

The accounting and auditing profession – what's happening around the globe

Are the self-regulating bodies meeting their public interest responsibilities?

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The public interest mandate of the accounting and auditing profession to act as watchdog and whistle blower, continuously places the actions of this profession under public scrutiny. The exclusive mandate to be allowed to provide auditing services and have this function exclusively reserved for its members, brings along social responsibilities. The public has a right to know if the members of the accounting and auditing profession fulfil their mandate and what the nature of any transgressions are.

It has been a while since major international corporate scandals such as Enron, WorldCom, Xerox, Quest and Merck, Tyco, Global Crossing, Vivendi, Bristol-Meyers Squibb, Élan, Halliburton and Harken Energy were reported. South Africa can also boast a long list of financial and accounting failures.

In South Africa many financial and corporate failures seem long forgotten. The list of shame is long: African Bank, Alpha Bank, Bankorp, Brokers Group, Cape Investment Bank (CIB), Crulife, Crusader Life, Discount House Merchant Bank, Drop Inn, Fancourt Group, Furngro, IGI Insurance Company, Kofkor Group, Macmed, Magnum Financial Holdings, Marina Martinique, the Masterbond group of companies, Millys' Fast Food Chain, Nedbank, NEI Africa, Owen Wiggins Trust, Pretoria Bank, Prima Bank, Real Africa, Rusfurn, Sechold, Supreme Bond, Supreme Holdings, Toco Holdings, Tollgate, Trustbank, Unidev and W&A Holdings. Other more recent well-known names may still be more remembered: FBC Fidelity, Saambou, Regal Bank Treasury, Retail Apparel Group (RAG), McCarthy, Tigon and LeisureNet.

In many cases the work of audit firms also came under scrutiny. Whilst it happens almost daily that auditing firms are sued for alleged negligence, industry spokespersons and partners from these audit firms are quick to point out that these are merely charges filed and not actual court decisions.

Just how material these charges are is proven by these recent headlines (*The Guardian*, David Teathe, Thursday August 19, 2004):



Parmalat sues auditors for \$10bn

"Parmalat, the Italian food company that went bankrupt after a crippling financial scandal, last night sued outside auditors Grant Thornton and Deloitte & Touche, seeking \$10bn (£5.5bn) in damages. The lawsuit, filed in the US state of Illinois, described Grant Thornton auditors as "active conspirators" with Parmalat's former management. Grant Thornton said the suit was illegitimate, adding neither its umbrella organisation nor its US affiliate could be held responsible for its former Italian unit. Deloitte vowed to defend itself. "It was the actions of Deloitte Italy which led to the fraud being uncovered," it said."

It is indeed so that these cases take many years to conclude and the result of the latest charges will only be known many years from now.

This raises the question of whether or not rulings are indeed made against auditing firms. *Auditing SA* commissioned me to find some evidence of some recently decided cases. The cases mentioned are not intended to be a complete list of events.

Stoy faces fine and lessons over Polly Peck

"Stoy Hayward (now BDO Stoy Hayward) has been fined £75,000 and ordered to pay £250,000 in costs for its role as auditor of Polly Peck International, the collapsed fashion house." *AccountancyAge.com*; 15 January 2002; by Michelle Perry

Accounting firm to compensate for SK Global

"Young Wha Corp., a local member of accounting firm of Ernst & Young, plans to compensate for its mistakes in auditing SK Global Co. (renamed SK Networks) last year, industry sources said. The accounting firm and 39 creditor banks of SK Networks have agreed on compensation of about 15 billion won in cash, they added. The amount is about 21 times Young Wha's net profit last year of 720 million won. The sides plan to sign the final agreement to settle the issue by the end of this week. If signed, it will be the first time in Korea for a large accounting firm to take financial responsibility for its failure to properly audit a customer.

Young Wha had audited SK Global for more than a decade. The company last year became embroiled in an accounting scandal to the tune of 2.02 trillion won (\$1.68 billion). The FSS imposed a fine of 319.6 million won on Young Wha for failing to uncover such a huge discrepancy."

