Janet Napolitano, Attorney General
Jennifer Boucek, #016129
Assistant Attorney General
LeRoy Johnson, #013889
Special Assistant Attorney General
Consumer Protection & Advocacy Section
1275 W. Washington
Phoenix, Arizona 85007
(602) 542-7721
Fax: (602) 542-4377
Attorneys for Plaintiffs

COPY

JAN 1 9 2001

MICHAEL K. JEANES, CLERK
M. MOLINA
DEPUTY CLERK

IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

STATE OF ARIZONA, ex rel. JANET NAPOLITANO, ATTORNEY GENERAL, AND THE ARIZONA CORPORATION COMMISSION, Plaintiffs, v. ARTHUR ANDERSEN, L.L.P., Defendant.	NO. CV2001-001004 **VERIFIED COMPLAINT AND APPLICATION FOR INJUNCTIVE AND OTHER RELIEF**

For their Complaint, Plaintiffs, State of Arizona, ex rel. Janet Napolitano, Attorney General, and the Arizona Corporation Commission allege as follows:

JURISDICTION AND VENUE

1. This action is brought under the Securities Act of Arizona, A.R.S. § 44-1801, et seq., and the Arizona Consumer Fraud Act, A.R.S. § 44-1521, et seq. Plaintiffs seek, among other forms of relief, restitution, civil penalties, investigative expenses, costs, attorneys' fees, and other ancillary relief to prevent and remedy the unlawful acts alleged in this Complaint.

2. The Defendant has transacted business within, through or from Maricopa County, Arizona and elsewhere in Arizona at all material times.

3. The Defendant has caused events to occur in this State out of which the claims which are the subject of this Complaint arose.

4. This Court has jurisdiction to enter appropriate orders both prior to and following a determination of liability, pursuant to A.R.S. §§ 44-1524, 44-1528, 44-2031, and 44-2032.

5. Venue is appropriate in Maricopa County pursuant to A.R.S. §§ 12-401(17), 44-2031, and 44-2032.

PARTIES

6. Plaintiffs are the State of Arizona, ex rel. Janet Napolitano, Attorney General, and the Arizona Corporation Commission ("Commission").

7. Defendant ARTHUR ANDERSEN is a limited liability partnership of licensed professional accountants with offices located worldwide, including Phoenix, Arizona. ARTHUR ANDERSEN, since 1984, served as the auditor of the Baptist Foundation of Arizona ("BFA"). In each year from 1984 through 1997, ARTHUR ANDERSEN issued an unqualified (clean) opinion on the Combined Financial Statements of BFA.[1] ARTHUR ANDERSEN also issued unqualified opinions on certain BFA subsidiaries including The Foundation Companies, Inc. f/k/a Foundation Development Corporation ("TFCI"). In addition to audit work, at various times from 1984 through 1998 ARTHUR ANDERSEN performed tax and consulting services for BFA.

INTRODUCTION

8. By issuing unqualified opinions from 1984 through 1997, ARTHUR ANDERSEN was giving assurance that (i) it had audited BFA's financial statements in accordance with generally accepted auditing standards ("GAAS")[2]; (ii) it had planned and performed the audits

---

[1] When years are used in this Complaint (1984 through 1997) the Complaint is referring to the calendar year ending December 31 and the audit performed on that year by ARTHUR ANDERSEN. For example, 1997 refers to the calendar year ending December 31, 1997, and the audit performed by ARTHUR ANDERSEN through its opinion date of April 27, 1998.

[2] GAAS are the standards, as opposed to particular procedures, promulgated by the American Institute of Certified Public Accountants which concern the auditor's professional qualities and the judgment exercised by him in the performance of his financial statement examination (audit)

to obtain reasonable assurance that the financial statements were free of material misstatement whether caused by error or fraud, (iii) in its opinion, BFA's financial statements presented fairly, in all material respects, the financial position of BFA in conformity with generally accepted accounting principles ("GAAP")[3]; and (iv) ARTHUR ANDERSEN's audits provided a reasonable basis for its opinions.[4]

9. Jay S. Ozer ("Ozer") was the lead audit partner on the BFA audit engagement from 1992 through 1998. Ann M. McGrath ("McGrath") was the lead audit manager on the BFA audit engagement from 1991 through 1998 and had been on the BFA engagement since 1988. Alan P. Hague was the tax partner on the engagement from at least 1997 through 1998.

10. In or about 1994 ARTHUR ANDERSEN began encountering an increasing number of significant warning signs that the management of BFA was perpetrating a financial fraud upon investors. During the 1996 audit, a former BFA employee provided disturbing information to ARTHUR ANDERSEN about the financial operations of BFA that confirmed what the warning signs had previously suggested. Soon after learning this information, ARTHUR ANDERSEN attempted to change its audit approach and obtain the data needed to confirm or deny the allegations of the former BFA employee. BFA's senior management refused, however, to produce the information ARTHUR ANDERSEN requested. At this point, instead of taking all steps necessary to either confirm or deny what was now a credible allegation of financial fraud, ARTHUR ANDERSEN simply accepted what limited information

---

and in his report (opinion).

[3] GAAP are the conventions, rules and procedures necessary to define accepted accounting practices at a particular time. GAAP includes both broad and specific guidelines. The primary source of GAAP is the Financial Accounting Standards Board.

[4] Separate opinions were also issued by ARTHUR ANDERSEN for certain BFA subsidiaries, including TFCI. When BFA financial statements are referred to in this Complaint, the reference is intended to include separate financial statements of BFA subsidiaries, including TFCI, where appropriate.

BFA senior management provided and issued a clean audit opinion for 1996.

11. Even when the allegations of fraud by BFA senior management became public through a series of articles in the *New Times*, a weekly newspaper based in Phoenix, Arizona, both during and after the 1997 audit, ARTHUR ANDERSEN did not take any steps to address, in a serious or meaningful manner, the evidence of financial improprieties. In fact, there is evidence that ARTHUR ANDERSEN purposefully modified its audit workpapers[5] or failed to include information in its audit workpapers that displayed knowledge of the fraud that was being perpetrated on the investing public. Ultimately, by its actions and inaction, ARTHUR ANDERSEN misled the BFA Board of Directors by continuing to issue unqualified opinions on the audited financial statements. The BFA Board of Directors, in turn, continued to offer securities to the public based on the clean audit opinions. ARTHUR ANDERSEN thus facilitated the perpetuation of the financial fraud upon investors.

12. For the reasons set forth in detail in this Verified Complaint and Application for Injunctive and Other Relief ("Complaint"), ARTHUR ANDERSEN's audit opinions on BFA's financial statements were materially false and misleading. ARTHUR ANDERSEN either knew or should have known that its audit opinions and the financial statements of BFA were false and misleading. Further, ARTHUR ANDERSEN knew or should have known that (i) it did not conduct its annual audits in accordance with GAAS; (ii) it did not plan and perform its audits in a manner to obtain reasonable assurance that BFA's Combined Financial Statements were free of material misstatement; (iii) BFA's Combined Financial Statements did not present fairly the financial position of BFA in conformity with GAAP; and (iv) it did not have a reasonable basis for its unqualified audit opinions. Finally, ARTHUR ANDERSEN knew or should have

---

[5] An auditor's workpapers serve both as tools to aid the auditor in performing his work, and as written evidence of the work done to support the auditor's report (opinion). Statement on Auditing Standards No. 41 (Working Papers) provides authoritative guidance on the functions and nature, general content, and ownership and custody of workpapers.

known that BFA's Board of Directors relied on ARTHUR ANDERSEN's unqualified audit opinions on BFA's financial statements each year in deciding to issue new securities to investors.

I. Overview of the Baptist Foundation of Arizona

13. BFA was organized as an Arizona nonprofit corporation and conducted some of its activities under the name Christian Investment Services, Inc. As a nonprofit corporation, BFA had no shareholders but had members who included the accredited messengers to the annual meeting of the Arizona Southern Baptist Convention ("Convention"), the Executive Board of the Convention, and the Board of Directors of BFA. A twenty-one member Board of Directors, elected by the messengers to the annual meeting of the Convention, purportedly governed BFA.

