacific
10 Region Practice Director's notes of his July 18, 1997 telephone conversation with the Senior
11 Counsel document that Andersen received a "credible inquiry" of an "anonymous source"
12 regarding a "Phoenix office client" was received. The notes describe the concerns conveyed
13 by the Senior Counsel. Most notable is the first item: "is client selling securities in Arizona
14 and outside, these are investment notes - is organization exempt? is this a Ponzi scheme?"

15 65. The Pacific Region Practice Director's notes ask if BFA is a "Ponzi scheme".
16 The Senior Counsel denies ever describing BFA as a "Ponzi scheme" or even using the term
17 "Ponzi scheme." While admitting his notes state "Ponzi scheme", the Pacific Region Practice
18 Director denies hearing anyone use that term and does not recall any discussion at any time
19 whatsoever in which BFA was called a "Ponzi scheme." The Pacific Region Practice
20 Director testified that his notes simply reflect his expansive analysis that he kept to himself.

21 66. After the Pacific Region Practice Director's July 1997 discussion with the
22 Senior Counsel, he called Ozer to tell him about the "anonymous call." Ozer testified that
23 after their telephonic discussion, Ozer instructed McGrath to send a packet of financial
24 statements and workpapers regarding BFA to the Pacific Region Practice Director, but never
25 told McGrath about the "anonymous call." McGrath testified that she did not ask and, thus,
26 did not know the reasons for sending documents about BFA to the Pacific Region Practice
Director.

27 67. McGrath first learned of the "anonymous call" on January 1998 during a
28 conference call with the Pacific Region Practice Director to discuss, with the Andersen tax
29 and audit engagement teams, whether to retain BFA as a client. During that conference call,
30 at Ozer's request, the Pacific Region Practice Director gave Ozer permission to bring "the
31 anonymous call" to BFA's Senior Management's attention.

32 ¹⁰The BFA insider never communicated this information or any information adverse to BFA to the audit
33 engagement team at Andersen's Phoenix office.

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2 68. On February 6, 1998, Ozer and Hague met with Crotts and Grabinski at BFA's
3 offices, for the purpose of disclosing to BFA that Andersen's Chicago headquarters received
4 an "anonymous call" about BFA. Notes found in Crotts' office, and identified by a BFA
5 employee as belonging to Crotts, contain the following phrases: (1) a Ponzi scheme; (2)
6 illegal sale of securities; and (3) related party transactions. Crotts' notes appear to reflect a
7 discussion of each item and assurances from Ozer. Ozer and Hague deny ever uttering the
8 words "Ponzi scheme"; deny ever hearing the words "Ponzi scheme" in reference to BFA and
9 deny that BFA was a "Ponzi scheme." Andersen's workpapers do not contain any references
10 to receiving information reflecting that BFA could be a "Ponzi scheme."

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iv. 1997 Field Work: The *New Times* Articles

69. Andersen's unqualified opinion on BFA's 1997 financial statements was dated
April 27, 1998 which followed the publication of two articles in a local newspaper, *The
Phoenix New Times* ("*New Times*"), that accused BFA of engaging in fraudulent conduct.
Andersen's analysis of these two articles was performed by McGrath and is documented in
Andersen's 1997 audit workpapers. The *New Times* articles reported that ALO had a
negative net worth of \$116 million at year-end 1996. Andersen did not perform a further
analysis concerning ALO's financial position.

70. McGrath's approach to the *New Times*' allegations, especially regarding year-
end related party transactions and the inadequacy of the notes receivable collateral, included
reviewing the relevant memos from prior years' audit workpapers. Before the 1996 audit,
Andersen did not review the collateral on performing notes nor ALO's ability to pay the
notes receivable on BFA's books. In spite of the issues reflected in Andersen's collateral
analysis in 1996 and 1997, Andersen relied on its previous work in concluding that the
allegations in the *New Times* articles could not be substantiated.

