JSI Shipping (S) Pte Ltd v Teofoongwonglcloong (a firm)
[2007] SGCA 40

Case Number : CA 1/2007

Decision Date : 30 August 2007

Tribunal/Court : Court of Appeal

Coram : Chan Sek Keong CJ; Andrew Phang Boon Leong JA; V K Rajah JA

Counsel Name(s) : Loh Yong Kah Alan and Edgar Chin (Kelvin Chia Partnership) for the appellant; R Chandra Mohan, Celia Sia, Melvin Lum and Khoo Yuh Huey (Rajah & Tann) for the respondent

Parties : JSI Shipping (S) Pte Ltd — Teofoongwonglcloong (a firm)

Companies – Auditors – Duties – Section 391 Companies Act (Cap 50, 1994 Rev Ed) – Whether auditors acted honestly, reasonably and in good faith

Tort – Negligence – Causation – Whether auditors' negligence effective cause of company's loss and loss of chance to discover fraud – Extent of loss attributable to auditor's negligence

Tort – Negligence – Contributory negligence – Relief via s 391 Companies Act or plea of contributory negligence dependent on circumstances of case and different threshold requirements – Whether auditors failed to act honestly, reasonably and in good faith – Attribution of fault between directors and auditors based on respective culpability – Section 391 Companies Act (Cap 50, 1994 Rev Ed)

Tort – Negligence – Duty of care – Auditors – Standard required under contract, statutes or regulations – Weight to be attributed to expert evidence relating to conduct of audit – Applicability of relevant auditing standards of governing professional body – Whether auditors obtained independent verification and reasonable assurance – Sections 205, 207 Companies Act (Cap 50, 1994 Rev Ed)

30 August 2007 Judgment reserved.

V K Rajah JA (delivering the judgment of the court):

Introduction

1 This judgment clarifies and restates the law of professional negligence in the context of statutory audits. More specifically, it evaluates the standard of care expected of an auditor in relation to the objective verification of relevant financial particulars and discusses the principles of causation applicable in a claim for damages against auditors.

The facts

Dramatis personae

2 The appellant carries on the business of providing freight-forwarding and other related services. At the material time, its only two directors were John Peake Riggs ("Riggs"), who was based in Singapore as Asia Director, and James Glenn Cullen ("Cullen"), who resided in California and headed JS International Shipping Corporation ("JSISC"), the ultimate holding company of the appellant.

3 JSISC is engaged in the business of providing international logistics and door-to-door freight-forwarding services to its mainly US-based customers. For its freight-forwarding operations in

Singapore, JSISC initially engaged local agents who would invoice JSISC, which in turn would invoice its customers with a mark-up. Subsequently, burgeoning business in Singapore made it more economical to incorporate a local subsidiary, resulting in the incorporation of the appellant on 26 September 1998 and, shortly thereafter, the engagement of Riggs to head the appellant as well as to oversee JSISC's Asia operations.

4 As Asia Director, Riggs had overall control and responsibility of the appellant's day-to-day operations in Singapore and reported to Cullen on all operational and business issues. Cullen was also the only person who decided on and was privy to Riggs' remuneration and employment terms in Singapore. Russ Peter Hora ("Hora"), a trained accountant and JSISC's then director of finance, assisted Cullen on financial matters, including those of the appellant. Hora was instructed by Cullen to monitor the appellant's monthly management accounts regularly and report to Cullen if there was something amiss with the accounts. The appellant's accounting manager, Sandy Wah ("Sandy"), prepared the monthly management accounts detailing the appellant's expenses.

5 The respondent is an established firm of Singapore certified public accountants which provides services including statutory auditing, special auditing, accounting, tax and corporate advisory services. At the material time, the respondent was a member of the same organisation, NEXIA, as JSISC's auditors in California.

Terms of the respondent's engagement

6 The respondent conducted three statutory audits of the appellant's accounts in respect of financial years ("FYs") 1999, 2000 and 2001. All three audits were unqualified. The material terms of engagement were encapsulated in a letter of appointment dated 26 March 1999 and a letter of consent dated 8 July 1999, which provided as follows:

> Our audit will be made in accordance with the requirements of Section 207 of the Companies Act, Cap. 50, with the objective of expressing an opinion on the accounts.
>
> In forming our opinion on the accounts, we will perform sufficient tests to obtain reasonable assurance as to whether the information contained in the underlying accounting records and other source data is reliable and sufficient as the basis for the preparation of the accounts. We will also decide whether the information is properly communicated in the accounts. In this regard, we will disclose significant deviation if the accounts do not comply with the Statements of Accounting Standard issued by the Institute of Certified Public Accountants of Singapore.
>
> Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered. Accordingly, our audit should not be relied on to disclose fraud, defalcations or other irregularities. However, if they exist, their disclosure may result from the audit tests we undertake. *We shall report to you any such matters and any material weaknesses in the system of accounting and internal control which come to our notice and which we think should be brought to your attention.*
>
> The Companies Act provides that the responsibility for the preparation of the accounts including adequate disclosure is that of the directors. This includes the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and safeguarding of the assets of the Company. As part of our audit process, we will request from the directors written confirmation concerning representations made to us about the audit.

> The Companies Act provides that we shall have a right of access to the accounting and other records including registers of the Company. In addition, we have access to such information and explanations as we require for the purposes of our audit. In this connection we look forward to full co-operation with your staff.
>
> [emphasis added]

7 These terms are very similar to the template provided in Appendix 2 of the Singapore Standard on Auditings ("SSAs") published by the Institute of Certified Public Accountants of Singapore ("ICPAS") in 1996, except that the respondent acknowledged an additional express duty (italicised above) to report material weaknesses in the system of accounting and internal control which came to its notice. The respondent accepted re-appointment on the same terms for the statutory audit of the appellant's accounts for the FYs ending 31 December 2000 and 2001.

Riggs' malfeasance

8 In or around May 2002, Cullen received an anonymous letter (subsequently ascertained to have originated from the appellant's office manager, Laili Bte Ya'akub ("Laili")), which imputed that Riggs and a few other employees were unlawfully engaging in a competing business with the appellant as well as privy to a scheme to fraudulently siphon off funds. The letter also notified Cullen that Riggs had been using company funds for his own personal expenses without Cullen's knowledge or authority. Laili subsequently testified that around January 2002, she had noticed certain questionable transactions involving Riggs and had conducted a discreet investigation. She took a few months to gather sufficient evidence and decided to act anonymously as she feared for her job security, given that Riggs was the most senior person in Singapore.

9 Cullen subsequently made two trips to Singapore. After his second trip, he was satisfied that Riggs had misused funds belonging to the appellant. He confronted Riggs. This eventually culminated in Riggs' resignation on 21 June 2002. Riggs later confessed to the misappropriations in a note dated 28 June 2002. In the meantime, a police report was lodged with the Commercial Affairs Department.

10 In early July 2002, the appellant engaged Ng Lee & Associates – DFK ("NLA") to conduct a special audit to ascertain the full extent of Riggs' malfeasance. In its first special audit report dating from 1 January 2001 to 30 June 2002, NLA stated that Riggs had misappropriated company funds amounting to $1.808m during the relevant period. These misappropriations comprised personal expenses charged as director's benefits without board approval, unsubstantiated travelling expenses, doubtful charges for office renovation, fictitious payments to a company controlled by Riggs and the unauthorised issuance of numerous cash cheques for fictitious transactions.

