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Were New Century's accounting lapses fraud or just sloppiness?

Federal investigators are examining the actions taken by New Century and its officers since the company disclosed last month that it failed to accurately tally losses from loan repurchases.

By Alex Veiga
The Associated Press

Federal investigators looking into Irvine-based New Century Financial Corp. will examine whether admitted accounting errors by the mortgage lender specializing in high-risk loans resulted from sloppy bookkeeping or fraud, legal experts said Thursday.

Among the areas that will be probed: whether executives began dumping their shares last year because they knew the company was headed for trouble.

"The key issue on both insider trading and securities or accounting fraud is going to be knowledge and intent," said attorney Michael Levy, who has represented Enron Corp., among other companies targeted by criminal probes, and also was an assistant U.S. attorney in Washington.

"The question is: Did individuals at the company know that the accounting was improper and nevertheless failed to correct it or trade based on that information?" he said.

The Securities and Exchange Commission and the U.S. Justice Department are investigating the actions taken by New Century and its officers since the company disclosed last month that it failed to accurately tally losses from loan repurchases and that it would have to restate financial results for the first three quarters of 2006.

In the wake of the revelation, the company has been left on the brink of bankruptcy, as creditors have cut off funding or taken steps to do so, many demanding the company buy back billions in mortgage loans.

Company stock has tumbled 96.8 percent since its 52-week high of $51.97 last May. It was suspended from the NYSE this week.

In addition, New Century faces several shareholder lawsuits that claim executives and directors misled investors while selling shares before the stock dove.

Attorney Jan Handzlik, a former assistant U.S. attorney in Los Angeles who has prosecuted fraud cases and now represents clients facing securities fraud investigations, said it's likely to be several months before investigators get the full picture of what happened at New Century and can determine whether any laws were broken.

"The symptoms that we're now seeing are very similar to what we've seen in other major securities cases, but whether or not the causes are the same is something that still needs to be determined," Handzlik said.

Officials with the U.S. Attorney's Office in Los Angeles, who are handling the criminal inquiry, declined to comment, citing the ongoing investigation.

New Century, once the second-biggest provider of relatively expensive home loans to people with low credit scores, built a billion-dollar business by making the loans then selling them to investment banks, using the proceeds to continue funding new loans for homebuyers.

That worked like gangbusters during the housing boom, but rising defaults coupled with the market's downturn last year prompted New Century's creditors to demand the company buy back the bad loans.

It's likely investigators have requested documents related to its financial transactions, and internal memos and e-mails.

"The question of whether or not the company and its officers acted willfully is something that might be reflected in the e-mails," Handzlik said.

Memos, e-mails and ultimately interviews of company officials are often used to determine if information was hidden from lawyers, auditors or others.

If investigators determine that the failure of the company's accounting procedures was not intentional, it could simply receive a fine as part of an SEC enforcement action, Handzlik said.

"In such a proceeding, the company might simply promise that its systems are adequate and that it never do this sort of thing again," Handzlik said.

"The more substantial question is whether or not the company was aware of the lapse in controls and yet continued to sell mortgage pools," he said.

To determine if laws were broken by New Century executives who sold shares during accounting lapses, investigators will look for evidence of stock trades being made on the basis of key information not already known to the public.

The company first disclosed on Feb. 7 that it would need to restate financial results for the first nine months of 2006 and that it expected earnings to be reduced.