

# *re:*The Auditors



## Global Fraud Happens Case Studies In Auditor Liability



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# Agenda

- Auditor Liability
  - The “Duped” Defense
  - Tesco
  - Colonial Bank
- Auditors Doing Consulting
- The Luxembourg Tax Leaks and PwC
- Andersen Tax: Too Soon?

# An Auditor's Public Duty

**The auditor's client is the shareholder and investor in the company, not the company's management.**

*...By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a **public responsibility transcending any employment relationship with the client**. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public.*

*This "public watchdog" function demands that the accountant maintain total independence from the client at all times, and requires **complete fidelity to the public trust**...United States v. Arthur Young & Co., 465 U.S. 805 (1984) [U.S. Supreme Court](#)*

# Independence Violations Individuals At Big 4 Firms

Client confidentiality breach compounded by, perhaps, violation of financial interest rules

- Auditors/Audit Engagements
  - Scott London KPMG - Tipper
  - Tom Flanagan Deloitte – Tipper and Trader
  - James T. Adams, Deloitte, Advisory Partner to Caesars audit borrowing and gambling at that casino
- Other Firm Professionals
  - James Gansman EY Tax - Tipper
  - Arnie McClellan and Wife Deloitte Tax M&A – Tippers
  - PwC Transaction Services Staff - Traders

# The “Duped” Defense

## Dupe

This defense is not pretty, but it’s being used by auditors more and more.

- 1. To trick or deceive.
- Thesaurus: delude, hoodwink, hoax, swindle, trick, deceive, cheat, bamboozle, defraud, rip off (slang), con (slang).  
noun
- 2. A person who is deceived.
- Thesaurus: victim, pawn, puppet, gull, stooge, slang: sucker, pushover, easy mark, sap, fall guy.

# Were These Auditors Duped?

- Bank Foreign Exchange Fines: HSBC (KPMG), StanChart (KPMG), BofA (PwC), JPM (PwC), Barclays (PwC), RBS (Deloitte)
- Standard Chartered, AML – KPMG
- HSBC, Libor, AML – KPMG
- JPM, Barclays FERC Energy market manipulation, PwC
- JPM, Bank of America, Barclays Libor – All PwC
- Six banks—JPMorgan (PwC), BofA (PwC), Citigroup (KPMG), Wells Fargo (KPMG), Goldman Sachs (PwC), and Morgan Stanley (Deloitte)—paid \$67 billion in settlements and penalties related to the financial crisis
- Deutsche Bank, Tax evasion 2X, now fair value accounting violations – KPMG
- Wal-Mart and News Corp, FCPA Pending – EY
- GlaxoSmithKline, FCPA Pending China - PwC
- Las Vegas Sands, FCPA and AML – PwC
- J&J, FCPA (2011) - PwC
- American Express, AML - EY
- UBS, Tax evasion, Libor, rogue trader – EY
- Eli Lilly (2012), FCPA - EY
- AstraZeneca, FCPA China, Pending, KPMG
- Pfizer (2012), Siemens (2008 and largest ever fine), Daimler (2010), KBR(2009) FCPA – All KPMG

# PwC Loves To Use The “Duped” Defense

Consider, for example how often recently PwC has claimed, after a massive fraud, that its auditors were duped by criminal or simply dishonest clients.

Better to claim incompetence than be found guilty of complicity.

- Satyam
- AIG (More than once)
- Colonial Bank
- MF Global
- SemGroup
- Tesco
- Yukos
- NQ
- Fairfield Greenwich Funds (Madoff feeder funds)

# Tesco

- Tesco is a UK supermarket chain that announced a £250 million (\$408 million) overstatement of profits on 9/22.
- PwC UK audited Tesco for more than 30 years.
- Five Tesco executives fired and now [the Chairman says he, too, will step down](#).
- Deloitte — ironically the auditor of similar retail frauds Parmalat and [Ahold](#) — investigated. Case is now with regulators for followup.
- PwC warned in annual report that commercial income, where vendor co-op payments and rebates are booked, was a risk for fraud. PwC missed the fraud anyway.
- PwC earned £10.4m for its auditing services and collected £3.6m more for its consultancy work in “organizational development”. Two of the 10 directors on the Tesco board are formerly PwC. One is chair of the audit committee.