The Korea Herald; 23 August 2004; by Sim Sung-tae

Grant Thornton and Doeren Mayhew nailed by SEC in "Bean Counters Bash"

"Two accounting firms, Grant Thornton and Doeren Mayhew, have been nailed by the SEC over their role, or perhaps lack of it, in the audit of fraud-ridden MCA Financial Corporation. One of the lessons of this case is auditors need to be always diligent in their conduct, irrespective of being plied with alcohol and invited on fun junkets by their clients."

"Lamentably, the shindig thrown on MCA money to "celebrate the completion of the annual audit" was known as the "Bean Counters Bash!" Sadly, those with the *real* hangover from the Bean Counters Bash are the investors who unwittingly bought the MCA junk bonds, trusting the auditors to do their job."

Sri Media; 23 August 2004; by Walter F. Janus

Ernst & Young settles case with government

"Federal prosecutors in Philadelphia have reached a \$1.5 million settlement with Ernst & Young. The agreement dismissed claims the national accounting firm provided nine hospitals with improper advice on Medicare claims."

Philadelphia Business Journal; July 20, 2004

PCAOB Hands Big Four "a Little Fear"

Auditor-watchdog group discovers serious accounting problems at the largest audit firms

The Public Company Accounting Oversight Board (PCAOB) has unearthed "significant audit and accounting issues" in audits conducted by the Big Four accounting firms, PCAOB Chairman William McDonough reportedly told a House subcommittee last week. The head of the federal auditor-watchdog group told lawmakers that Ernst & Young, PricewaterhouseCoopers, KPMG, and Deloitte & Touche, had agreed to voluntary limited inspections of several "high-risk" client companies with complex finances, according to the Associated Press."

"PCAOB found in its preliminary inspections that the audits of the firms leave "room for improvement," McDonough reportedly said."

CFO.com; June 28, 2004; by Stephen Taub

Money laundering failure revealed

"Accountants have failed to respond to the obligation to report money laundering suspicions, according to the National Criminal Intelligence Service."

Accountancy Age.com; 16 June 2004; by Brian Moher

PwC pays \$50m over Raytheon

"Auditor Pricewaterhouse-Coopers has agreed to pay \$50m (£28m) to settle claims with New York State regarding its role in a 1999 lawsuit involving its defence-contractor client Raytheon. PwC's settlement follows Raytheon's \$410m settlement this month on the same lawsuit, in which shareholders accused the defence firm of hiding financial problems. In the lawsuit, PwC, Raytheon's auditor, was accused of turning a blind eye to the company's improper accounting practices."

The Guardian; Wednesday May 26, 2004; Reuters

Second big firm hit in tax sweep

"Ernst & Young admitted it had settled a multimillion-dollar tax claim over income splitting through service trusts, while PricewaterhouseCoopers blasted KPMG for being overly aggressive on tax."

The Sidney Morning Herald; 18 May 2004; by John Garnaut

KPMG hit with penalty tax bill

"Lawyers, accountants and other professionals operating in partnership structures face turmoil after partners from leading tax firm KPMG were hit with a claim for up to \$100 million in unpaid taxes and penalties for allegedly breaching Part IVA anti-avoidance tax laws. Another large accountancy firm is believed to have settled a similar claim with the Australian Tax Office in recent months."

The Sidney Morning Herald; 17 May 2004; by John Garnaut

PwC to pay \$2.4M for Warnaco work

"The auditor will settle charges by the SEC of abetting reporting violations; Warnaco ex-CEO Linda Wachner and ex-CFO William Finkelstein will disgorge bonuses.

Former Warnaco executives, including ex-CEO Linda Wachner and ex-CFO William Finkelstein, agreed to disgorge bonuses paid to them in 1998, and PricewaterhouseCoopers agreed to pay a \$2.4 million fine as part of a settlement with the Securities and Exchange Commission over misleading financial statements made by the apparel maker. "

New York Business; May 11, 2004

Wickes plc – Andersen and others

"Former firm of Andersen (previously Arthur Andersen), the auditors of Wickes plc, fined £400,000 by a Joint Disciplinary Tribunal, and ordered to pay £700,000 towards the costs of the Executive Counsel. Two former Andersen partners each fined £25,000."