14. In 1982, William P. Crotts ("Crotts") became the President of BFA and continued in that position until his termination in August 1999. Donald D. Deardoff ("Deardoff"), who began his employment with BFA in 1980, served as Senior Vice President and Treasurer/Controller of BFA until his termination in August 1999. Thomas D. Grabinski ("Grabinski"), who began his employment with BFA in 1988, served as Senior Vice President, General Counsel and Secretary of BFA until his termination in August 1999.

15. In July 1999, staff of the Securities Division of the Commission ("Division") and the Arizona Attorney General's office met with counsel for BFA, Arizona Southern Baptist New Church Ventures, Inc. ("New Church Ventures"), Christian Financial Partners, Inc. ("Christian Financial Partners"), A.L.O., Inc. ("ALO") and E.V.I.G., Inc. ("EVIG") and notified them that they believed that these entities were operating an accounting and securities fraud and that the offering documents given to investors were false and misleading. These initial meetings led the three issuers of securities, BFA, New Church Ventures and Christian Financial Partners, to enter into a consent order to cease and desist on August 10, 1999. A copy of the cease and desist order issued by the Commission is attached hereto as Exhibit 1. On August 28, 1999, the

BFA Board of Directors terminated the employment of Crotts, Grabinski and Deardoff. Henceforth in this Complaint, Crotts, Grabinski and Deardoff may individually and/or collectively be referred to as "Senior Management."

16. BFA, New Church Ventures, ALO and EVIG, through BFA's Senior Management, were operating a variation of a ponzi scheme. Certain individual related parties assisted Senior Management in perpetuating the ponzi scheme. These individuals include: Harold Friend ("Friend"), Dwain Hoover ("Hoover"), Jalma Hunsinger ("Hunsinger"), and Edgar Alan Kuhn ("Kuhn"). Henceforth in this Complaint, Friend, Hoover, Hunsinger and Kuhn may individually and/or collectively be referred to as the "Individual Related Parties."

17. Hunsinger was reflected as owning all of the outstanding stock of ALO, which in turn owned, either directly or indirectly, the stock of all the corporate entities reflected on Exhibit 4. Kuhn became Secretary and Director of ALO in 1990 and remained an officer and director until the BFA bankruptcy.[6] Friend was reflected as an officer of Select Trading Group, Inc. ("Select") and as president of many of its subsidiaries. Select is a subsidiary of ALO. Since its incorporation, ALO and its subsidiaries and affiliates acted as the primary "bad bank"[7] used by Senior Management to hide the true financial condition of BFA. Although Hunsinger, Kuhn and Friend appear on corporate documents as officers and directors of the ALO entities, Senior Management of BFA made all essential decisions affecting ALO.

18. Kuhn incorporated EVIG in May 1996 and was reflected as its sole officer and director. Kuhn was reflected as owning all of the outstanding stock of EVIG, which in turn

---

[6] On November 9, 1999, BFA, New Church Ventures, ALO and EVIG filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. In documents filed with the Bankruptcy Court, BFA estimated that assets of all entities totaled $220 to $260 million, with liabilities due to investors approximating $590 million.

[7] "Bad bank" is a term used by BFA insiders to describe the entities (i.e., New Church Ventures, ALO and EVIG) that were used to get non-performing assets off of the books of BFA or to otherwise facilitate a transaction that benefitted BFA but not the "bad bank."

owned the stock of all the corporate entities reflected in Exhibit 5. Since its incorporation, EVIG also acted as a "bad bank" for Senior Management. Although Kuhn appeared on corporate documents as officer and director of the EVIG entities, Senior Management made all essential decisions affecting EVIG.

19. The organization charts of BFA, New Church Ventures, ALO and EVIG as they existed at the time of the filing of the bankruptcy petition are attached as Exhibits 2, 3, 4 and 5 respectively.[8] Henceforth in this Complaint, New Church Ventures, ALO and EVIG may individually and/or collectively be referred to as the "Entity Related Parties."[9]

II. Representations by the Baptist Foundation of Arizona

20. From at least the mid-1980s through July 1999, BFA, TFCI, New Church Ventures and/or Christian Financial Partners offered and sold securities to investors located in Arizona and throughout the United States and several foreign countries. The principal amount of securities offered and sold grew dramatically over the years and at the time of bankruptcy the amount due to investors was approximately $590,000,000.

21. The securities offered and sold by BFA, New Church Ventures and Christian Financial Partners were offered through "Offering Circulars" and "Offering Circular Supplements." The Offering Circulars and Offering Circular Supplements set forth a detailed description of the particular security being offered, the terms of the investments, including repayment and reinvestment options, and the purposes for which the proceeds of the investments would be used. Each BFA Offering Circular Supplement included a set of the most

---

[8] Henceforth in this Complaint, when referring to BFA, New Church Ventures, ALO or EVIG the defined term includes the entity and any of its subsidiaries and affiliates as reflected on the attached organization charts.

[9] The term "Related Party" as used in this Complaint is intended to be defined as in the accounting and auditing authoritative pronouncements pertaining to related parties and related party transactions including Statement of Financial Accounting Standards No. 57.

recent Combined Financial Statements. In the Offering Circular Supplements dated in 1996 and 1997 the Combined Financial Statements (marked unaudited) were identical (with some changes to footnotes) to the Combined Financial Statements audited by ARTHUR ANDERSEN. In the Offering Circular Supplement dated in 1998 the Combined Financial Statements (marked unaudited) were identical to the Combined Financial Statements audited by ARTHUR ANDERSEN. The Combined Financial Statements were incorporated in the Offering Circulars and Offering Circular Supplements after ARTHUR ANDERSEN had issued its unqualified audit opinions on the Combined Financial Statements. The Board of Directors of BFA relied on ARTHUR ANDERSEN's issuance of unqualified audit opinions in determining whether to issue new investments each year.

22. Each year from 1988 through 1997 BFA reported in its Combined Financial Statements that its revenue exceeded its expenses (net income or increase in net assets) ("net income"). These financial statements reflected that BFA had net income of $345,042 in 1988; $1,968,746 in 1989, $1,256,610 in 1990, $842,246 in 1991, $1,120,484 in 1992, $2,872,540 in 1993, $458,577 in 1994, $1,599,020 in 1995, $1,172,822 in 1996, and $2,543,271 in 1997.

23. ARTHUR ANDERSEN's unqualified audit opinion and the Combined Financial Statements were bound in "brown cover"[10] copies, which were provided to BFA each year. The number of copies provided to BFA was based upon requests made by BFA. The number of the brown covers given to BFA each year was substantially more than would be needed for BFA management and the BFA Board of Directors. Upon request, an investor could obtain a brown cover of the BFA Combined Financial Statements with ARTHUR ANDERSEN's opinion.

24. Included within the brown cover each year was a letter to the BFA Board of

[10] "Brown cover" is the term used by ARTHUR ANDERSEN to describe the bound financial statements given to its clients. The term brown cover comes from the fact that cover pages of the report are brown in color. Separate brown covers were issued for certain BFA subsidiaries, including TFCI.

Directors from Crotts as President of BFA (the "President's Letter"). ARTHUR ANDERSEN never performed any audit testing on the information contained in the President's Letter and never limited its opinion so as not to include the President's Letter.

25. ARTHUR ANDERSEN's unqualified opinion on the TFCI financial statements was included in various private offering memoranda pertaining to TFCI Note Trusts. Funds were raised from the public in reliance on the TFCI private offering memoranda.

26. BFA's Combined Financial Statements with ARTHUR ANDERSEN's unqualified audit opinion were contained in the yearly "Book of Reports" and a document called the "Annual" issued by the Convention. The Book of Reports was available to messengers to the annual conference of the Convention and to others upon request. The Annual contained everything in the Book of Reports (including the Combined Financial Statements of BFA with ARTHUR ANDERSEN's unqualified audit opinion) plus other material such as church statistics. In each year since 1991, hundreds of copies of the Book of Reports and the Annual were distributed. Further, ARTHUR ANDERSEN knew that its name was used in promotional literature that was widely distributed and given to investors.

