

# How Nortel, auditor became joined at hip

**Duncan Mavin, Financial Post**

Friday, March 17, 2006

Nortel Networks Corp. has faced years of financial statement restatements, accounting crises, a rollercoaster stock price, and changes to executive management, but throughout it all, Deloitte and Touche LLP has been a constant.

Deloitte, the world's biggest accounting services firm, has held on to the Nortel account even in the company's darkest times.

During Nortel's restatement years, Deloitte was paid \$57-million in 2004 and \$72.7-million in 2003 -- for what amounts to the largest fees in those years for audit, tax and related services paid by any Canadian company.

But after Nortel's decision last week to restate its accounts for the third time in as many years, the issue that's puzzling many is how Deloitte has held on to the Nortel account.

"It's a question we've been asking since last year at the [Nortel] annual meeting," said Bill Mackenzie, president of governance watchdog Fairvest Corp.

One answer is that other auditors are not in a position to do a better job than Deloitte, and might not be willing or able to tackle Nortel, Mr. Mackenzie said.

Nortel's sprawling business is "so complex," that it's difficult for any auditor to understand, he said. In fact, Deloitte's experience means the firm has the best knowledge of Nortel of any of the audit firms, Mr. Mackenzie said. And while it could seem like a sensible option to have another set of eyes look at the accounts, there have already been "a lot of fresh eyes on the Nortel accounts," he said.

Also, if Nortel was to seek a new auditor, it would be faced with another problem -- lack of choice. There have been almost constant concerns about the lack of options for firms seeking auditors since Arthur Andersen collapsed in the wake of the Enron Corp. scandal, reducing the number of the largest audit firms to four. Alongside Deloitte, the others are KPMG LLP, PricewaterhouseCoopers LLP, and Ernst & Young LLP. One of the problems of the audit industry going down to four players is that any of the big firms that already provide other services, such as consulting or tax services, would be precluded from becoming the firm's auditor, said Steve Salterio, an accounting professor at Queen's University.

Furthermore, firms smaller than the big four would not have the resources to service Nortel -- it is believed as many as 150 Deloitte staff may have worked on the Nortel account. Nor would a smaller firm have deep enough pockets to assume Nortel-sized litigation risks.

But even if Deloitte were taken off the account, other auditors could be reluctant to take its place, especially after Deloitte gave a "damning" opinion on the state of Nortel's accounting controls last year as part of its audit, Mr. Salterio said. Nortel has endured "a horrible internal control meltdown," which makes it a high-risk client for any auditor, he said.

In fact, Mr. Salterio said, "The question ought to be, 'Why is Deloitte sticking with this client?' "

Nortel is "a huge drain" on Deloitte's resources at a time when there is a lot of demand for the services of audit firms, especially because of Sarbanes-Oxley and other similar regulations, he said.

Nevertheless, the audit process at Nortel has "made a laughing stock of the [audit] industry," said **Anthony Scilipoti**, executive vice-president at **Veritas Investment Research**. **Mr. Scilipoti** is also a chartered accountant and a member of a key accounting-issues committee at the Canadian Institute of Chartered Accountants.

Nortel said the latest restatement is the result of a thorough review of sales contracts that showed the company was recording revenue in the wrong periods. The company will now be able to record higher revenue in future years.

There have been no significant changes in accounting standards to force a change in policy. Some observers said yesterday the restatement shows either Deloitte and Nortel still haven't got the numbers right despite all the hundreds of thousands of billable hours, or the auditors are not able to stand up to Nortel's management on decisions about accounting treatments.

"It brings the audit process itself into question, and that's saddening for me. It's the equivalent of a historian going back to re-write history," he said.

Al Rosen, a Toronto-based forensic accountant, questioned the decision to retain Deloitte as auditor for restatements of the same financial statements they had previously said were fine. "You bring in the very same people, then you automatically have a risk that they don't want to be embarrassed."

A spokesperson for Nortel said yesterday the company does not have any intention of replacing its auditor, while Deloitte said the audit firm considers public discussion of their relationship with Nortel to be inappropriate.

© National Post 2006