The Accountants' Joint Disciplinary Scheme Website; 10 May 2004; by Christopher Dickson

Judge fines Ernst & Young for allegedly understating net worth

"Accounting firm Ernst & Young was fined more than \$134,000 for allegedly understating its net worth during a trial that resulted in an award of more than \$100 million against the company. The judge said Ernst & Young misled him, but he didn't rule on the company's value. In November, Yeager ruled that Ernst & Young wrongfully understated the value of a real estate development company that was partly owned by Reilly and her husband, Thomas J. Reilly, when the company filed for Chapter 11 protection in the mid-1980s. Had the accounting firm listed the development as an asset instead of debt, the judge ruled, Barbara Reilly would not have lost her share of the multimillion dollar investment."

Kansas Com The Wichita Eagle; Associated Press; 1 May 2004; by PA Butler

Judge finds Ernst & Young in contempt of court

"A Butler County judge has found the accounting firm Ernst & Young in contempt of court for failing to produce appropriate witnesses and documentation in a malpractice lawsuit related to the Seven Fields development scam. Judge Michael Yeager ordered the firm to pay a \$134,642 fine. Yeager determined there was an intentional effort to mislead." ... Ernst & Young chose to send [the wrong person], although in direct contravention of this court's order [and with] the desired effect of subverting these proceedings," the judge wrote in a 22-page opinion."

Pittsburgh Post-Gazette 01 May 2004; by Karen Kane

Ernst & Young Hit Hard in PeopleSoft Case

"Ernst & Young should pay the government \$1.7 million and be barred from taking new auditing clients for six months for breaching a Securities and Exchange Commission conflict-of-interest regulation, an administrative law judge recommended Friday."

"The SEC brought a proceeding against Ernst & Young in May 2003 after determining the firm collected huge royalties under a marketing agreement with PeopleSoft. PeopleSoft wasn't charged. In a 69-page ruling, Chief Administrative Law Judge Brenda Murray found that Ernst "engaged in improper professional conduct because it violated applicable professional standards for auditors by conduct that was both reckless and negligent."

"The judge, who presided over an 11-day hearing last spring, said she found "overwhelming evidence" that Ernst's "day-to-day operations were profit-driven and ignored consideration of auditor independence in business relationships with PeopleSoft. She also ordered the audit firm to hire an

independent consultant to monitor its activities, and said that punitive measures were necessary because the evidence suggests that without them, Ernst "will likely commit future violations" of the auditor independence rule."

TheStreet.com Senior Writer, 16 April 2004, by Matthew Goldstein

KPMG Settles Travel-Related Suit

The firm allegedly charged its clients full price, then kept any rebates it received

"KPMG LLP and its former consulting arm, BearingPoint Inc., have agreed to pay \$34 million to settle their part of a class-action lawsuit alleging that they overbilled clients for travel expenses, according to *The Wall Street Journal*."

"The plaintiffs had accused the two firms of charging them full price and then keeping any rebates received, said the paper. KPMG and BearingPoint will each pay \$17 million as part of the preliminary settlement in the lawsuit, which is being litigated in a Texarkana, Arkansas, state court."

CFO.com; 06 April 2004, by Stephen Taub

KPMG Admits U.S. Breach on NAB

"Accounting firm KPMG has acknowledged it breached US corporate rules in dealing with the National Australia Bank. KPMG says it has in no way breached auditor independence, but accepts it did break U.S. rules. The firm says senior staff have been disciplined."

Australian Broadcasting Corporation; 27 February 2004

Deloitte & Touche Wealth Management Limited fined £750,000

"The Financial Services Authority (FSA) has fined Deloitte & Touche Wealth Management Limited (DTWM), £750,000 for serious compliance failings and for not taking reasonable steps to complete both Phase 1 and 2 of its Pensions Review within set standards and to regulatory deadlines."

The Financial Services Authority Press Releases; 28 January 2004

Deloitte & Touche offers settlement

"Deloitte & Touche has offered a \$32 million settlement for a class action lawsuit filed in respect the Manhattan Investment Fund fraud, according to a legal notice published in *The Royal Gazette* on Friday."

"The pay out will be available to individuals and companies that bought shares in the scam between October, 1995 and January, 2000 and lost money. Deloitte & Touche were the Bermuda auditors of the scheme in which investors lost an estimated \$430 million."