III. Representations by Arizona Southern Baptist New Church Ventures, Inc. and Christian Financial Partners, Inc.

27. BFA acted as a custodian for funds in Individual Retirement Accounts ("IRAs"). As custodian, BFA could not direct funds to its own investment products. This fact led BFA management to create New Church Ventures and later Christian Financial Partners. As an IRA custodian, BFA owed a fiduciary obligation to the IRA investors who placed their funds with New Church Ventures and Christian Financial Partners. BFA performed all of the marketing of New Church Ventures and Christian Financial Partners investment products. New Church Ventures and Christian Financial Partners emphasized "stewardship investing" which purportedly enabled individuals through IRAs to invest for themselves and Southern Baptist churches or Christian ministries. New Church Ventures and Christian Financial Partners

ostensibly had a single mission, which was to raise funds for the financing of Southern Baptist churches or Christian ministries. New Church Ventures and Christian Financial Partners purportedly loaned funds to Southern Baptist churches and made other investments they deemed prudent.

28. New Church Ventures and Christian Financial Partners were incorporated in Arizona in 1984 and 1996, respectively, as nonprofit corporations. As nonprofit corporations, New Church Ventures and Christian Financial Partners had no shareholders.

29. Hunsinger incorporated New Church Ventures, and was a Director through August 1999. Kuhn was a Director of New Church Ventures from 1990 until August 1999. Kuhn was a Director and President of Christian Financial Partners since its incorporation in 1996.

30. Securities Offering Circulars and Offering Circular Supplements represented that Hunsinger was President of New Church Ventures from 1987 (other documents state that Hunsinger was President since 1984) to 1997. Kuhn served as Vice President of New Church Ventures from 1990 to 1997 and as Secretary from 1992 to 1997. Kuhn was made President of New Church Ventures in 1997.

31. New Church Ventures and Christian Financial Partners had no paid staff, but contracted with Foundation Administrative Services, Inc. ("FAS") and/or TFCI, both subsidiaries of BFA, to provide management services under "Management Services Agreements." Pursuant to these agreements, BFA received significant fees for the management of the IRA funds invested with New Church Ventures and Christian Financial Partners.

32. The Management Services Agreements required FAS and/or TFCI to perform management services for New Church Ventures and Christian Financial Partners, to provide marketing services for fund raising (the selling of IRA investments), to administer the church loan program, and to render regular financial and other reports.

33. New Church Ventures and Christian Financial Partners were controlled by Senior

Management. This allowed Senior Management to use New Church Ventures and Christian Financial Partners investor IRA funds to further the ponzi scheme being perpetrated by Senior Management to hide the true financial condition of BFA. This was accomplished by loaning IRA funds to ALO and EVIG so that they could appear to remain current on loans they owed to BFA.

IV. Overview of the Fraud that Arthur Andersen Ignored or Willfully Failed to Discover

34. BFA in the 1980s began investing heavily in real estate and notes receivable collateralized by real estate primarily located in the Phoenix area.

35. By 1988, BFA was disclosing in its audited Combined Financial Statements that the Phoenix area had been adversely affected by difficult economic conditions. This disclosure continued through the audited Combined Financial Statements for 1992. In spite of the difficult economic conditions, the audited Combined Financial Statements for 1988 through 1992 indicated that BFA management believed "that the carrying value of the real estate [was] not in excess of its net realizable value." In fact, the value of BFA's real estate holdings had declined significantly by the late 1980s and early 1990s.

36. By 1988, Senior Management had to decide whether to (i) write down BFA's real estate holdings to their true value and disclose the precarious financial condition of BFA to the BFA Board of Directors and BFA's investors, or (ii) hide the true facts from the Board and the investors. Senior Management chose the latter course of action to the great detriment of investors.

37. Senior Management and the Individual Related Parties used ALO and EVIG to hide the true financial condition of BFA and New Church Ventures. BFA insiders referred to the Entity Related Parties as the "bad banks."

38. Initially, BFA "sold" its bad assets (overvalued real estate) to the "bad banks" or to the Individual Related Parties so that BFA (an entity audited by ARTHUR ANDERSEN)

would not be required to write the assets down and recognize a loss in accordance with GAAP on its Combined Financial Statements. BFA sold these assets either at book value or at a profit even though the actual fair market value of the assets was significantly lower than the amount recorded on BFA's books. These transactions usually occurred in the last month (December) of each calendar year in order for BFA to create income, or to avoid loss. Over time, this system of orchestrating the sale of assets at either book value or at a gain at year-end to make BFA appear profitable became the normal mode of operations for BFA. Without these fabricated transactions, BFA would have lost money each year. The Entity Related Parties and Individual Related Parties who facilitated transactions with BFA did not have any of their own funds at risk in the transactions.

39. In addition to the bogus transactions that were structured between BFA and the Entity Related Parties, Friend and Hoover made purported "gifts" to BFA at year-end in order for BFA to recognize income. These gifts often involved real estate, or stock in controlled corporations, owned by Friend and Hoover. The value placed on the real estate and stock was speculative and often not properly supported by independent appraisals.

40. Because ALO and EVIG had few liquid assets, they borrowed money from either New Church Ventures, Christian Financial Partners (IRA investors' money) or directly or indirectly from BFA itself to facilitate their transactions with BFA. Generally, when the Entity Related Parties or the Individual Related Parties purchased assets from BFA they made a small cash down payment (usually provided directly or indirectly by New Church Ventures) and borrowed the remainder from BFA through a carry-back note. ALO (the primary "bad bank") had to borrow more and more money to pay the debt service on the promissory notes and to facilitate new transactions with BFA. This ability of ALO to borrow more funds from New Church Ventures allowed the notes receivable on BFA's books to appear as if they were performing as agreed.

41. As a result of the fraudulent scheme, ALO's debt increased each year from 1989

through 1997 (primarily owed to BFA and New Church Ventures) and its deficit from operations likewise increased.

	ALO LOSS FOR YEAR[11]	ALO ACCUMULATED DEFICIT[12]	ALO DEBT AT YEAR-END[13]
12/31/89	($961,000)	($961,000)	$6,771,000
12/31/90	($7,291,000)	($8,252,000)	$31,382,000
12/31/91	($4,076,000)	($12,328,000)	$58,550,000
12/31/92	($33,914,000)	($46,242,000)	$84,395,000
12/31/93	($9,899,000)	($56,141,000)	$112,337,000
12/31/94	($14,040,000)	($70,077,000)	$134,396,000
12/31/95	($23,321,000)	($94,150,000)	$197,239,000
12/31/96	($21,533,000)	($115,720,000)	$251,651,000
12/31/97	($22,220,000)	($138,938,000)	$260,064,000

ALO's true financial condition was actually worse than portrayed by its unaudited consolidated financial statements because ALO held overvalued, and in some cases non-existent, assets on its books which should have been written down or written off.

42. A fraud of this duration (ALO was created in 1988) and magnitude (potential investor losses could exceed $350,000,000) could not have occurred without ARTHUR ANDERSEN knowingly or recklessly ignoring the repeated warnings, or "red flags" uncovered during its audits. These red flags should have caused ARTHUR ANDERSEN to significantly expand its audit scope and determine the true relationship of BFA to New Church Ventures, ALO and EVIG.

---

[11] From ALO's unaudited Consolidating Income Statements for the year reflected.

[12] From ALO's unaudited Consolidating Balance Sheets at year-end.

[13] Includes credit lines and notes payable as reflected on the unaudited ALO Consolidating Balance Sheets.

43. Had ARTHUR ANDERSEN conducted its audits in accordance with GAAS, it would have discovered that BFA assets were substantially overstated due to net realizable value issues. Instead, for years ARTHUR ANDERSEN ignored repeated warning signs and did not perform its audits in accordance with GAAS. ARTHUR ANDERSEN did not take appropriate steps to prevent the deliberate misstatement of BFA's financial results in direct contravention of GAAS. ARTHUR ANDERSEN did not significantly expand its audit scope pertaining to the realizability of BFA assets until its audit of the December 31, 1998 Combined Financial Statements (which was never completed).[14] By that time it was too late for investors.

