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PwC Lawsuit Tests Whether Auditors Must Guarantee Against Fraud

Legal Newsline, CONTRIBUTOR

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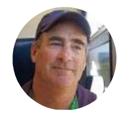

I am a writer and communications consultant and former senior editor with Forbes magazine.

PricewaterhouseCoopers is the defendant in a lawsuit brought by the Federal Deposit Insurance Corp. that seeks to hold it liable for fraud committed at an Alabama bank. The lawsuit, which goes to trial Monday, is an attempt to find the company accountable for not detecting the fraud during audits of the bank. (Photo by Matt Cardy/Getty Images)

Auditors are paid to make sure a company's books are accurate. Fraud artists specialize in misleading auditors. So should an auditor pay for the damages caused by a fraud artist?

That's the question that may be decided in a trial beginning in federal court in Washington, DC, on Monday, over whether Big Four accounting firm PricewaterhouseCoopers is responsible for $2.5 billion in losses by failing to uncover a long-running fraud at Colonial Bank, an Alabama bank that failed in 2009. The law in this area is surprisingly murky.

The fraud was engineered by the former chairman of Taylor Bean & Whitaker, Colonial's biggest mortgage banking customer, with the help of a top executive within the bank. It went undetected not just by PwC, but another outside accounting firm hired to conduct internal audits, state and federal banking regulators and even a third accounting firm that conducted a forensic audit after Colonial grew suspicious about Taylor Bean.

None of that deterred the Federal Deposit Insurance Corp., which is among the regulators that missed the fraud. It is suing PwC for the money it lost in the bank's collapse. And in rulings including an order issued last week, U.S. District Judge Barbara Jacobs Rothstein has rejected most of PwC's defenses.

Due to quirks in the underlying contracts between PwC and Colonial Bank between 2002 and 2009, the accounting firm first faces a bench trial before Rothstein, and then a second jury trial scheduled for January.

PwC argued unsuccessfully the legal doctrine of *in pari delicto* – legal Latin for "in equal fault" – bars the FDIC, which is standing in Colonial's shoes, from collecting money for crimes its own employees committed. The accounting firm also argued that Alabama is one of four states that prevents plaintiffs that are themselves negligent from suing third parties for damages stemming from their negligence.

There's no question Colonial was negligent. Its internal auditors failed to discover an audacious fraud in which, Catherine Kissick, the head of its mortgage lending department, "bought" hundreds of millions of dollars in mortgages from Taylor Bean that Taylor Bean either didn't own or had pledged to other lenders. Kissick, who was sentenced to eight years for the fraud, also allowed Taylor Bean to "sweep" Colonial's money into an overdraft account to keep it from going broke.