71. The State contends and Andersen disputes that during her *New Times* analysis,
McGrath did not identify the inadequacies in BFA's 1996 and 1997 financial statements
regarding collateral, overlooked BFA's material misstatements in the financial statements,
rejected the *New Times* articles' disclosure of accurate information and adopted and
supported BFA's Senior Management's response to the *New Times* and inquiring investors.

v. Post 1997 Audit Opinion: Disclosure of BFA Former
Employees' Resignation Letters

72. On November 23, 1998, Andersen received 1996 resignation letters of former
BFA personnel Michael Maxson, CPA, Richard Polley, CPA, and Kyle Tresch, Esq. which

1 were placed in Andersen's 1998 workpapers. Andersen's response, documented in its
2 workpapers, to all of the following issues raised in the resignation letters was "N/A" meaning
3 "not applicable":

- 4 1) Richard Polley (Trust Accounting Manager) criticized
5 the transfer of stop-accrual notes to a newly formed
6 organization, (EVIG) and expressed concern that IRA
7 money was at risk in the transaction and pointed to the
8 "deficit" problem at ALO;
- 9 2) Kyle Tresch described the ALO deficit problem (\$100
10 million and growing by an annual loss of \$25 million)
11 and the lack of full disclosure to the BFA board and
12 auditors. He said that BFA was "raiding Arizona
13 Southern Baptist New Church Ventures IRA dollars in
14 order to 'supply the liquidity needed to mature the assets
15 of ALO.'" He noted that income from ALO assets was
16 "wholly insufficient to facilitate the debt";
- 17 3) Richard Polley described New Church Ventures and
18 ALO as "bad banks" used to take losses to make BFA
19 look like a "good bank";
- 20 4) Michael Maxson expressed similar concerns and the
21 likelihood of civil and criminal liability.

22 72. Andersen did not investigate the former employees' claims to determine
23 whether they were reliable. The resignation letters and the *New Times* articles provided
24 Andersen with information about the former BFA employees' concerns about ALO, New
25 Church Ventures and a third off-balance sheet company, EVIG. This information
26 corroborated Paetz' remarks to McGrath and information Ozer and McGrath learned in July
1997 and March 1998 about the "anonymous call".

27 5. 1997-1998: Special Tax Risk Assessment

28 73. Beginning in 1997, during the field work of Andersen's 1996 audit, BFA's
29 legal counsel engaged Andersen to perform a multi-phase Tax Risk Assessment of BFA to
30 identify possible areas of tax exposure and to determine if BFA's tax exempt status was at
31 risk because of BFA's activities that generated Unrelated Business Taxable Income
32 ("UBTI"). Hague, the tax partner in charge of this engagement, supervised Andersen's Non-

1 Profit Tax Specialist, who conducted the first phase of the engagement. The Non-Profit Tax
2 Specialist's February 21, 1997, notes indicate that the engagement was to be a high-level
3 diagnostic, "shadow" IRS audit.

4 74. In December 1997, the Non-Profit Tax Specialist conducted interviews of BFA
5 personnel and Andersen auditors and tax accountants through which she learned that New
6 Church Ventures loaned significant amounts of money to Hunsinger (ALO) and Friend. The
7 Non-Profit Tax Specialist's notes reflect McGrath's reservations about these related party
8 transactions and concerns about documentation that suggested BFA was functioning as a
9 "bank" for Hunsinger, Friend and Crotts. McGrath's concerns, expressed during the planning
10 stages of the 1997 audit, were not reflected in the workpapers.

11 75. In January 1998, shortly before Andersen's 1997 audit field work, the Non-
12 Profit Tax Specialist was near completion of her analysis. According to the Non-Profit Tax
13 Specialist's sworn testimony, Hague asked her to prepare talking points of issues to share
14 with the audit partner. On January 15, 1998, the Non-Profit Tax Specialist transmitted a draft
15 of her "Opinion of Exposures" to Hague and others within Andersen. The Non-Profit Tax
16 Specialist's opinion was in the form of a four column matrix that identified: (1) the "Issues"
17 to be addressed; (2) BFA's "Expected Dollar Exposure" to the IRS; (3) "If Audited,
18 Likelihood of IRS Scrutiny"; and (4) "Comments".