11 A second special audit report dating from September 1998 to December 2000 was subsequently commissioned. It revealed that there was an overpayment of salary for Riggs amounting to $18,000 during the stated period. The report also stated that he had received non-approved sums of money for allowances and other benefits amounting to about $174,000. These figures were, however, altered several times during the proceedings as additional documents inconsistent with some of the initial findings surfaced.

The proceedings below

12 At first instance, the appellant claimed that all its losses were caused by the respondent's breaches of its contractual obligations and duty of care in relation to the three audits which it carried out for FYs 1999, 2000 and 2001. These breaches were alleged to have taken place in three critical

areas:

(a) Although the respondent had been in substantial doubt as to Riggs' entitlement to the amount of salary and benefits attributed to him as director's remuneration, it failed to obtain sufficient appropriate audit evidence to remove such doubt. Alternatively, the respondent had not planned and performed its audits in 1999, 2000 and 2001 with the required attitude of professional scepticism.

(b) The respondent had failed to express a qualified audit opinion or a disclaimer that would serve to document or highlight the limitation of the scope of its audit and the existence of any factors which prevented it from obtaining sufficient appropriate audit evidence.

(c) The respondent had failed to issue a management letter or internal control report to advise the plaintiff that there was a practice of:

(i) splitting payment of invoices of more than $12,000 to circumvent the single cheque signatory limit;

(ii) signing of blank cheques; and

(iii) having large prepayment accounts comprising transactions that had no substantiating documents,

thereby breaching its contract and duty to bring to the appellant's attention material weaknesses in the system of accounting and internal control that had come to its notice.

13 The respondent's case at first instance was that it had carried out all three audits in accordance with the requirements of s 207 of the Companies Act (Cap 50, 1994 Rev Ed) ("CA") and the SSAs. The respondent contended that in undertaking these audits, it had, in accordance with the SSAs:

(a) planned and performed the audit with a view to obtaining reasonable assurance about whether the financial statements were free of material misstatement;

(b) undertaken an examination of evidence supporting the amounts and disclosures in the financial statements on a test basis; and

(c) assessed the accounting principles used and significant estimates made by the directors, as well as evaluated the overall financial statement presentation.

14 Both parties adduced expert evidence supporting their positions, the material portions of which are summarised below.

The findings of the appellant's expert

15 The appellant's expert, Michael Chin ("Chin"), a director in the firm of Corporate Advisory Partners, reviewed the audits with the objective of ascertaining whether they had been conducted in accordance with the SSAs, Chin also drew attention to various steps that the respondent had taken or had omitted to take which, in the circumstances, constituted a breach of its contractual duty to the appellant.

16 Relying on the various standards encapsulated in the SSAs, Chin noted that Riggs'

remuneration was material in the context of the financial statements of the appellant and that the respondent had failed to document in its working papers the unusual difficulties it had encountered in the course of its repeated efforts to gather sufficient appropriate audit evidence of Riggs' remuneration. In particular, the respondent had been unable to:

(a) obtain Riggs' employment contracts and related correspondence on remuneration matters;

(b) obtain confirmation replies from the other director, Cullen; and

(c) obtain management representation letters for FYs 2000 and 2001 which included specific representations on Riggs' remuneration.

Given the lack of appropriate audit evidence, which constituted a scope limitation, Chin was of the view that the respondent should have expressed a qualified opinion or disclaimer.

17 In addition, Chin expressed doubts as to whether the respondent had carried out the audit with an attitude of professional scepticism in terms of assessing and addressing the risk factors in the context of a control environment dominated by Riggs, who was the sole signatory for cheques up to, initially, $10,000 and, subsequently, $12,000. Best practice would have required the issuance of a management letter highlighting such internal control weaknesses.

18 Viewed from this perspective, the crux of the respondent's alleged negligence in the audit of the appellant was its failure to carry out a proper verification process of Riggs' remuneration. In this regard, the respondent had allegedly made an incorrect professional judgment in accepting the signed statement by directors and directors' report in the appellant's financial statements as sufficient appropriate audit evidence to substantiate Riggs' remuneration. A qualified audit opinion or disclaimer should have been incorporated in the prevailing circumstances.

The findings of the respondent's expert

19 The respondent's expert, Kaka Singh ("Singh"), a partner in RSM Chio Lim, Singapore, undertook a similar review and came to a diametrically opposed conclusion. Singh took the view that the work carried out by the respondent in the three audits had been adequate and sufficient to give it a reasonable basis to express an unqualified opinion on the financial statements. In particular, Singh concurred with the respondent's view that the appellant did not have any difficult or accounting areas that needed special attention.

20 Singh observed that the appellant, as a wholly-owned subsidiary of a multi-national corporation, which would be closely supervised and monitored by the parent company, and that the assessment of audit risk was low. He focused on the sufficiency of the nature and extent of the procedures taken for the audit, and noted that the manpower allocations and change of audit staff every year were more than adequate in the circumstances.

21 In his report, Singh further stated that the respondent had made a proper assessment of the materiality criteria which determined the scope of the audit. He explained that an audit was inherently imprecise as it was, for practical reasons, premised on a sampling of less than 100% of all recorded balances and transactions. By setting materiality criteria, auditors were required to audit all items over the materiality criteria amount or justify why no audit work was necessary. Conversely, amounts which were less than the materiality criteria amounts would not ordinarily be audited.

22 Singh took the position that the appellant had a good control environment to ensure that there was no risk of the financial statements containing material misstatements that had not been actively prevented or detected in the normal course of business. He also opined that auditors were entitled to rely on the management to provide honest explanations and could not be expected to detect fraud involving collusion amongst employees or by management.

23 Singh clarified that the primary objective of the audits was to express an opinion on the appellant's financial statements and that it was not the respondent's responsibility to prevent fraud or error or to provide assurance on internal control. Therefore, the respondent was neither obligated to search for material weaknesses, nor expected to discover all such deficiencies. The respondent's only obligation was to report such deficiencies which had come to its notice and which it thought to be material.

24 In the light of the inherent limitations of a statutory audit, Singh concluded that the respondent had a reasonable basis for expressing its opinion on the appellant's financial statements for the three years running, and that it should not be held to an unrealistically high standard that required the prevention and detection of every item of irregularity and/or fraud.

The decision at first instance

25 The trial judge accepted Singh's evidence in its entirety and found that the respondent had conducted the three audits in question without breach of duty or negligence: see *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 1 SLR 821 ("GD") at [75]). Whilst the trial judge accepted that an auditor had to use reasonable skill, care and caution, he held that what amounted to reasonable care depended on the circumstances of each case. More specifically, the trial judge cited in *Lloyd Cheyham & Co Ltd v Littlejohn & Co* [1987] BCLC 303 and applied the same test for auditors as that applied for medical doctors (in *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582) ("the *Bolam* test"). The trial judge thus proceeded on the basis that "there would be no breach of duty if the auditor has acted in accordance with a practice accepted as proper by a body of skilled and responsible auditors" (GD at [68]).

26 With respect to the verification of Riggs' entitlement to remuneration, the trial judge found that the respondent was entitled to rely on representations by Riggs and Sandy in seeking verification of Riggs' own remuneration as there was no reason to doubt either of them (GD at [72]). He held that it would have been very onerous and beyond the scope of the engagement to impose a duty on the respondent to contact Cullen. In any event, the trial judge noted that the respondent did obtain Cullen's signature on the director's report, which the respondent was entitled to rely upon in the absence of dishonesty or fraud. In addition, the trial judge emphasised that the respondent was relying on the directors' statements to confirm only one aspect of the audit, and not the entire audit (GD at [73]).