V. Overview of Involvement of and Facts Known to ARTHUR ANDERSEN

44. ARTHUR ANDERSEN knew that the Phoenix area real estate market was adversely affected by difficult economic conditions in the late 1980s and early 1990s. Beginning at least as early as 1991, ARTHUR ANDERSEN knew that certain real estate properties on the books of BFA had not been appraised for several years. Further, ARTHUR ANDERSEN knew that BFA sold those real estate properties at amounts greater than or equal to book value to Hunsinger (ALO).

45. From at least 1991, ARTHUR ANDERSEN knew that BFA consistently had losses from operations during most of the year and ended up with net income at year-end through transactions primarily with Individual and Entity Related Parties. In its workpapers ARTHUR ANDERSEN documented that BFA management appeared to have a philosophy of significantly managing reported financial results by selling assets to related parties or obtaining gifts from related parties near year-end.

46. Beginning in 1984, ARTHUR ANDERSEN knew that Hunsinger was a Related Party because Hunsinger served as a BFA Board member and later was associated with ALO and served as an officer and director of New Church Ventures. From at least 1992, ARTHUR

[14] ARTHUR ANDERSEN did complete the audit of TFCI and issued a clean opinion for 1998. ARTHUR ANDERSEN withdrew its opinion after the fraud was brought to light in July 1999.

ANDERSEN knew that Kuhn was not only a prior BFA Board member but was an officer and director of New Church Ventures. From at least 1992, ARTHUR ANDERSEN knew that ALO and New Church Ventures had no employees of their own but instead relied on subsidiaries of BFA to manage the day-to-day operations of those entities.

47. ARTHUR ANDERSEN knew that BFA not only acted as the custodian of self-directed IRA trust funds, but also received significant fees for managing the investment of those funds. This activity created a fiduciary relationship between BFA and IRA account holders that created significant issues pertaining to federal and state laws that ARTHUR ANDERSEN was obligated to address as part of GAAS. ARTHUR ANDERSEN also knew that BFA marketed the investment products offered and sold by New Church Ventures and Christian Financial Partners and that BFA managed the day-to-day operations of those entities. From at least 1991, ARTHUR ANDERSEN performed audit testing of BFA's Trust Department.

48. By 1994, ARTHUR ANDERSEN had reviewed a detailed listing of New Church Ventures Credit Corporation ("NCVCC")[15] notes receivable and thus was aware ALO was the largest single creditor of both BFA and New Church Ventures. Nevertheless, ARTHUR ANDERSEN failed to determine the financial condition of ALO at this point even though it could have obtained balance sheets of ALO through the public record. (As noted in paragraph 41 above, ALO lost $14,040,000 in 1994 and had an accumulated deficit at the end of 1994 of $70,077,000.) A review of these records should have compelled a reasonable auditor to question how ALO was able to remain current on its obligations to BFA and New Church Ventures while losing millions of dollars each year. In addition, an auditor who had reviewed ALO's balance sheets should have questioned whether its testing in the trust area was sufficient to satisfy its stated objectives pertaining to IRA investor trust funds. ARTHUR ANDERSEN's stated audit objectives in the trust area should have detected the fact that BFA's Senior

---

[15] NCVCC is a subsidiary of New Church Ventures. Most of the loans due to BFA from New Church Ventures were in fact due from NCVCC.

Management was fraudulently diverting IRA funds to ALO in order to perpetrate the ponzi scheme.

49. ARTHUR ANDERSEN knew that from 1991 through 1997 the largest single asset category on the audited BFA Combined Balance Sheets was "Notes Receivable." ARTHUR ANDERSEN knew that in every year from 1995 through 1997 the Entity Related Parties owed no less than 63% of total Notes Receivable. ARTHUR ANDERSEN knew that from 1991 through 1997, Hunsinger signed virtually all of the Notes Receivable confirmations sent to ALO and New Church Ventures. ARTHUR ANDERSEN knew that for 1996 and 1997 Kuhn signed the Notes Receivable confirmations sent to EVIG. The following chart shows the significance of the Entity Related Party Notes Receivable to the BFA Combined Financial Statements in 1995 through 1997.

For Year Ended December 31,	Total Notes Receivable per BFA Combined Balance Sheets	Total Notes Receivable due from ALO, New Church Ventures, and EVIG	Percentage of BFA Total Notes Receivable due From ALO, New Church Ventures and EVIG
1995	$143,674,000	$90,953,000	63%
1996	$157,432,000	$103,413,000	66%
1997	$185,318,000	$135,111,000	73%

50. ARTHUR ANDERSEN's audit approach related to BFA Notes Receivable varied from 1991 through 1997. From 1991 through 1993, ARTHUR ANDERSEN performed little audit work pertaining to the net realizable value of collateral purportedly securing Notes Receivable due to BFA from ALO and New Church Ventures. Instead, ARTHUR ANDERSEN relied primarily on the fact that Notes Receivable appeared to be performing and that ARTHUR ANDERSEN confirmed the account balances. In 1994 and 1995, ARTHUR ANDERSEN's audit approach was modified to include a review of the underlying collateral purportedly securing Notes Receivable that were on "stop accrual." Stop accrual Notes Receivable are those

that are delinquent on principal and/or interest payments and therefore the notes' realizability would be in question absent sufficient collateral. In 1996 and 1997, ARTHUR ANDERSEN began testing certain collateral purportedly securing the performing Notes Receivable.

51. When ARTHUR ANDERSEN did begin to review the underlying collateral purportedly securing performing Notes Receivable in 1996 and 1997, it largely ignored valuation issues brought to light by its own audit work. ARTHUR ANDERSEN consistently relied on Senior Management's representations to support the value of real estate and collateral for Notes Receivable when it should have been requiring third party verification of values including independent appraisals and reviews. ARTHUR ANDERSEN largely ignored valuation issues raised by its own appraisal expert.

52. ARTHUR ANDERSEN knew that collateral for BFA Notes Receivable was routinely replaced by new or different collateral. ARTHUR ANDERSEN also knew that Notes Receivable due from ALO and New Church Ventures were routinely "recast" to extend the maturity dates when they became due and payable. This should have indicated to ARTHUR ANDERSEN that the Notes Receivable were impaired. Accordingly, ARTHUR ANDERSEN should have required BFA management to record writedowns in accordance with GAAP. ARTHUR ANDERSEN's methodology for testing of collateral in 1996 and 1997 was not in accordance with GAAS.

53. ARTHUR ANDERSEN never questioned, or ignored the issue of, how BFA's real estate was unaffected by the adverse real estate conditions and instead appreciated in value. Nor did the significant managing of income through year-end transactions with the Entity and Individual Related Parties cause ARTHUR ANDERSEN to change its audit approach to look at collateral values securing performing Notes Receivable until 1996. Because ARTHUR ANDERSEN knew by the end of 1994 that ALO was the primary creditor of both BFA and New Church Ventures, ARTHUR ANDERSEN should have performed audit procedures to ascertain the true nature of the relationship of BFA to ALO and New Church Ventures. In

addition, ARTHUR ANDERSEN should have been determining ALO's true ability to perform on its obligations to BFA and New Church Ventures.

54. While ARTHUR ANDERSEN's audits were seriously flawed in 1991 through 1994, beginning in 1995 the facts lead to the conclusion that ARTHUR ANDERSEN not only aided and abetted the securities fraud being perpetrated on investors but, in fact, may have directly or indirectly participated in that fraud.

VI. Additional Warnings Known to ARTHUR ANDERSEN from 1995 through 1997

A. 1995 Audit Engagement

55. From at least 1991 through 1998, ARTHUR ANDERSEN issued separate unqualified opinions on certain BFA subsidiaries, including TFCI. ARTHUR ANDERSEN knew that Ron Estes ("Estes") was the Chief Financial Officer of TFCI in 1995. By the end of 1995, Estes had been voicing to Senior Management his concerns about transactions with the Entity and Individual Related Parties. One particular transaction that occurred in December 1995 between BFA and Hoover allowed BFA to book in excess of $4,000,000 in income that Estes viewed as "bogus." Estes concluded at that time that he would not sign the management representation letter[16] to ARTHUR ANDERSEN if asked. In April 1996, as part of the 1995 audit of TFCI, ARTHUR ANDERSEN submitted to BFA a draft TFCI management representation letter requesting Estes' signature. Estes did not sign the letter, and ultimately ARTHUR ANDERSEN accepted a representation letter with Deardoff's signature replacing Estes'. Although normally the chief financial officer of an audited entity is expected to sign the representation letter, ARTHUR ANDERSEN ignored or failed to question why, in this case,

---

[16] A management representation letter is required to be obtained on every audit engagement. The representation letter is a written representation from management used to complement the auditor's other auditing procedures. Written representations from management ordinarily confirm oral representations given to the auditor and indicate and document the continuing appropriateness of such representations.

the letter was signed by an officer of the audited entity's parent corporation.