19 76. The first issue addressed in the Non-Profit Tax Specialist's matrix was "BFA's
20 Exempt Purpose" which she identified as "The **BIG** issue - One that could affect our audit
21 opinion and should be addressed." (emphasis in original)

22 77. The Non-Profit Tax Specialist and Hague discussed the initial draft "Opinion
23 of Exposures" by telephone approximately one day after Hague received it. According to the
24 Non-Profit Tax Specialist's deposition testimony, she understood from Hague that the audit
25 partner (Ozer) wanted her to delete any references to "The **BIG** issue" and to delete the fact
26 that "The **BIG** issue" could affect Andersen's 1997 audit opinion on BFA's financial
statements. The Non-Profit Tax Specialist complied with Hague's request.

78. Hague claims that he never asked the Non-Profit Tax Specialist to prepare the
chart for Ozer and that the Non-Profit Tax Specialist did not have the expertise to opine on
possible audit issues. Ozer claims he was not aware of the chart and Hague did not share any
information with him on the likelihood of BFA's exposure to IRS scrutiny with respect to
BFA's tax exempt status.

79. Andersen's audit team knew of the Tax Risk Assessment engagement, but there
is no indication in the 1997 audit workpapers that Andersen considered the issues raised in

1 the Tax Risk Assessment, including "The BIG issue" described in the Non-Profit Tax
2 Specialist's draft matrix. In a meeting on February 6, 1998, with Crotts, Grabinski and Ozer
3 present, Hague presented a written report to the BFA Board. The written report was drafted
4 by the Non-Profit Tax Specialist. The very first issue discussed in the report is the audit
5 exposure, so called "Big" issue. Andersen documented its knowledge of BFA's exemption
6 status in an internal memo dated April 27, 1998 (the last day of field work for Andersen's
7 1997 audit of BFA), which referenced Hague's belief that an IRS audit was very likely.
8 There is no indication in the 1997 audit workpapers that Andersen sought nor received any
9 assurance from BFA that the contingencies in the April 27, 1998 memo had been addressed
10 or disclosed before issuing its 1997 unqualified audit opinion.

8 III. CONCLUSIONS OF LAW

9 80. The Board has personal and subject matter jurisdiction over Respondent
10 pursuant to A.R.S. § 32-701, *et seq.* and A.A.C. R4-1-101 *et seq.* The Board has the
11 authority to discipline Andersen pursuant to A.R.S. §§ 32-741(A)(4); (A)(6) and (A)(9), and
12 32-742.

13 81. Pursuant to A.R.S. § 32-742, after notice and opportunity for hearing, the
14 Board may revoke or suspend Andersen's registration to practice public accounting and take
15 additional disciplinary action concerning Andersen for engaging in dishonesty, fraud or gross
16 or continuing negligence in the practice of accounting (A.R.S. § 32-741(A)(4)) and for
17 violating any provisions of Title 32, Chapter 6, Arizona Revised Statutes (A.R.S. § 32-
18 741(A)(6)). This Consent Order is in lieu of an administrative hearing set for August 19,
19 2002 and is a disciplinary action as defined in A.R.S. § 32-701.01.

20 82. At all material times, Arizona Administrative Code, A.A.C. Rules R4-1-455
21 through 455.04 set forth the standards and rules of professional conduct with which all
22 registrants must comply. While Andersen denies that any violations of professional
23 standards have occurred in connection with the engagements in issue, and disputes that the
24 Findings of Fact are accurate and complete, if this matter proceeded to hearing, the State
25 would introduce evidence it contends would show that Andersen's conduct, in connection
26 with the audits and services described in the Findings of Fact, constitutes a failure to comply
with applicable professional standards set forth in A.A.C. R4-1-455.01 and the principles of
professional conduct as established by A.A.C. R4-1-455.03.