27 Finally, the trial judge observed (GD at [75]) that it was "indeed unfortunate that the [respondent] did not seek more evidence to verify Riggs' remuneration and other payments", but held that this was different from saying that the respondent had not discharged its duty under the contract or had been negligent in the performance of the audits. The trial judge concluded that the evidence did not support the appellant's case and, accordingly, dismissed the action, resulting in the present appeal before us.

Issues arising in the appeal

28 The nub of the controversy in this appeal falls into two broad categories, namely, breach of

duty and causation, both of which constitute essential elements of any claim in negligence. The alleged breach of duty can be broadly attributed to three main areas of the audit, namely: (a) the failure to verify Riggs' entitlement to remuneration; (b) the failure to report abuses by Riggs of the cheque signing limit; and (c) the failure to properly verify the renovation expenses of the appellant's warehouse in Singapore and its Hong Kong subsidiary ("Ten-Up Hong Kong"). Once breach of duty is established, the next logical question crucial to the claim for damages would be whether the respondent's negligence caused the losses suffered by the appellant.

29 In addition to these questions of fact, the present appeal also raises important questions of law relating to the application of the *Bolam* test ([25] above) and the appropriate weight to be accorded to conflicting expert evidence. As part of its defence arsenal, the respondent has resorted to an allegation that it was induced by the fraudulent representations of the appellant's employees, and, in its final stand, seeks to rely on s 391 of the CA as a ground for total or partial relief from liability. Each of these issues will be visited *in seriatim*.

Our decision

30 It should be noted, at the outset, that the present appeal encompasses an action initiated by the auditor's client. This absolves us of the need to delve into the web of controversy surrounding the duty of care owed to third parties (see *Spandeck Engineering (S) Pte Ltd v Defence Science & Technology Agency* [2007] SGCA 37 for an exegesis on the duty of care in the context of negligence).

31 However, before we deal with the parties' contentions, it would be apposite to preface the discussion by reviewing the body of case law prescribing the standard of care expected of an auditor, as this would provide useful signposts to assess the respondent's alleged failures or omissions. We want to emphatically state that the present appeal does not establish any new legal propositions or principles, but simply clarifies and restates the principles of professional liability relating to auditors.

The law on auditors' negligence

32 As a starting point, it would be apposite to identify the sources from which we can glean the appropriate standard of care expected of an auditor. In this regard, it is helpful to refer to the seminal case of *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30 ("*Dairy Containers*") at 54 which, in our view, quite correctly assimilated the requisite standard of care from: (a) the standard required as a matter of contract and under the relevant statutes or regulations; (b) expert evidence relating to the conduct of the audit; and (c) the relevant auditing standards set by the governing professional body: see *Jackson & Powell on Professional Liability* (Sweet & Maxwell, 6th Ed, 2007) ("*Jackson & Powell*") at para 17-050. In short, it is an amalgam of considerations that almost invariably permutate and should, therefore, be specifically assessed in accordance with each factual matrix.

33 In Singapore, the relevant statutory role of an auditor is broadly set out in ss 205 and 207 of the CA. Subject to certain limited exceptions, directors of a company are required to appoint auditors within three months of incorporation (s 205(1)). The auditors' role is to report to the company's members whether the company's the accounts give a "true and fair view" of the company's financial position (s 207(2)). This serves the dual purpose of protecting the company from undetected errors or wrongdoing and providing its shareholders with reliable information for the purpose of enabling them to scrutinise the conduct of the company's affairs. To meet this objective, s 207 of the CA confers upon auditors extensive rights of access to accounting and other records as well as any other information or explanations necessary for the performance of their duties.

34 The relevant industry auditing standards in Singapore are encapsulated in standards and pronouncements issued by the ICPAS. These include, *inter alia*:

(a) the SSAs;

(b) the Singapore Auditing Practice Standards;

(c) the Singapore Standards on Review Engagements;

(d) the Singapore Standards on Assurance Engagement.

Whilst the standards provided therein will not always be conclusive or determinative of negligence, they are highly persuasive signposts in so far as they represent some form of professional consensus on the standard of care to be expected from an auditor. Belinda Ang Saw Ean J in *Gaelic Inns Pte Ltd v Patrick Lee PAC* [2007] 2 SLR 146 ("*Gaelic Inns*") correctly observed at [11]:

> [G]enerally, an auditor who adheres to the accounting standards of the day to convey a true and fair view of the financial statements has a better chance of defending criticisms in the conduct of the audit as compared to an auditor who departs from them.

That said, these standards must not be applied unthinkingly. Accounting standards are, as *Jackson & Powell* ([32] *supra*) vividly put it (at para 17-012), "good servants but bad masters". Prudent accounting invariably demands the exercise of sound judgment.

35 The nature and extent of an auditor's professional obligations in any given matrix is, therefore, to be assessed by a composite review of the precise contractual obligations undertaken, the duties imposed by statute, the auditing standards reflected in the SSAs and the expert evidence adduced in relation to the conduct of the audit. The multiplicity of criteria is an inevitable function of the dynamic interface between the various interpretative processes which interact in an audit. There is no single all-embracing rule or criterion that consistently or exclusively predominates.

36 In addition, case law has established a framework of principles relating to the scope and extent of an auditor's duty. Our focus in this appeal will be directed at the requisite degree of scrutiny to be applied by an auditor and, more particularly, the extent to which management representations can be accepted at face value. These issues take centre stage in the present appeal and will be crucial in establishing a breach of duty by the respondent, if any.

Standard of reasonable care

37 By way of introduction, it would be helpful to embark on our discussion by restating and adopting the perceptive and sensible observations of Lopes LJ in *In re Kingston Cotton Mill Company (No. 2)* [1896] 2 Ch 279 ("*Re Kingston*") at 290:

> The duties of auditors must not be rendered too onerous. Their work is responsible and laborious and the remuneration moderate. … Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion, and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable.

38 This measured approach has now been adopted by case law in all the principal common law jurisdictions. It has been consistently emphasised that because of the inherent limitations of an audit

and the corresponding audit risk, auditors cannot be expected to detect all material misstatements or instances of fraud. Indeed, case law is replete with variegated judicial observations and metaphorical references stressing the limitations of an auditor's duty and reiterating that an auditor is neither a "detective", "insurer", "paragon" nor "prophet" (for example, see *Barings plc v Coopers & Lybrand* [2003] Lloyd's Rep IR 566 ("*Barings*") at [578]).

39 Such "disclaimers" similarly prevail in SSA 1, which specifically recognises (at para 9) the "inherent limitations in an audit that affect the auditor's ability to detect material misstatements". As a result, SSA 11 cautions (at para 6) that "[t]he auditor is not and cannot be held responsible for the prevention of fraud and error" and highlights (at para 12) the "unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SSAs".

40 The limitations inherent in the audit process and the fact that an audit cannot, in practical terms, guarantee the veracity of the financial statements have been constantly underscored by the respondent in its submissions. We accept this in a broad sense. An auditor's opinion should not be airily relied upon by a party without a proper appreciation of its limitations or qualifications as well as its context. Nonetheless, we cannot allow the inherent limitations of an auditor's duty to detract from a proper appreciation of the legal issue at hand. Professional limitations cannot be said to invariably provide immunity from liability arising as a consequence of professional lapses amounting to negligence.

41 In particular, one must be careful to distinguish between the extent to which a party has placed reliance upon an auditor's verification of the accounts and the standard of care which the auditor is obliged to meet in performing his or her statutory and contractual tasks. In the latter scenario, the auditors must be expected to comply with "reasonable professional standards" or face the consequences (*per* Thomas J in *Dairy Containers* ([32] *supra* at 55)).

