

Experts question Deloitte's role in Nortel accounting problems

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Court documents filed by the SEC against former executives of Nortel Networks Corp. this week state the company's auditor, Deloitte & Touche LLP, knew about some of the biggest problems at Nortel several years ago.

The documents filed by the U.S. Securities and Exchange Commission contain specific allegations against four former Nortel executives for their role in an accounting meltdown at the telecommunications giant that took place over a four-year period.

And audit industry experts say the auditors could have done more to raise the alarm.

"There's a huge audit failure here, either of Deloitte or of the audit system," said Karim Jalal, professor and Chartered Accountants' distinguished chair in accounting at the University of Alberta business school.

According to the allegations, Deloitte was aware of some of the problem areas and had discussed them with Nortel's management as early as October, 2000. Deloitte also continued to sign "clean" audit opinions at Nortel despite a series of four financial-statement restatements with adjustments going back to 1999 at the Brampton, Ont.-based company.

Some in the audit industry ask why, if Deloitte knew about the issues at Nortel as the SEC alleges, the auditor did not do more to resolve the problems or to bring them into the open.

"They could have withheld their [audit] opinion," said **Anthony Scilipoti**, executive vice-president at **Veritas Investment Research**. "They could have resigned if they felt [the problems] were material enough."

In the first quarter of 2003, for instance, the SEC alleges Deloitte asked Nortel's management to provide documentation to support the release of US\$80- million of reserves -- effectively a US\$80-million boost to earnings, sufficient to turn Nortel's results from a loss to a profit for that period.

When Nortel's management did not provide supporting documentation for the accounting entry, Deloitte's only action was to let the US\$80-million entry stand and recommend the company should provide support for similar entries in the future, the SEC documents state.

Also, in 2000, Deloitte complained to Nortel's management that guidance given to the company's staff on how to account for certain types of controversial transactions was too brief, according to the SEC. However, Nortel's management was able to deflect Deloitte by simply telling the auditor that the guidance was a tool to help raise potential problems to more senior staff, the SEC document says.

The U.S. regulator's version of events shows a "very lax" response from Deloitte and suggests a breakdown in the relationship between the auditor and Nortel's management, Prof. Jalal said. "That's when Deloitte should have resigned."

Instead, Deloitte continued on as Nortel's auditor until December last year, when the telecom company dropped the audit firm in favour of rival KPMG LLP. Deloitte had been Nortel's auditor for 92 years. The auditor was paid fees of about \$81-million from Nortel in 2005, more than from any other client on the Toronto Stock Exchange.

A spokesman for Deloitte said it is not appropriate for them to comment on an ongoing investigation. Canada's audit regulator, the Canadian Public Accountability Board, also said it is not appropriate for the organization to comment on whether it is specifically investigating Deloitte's audit of Nortel.

Prof. Jalal said the alleged failures at Nortel show a systemic problem with auditing.

"The problem is in the current system, [the auditor's disagreements with management] don't get out into the public," he said. "The information never comes out until the shareholder gets wiped out."

One reason the SEC might not have come down hard on Deloitte is because of concerns about the lack of competition in the audit industry, said Tim Leech, principal at governance consultancy Paisley Consulting.

Since the collapse of Arthur Andersen in the wake of the Enron Corp. scandal, the audit profession has been dominated by four firms with global reach, which means there is little choice for multi-national corporations like Nortel.

The SEC would not want to cause the number of global audit firms to fall any lower, Mr. Leech said.

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