23 A. Violations of GAAP

24 83. Pursuant to paragraph 82 above, while Andersen denies that any violations of
25 professional standards have occurred in connection with the engagements in issue, and
26

1 disputes that the Findings of Fact are accurate and complete, if this matter proceeded to
2 hearing, the State would introduce evidence it contends would show that Andersen's conduct
3 constitutes a failure to comply with the following professional standards:

4 1. BFA's 1992-1994 financial statements:

- 5 a. Statements on Financial Accounting Standards (SFAS) No. 57:
6 *Related Party Disclosures*;
7 b. SFAS No. 5: *Accounting for Contingencies*.

8 2. BFA's 1995-1997 financial statements:

- 9 a. SFAS No. 5: *Accounting for Contingencies*;
10 b. SFAS No. 57 - *Related Party Disclosures*;
11 c. SFAS No. 66 - *Accounting for Sales of Real Estate* which
12 requires a minimum downpayment, not funded directly or
13 indirectly by the seller, on sales of real estate before full profit
14 on a real estate transaction can be recognized;
15 d. SFAS No. 114 - *Accounting for Creditors for Impairment of a*
16 *Loan* which requires recognition of losses on impaired loans;
17 e. SFAS No. 116 - *Accounting for Contributions Received and*
18 *Contributions Made* which requires gifts and contributions to be
19 recorded at fair market value.

20 B. Violations of GAAS

21 84. Pursuant to paragraph 82 above, while Andersen denies that any violations of
22 professional standards have occurred in connection with the engagements in issue, and
23 disputes that the Findings of Fact are accurate and complete, if this matter proceeded to
24 hearing, the State would introduce evidence it contends would show that Andersen's conduct
25 constitutes a failure to comply with the following professional standards:

- 26 1. Andersen's Audits of BFA's 1992-1997 Financial Statements (All
Issues).

1 b. AU §§ 110.02 and 317.05 (1997) which require an auditor to
2 properly plan and perform the audit to obtain reasonable
3 assurance that the financial statements are free from material
4 misstatements caused by fraud and caused by violation of laws
5 and regulations with a direct and material effect on the financial
6 statements.

7 c. AU § 311.07 which requires an auditor to obtain knowledge of
8 matters that relate to the client's business including government
9 regulations.

10 4. Andersen's Audits of BFA's 1995-1997 Financial Statements regarding
11 NRV.

12 a. AU § 508.22 which requires an auditor to express a qualified or
13 to disclaim an opinion in the absence of sufficient competent
14 evidential matter to substantiate the values estimated by a client
15 for the collateral on a client's notes receivable.

16 b. AU § 333 which prohibits an auditor from relying upon
17 management representations which are not verifiable through
18 third party information and proper audit testing and analysis that
19 afford a reasonable basis for the auditor's opinion, particularly
20 when contradictory evidence exists.

21 c. AU § 326.23 which prohibits an auditor from forming an
22 opinion without sufficient competent evidence.

23 d. AU § 339.05 which requires an auditor to maintain sufficient
24 evidential documentation that the audit was properly planned,
25 performed and supervised and to carry out sufficient procedures
26 to verify evidential matter and to substantiate the basis of the
auditor's conclusions.

e. AU § 342 which requires an auditor to exercise professional
skepticism in evaluating management's accounting estimates
and to examine the reasonableness and the data sources of the
estimates.

1 5. Andersen's Audits of BFA's 1995-1997 Financial Statements regarding
2 Year-End transactions.

3 a. AU § 508.40-49 which prohibits an auditor from issuing an
4 unqualified opinion when the client places a limitation on the
5 scope of the audit.

6 b. AU § 333 which prohibits an auditor from relying upon
7 management representations which are not verifiable through
8 third party information and proper audit testing and analysis that
9 afford a reasonable basis for the auditor's opinion, particularly
10 when contradictory evidence exists.

11 c. AU § 339.05 which requires an auditor to maintain sufficient
12 evidential documentation that the audit was properly planned,
13 performed and supervised and to carry out sufficient procedures
14 to verify evidential matter and to substantiate the basis of the
15 auditors conclusions.