42 Such "professional standards" have been variously articulated in classic expositions such as *Leeds Estate, Building and Investment Company v Shepherd* (1887) 36 Ch D 787 at 802, where it was determined that "the duty of the auditor [is] not to confine himself merely to the task of verifying the arithmetical accuracy of the balance sheet, but to inquire into its substantial accuracy".

43 Similarly, in *In re London and General Bank (No 2)* [1895] 2 Ch 673 ("*Re London*"), Lindley LJ considered the auditor's true function (at 682–683) to be as follows:

> His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question, How is he to ascertain that position? The answer is, By examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books themselves shew the company's true position. *He must take reasonable care to ascertain that they do so. Unless he does this his audit would be worse than an idle farce.* … An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. … Such I take to be the duty of the auditor: he must be honest – i.e., he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case must depend upon the circumstances of that case. [emphasis added]

44 The function of an auditor was further elucidated in *Fomento (Sterling Area) Ltd v Selsdon Fountain Pen Co Ltd* [1958] 1 WLR 45 (cited in the local case of *United Project Consultants Pte Ltd v Leong Kwok Onn* [2005] 4 SLR 214 at [41]) as follows at 61:

> What is the proper function of an auditor? It is said that he is bound only to verify the sum, the arithmetical conclusion, by reference to the books and all necessary vouching material and oral explanations; and that it is no part of his function to inquire whether an article is covered by patents or not. I think this is too narrow a view. An auditor is not to be confined to the mechanics of checking vouchers and making arithmetic computations. He is not to be written off as a professional "adder-upper and subtractor". *His vital task is to take care to see that errors are not made, be they errors of computation, or errors of omission or commission, or downright untruths*. To perform this task properly, he must come to it with an inquiring mind – not suspicious of dishonesty, I agree – but suspecting that someone may have made a mistake somewhere and that a check must be made to ensure that there has been none. [emphasis added]

45 These propositions find similar expression in SSA 11, which provides (at para 13) that "the auditor should plan and perform the audit with an attitude of professional scepticism, recognising that conditions or events may be found that indicate that fraud or error may exist" [emphasis in original omitted] and (at para 18) that "[t]he auditor should consider the implications of fraud and significant error in relation to other aspects of the audit, particularly the reliability of management representations" [emphasis in original omitted]. Whilst auditors are not obliged to "turn every stone and open every cupboard", they are undoubtedly bound to exercise their very "considerable skill and judgment in carrying out checks and investigations in accordance with complex but nonetheless detailed and explicit professional standards": see *Caparo Industries plc v Dickman* [1989] 1 QB 653 at 690.

46 In the light of the fact that an audit is not expected, as a matter of course, to involve an examination of every item or class of transactions, the inherent limitations of any accounting and internal control system, as well as the fact that most audit evidence is persuasive rather than conclusive (SSA 1 at para 9), an auditor is not required to eliminate audit risk, but to reduce it to an acceptable level. This is an exercise that mandates a prudent assessment of the risks and benefits of a company's financial accounting and bookkeeping. It requires a proper assimilation and an adequate appreciation of the relevant audit evidence in order to obtain reasonable assurance of the matters that ought to be verified.

47 Stripped of all verbiage, it can be said that the demarcation of the boundaries of professional liability remains the judicially determined standard of reasonable care. In other words, the auditor must exercise the reasonable care and skill of an ordinary skilled person embarking on the same engagement. His duty is not to provide a warranty that the company's accounts are substantially accurate, but to take reasonable care to ascertain that they are so. The precise degree of scrutiny and investigative effort which constitutes reasonable care is to be determined on the facts of each individual case.

48 Having established the legal, factual and, to some extent, historical context, we now proceed to examine the merits of the parties' submissions.

The Bolam test and "the Bolitho addendum"

49 A preliminary point of contention in this appeal relates to the trial judge's failure to consider that the *Bolam* test ([25] *supra*) has since been qualified or clarified by the subsequent case of *Bolitho v City and Hackney Health Authority* [1998] AC 232 ("*Bolitho*"), which "presented a timely addendum to the *Bolam* test" (*Dr Khoo James v Gunapathy d/o Muniandy* [2002] 2 SLR 414 ("*Gunapathy*") at [63]) and required evidence from a body of experts to have a "logical basis" (*Bolitho* at 242).

50 We note that the respondent quite sensibly does not dispute the applicability and relevance of the "logical basis" requirement. It can now be confidently stated that the application of the *Bolam* testis necessarily subject to and qualified by Lord Browne-Wilkinson's statement in *Bolitho* ([49] *supra*) at 241–242 ("the *Bolitho* addendum"), which when adapted to the context of auditors, would read as follows:

> [T]he court is not bound to hold that a defendant [auditor] escapes liability for negligent [auditing] just because he leads evidence from a number of [auditing] experts who are genuinely of opinion that the defendant's [audit] accorded with sound [audit] practice. … [T]he court has to be satisfied that the exponents of the body of opinion relied upon can demonstrate that such opinion has a logical basis. In particular in cases involving, as they often do, the weighing of risks against benefits, the judge before accepting a body of opinion as being responsible, reasonable or respectable, will need to be satisfied that, in forming their views, the experts have directed their minds to the question of comparative risks and benefits and have reached a defensible conclusion on the matter.

51 The *Bolitho* addendum merely affirms the supervisory judicial responsibility to ensure, at a minimum, that the expert opinion is defensible and grounded in logic and plain common sense. This non-delegable adjudicatory mandate to assess the appropriate standard of care cannot be seriously denied. In this context, we also find the observations of Moffitt J in *Pacific Acceptance Corporation Ltd v Forsyth* (1970) 92 WN (NSW) 29 ("*Pacific Acceptance*") at 75, cited by Belinda Ang J in *Gaelic Inns* ([34] *supra*) at [11], particularly pertinent:

> When the conduct of an auditor is in question in legal proceedings it is not the province of the auditing profession itself to determine what is the legal duty of auditors or to determine what reasonable skill and care requires to be done in a particular case, although what others do or what is usually done is relevant to the question of whether there had been a breach of duty.
>
> It follows, if the auditing profession or most of them fail to adopt some step which despite their practice was reasonably required of them, such failure does not cease to be a breach of duty because all or most of them did the same.

52 When assessing whether a professional has been negligent, courts will normally use as their benchmark the common practice within the relevant profession. However, notwithstanding that an expert witness may have considerable professional experience and knowledge about the reasonableness of prevailing standards, the court retains the supervisory responsibility to condemn an unjustifiably lax, albeit common, practice as negligent: see *Edward Wong Finance Co Ltd v Johnson Stokes & Master* [1984] AC 296.

53 In the light of the foregoing even if the respondent's expert's evidence of the respondent's expert about prevailing standards is accepted, a pertinent consideration is whether these standards fail the *Bolitho* addendum.

Conflicting expert evidence

54 In invoking the *Bolitho* addendum, the appellant has mounted an unrestrained and somewhat intemperate root-and-branch attack against Singh's expert evidence, variously alleging bias and unsubstantiated assumptions in attempting to undermine the trial judge's findings of fact. The respondent, quite predictably, responds with a riposte of a similar nature seeking to undermine the credibility of Chin's expert evidence.

55 The expert evidence before us has to be carefully assessed to see if it establishes whether the respondent had acted reasonably in the circumstances.