Accountancy .com pk; 28 November 2004, *The Royal Gazette*

Pay bonanza for Mothercare duo

"The auditor to Mothercare has helped devise a pay scheme set to yield chief executive Ben Gordon £2m for his first year's work. The scheme, designed by Deloitte & Touche, is also on course to produce total remuneration of more than £1m for finance director Steven Glew just eight months after he joined. The retailer's spectacular share price bounce has ensured Gordon and Glew will be two of the highest paid executives on the High Street, earning more than rivals in much bigger companies."

"The pay scheme was created by the Executive Compensation Practice arm of Deloitte, which also audits Mothercare. The accountancy watchdog, the Auditing Practices Board, today launched a crackdown on accounting firms that receive fees for non-audit work from their audit clients. The board recommends explicitly outlawing audit firms from advising on boardroom pay. The Combined Code on Corporate Governance puts some restrictions on the use of auditors, but fails to address the issue of auditors that help set boardroom pay."

Evening Standard; 24 November 2003; by Patrick Hosking

Deloitte fined £1.5m over Barings

"Deloitte & Touche Singapore, the auditor of Barings Bank when it collapsed due to the activities of rogue trader Nick Leeson, will pay the bank just £1.5m, a high court judge has ruled."

AccountancyAge.com; 17 October 2003

Queens Moat director 'was dishonest'

"The career of the former deputy chairman of hotels group Queens Moat Houses (QMH) ended in disgrace today after he was excluded from membership of the Institute of Chartered Accountants and ordered to pay a fine of £250,000 plus legal costs. Investors in QMH lost hundreds of millions of

pounds after misleading financial announcements in 1991 and 1992 gave a false impression of the company's true position."

"Bird Luckin, the former auditors of QMH, were severely reprimanded and fined £17,000 and Alan Radford, the former engagement partner at the firm, was given a reprimand."

This Is Money; 1 June 2004; by Guy Dresser

Versailles Group Plc – Nunn Hayward And others

"Nunn Hayward, the former auditors of Versailles Group plc ("Versailles"), and former Nunn Hayward partner Thomas Peter Dales, found to have breached the fundamental ethical principle that they behave with integrity in all professional and business relationships;"

"Nunn Hayward was severely reprimanded, fined and ordered to pay costs; Mr Dales excluded from membership of the Institute of Chartered Accountants in England and Wales ("ICAEW")."

The Accountants' Joint Disciplinary Scheme Website; Accountants' Joint Disciplinary Tribunal; May 25th 2004; by Christopher Dickson

Former Deloitte auditing partners disciplined

"The Companies Auditors and Liquidators Disciplinary Board (CALDB) has reprimanded two auditors, Ms Sarah Merridew of Launceston and Mr Mark O'Shea of Brisbane, following applications brought by the Australian Securities and Investments Commission (ASIC). Ms Merridew and Mr O'Shea were former audit partners of Deloitte Touche Tohmatsu based in Brisbane. The CALDB issued the reprimands after finding that Ms Merridew and Mr O'Shea had failed to carry out, or to perform adequately and properly, the general duties of an auditor and duties imposed on an auditor under the Corporations Act 2001."

Accounting Education.com's Double Entries; 02 September 2004; by Andrew Priest

Conclusion



Apart from the first headline: "**Parmalat sues auditors for \$10bn**", this article presented *actual decided* cases. The amount of charges laid against auditing firms is mind-boggling. From published reports it seems that the majority of cases are settled outside court, thereby making a full assessment of wrong-doings or wrong accusations impossible.

The profession's regulators (the accounting and auditing institutes) expect the public to rely on services of their members (the auditing and accounting firms). They also vigorously defend their members and their tarnished image that resulted from audit failures.

Although the serious charges laid against auditing and accounting firms cast long shadows over the credibility of these institutions, the regulators provide the public with little information regarding the outcome of these proceedings. It seems obvious that as regulators, the professional bodies have a responsibility to monitor significant legal charges made against their members. However, the professional bodies' silence on these matters seems to indicate that they have not been able to reconcile their self-assumed functions as both regulators and trade unions.

In the absence of greater transparency, the public has to rely on selected information and reports, that often contradict the "claims of innocence" made by the voices from within the profession.