16 d. AU § 326 which requires an auditor to consider and evaluate
17 evidential matter regardless of whether it corroborates or
18 contradicts management's assertions.

19 6. Andersen's 1995-1997 Fraud Risk Analysis.

20 a. AU § 316 (SAS No. 82 for 1997) which requires an auditor to
21 identify and address the fraud risk factors that would have raised
22 substantial doubt about the reasonableness of a client's financial
23 statements and indicate client's management may be engaging
24 in fraud.

25 b. AU § 316.05 (SAS No. 53 for 1995-1996) which requires an
26 auditor to assess the risk that errors and irregularities may cause
27 the financial statements to contain material misstatements.

28 7. Andersen's Analysis of the 1998 Series of *New Times* Articles.

29 a. AU § 508.35 which requires an auditor to express a qualified or
30 an adverse opinion if there are material departures from GAAP
31 reflected in the financial statements.

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2 b. AU § 508.41 which requires an auditor to express a qualified or
3 an adverse opinion if the financial statements fail to disclose
4 information required by GAAP.

5 c. AU § 561 which requires an auditor to take action when facts
6 that existed at the date of the auditor's report are subsequently
7 discovered.

8 8. Andersen's Tax Risk Assessment.

9 a. AU §§ 110.02 & 317.05 which require an auditor to properly
10 plan and perform the audit to obtain reasonable assurance that
11 the financial statements are free from material misstatements
12 caused by fraud and caused by violation of laws and regulations
13 with a direct and material effect on the financial statements.

14 b. AU § 311.04(b) which requires an auditor, in planning an audit,
15 to consider discussing matters that may affect an audit with firm
16 personnel responsible for non-audit services. (See also AU §
17 9311.01-.03)

18 c. AU § 561 which requires an auditor to take action when facts
19 that existed at the date of the auditor's report are subsequently
20 discovered.

21 Based upon the aforementioned Findings of Fact and Conclusions of Law, IT IS
22 HEREBY ORDERED THAT:

23 IV. ORDER

24 85. The provisions of this Order shall apply to Andersen and any successor firms
25 to Andersen, but not to other certified public accounting firms with which Andersen partners
26 or employees may now be employed. This Order shall remain in full force and effect for a
term of two years commencing on the date of execution of the Order.

86. Andersen has paid the principal amount of \$217 million pursuant to the global
settlement entered into the record in *Baptist Foundation of Arizona Liquidation Trust v.
Arthur Andersen LLP*, Case No. CV-2000-01589 ("the Trust Action") the terms of which are
incorporated herein to this Order, including the Stipulation of Settlement entered in that case.

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2 87. The payment of \$217 million is deemed restitution to BFA investors, except
3 for \$640,000 which has been paid to the Board as reimbursement of costs.

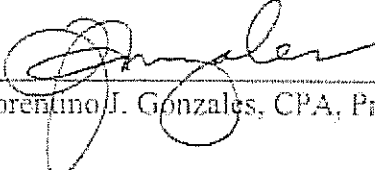
4 88. Andersen has represented to the Board that it is no longer performing audits
5 of clients that issue securities. Andersen has also represented to the Board that it will not be
6 performing public audit work of any kind after August 31, 2002, in Arizona. Based upon
7 these representations, the provisions in the Trust Action settlement which call for a
8 Monitoring Board are moot and need not be enforced. The retainer posted by Andersen in
9 the amount of \$40,000 for purposes of setting up and operating the Monitoring Board shall
10 remain with the Board and shall be applied to costs incurred in the Board's investigations of
11 File No. 2001.134.

12 89. Andersen's registration to practice in Arizona is subject to a biennial renewal
13 on September 1, 2002. Andersen decided not to renew its registration to practice in Arizona
14 and relinquished its registration on August 31, 2002.

15 90. This Order shall fully and finally resolve each and every allegation or issue that
16 was, or could have been, the subject of this matter between Andersen and the Board. In the
17 event Andersen or any successor firm applies for a registration to practice public accounting
18 in Arizona, the Board will consider all disciplinary actions currently pending as of August
19 31, 2002 as well as all other matters it determines to be appropriate.