56 Suffice it to say for now that the court will usually give due deference to expert evidence and accord significant weight to the particular case-by-case professional assessment of risks and judgment that can only be made by professionals armed with the necessary expertise and experience. The core inquiry, nevertheless, remains whether the trial judge has "carefully and dispassionately directed his mind to the value, impressiveness and reliability of the expert evidence" (*Muhammad Jefrry v PP* [1997] 1 SLR 197 at [114]).

57 Once a judge has weighed the conflicting opinions and reached a conclusion as to which opinion he prefers, it is a finding of fact which an appellate court would be loath to disturb unless there are compelling grounds to do so (*Pertamina Energy Trading Limited v Credit Suisse* [2006] 4 SLR 273). At the end of the day, the law makes an allowance for differing opinions among auditors just as it does within the medical and legal professions (*Sceptre Resources Ltd v Deloitte Haskins & Sells* (1991) 120 AR 6 (CA, Alta)).

58 After a perusal of the relevant reports, and applying the two-stage inquiry adopted by the Court of Appeal in *Gunapathy* ([49] *supra*) at [64]–[65], we are satisfied that Singh did in fact "[direct] his mind to the comparative risks and benefits relating to the matter", thus arriving at a "defensible conclusion" as a result of the balancing process. Having said that, we must observe that several aspects of Singh's evidence appeared rather partisan and were, regretfully, neither as wholly objective nor as independent as that to be expected from a court expert. To illustrate this, we provide some examples.

59 First, Singh had alleged in his report at para 4.62 that "there were serious attempts within the [appellant's] staff and management to fraudulently override internal control", and had concluded that on the basis of the nature and extent of the audit, "*it would be impossible to detect such fraudulent practices*". [emphasis added] We find such a sweeping generalisation redolent of a predisposition to shore up the respondent's stance. This belies Singh's role as an independent expert. In addition, Singh's inclination to make suppositions or assumptions in favour of the respondent is apparent, for example, from his assertion at para 4.57 of his report that "Cullen and the officer(s) at the parent company, specifically Russ Hora, *would have taken the necessary actions to satisfy themselves* that the draft financial statements present a true and fair view of the financial position and results of the [appellant]" [emphasis added], notwithstanding that he had interviewed neither Cullen nor Hora.

60 Finally, we observed that Singh had selectively quoted, in support of his conclusions, portions of the SSAs while omitting to include qualifications which were adverse to the respondent's case. For example, at para 4.66.b.i of his report, he cited SSA 11 (at para 13), as follows, but left out the entire italicised portion (below) on the basis that he "thought it was not relevant":

> The risk of not detecting material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error, because fraud ordinarily involves acts designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Unless the audit reveals evidence to the contrary, the auditor is entitled to accept representations as truthful and records and documents as genuine. ***However in accordance with SSA "Objective and General Principles Governing an Audit of Financial Statements", the auditor should plan and perform the audit with an attitude of professional scepticism, recognising that conditions or events may be found that indicate that fraud or error may exist.*** [emphasis in bold in original]

These illustrations are indicative of the partiality evident in significant portions of Singh's evidence, which was apparently tailored to prop up the respondent's cause. Indeed, our conclusion is fortified by Singh's reluctant concession during cross-examination that he had no basis for making some of the allegations in his report.

61 Neither was the appellant's expert, Chin, immune to similar partiality. In particular, we noted that the writ of summons for the present suit was filed only some six months after Chin had been engaged. His testimony appeared to be somewhat coloured by the fact that he had initially acted as a consultant to the appellant and had assisted in the advocacy of its case. The conflicting nature of these roles was reprised in *Vita Health Laboratories Pte Ltd v Pang Seng Meng* [2004] 4 SLR 162, where the court (citing at [84] a passage from Ian Freckelton and Hugh Selby, *Expert Evidence* (The Law Book Company, 1993) at 123.420) observed:

> When the accountant acts as a consultant, he or she is assisting in the advocacy of the client's case, *which is a role that is inconsistent* with the forensic expert's need for independence. *Accordingly, the accountant should generally avoid accepting instructions that would require the accountant to act both as an independent expert and a partisan consultant*.
>
> …
>
> [C]areful consideration has to be accorded to the evidence of an expert accountant who has been engaged as an investigator and collator of facts, and later reprises in court the role of an advocate in support of evidence that he himself has gathered. Such evidence may at times, be coloured by the difficult and sometimes conflicting roles being discharged by him.
>
> [emphasis in original]

62 In the same vein, we note that despite Chin's fairly limited terms of reference, his perception of the actual process of verification of Riggs' entitlement was visibly coloured by his attempts to support the appellant's version of events.

63 Whilst we recognise that a certain degree of partisan advocacy may be an inevitable consequence of adducing expert evidence in the gladiatorial context of an adversarial system, we must emphatically reiterate that the court will not hesitate, in an appropriate case, to disregard or even draw an adverse inference against expert evidence that exceeds the judicially determined boundaries of coherence, rationality and impartiality. When that happens, experts should note that the primary casualty will be their professional reputation.

64 That said, we are disposed to find that the diametrically opposed reports do, in the ultimate analysis, represent defensible differences of opinion that satisfy the threshold test of logic imposed by the *Bolitho* addendum, as they are largely internally consistent and do not fly in the face of facts relevant to the matter. Bearing in mind the caution expressed in *Gunapathy* ([49] *supra*) at [65], we must reiterate that the review of expert evidence pursuant to the *Bolitho* addendum should not "unwittingly herald invasive inquiry into the merits of [audit] opinion". The spotlight will now turn to these differences of opinion.

Whether the respondent negligently breached its duty of care to the appellant during the audits for FYs 1999–2001

65 The nub of the present appeal involves the difficult but unavoidable task of demarcating the scope of an auditor's duty, *ie*, whether or not a particular omission in the circumstances constitutes a

breach of duty pursuant to the requisite standard of care. Whether or not a duty has been breached is a question of fact to be determined according to the specific circumstances of each case. For this reason, precedents are of value only in terms of the general principles which they establish (*Qualcast (Wolverhampton) Ltd v Haynes* [1959] AC 743). It goes without saying that the principles enunciated by older case law should be treated with a degree of wariness to the extent that it must be acknowledged that the standards of auditing which prevailed more than a century ago have evolved into more exacting ones today (*see In re Thomas Gerrard & Son Ltd* [1968] Ch 455 ("*Thomas Gerrard*") at 475).

66 On the facts, we have to bear in mind the fact that the audits in question were statutory audits (as opposed to special investigative audits commissioned for a specific purpose) involving the audit of samples on a test basis. It is axiomatic that the nature of the audit is crucial in ascertaining the requisite standard of care to be imposed. In addition, the scope and extent of the respondent's duties as auditors can be gleaned from the contractual terms of engagement, under which the respondent bound itself to "*perform sufficient tests to obtain reasonable assurance* as to whether the information contained in the underlying accounting records and other source data [was] reliable and sufficient as the basis for the preparation of the accounts" [emphasis added] (above at [6]).

67 Singh's report describes in painstaking detail, the manner in which the audits were carried out in accordance with the standards prescribed by the SSAs. Whilst this is undoubtedly relevant, it should be noted that what is really in controversy is not so much the defensibility of the general manner in which the respondent carried out the audits (which is largely undisputed), but rather, whether its failure to verify information or detect weaknesses in relation to three specific matters (see [28] above) constituted a breach of duty amounting to negligence as a matter of law.