56. As noted in paragraph 50 above, in 1995 ARTHUR ANDERSEN's audit approach to Notes Receivable included testing of collateral securing delinquent Notes Receivable. In the testing of the collateral purportedly securing the delinquent Notes Receivable, ARTHUR ANDERSEN relied almost exclusively on representations of Grabinski as to the value of the collateral. There is little documentation contained in ARTHUR ANDERSEN's audit workpapers indicating that information independent of that provided by BFA management was obtained or reviewed. In fact, many of the statements made pertaining to collateral securing delinquent Notes Receivable in 1994 were simply carried forward to the 1995 audit workpapers. In addition, ARTHUR ANDERSEN placed substantial reliance on the fact that most of the delinquent Notes Receivable at December 31, 1995, were sold subsequent to year-end to EVIG or ALO at book value or at a profit. In other words, BFA was able to turn non-performing Notes Receivable into performing Notes Receivable by a "sale" to an Entity Related Party. ARTHUR ANDERSEN accepted these sales to Entity Related Parties as evidence that the delinquent Notes Receivable were fully realizable at December 31, 1995. ARTHUR ANDERSEN apparently ignored or never asked why EVIG or ALO would purchase non-performing Notes Receivable at book value or higher.

57. ARTHUR ANDERSEN apparently ignored or never inquired as to EVIG's financial condition or its ability to perform on its note obligations to BFA. Had such inquiries been made, ARTHUR ANDERSEN would have discovered that EVIG had not even been incorporated at the time of the purported sales of the delinquent Notes Receivable to EVIG. Further, ARTHUR ANDERSEN apparently did not inquire as to the ownership of EVIG. The purported owner and sole officer and director of EVIG was Kuhn. Kuhn was also an officer and director of both ALO and New Church Ventures and a former director of BFA. Therefore, EVIG and Kuhn should have been disclosed as additional Related Parties in the Combined Financial Statements, but were not.

B. 1996 Audit Engagement

58. Beginning in 1996, a number of employees of BFA, including accountants and an attorney, began expressing to Senior Management their concerns surrounding the transactions and relationships between BFA and the Related Entities. ARTHUR ANDERSEN had previous dealings with many of the accountants as part of its prior audit engagements. By the end of 1996, all of these accountants and the attorney had resigned from BFA as a result of their concerns that BFA financial statements were being deliberately manipulated and misstated by Senior Management. ARTHUR ANDERSEN recognized that the loss of key accounting personnel in 1996 caused additional audit risk.

59. One of the employees who resigned because of her concerns was Karen Paetz ("Paetz"). Paetz was an Accounting Manager of BFA whose responsibilities included maintaining the accounting records of both ALO and New Church Ventures. Paetz was therefore in a position to understand the true relationship of BFA to ALO and New Church Ventures. During the course of her employment with BFA, Paetz became concerned that BFA financial statements were being deliberately manipulated and misstated by Senior Management. Therefore, Paetz, along with other accountants at BFA, voiced their concerns to Senior Management. After Senior Management failed to take any corrective action, Paetz terminated her employment with BFA in approximately July 1996.

60. In February 1997, prior to or shortly after ARTHUR ANDERSEN began its year-end fieldwork pertaining to the 1996 audit, Paetz arranged a meeting with Ann M. McGrath ("McGrath"), who was the lead manager for ARTHUR ANDERSEN on the BFA engagement. During the course of that meeting Paetz provided McGrath with a detailed road map of the fraud that was occurring at BFA.

61. Specifically, Paetz disclosed the following to McGrath:

a) ALO had in excess of a $100,000,000 deficit and was losing $2,500,000 each month;

b) To pay the interest due on loans from BFA, ALO had to turn around and obtain funds from BFA and New Church Ventures;

c) EVIG was created to get non-performing loans off of BFA's balance sheet and Alan Kuhn was associated with EVIG (see paragraphs 56-57 above);

d) Kyle Tresch could corroborate concerns with regard to a particularly troublesome transaction in 1995 involving Hoover (see paragraph 55 above);

e) Senior Management set up Rick Rolfes as bookkeeper of ALO and New Church Ventures to create the appearance that BFA was not in control of these entities;

f) ARTHUR ANDERSEN should obtain the ALO and New Church Ventures financial statements along with a detailed listing of Notes Receivable on New Church Ventures' books;

g) Paetz was one of a group of BFA employees that had concluded that Senior Management was not being honest to its Board, the Convention or ARTHUR ANDERSEN;

h) A group of concerned BFA employees had confronted Crotts, individually and collectively, on several occasions and were convinced there would be no change in the way Crotts would conduct the business activities of BFA; and

i) When the group of concerned BFA employees confronted Senior Management with their concerns on April 15, 1996, Senior Management never denied the accusations of the group.

By February 1997, as a result of McGrath's meeting with Paetz, ARTHUR ANDERSEN had a clear picture of the fraudulent scheme being perpetrated at BFA.

62. After the meeting between Paetz and McGrath, ARTHUR ANDERSEN

completely changed its planned audit approach for the 1996 audit. ARTHUR ANDERSEN determined it was necessary for it to (i) obtain and test NCVCC Notes Receivable including underlying collateral, and (ii) obtain the ALO and New Church Ventures detailed financial statements. This is precisely what Paetz told McGrath ARTHUR ANDERSEN needed to do to uncover the fraudulent financial manipulation that had been going on for years. Senior Management refused to turn over to ARTHUR ANDERSEN the NCVCC Notes Receivable listing and ALO and New Church Ventures detailed financial statements. Senior Management falsely told ARTHUR ANDERSEN that Hunsinger and the Board of Directors of New Church Ventures would not permit the release of the requested information. ARTHUR ANDERSEN never attempted to independently contact either Hunsinger or the Board of Directors of New Church Ventures to try and obtain the needed information. Instead, ARTHUR ANDERSEN accepted the position as explained by Senior Management even though ARTHUR ANDERSEN knew that BFA had kept the books of ALO and New Church Ventures and ARTHUR ANDERSEN had been provided the NCVCC Notes Receivable detailed listing in 1994.

63. When confronted with the fact that Senior Management was refusing to produce the very information that ARTHUR ANDERSEN needed to determine if a fraud was taking place, ARTHUR ANDERSEN should have considered this a major limitation of its audit scope. The auditors should have demanded the documents be produced, and when they were not, they should have withdrawn from the engagement.

64. Had ARTHUR ANDERSEN received the documents and performed the planned testing on NCVCC Notes Receivable[17] and ALO and New Church Ventures financial statements,[18] they would have uncovered the fraud that was placing hundreds of millions of

---

[17] The critical memorandum detailing the planned (but never performed) NCVCC Notes Receivable testing never found its way into ARTHUR ANDERSEN's audit workpapers.

[18] ALO financial statements for the year ended December 31, 1996 would have indicated that ALO lost an additional $21,533,000 in 1996 and had an accumulated deficit of $115,720,000.

dollars of investors' funds at risk. Had ARTHUR ANDERSEN withdrawn from the engagement, the result again would have been to bring the fraud to an end. Instead, ARTHUR ANDERSEN decided to perform alternative testing of collateral purportedly securing performing Notes Receivable from ALO and NCVCC in the hopes this would provide it with comfort as to the realizablity of Notes Receivable on BFA's books. This was the first time ARTHUR ANDERSEN had ever tested collateral purportedly securing performing Notes Receivable. This testing of collateral led ARTHUR ANDERSEN to conclude that the Notes Receivable at December 31, 1996, were "not adequately collateralized."