20 DATED this 11th day of September, 2002.

21 ARIZONA STATE BOARD OF ACCOUNTANCY

22 
23 _____
24 Florentino J. Gonzales, CPA, President

25 **CONCURRING:**

26 William D. Baker, Esq.
Richard M. Gardner, CPA
Loretta Peto, CPA
Lehman William Williams

CONSENT TO ORDER

I, EDWARD F. NOVAK, after being duly sworn, state under oath the following:

1 I am an authorized representative of Arthur Andersen LLP, Certified Public
2 Accounting Office Registration No. 964-B, with the authority to enter into this Consent to
3 Order on behalf of the firm in the matter pending before the Arizona State Board of
Accountancy (hereinafter "the Board"); Case No. 00A-98230-ACY.

4 I have read and understand everything contained in the foregoing Findings of Fact,
5 Conclusions of Law and Order (hereinafter "Consent Order"). If it is approved by the Board,
6 while denying the allegations contained therein, I agree that Arthur Andersen will be bound
7 by the terms of this Consent Order. Arthur Andersen is aware of its right to an administrative
hearing in this matter and hereby waives the same.

8 In the event Andersen or any successor firm applies for a registration to practice public
9 accounting in Arizona, the Board will consider all disciplinary actions currently pending as
of August 31, 2002 as well as all other matters it determines to be appropriate.

10 Arthur Andersen waives all rights to challenge the foregoing Findings of Fact,
11 Conclusions of Law and Order on appeal, or otherwise, to the Board or any other court or
12 tribunal. I understand that a violation of any of the terms of this Consent Order may
constitute grounds for disciplinary action.

13 I understand that this Consent Order and the related investigation is a matter of public
14 record. By my signature, I verify that I have read and understand everything contained in the
15 foregoing Consent Order.

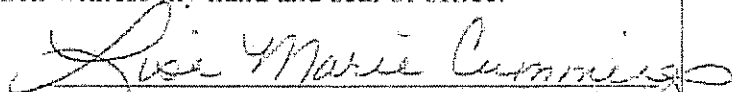
16 Dated 13 of Sept, 2002



17
18 Arthur Andersen Representative

19 SWORN TO AND SUBSCRIBED BEFORE ME, this 13th day of
20 September, 2002, to certify which witness my hand and seal of office.

21 SEAL

22 
23 Notary Public in and for the State of Arizona



1 COPY of the foregoing mailed via
2 certified mail, this 17 day of SEPTEMBER, 2002, to:

MAIL NO. 7000 1670 0006 4337 3626

3 Edward F. Novak, Esq
4 April Wynne, Esq.
5 Quarles & Brady Streich Lang, PA
6 Two North Central Avenue
7 Phoenix, AZ 85004-2391
8 Attorneys for Arthur Andersen

9 COPY of the foregoing mailed
10 this 17 day of SEPTEMBER, 2002, to:

11 Miles N. Ruthberg, Esq.
12 Peter W. Devereaux, Esq.
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15 633 West Fifth Street, Suite 4000
16 Los Angeles, CA 90071-2007
17 Attorneys for Arthur Andersen

18 COPY of the foregoing mailed
19 this 17 day of SEPTEMBER, 2002, to:

20 Felecia A. Rotellini, Chief Counsel
21 Joel P. Nordquist, Assistant Attorney General
22 Accountancy Enforcement Unit, LES/Civil Division
23 Arizona Attorney General's Office
24 1275 W. Washington
25 Phoenix, AZ 85007
26 Attorneys for Arizona State Board of Accountancy

27 ORIGINAL filed this 17 day of September 2002 with:

28 Arizona State Board of Accountancy
29 100 N. 15th Avenue, Suite 165
30 Phoenix, AZ 85007

1 Copy of the foregoing mailed this 17 day of September 2002 to:

2 Cliff Varnell, Director
3 Office of Administrative Hearings
4 1400 W. Washington, Suite 101
5 Phoenix, AZ 85007

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