68 In the same vein, the respondent's single-minded emphasis on the inherent limitations of an audit and its submission on the "unrealistically high standard that requires the prevention and detection of every bit of irregularity and fraud" (at para 5.7 of Singh's report) cannot deter us from making a finding in relation to the respondent's undisputed series of inactions or omissions in the present case apropos an issue that had initially caused it considerable concern. It cannot be gainsaid that it was the respondent itself who had appreciated the need, at the outset, for independent verification of Riggs' remuneration. It, however, failed, quite inexplicably, to diligently pursue the concern(s) it had earlier identified. Thus, the thrust of the inquiry should be on whether these omissions amounted to a lack of reasonable care and/or a breach of the respondent's contractual duty to the appellant.

69 At this juncture, it is also necessary to reiterate that a court must always guard against the "scapegoat effect" that often magnifies *ex post facto* and makes plausible culpability by employing the spectacles of hindsight. It is almost intuitive for a third party observer, after the occurrence of an unhappy event, to conclude that procedures could or should have been adopted to obviate the subsequently known risks. On the other hand, an auditor looking at the matter as it presented itself at the material time would usually quite naturally conclude that he or she was acting reasonably. It is crucial, in the interests of justice, that the standard of reasonable care be objectively assessed on the basis of knowledge then reasonably available as well as measures that could have been reasonably adopted at the material time. The acid test is certainly not one of retrospective plausibility.

Failure to verify Riggs' entitlement to remuneration

70 The first and, in our view, most crucial issue in the present appeal relates to the appellant's contention that the respondent had negligently failed to verify Riggs' entitlement to remuneration

during the audits for FYs 1999 to 2001. The respondent could not have missed the fact (and, indeed, did not) that Riggs was the only director in Singapore whose remuneration and benefits amounted to more than half a million dollars, a substantial amount by any yardstick. In relation to FY 2000, Riggs' remuneration of $456,574 constituted 23% of the appellant's total staff costs of $1,993,927 and approximately 6% of its total revenue. As for FY 2001, Riggs' remuneration was $617,229, constituting approximately 25% of the total staff costs of $2,424,198. This amounted to approximately 9% of the appellant's total revenue for that year.

71 It should also be pointed out that the appellant's expert, Chin, conceded under cross-examination that he was satisfied that the respondent had carried out the statutory audits for all three FYs in compliance with the terms of engagement and the relevant auditing standards, *except in the area of Riggs' remuneration*. All said and done, this particular allegation constitutes the only sustainable assertion that merits judicial scrutiny and must, therefore, be critically evaluated on the touchstone of reasonable care.

72 In relation to the FY 1999 audit, there was some dispute as to whether Ken Ling, an audit assistant assigned to the FY 1999 audit, had in fact asked for Riggs' employment contract. Ken Ling denied ever having done so, whereas Sandy testified to the contrary. Similar obstacles were encountered in the FY 2000 audit when Pamela Pang, the officer-in-charge of that particular audit, asked Riggs for a copy of his employment contract. There is a similar dispute as to whether Riggs had then *refused* to produce his employment contract (Sandy's version of the material events) or whether he had informed Pamela that he *did not have* an employment contract (Pamela's version).

73 Having considered the evidence, we see no reason to disturb the trial judge's findings of fact on this issue (see GD at [19]). First, we note that Ken Ling did not ask for Riggs' contract during the FY 1999 audit, and, secondly, that Pamela had in the FY 2000 audit asked Sandy for it. Sandy then told her to check with Riggs. Riggs gave Pamela the impression that no such contract existed and suggested that she obtain confirmation from the other director, Cullen. Riggs was clearly giving the auditors the runaround. For the avoidance of doubt, we should state that the following analysis proceeds on the basis of our acceptance of this factual substratum.

Absence of Riggs' employment contract

74 To begin with, it appears that the partner-in-charge of the FY 1999 audit failed to adequately direct his mind to the proper certification of Riggs' remuneration. Apart from the failure to inquire about the existence of Riggs' employment contract, the respondent failed to even obtain a certification by Cullen despite this being its initial preferred form of verification). It simply neglected to pursue the matter any further.

75 Regarding the FY 2000 audit, we find the respondent's unquestioning acceptance of the absence of Riggs' employment contract somewhat perplexing and clearly open to criticism. If Riggs did not have an employment contract or terms of engagement, how would any objective verification of his entitlements be possible without direct confirmation from Cullen?

76 In *Pacific Acceptance* ([51] *supra*) at 67–68, Moffitt J explained "the dictates of reason and experience" requirement in the following measured terms:

> Prima facie the auditor's job is to check material matters for himself from available documents and he does not ordinarily do his job or "audit" if he merely seeks the assurance of another as to the check that other has made or as to his views as to the effect of documents.

> In principle an auditor is really in no different position from any skilled inquirer. To the inquirer in any field to know by direct examination is surer proof than to believe on the hearsay of others or by inference. The latter and second-best alternatives may well be acceptable if a direct examination is not possible or the delay, expense or effort that will be occasioned by such examination is out of proportion to the importance of the matter to be proved.

77 The absence of an employment contract or similar document in the circumstances of this case would have tolled the alarm bells in the mind of a reasonably competent auditor exercising the requisite skill and responsibility tempered by a healthy degree of professional scepticism. Given that an auditor's core competence entails the derivation of reasonable assurance that the underlying information contained in the accounting records are reliable and sufficient, the respondent should have, at the very least, made further inquiries into Riggs' anomalous position and uncompromisingly required independent verification.

78 In any event, the respondent's unreflective attitude towards the actual existence of Riggs' employment contract is not in itself determinative, given that alternative forms of audit evidence could still have been procured. Whilst we accept that the choice of "sufficient appropriate audit evidence" is necessarily a function of each individual auditor's judgment (in accordance with the guidelines prescribed by SSA 8), such judgment has to be exercised with the requisite standard of skill and care. Whether nor not there has been a breach of the requisite standard of reasonable care hinges on the objective sufficiency of such alternative evidence.

Sufficiency of Cullen's signature on the director's reports and draft financial statements as alternative audit evidence

79 In the FY 2000 audit, after Riggs had informed the respondent that he did not have an employment contract, the respondent requested for alternative evidence of Riggs' remuneration in the form of a letter dated 21 February 2001 to the appellant. The material portion of the said letter stated as follows:

> We would appreciate your assistance in following up on the outstanding matters stated below:
>
> (a) *Certificate of director's remuneration from John P. Riggs;*
>
> (b) *Confirmation from James Glenn Cullen in the remuneration package to John P. Riggs* and his shareholding percentage in Cranberry Gold Limited [the appellant's immediate holding company]; and
>
> (c) Certificate of minutes from your Company Secretary.
>
> [emphasis added]

80 On 22 February 2001, Sandy forwarded to the respondent an e-mail from Riggs dated 21 February 2001 stating that "once [the appellant] receive[d] the final audit write up … [Riggs would] sign then forward to [Cullen] for his signature … once [Cullen] sign[ed] this audit report, this [would] be his acknowledgement of [Riggs'] remuneration …" Unfortunately, the respondent failed to obtain any of the confirmations it had itself initially sought. Instead, the respondent unthinkingly certified the unqualified accounts as true and fair by purporting to rely on management representations "evidenced" in the form of Cullen's signature on the draft financial statements.