65. Although ARTHUR ANDERSEN was unable to obtain the very information it needed to confirm the fraud, and its alternative procedures led to the conclusion that the Notes Receivable on BFA's books were not adequately collateralized, there is no evidence that ARTHUR ANDERSEN performed any other audit procedures to verify the information provided by Paetz. ARTHUR ANDERSEN made no attempt to contact any of the other employees that left BFA in 1996 even though Paetz had specifically named key personnel who could confirm her allegations. Instead, on April 23, 1997, ARTHUR ANDERSEN issued an unqualified audit opinion on the 1996 Combined Financial Statements of BFA. At this point, ARTHUR ANDERSEN became a full participant in hiding the fraud being perpetrated on the investing public.

66. After ARTHUR ANDERSEN issued its unqualified audit opinion on the 1996 Combined Financial Statements of BFA, in excess of $200,000,000[19] of new investor money was raised by BFA, New Church Ventures and Christian Financial Partners.

C. 1997 Audit Engagement

67. For the 1997 audit engagement, Statement on Auditing Standard No.

[19] New investment here is measured by the net increase in investment liabilities outstanding and does not consider reinvestments (rollovers). Considering reinvestments would increase this figure significantly. For example, ARTHUR ANDERSEN's audit workpapers indicate that in excess of $73,000,000 was reinvested in 1996.

82—Consideration of Fraud in a Financial Statement Audit ("SAS 82") was effective. In order to implement SAS 82, ARTHUR ANDERSEN created a firm-wide practice aid, form AP-125. The practice aid is essentially a checklist of "red flags" that signal a need to maintain a "heightened awareness" of fraud. In the BFA practice aid, ARTHUR ANDERSEN originally checked and subsequently erased some of the "red flag" boxes. The risks identified by ARTHUR ANDERSEN were summarized in a memorandum to the files dated February 24, 1998. The identified risks discussed in the memorandum included:

a) Allegations of misappropriation of assets;

b) The continuing existence of a deficient accounting staff;

c) The fact that Senior Management had a philosophy of significantly managing earnings;

d) BFA's high dependence on debt (investor funds) and its vulnerability to interest rate changes;

e) Accounting valuations based on significant estimates involving subjective judgments or uncertainties;

f) Significant related party transactions that are not in the ordinary course of business and may be difficult to verify substance; and

g) Significant, unusual or highly complex transactions, especially those close to year-end.

Once again, risk factors that ARTHUR ANDERSEN had consistently confronted in previous BFA engagements were identified as being red flags for fraud.

68. ARTHUR ANDERSEN, based upon its SAS 82 evaluation, determined that "an audit response [was] required to address [the] risks." The engagement team was to maintain a "heightened awareness" of the potential for fraudulent reporting, misappropriation of assets and other illegal acts. The audit response was to include:

a) Year-end transactions were to be reviewed closely due to management's known desire to achieve a net income in 1997.

b) Significant estimates were to be identified and addressed through verification of valuation estimates, review of BFA's investment and collateral monitoring procedures and ARTHUR ANDERSEN's use of outside appraisers to verify the reasonableness of significant appraisals.

c) Significant Related Party transactions throughout the year were to be reviewed and proper recording and disclosure was to be tested.

69. ARTHUR ANDERSEN did not in fact approach the audit with a heightened awareness. Quite the contrary, ARTHUR ANDERSEN had determined at the end of the 1996 audit that it could not afford to disclose the fraud. During the 1997 audit, ARTHUR ANDERSEN engaged in a full cover-up of the fraud as evidenced below.

70. The February 24, 1998 memorandum indicates the allegations of misappropriation of assets arose from an anonymous telephone call to the Legal Group in ARTHUR ANDERSEN's world headquarters in Chicago. According to the February 24, 1998 memorandum, ARTHUR ANDERSEN's Risk Management Group reviewed the claims and found no evidence to support the allegations.

71. Contrary to what is reflected in the audit workpapers, McGrath documented in a March 24, 1998 memorandum that the call "to the firm's Legal Group in Chicago alleg[ed] a Ponzi scheme and the illegal sale of securities." This critical memorandum did not find its way into ARTHUR ANDERSEN's audit workpapers. Instead, the complaint of a ponzi scheme and illegal sale of securities is reflected in the audit workpapers as an allegation of misappropriation of assets.

72. Upon information and belief, in February 1998, Jay Ozer and Alan Hague met with Crotts and Grabinski. One of the topics discussed at that meeting was the complaint received by ARTHUR ANDERSEN's world headquarters regarding BFA perpetuating a ponzi scheme. Ozer discounted the complaint regarding the ponzi scheme by indicating that

ARTHUR ANDERSEN follows the money.

73. ARTHUR ANDERSEN's audit approach to address the significant valuation and realizability issues surrounding BFA's assets was to again test collateral purportedly securing Notes Receivable and the value of certain operating businesses and real property. This testing was performed through a judgmental selection of collateral and assets. As in 1996, ARTHUR ANDERSEN relied on BFA management estimates and discussions with BFA employees, including Grabinski, to support the estimated net realizable value of certain of the assets and collateral tested. ARTHUR ANDERSEN identified certain assets for which it could not identify external sources of information to support management's estimate of value. ARTHUR ANDERSEN's methodology for calculating the value of collateral on certain assets was not in accordance with GAAS.

74. Again in 1997, ARTHUR ANDERSEN asked for, and never received, financial statements of ALO. ALO's unaudited financial statements for the year ended December 31, 1997, indicated that ALO lost an additional $22,220,000 in 1997 and had an accumulated deficit of $138,938,000.

D. The April 1998 *New Times* Articles

75. In April 1998, prior to the completion of the 1997 audit engagement, a series of articles titled "The Money Changers" appeared in the *New Times*. The *New Times* articles contained serious allegations of fraud and insider dealings involving BFA, mentioned specific questionable transactions and implied misdealing by Grabinski, Crotts, Hunsinger, Friend and Hoover.

76. ARTHUR ANDERSEN updated its SAS 82 analysis based on the *New Times* articles. ARTHUR ANDERSEN's approach to the allegations contained in the *New Times* was to have McGrath look at each perceived allegation contained in the articles, obtain BFA's response and determine what work ARTHUR ANDERSEN had previously done that might address the allegations. ARTHUR ANDERSEN determined BFA's response by speaking to

Grabinski, one of the key figures in the transactions questioned in the *New Times* articles. ARTHUR ANDERSEN carried forward its previously flawed audit work to a separate audit file labeled *New Times*, but did no new audit work to determine if the allegations regarding the transactions had any substance. Regarding one high profile transaction described in the *New Times* involving the Simms Tower in Albuquerque, New Mexico, ARTHUR ANDERSEN had evidence that the *New Times* allegations were true, and yet ARTHUR ANDERSEN failed to address that evidence. Had ARTHUR ANDERSEN performed any new independent audit work on the transactions discussed in the *New Times* it would have determined that its prior work was flawed and its prior clean opinions should be questioned and withdrawn.

77. The BFA Board of Directors was concerned with the allegations contained in the *New Times*. Consequently, the BFA Board directed management to have BFA's outside legal counsel review the allegations contained in the *New Times* articles and report to the Board counsel's findings. Counsel's findings were reported to the BFA Board in June 1998. Outside counsel consulted with ARTHUR ANDERSEN and was assured that ARTHUR ANDERSEN was "comfortable with the financial information of the Foundation as reported in the audited combined financial statements for 1995, 1996 and 1997." Further, the BFA Board was told that "because the *New Times* articles were published before Arthur Andersen had completed its audit for 1997, they specifically reviewed again the transactions mentioned in the articles and found no basis for adjusting the manner in which those transactions were reported in the audited combined financial statements for the Foundation."