# Colonial Bank

- PwC first audit firm sued by FDIC for crisis-era failure - Colonial Bank.
- In highly unusual step by regulator, FDIC also sues internal audit co-sourcer Crowe Horwath.
- Allegations made by FDIC complaint supported by knowledge of the audit choices PwC made, or did not make, including those related to its reliance or lack of reliance on the work of the internal audit co-source firm Crowe Horwath.
- FDIC used
  - The workpapers
  - PCAOB inspection findings pertaining to Colonial
  - The reluctant but compelling cooperation of PwC
- Crowe Horwath LLP was a consultant acting as Colonial Bank's internal audit department.
  - AICPA standards but not IIA
- The FDIC claims PwC did not do enough to compensate for failings or verify internal control assertions Crowe made on behalf of Colonial management.
- Will go to trial barring a settlement.

# Auditors As Consultants

Despite Sarbanes-Oxley prohibitions and legacy independence rules and principles, enforcement minimal and so independence suffers.

- PwC Bank of Tokyo Mitsubishi Fine (\$25 million) and Ban (2 years)
- Deloitte and Standard Chartered Fine (\$10 million) and Ban (\$1 year)
- Deloitte JPM Foreclosure Reviews of WaMu and Bear EMC transactions
- EY tax lobbying for audit clients SEC Sanction and Fine
- Deloitte and PwC at Kabul Bank
- Caterpillar, HP, AIG, Apple, Microsoft Senate investigation of tax avoidance schemes leading to PwC LuxLeaks revelations
- Broker-dealer auditors doing f/s compilation and other prohibited work.
- Deloitte MG Rover UK sanctions
- KPMG Tax Loaned Staff to GE and Others SEC sanctions and fine
- KPMG due diligence HP acquisition of Autonomy
- KPMG, EY due diligence CAT acquisition of ERA, Chinese company
- PwC Ally/ResCap foreclosure reviews
- PwC Thomson Reuters tax software alliance
- Auditors and corporate investigations (EY Lehman case)

# Luxembourg PwC Tax Leaks

- [International Consortium of Investigative Journalists \(ICIJ\)](#) and its media partners all over the world released 28,000 PwC Luxembourg tax ruling
- 340 corporate clients – 548 comfort letters issued from 2002 to 2010
- PwC sold 100+ audit clients tax avoidance schemes that have already been deemed illegal or are now under scrutiny by US and EU regulators and the IRS.

# Luxembourg PwC Tax Leaks

- PwC's main [#LuxLeaks](#) defenses:
  - The documents were obtained illegally.
  - The advice PwC provided was legal.

# Luxembourg PwC Tax Leaks

- PwC sold tax schemes, and the audit committees approved non-audit tax services for 100+ audit clients:

“transaction[s] initially recommended by the accountant, the sole business purpose of which may be tax avoidance and the tax treatment of which may be not supported in the Internal Revenue Code and related regulations.”

- That’s [prohibited](#) by the Sarbanes-Oxley Act of 2002.
- Shareholders for big names like AIG, [GlaxoSmithKline](#), Heinz, International Flavors & Fragrances, Interpublic, [Itau/Unibanco](#), JPMorgan, and Burberry paid PwC for audits that are supposed to be independent and objective but instead are tainted by an auditor blessing its own work.

# Andersen Tax: Too Soon?

A tax consulting firm, made up of ex-Arthur Andersen tax partners and previously called Wealth and Tax Advisory Services LLC, bought the Andersen portion of the Arthur Andersen name from what's left of that firm.

*“We’ve been **considering this change since 2002**. A group at Arthur Andersen tried to put together a tax-only firm but the firm was dissolving too quickly. A few years later, we were approached by a group of former partners who wanted to pursue an Andersen concept but we were owned by HSBC at the time and it was not feasible. As part of our **global expansion**, we knew we needed a **common identity**. After determining there were some impediments to using the WTAS name outside the U.S., the logical name was ‘Andersen’ because it **best represents our values**.”*

# Andersen Tax: Too Soon?

Andersen was no angel when it comes to the same tax shelter schemes that almost brought down KPMG in 2005.

[U.S. Tax Shelter Industry: The role of accountants, lawyers, and financial professionals, Four KPMG case studies: flip, opis, blips, and sc2](#)

[Authored by Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate](#) in 2003 focuses on KPMG but also mentions Andersen more than once with regard to serial shelter opinion writer law firm Sidley Austin Brown and Wood.

The firm and its files had been summoned by the IRS in spring of 2002 at the time of its dissolution.

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