81 In the FY 2001 audit, the respondent made a similar request for the same three forms of

audit evidence earlier solicited. Although Riggs' certification of his own remuneration was eventually received, the management representation letter and Cullen's confirmation of Riggs' remuneration were once again not obtained, notwithstanding that John Teo ("John"), the partner-in-charge of the audit, had made it clear to the appellant that the respondent required these confirmations prior to its approval of the financial statements. This was done via an e-mail dated 17 May 2002 addressed to Sandy, which stated as follows:

> Today I have sent by fax the following for you to arrange for them to be duly signed and returned to us so that we [can] sign the auditor's report:
>
> 1) Confirmation of S$21,150.71 due from Mr John P Riggs
>
> 2) Director's remuneration of Mr John P Riggs to be duly signed. Since Lim Cheng Hui is on leave, perhaps he may want to speak to our audit partner, Mr John Teo before signing;
>
> 3) Management Representation Letter to be duly signed and returned to us by fax and mail.
>
> …
>
> Would appreciate your urgent attention to the above so that we [can] close our audit file and your audited financial statements could be quickly submitted to the Registrar of Companies.

82 In the light of the fact that Cullen's signature on the director's reports and draft financial statements was eventually accepted and relied upon by the respondent as an adequate verification of Riggs' entitlement to remuneration, the nub of the issue before us is whether Cullen's signature constituted *reasonable assurance*. The respondent's process of reasoning, choice of audit procedure and purported basis for concluding that the audit evidence relating to Riggs' remuneration was sufficient and appropriate must, therefore, be carefully scrutinised.

83 John testified that he had considered the appellant's organisation and reporting structure before deciding that he could rely on Cullen's signature on the draft financial statements. He allegedly took into account and evaluated, *inter alia*, the following:

(a) JSISC had overall control and exercised close supervision of the appellant's accounts;

(b) John expected detailed accounts to be continuously sent by the appellant to JSISC;

(c) Riggs' remuneration was monitored and reviewed by Cullen and/or Hora;

(d) the amount of director's remuneration was calculated from information, figures and schedules given to the respondent by Sandy or Riggs;

(e) the appellant's draft financial statements would always be sent to JSISC for approval; and

(f) Riggs was the only paid director whose remuneration was disclosed as a separate item in each year's financial statements.

84 The common thread linking these factors appears to be the oversight and control allegedly exercised by JSISC over the appellant as well as the monitoring and review function assumed to have been carried out by Cullen and/or Hora apropos the draft financial statements.

85 With respect, we find this justification rather contrived and unconvincing. While we accept that alternative sources of oversight and control may impact the initial assessment of audit risk, the alleged checks and balances provided by JSISC cannot and should not detract from the respondent's core responsibility as auditors to directly verify Riggs' remuneration, or, failing which, to seek "reasonable assurance" by obtaining sufficient and appropriate alternative audit evidence. John could have, without any difficulty or unpleasantness, insisted on Cullen directly sending him an e-mail message confirming that the remuneration had indeed been authorised, a point that we will return to subsequently.

86 In *Pacific Acceptance* ([51] *supra*) at 87, Moffitt J considered a similar attempt to rely on a company's system of internal control and noted:

> [I]t is well to remember that reliance on a company's own system cannot validly and reasonably be used by auditors so as to excuse them for passing responsibility on to others for the performance of their own duty. It ought not to be used after a perfunctory appraisal and token testing of the company's system to substitute the opinion and work of management for their own.
>
> There are three essentials that must be met before an auditor can reasonably rely on the company's system of internal control. First, there must be a proper inquiry to ascertain the company's system. This would include ascertaining such features as indicate the strength and weaknesses of the system and hence its reliability. Second, there must be an appraisal of it, in that a person of sufficient auditing competence should make a decision as to the extent, if any, that the auditors can properly rely upon it. He should decide what procedures should be adopted to check that it is operating as intended and what other conditions should be met before reliance can be placed upon it. Third, there must be a testing of its operation. All these essentials may call for revision in the course of the audit.

87 On the facts, there was no evidence that the respondent had carried out any appraisal of the system of oversight and control allegedly exercised by JSISC. As such, a breach would be established if the respondent had failed to obtain reasonable assurance or verification of the requisite figures (see above at [77]), regardless of whether or not another entity was negligently supervising or monitoring the same figures. In any event, such an argument would, if at all, be more relevant to a claim in contributory negligence.

88 Unsurprisingly, the respondent has tendered an admirable laundry list of the steps which it allegedly took for the purpose of verifying Riggs' remuneration. These include:

(a) reviewing the audit working papers for the preceding year;

(b) analysing the type of expenditure charged as Riggs' benefits;

(c) comparing the benefits Riggs received to those received in the previous year;

(d) examining the draft profit and loss statements to determine the variances in Riggs' remuneration and other benefits from the preceding year; and

(e) where the variance was above the materiality criteria level, carrying out an analytical review of "director's other benefits" to determine if the variance was reasonable.

89 At first blush, these purported processes create an impression of professional comprehensiveness accompanied by studied meticulousness. However, we are of the view that these

supplemental steps, even if actually carried out, lose much of their cogency or effectiveness in the light of the respondent's ultimate and inexplicable failure to adequately verify Riggs' entitlement to remuneration by simply following up on its *very own* requirements. Analytical reviews and variance comparisons must be assessed in relation to their subsequent verification against sufficient and appropriate audit evidence as figures cannot simply be "analysed" or "compared" in isolation. The alleged positive steps taken by the respondent are quite commendable, but they cannot detract from the respondent's eventual slipshod reliance on Cullen's signature on the draft financial statements, *without even informing Cullen that his signature would be relied on for this purpose* – a crucial omission that constitutes the heart of the breach of duty.

90 In the proceedings below, the trial judge accepted the respondent's submission (GD at [48]) that as Riggs was the sole director receiving remuneration, a confirmation from Cullen, who was the only other director and the majority shareholder, was "better audit evidence compared to the mere sighting of an employment contract". The trial judge concluded that this would cover the situation where an employment contract became outdated or did not comprehensively cover all benefits. He observed (GD at [47]) that "Cullen had adopted a rather informal approach on the issue of Riggs' entitlement to benefits and approved specific expenses outside of what was agreed upon", and accordingly concluded that the respondent was justified in accepting Riggs' suggestion that Cullen's approval by his signature on the draft financial statements would constitute approval of Riggs' remuneration package.

91 In addition, the trial judge noted (GD at [50]) that Riggs was completely transparent about his remuneration, which was specifically disclosed in monthly profit and loss accounts, schedules, operating budgets and draft financial statements. The respondent has latched on to this point on appeal, and has accordingly emphasised that Riggs' behaviour was completely open and aboveboard as he had made full and specific disclosure of his actual remuneration and benefits to all concerned. While this may be so, it does not exonerate or relieve the respondent from its responsibility of verifying Riggs' actual entitlement.

92 To begin with, while we find the trial judge's acceptance of Cullen's confirmation as "better audit evidence" (see [90] above) theoretically defensible, we should point out that this wholesale acceptance of Singh's expert opinion that such confirmation obtained was adequate fails to adequately take into account the *manner in which the confirmation was obtained*. This is pivotal in determining whether the respondent had acted reasonably in the circumstances.

93 In particular, the trial judge alluded to the reasonableness of relying on Cullen's signature to confirm only "one aspect" of the audit (GD at [73]), *viz*, Riggs' remuneration, in contrast with the impermissibility of a blanket reliance on the same as confirmation of the "entire audit". With respect, the trial judge's inquiry should not have been directed to the *scope* of confirmation sought to be achieved by reliance on Cullen's signature, but rather, to the more crucial *process* of verification. While reliance on a director's signature to "indemnify" the entire audit process is clearly unjustifiable, it surely does not follow that reliance on the same to confirm "one aspect" of the audit will always be permissible. The element of "reasonable assurance" remains paramount.