E. The Special Risk Assessment

78. In 1997, ARTHUR ANDERSEN performed a special risk assessment concerning tax-related matters at BFA (the "Risk Assessment"). ARTHUR ANDERSEN was engaged to perform the Risk Assessment by outside legal counsel for BFA. As part of the Risk Assessment, interviews were conducted of BFA personnel and ARTHUR ANDERSEN audit and tax personnel. These interviews reflected an awareness of substantial New Church Ventures funds

being loaned to Hunsinger (ALO). Further, the interviews reflect that McGrath did not believe ALO could be successful unless BFA functioned as its "bank."

79. In January 1998, ARTHUR ANDERSEN was completing the initial phase of the Risk Assessment and preparing to deliver its report to BFA. To assist in discussing "with BFA the difficult issues included in the report" an ARTHUR ANDERSEN tax manager and specialist (not from Arizona) who worked on the Risk Assessment prepared a document titled "Opinion of Exposures." The initial draft of the Opinion of Exposures identified what was described as the "**BIG** issue." The "**BIG** issue" concerned BFA's tax-exempt status. The initial draft also indicated that the "**BIG** issue" was "[o]ne that could affect our audit opinion and should be addressed."

80. ARTHUR ANDERSEN's BFA audit team had a responsibility to address the Risk Assessment in connection with its planning of the BFA engagement for 1997. The issues raised by the Risk Assessment called into question the availability of the exemption from registration of securities relied on by BFA. Further, BFA's exposure to an Internal Revenue Service ("IRS") audit and the risk of a resultant monetary settlement or loss of its tax-exempt status had potential direct and indirect effects on its financial statements. In fact, in April 1998, ARTHUR ANDERSEN staff informed Deardoff that the *New Times* articles along with the fact Hoover was being audited "significantly increase[d] the BFA's risk of IRS audit."

81. Instead of addressing the "**BIG** issue," Alan Hague, tax partner on the BFA engagement, directed that the reference to the "**BIG** issue" and its possible effect on the audit opinion be deleted from the Opinion of Exposures. The final draft of the Opinion of Exposures, in fact, deleted the reference to the "**BIG** issue" and its possible effect on the audit opinion.

82. In addition to the information it had ignored in 1996, ARTHUR ANDERSEN in 1997 knew it needed to (i) address a number of red flags of fraud associated with BFA's transactions; (ii) address whether BFA was operating a ponzi scheme and was selling securities illegally; (iii) further address the allegations contained in the *New Times*; (iv) adequately

address the issues raised in the Risk Assessment; (v) obtain the ALO financial statements; and (vi) adequately test collateral purportedly securing BFA Notes Receivable. Instead of addressing these issues, ARTHUR ANDERSEN (i) attempted to hide the fact that a complaint regarding a ponzi scheme and illegal securities sales had been received, (ii) attempted to hide the fact that its Risk Assessment raised issues of audit concern, (iii) ignored direct evidence that the *New Times* allegations were correct and instead relied on the word of Grabinski to conclude the *New Times* allegations were unsupported without doing any new substantive audit work on transactions described in the *New Times,* (iv) requested and was denied access to the ALO financial statements, and (v) performed inadequate audit work on collateral.

83. Before it signed off on its audit opinion for the 1997 audit, ARTHUR ANDERSEN began allowing its name to be used in promotional materials that BFA gave to potential investors reflecting 1997 results. BFA represented that:

> BFA's financial records are kept in accordance with Generally Accepted Accounting Principles (GAAP). Arthur Andersen, BFA's auditor for 14 years, audits the financial statements.
> Outside auditors follow and trace all cash coming into BFA and how it is invested. Related-party transactions with benefactors are disclosed in accordance with GAAP in footnotes to the financial statements.
> All BFA assets are recorded at the 'lower of cost or market value,' in accordance with GAAP, which ensures a conservative value for BFA's portfolio of real estate assets.

ARTHUR ANDERSEN knew that BFA included this information in its promotional materials because it maintained several copies of the promotional material in its workpapers.

84. On April 27, 1998, ARTHUR ANDERSEN issued an unqualified audit opinion on the 1997 Combined Financial Statements of BFA. By doing so, it facilitated the perpetuation of the fraud and the cover-up of the fraud.

F. The December 1998 *New Times* Article

85. In December 1998, the *New Times* published a final article in its series begun in April 1998. The information provided in the December 1998 article, and related documents, served to corroborate the information that ARTHUR ANDERSEN dismissed in its 1996 and

1997 audits. The articles pointed out that:

86. The April 15, 1996 resignation letter of Kyle Tresch ("Tresch") mentioned the ALO deficit problem ($100,000,000 and growing by an annual loss of $25,000,000) and the lack of full disclosure to the auditors. Tresch said that BFA was "raiding [New Church Ventures'] IRA dollars in order to supply the liquidity needed to mature the assets of ALO." Tresch noted the ALO assets were wholly insufficient to facilitate the debt owed to BFA and New Church Ventures. Tresch, an attorney, spoke of possible criminal liability of management.

87. The August 5, 1996 resignation letter of Rich Polley ("Polley"), Trust Accounting Manager and one of the accountants who was confronting Senior Management, mentioned New Church Ventures and ALO as being "bad banks" used to take losses to make BFA look like a "good bank." A separate memorandum to the files from Polley dated May 9, 1996, criticized the transfer of stop-accrual notes to a newly formed organization, EVIG (see paragraphs 56-57 above). Polley expressed concern that in the final analysis it was IRA money at risk in the transaction and pointed to the deficit problem at ALO.

88. The November 3, 1996 resignation letter of Mike Maxson ("Maxson"), Financial Services Accounting Manager for BFA and another accountant who was confronting Senior Management, expressed concerns about New Church Ventures and ALO acting as the "bad banks" for BFA. Maxson also raised the issue of possible civil and criminal liability on the part of Senior Management.

89. ARTHUR ANDERSEN prepared a three-column analysis of the December 1998 *New Times* article. The analysis covered two main issues: the effect of ALO's negative financial position on BFA's financial statements and the use of IRA funds to finance ALO and insider transactions. Except for pointing to its testing of collateral for BFA's notes receivable from ALO, ARTHUR ANDERSEN's analysis simply dismissed, point by point, the serious allegations made by the resignation letters of Tresch, Polley and Maxson by indicating "N/A."

90. GAAS required that ARTHUR ANDERSEN make a thorough investigation of

the allegations being made by former BFA employees to determine whether they were reliable, and consider the effects on its audits of the prior years, especially 1996 and 1997. Instead, ARTHUR ANDERSEN continued to ignore the evidence and dismissed serious allegations as being not applicable to its audit responsibilities.

FIRST CLAIM FOR RELIEF
(Securities Fraud)

91. Each of the preceding paragraphs is incorporated by reference.

92. In connection with the offers or sales of securities within or from Arizona, ARTHUR ANDERSEN directly or indirectly: (i) employed a device, scheme or artifice to defraud; (ii) made untrue statements of material fact or omitted to state material facts which were necessary in order to make the statements made not misleading in light of the circumstances under which they were made; and (iii) engaged in transactions, practices or courses of business which operated or would operate as a fraud or deceit upon offerees and investors. ARTHUR ANDERSEN's conduct included:

a) Issuing unqualified opinions on the BFA Combined Financial Statements for 1991 through 1994 while failing to address the increasing number of significant warning signs it had that Senior Management of BFA was perpetuating a financial fraud (ponzi scheme) upon investors. ARTHUR ANDERSEN failed to address the warning signs even though by 1994 it knew the largest single creditor of both BFA and New Church Ventures was ALO, a company that was losing millions of dollars each year.

b) Issuing unqualified opinions on the BFA Combined Financial Statements in 1995 while failing to address in a serious and meaningful way why the Chief Financial Officer of TFCI would not sign the representation letter to ARTHUR ANDERSEN and why EVIG and ALO would buy non-performing Notes Receivable from BFA at book value or higher.

c) Issuing unqualified opinions on the BFA Combined Financial Statements in 1996 while failing to address in a serious and meaningful way the credible allegation of financial manipulation and fraud raised by Paetz. Instead, ARTHUR ANDERSEN accepted the limited information provided by Senior Management, even though it requested and was refused the very information that could have uncovered the fraud.

d) Issuing unqualified opinions on the BFA Combined Financial Statements in 1997 while failing to address in a serious and meaningful way the red flags of fraud brought to light by its own SAS 82 review.

e) Issuing unqualified opinions on the BFA Combined Financial Statements in 1997 while failing to address, in a serious and meaningful way allegations made directly to ARTHUR ANDERSEN's world headquarters in 1997 that BFA management was operating a possible ponzi scheme and illegally selling securities. Instead, ARTHUR ANDERSEN characterized the allegations as one of misappropriation of assets and made no mention of possible ponzi scheme or illegal securities sales in its 1997 audit workpapers.

f) Issuing unqualified opinions on the BFA Combined Financial Statements in 1997 while failing to address in a serious and meaningful way allegations of fraud raised in the series of articles in the *New Times*. Instead, ARTHUR ANDERSEN ignored direct evidence that certain *New Times* allegations were correct, accepted the word of Grabinski that the allegations were without merit, and relied on its previously flawed audit work.

g) Issuing unqualified opinions on the BFA Combined Financial Statements in 1997 while failing to address in a serious and meaningful way the "**BIG** issue" raised by an ARTHUR ANDERSEN manager and tax specialist, even though the "**BIG** issue" was identified as one that could affect the audit opinion. Instead, ARTHUR ANDERSEN tried to remove all evidence of the **BIG** issue from the Risk Assessment workpapers.

h) Issuing unqualified opinions on the BFA Combined Financial Statements in 1991 through 1997 while failing to address in a serious and meaningful way issues surrounding the value of real estate and collateral securing BFA Notes Receivable. ARTHUR ANDERSEN never even reviewed collateral purportedly securing performing Notes Receivable until 1996, at which time it concluded the Notes Receivable were not adequately collateralized. Further, ARTHUR ANDERSEN ignored appraisal issues raised by its own appraisal expert. Instead, ARTHUR ANDERSEN consistently relied on Senior Management's representations to support the value of real estate and collateral for Notes Receivable when it should have been requiring third party verification of values including independent appraisals and reviews.

i) Issuing unqualified opinions on the BFA Combined Financial Statements in 1991 through 1997 while failing to address in a serious and meaningful way the fact that BFA was not complying with its fiduciary obligations surrounding IRA trust funds. ARTHUR ANDERSEN's stated audit objectives in the trust area failed to detect the fact that BFA Senior Management was diverting IRA funds to ALO and was committing fraud with the IRA investors' money.

This conduct violates A.R.S. § 44-1991.

93. In connection with the offers or sales of securities within or from the State of Arizona, ARTHUR ANDERSEN aided and abetted the unlawful sale of securities by BFA in violation of A.R.S. § 44-1991.

<u>SECOND CLAIM FOR RELIEF</u>
(Offer and Sale of Unregistered Securities)

94. Each of the preceding paragraphs is incorporated by reference.

95. From in or about February 1997, ARTHUR ANDERSEN aided and abetted the unlawful sales of securities by BFA in violation of A.R.S. § 44-1841. The securities offered or sold were in the form of notes and/or investment contracts and/or evidences of indebtedness, and were sold within or from Arizona.

96. The securities referred to above were not registered under A.R.S. §§ 44-1871

through 44-1875, or 44-1891 through 44-1902; were not securities for which a notice filing has been made under A.R.S. § 44-3321; were not exempt under A.R.S. §§ 44-1843 or 44-1843.01; were not offered or sold in exempt transactions under A.R.S. § 44-1844; and were not exempt under any rule or order promulgated by the Commission. This conduct violates A.R.S. § 44-1841.

THIRD CLAIM FOR RELIEF
(Violation of Audit Procedures)

97. Each of the preceding paragraphs is incorporated by reference.

98. In the course of conducting its audit of BFA's financial statements, ARTHUR ANDERSEN knew or should have known that illegal acts had or may have occurred, but failed, in accordance with general accepted auditing standards, to:

a) Determine whether it was likely that an illegal act had occurred and, if so, determine and consider the possible effect of the illegal act on the financial statements of BFA, including any contingent monetary effects such as fines, penalties and damages.

b) Inform BFA's management and ensure that BFA's audit committee or Board of Directors was adequately informed about the illegal acts that had been detected or had otherwise come to the attention of ARTHUR ANDERSEN in the course of the audit.

This conduct violates § 44-2123(A).

99. Even though ARTHUR ANDERSEN knew or should have known that (i) illegal acts having a material effect on BFA's financial statements had or may have occurred; (ii) Senior Management had not taken timely and appropriate remedial actions with respect to the illegal acts; and, (iii) the failure to take remedial action was reasonably expected to warrant departure from a standard report of the auditor, or warrant resignation from the audit engagement, ARTHUR ANDERSEN failed to provide a written report of its findings to the Board of Directors of BFA. This conduct violates A.R.S. § 44-2123(B).

100. Although ARTHUR ANDERSEN, in the course of conducting audits of BFA's

financial statements, knew or should have known that (i) illegal acts having a material effect on the financial statements of BFA had or may have occurred, and (ii) BFA had not notified the Commission of such acts as required by A.R.S. § 44-2123(C), ARTHUR ANDERSEN failed to resign from the engagement or give the Commission any written report or documentation of any oral report concerning such illegal acts. This conduct violates A.R.S. § 44-2123(C) and (D).

FOURTH CLAIM FOR RELIEF
(Violation of Consumer Fraud Act)

101. Each of the preceding paragraphs is incorporated by reference.

102. ARTHUR ANDERSEN, in connection with the advertisement and sale of merchandise, including, but not limited to, notes and/or investment contracts and/or evidences of indebtedness, has employed, or aided and abetted the employment of, deception, deceptive acts and practices, fraud, false pretenses, false promises or misrepresentations, and has concealed, suppressed, and omitted material facts with the intent that others rely upon the concealment, suppression, and omission of such material facts, in violation of A.R.S. § 44-1522. ARTHUR ANDERSEN's conduct as alleged in this Complaint was willful as defined by A.R.S. § 44-1531(B).

REQUEST FOR RELIEF

WHEREFORE, Plaintiffs, State of Arizona ex rel. Janet Napolitano, Attorney General, and the Arizona Corporation Commission, respectfully request the Court:

1. Enter an order restraining and enjoining ARTHUR ANDERSEN and its agents, officers, stockholders, directors, partners, employees, and all other persons acting in concert or participation with it, temporarily, preliminarily and permanently, from engaging in the acts and practices alleged in this Complaint. A.R.S. §§ 44-1528 and 44-2032(2).

2. Enter an order requiring ARTHUR ANDERSEN to restore to all persons any money or property, real or personal, which was acquired by means of any practice alleged herein to be in violation of A.R.S. §§ 44-1522(A), 44-1841, and 44-1991. A.R.S. §§ 44-1528

and 44-2032.

3. Enter an order requiring ARTHUR ANDERSEN to pay civil penalties in an amount not to exceed $5,000 for each violation of the Securities Act of Arizona. A.R.S. § 44-2037.

4. Enter an order requiring ARTHUR ANDERSEN to pay civil penalties in an amount not greater than $10,000 per willful violation of the Arizona Consumer Fraud Act. A.R.S. § 44-1531.

5. Enter an order requiring ARTHUR ANDERSEN to pay the State's costs and expenses of investigating the matter of the Complaint herein, court costs, and the cost of prosecuting this matter, including reasonable attorneys' fees. A.R.S. §§ 44-1534 and 44-2038.

6. Enter an order providing that this Court retain jurisdiction of this action in order to implement and carry out the terms of all orders and decrees that may be entered herein, and in order to entertain any suitable applications or motions by Plaintiffs for additional relief within the jurisdiction of the Court.

7. Enter orders for such other and further relief as provided by the Securities Act of Arizona, A.R.S. § 44-1801, et seq. and the Arizona Consumer Fraud Act, A.R.S. § 44-1521, et seq., or as the Court deems just and proper.

RESPECTFULLY SUBMITTED this 18th day of January, 2001.

JANET NAPOLITANO, Attorney General

By: Jennifer A. Boucek
JENNIFER A. BOUCEK
Assistant Attorney General
LeRoy Johnson
Special Assistant Attorney General
Attorneys for Plaintiffs