94 Notwithstanding Singh's general opinion that it was proper for the confirmation of Riggs' remuneration to come from Cullen in the form of a signed copy of the appellant's audited financial statements, we are of the view that the legitimacy of such a course of action can be sustained only if the relevant fields for verification were adequately drawn to Cullen's attention for *specific* review and confirmation. On the facts, Cullen was clearly unaware that his signature would be relied on by *the respondent* as confirmation of Riggs' entitlement to the specified remuneration. It simply did not suffice for the respondent to rely on the appending of Cullen's signature to the entire agglomeration

of audited statements as confirmation of Riggs' remuneration without first breathing a word to Cullen or even hinting that his signature would be relied on for this purpose. To sanction such an unsatisfactory process would create a charter for the dereliction of core auditing responsibilities.

95 Second, this argument assumes that Cullen would be able to decipher from the general entry "directors' remuneration" in the draft financial statements the precise breakdown of the remuneration Riggs had received for the year in question. While the respondent was quick to highlight the fact that the appellant's audited financial statements separately and distinctly set out the directors' remuneration which included Riggs' benefits, this must be evaluated in the light of the fact that no notice whatsoever was given to Cullen that he was to particularly note and verify Riggs' remuneration by his signature. Admittedly, Cullen would have been expected to review the financial statements before appending his signature, but, without the particular item being specifically brought to his attention, it is untenable to suggest that his signature constituted adequate verification of all of the hundreds of items contained therein, thereby completely absolving the respondent of further responsibility. Indeed, a comprehensive verification by Cullen of every single figure in the statements would simply have rendered the task of the auditors otiose.

96 Third, the trial judge should not have taken into account Cullen's informal approach to the issue of Riggs' entitlement to benefits in assessing the materiality of the breach at the time of the audit. The crucial issue is whether the respondent took the appropriate steps to obtain reasonable assurance of Riggs' entitlement to remuneration, and not whether objective evidence did in fact exist to ascertain this – a consideration which, if at all, would be more relevant to refuting causation.

97 Fourth, Riggs' seemingly barefaced approach cannot inevitably exonerate the respondent's dereliction of duty. His full disclosure could have reflected his bravado and/or confidence that his malfeasance would not be discovered, or it may just as well have been a tactical manoeuvre to mislead any investigative efforts, *ie*, by being barefaced about the monies received but concealing his true entitlement. Seen in this light, the respondent's breach of duty is coloured by a more disturbing hue, as it reflects the failure to identify, verify and detect a material error on the face of the appellant's financial statements (see above at [66]).

98 Ultimately, the crux of the respondent's breach can be unmistakably attributed to the eventual unjustified reliance on Cullen's signature without any attempt whatsoever to ensure that his attention had been drawn to the importance of verifying Riggs' remuneration. It is this error of judgment based on a misguided assumption of sufficiency and reliability that is the kernel of our finding that the respondent failed to exercise due care and skill in auditing the appellant's accounts.

99 In addition to reliance on Cullen's signature, the respondent sought to rely on the self-certification by Riggs of his entitlement to the remuneration. In the proceedings below, the appellant relied on the case of *Deputy Secretary v Das Gupta* [1956] AIR 414 for the proposition that an auditor was not entitled to simply rely on the representations of management without independent verification. The trial judge sought to distinguish this on the basis that it involved "specific actions required in a special form of audit", whereas the present case involved "one of many items to be audited and … did not require any special form of verification" (see GD at [71]). The particular extract cited to the trial judge was as follows:

> The whole object of an audit is an examination of what the management have done and if the statements of the very persons who constitute the management were to be accepted in all matters, even in matters capable of direct verification, an audit would be an idle farce.

100 With respect, the trial judge did not adequately appreciate the need for specific verification in

the prevailing circumstances. The general precaution against over-reliance on management representations, which is articulated so lucidly in this extract, makes eminent sense, especially in relation to items which are capable of direct verification. An auditor exercising the requisite level of skill and judgment cannot abdicate his core responsibility of verification by simply relying on management representations to the same effect, particularly if the item in question relates to a matter in which the representor has a direct interest. It is also plain common sense that an auditor should seek independent objective verification of any controversial item that causes him concern.

101 This principle, a corollary of the requisite standard of care, is mirrored in SSA 1, which mandates (at para 6) that:

> **The auditor should plan and perform the audit with an attitude of** *professional scepticism* recogni[s]ing that circumstances may exist **which cause the financial statements to be materially misstated**. For example, the auditor would ordinarily expect to find evidence to support management representations and not assume they are necessarily correct. [emphasis added in bold italics]

SSA 1 is further reinforced by SSA 8, which unequivocally provides (at para 2) that "[t]he auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion" [emphasis in original omitted].

102 In *Pacific Acceptance* ([51] *supra*) at 71, the court considered the process of obtaining verification from the management of a company, and held that:

> [I]nquiry should be directed to management or the company's staff at the appropriate level, and … in deciding the level to which the inquiry should be directed or the level from which information should be accepted and acted on without more, the interest of the person concerned is relevant. … [In circumstances where the matter is of interest to the person to whom the inquiry is directed] the inquirer would need to reali[s]e that the information was being given by an interested party and weigh it accordingly and, if the matter was possibly material, look for other confirmation of the explanation and be prepared, if the matter was sufficiently material, to go to the board in the case of a general manager, or to head office in the case of a branch manager.

103 The trial judge sought to minimise the relevance of these observations on the basis that the respondent had no reason to doubt Riggs or Sandy and that it would be onerous to require the respondent to obtain direct confirmation from Cullen (see [26] above). With respect, we are unable to agree.

104 On the facts, the respondent was already in direct contact with Hora, and it would have been both a natural and logical progression to direct its inquiry on Riggs' entitlement to remuneration to him (Hora) or to Cullen directly in the form of a direct e-mail, as was the usual practice. It certainly did not require the respondent to embark on any particularly novel course of action or to really exert itself in pursuing its queries in this matter to a satisfactory conclusion. At the very least, the respondent should have informed Cullen that it would be relying on his signature to confirm Riggs' entitlement to remuneration, instead of simply leaving the process of verification to Riggs, who was undoubtedly an interested party.

105 Indeed, the appellant's allegations of negligence resonate even more strongly when we consider the respondent's actual awareness of Riggs' attempt to cloud the issue when he obtained Cullen's signature. Riggs had sent an e-mail to Cullen dated 25 February 2001, which was later forwarded to the respondent, that stated:

> I have signed the original sets of audit reports and Sandy will forward via pouch to you now … re this additional message from [the respondent], would you be able to give us a "simple" email message to confirm what they are asking about which is the 50/50 profit share we have on the air freight between Ten-Up and JSI SFO … our files show this is the case but [the respondent] wants something from SFO confirming this is the arrangement between the two offices.

106 The smoke and mirrors conjured by Riggs in the above e-mail are all too apparent. Riggs had insidiously lulled Cullen into a false sense of security by telling him that he (Riggs) had already signed the audit reports (thus representing that everything was in order). He cemented the misdirection by raising the profit sharing query, but deliberately omitted to tell Cullen of the respondent's request for verification of his (Riggs') remuneration and then completely avoided the crucial fact that the respondent would be relying on Cullen's signature for such a purpose. This sleight of hand bears all the devious hallmarks of a person well familiar with the working dynamics (and loopholes) of the processes involved and, in particular, the likelihood that Cullen would not delve too deeply into the financial reports that had been submitted for his signature. This is confirmed by Cullen himself, when he testified that he delegated all such accounting functions to Hora. Despite being privy to the e-mail, which quite clearly obfuscated the nature of the inquiry sought, the respondent nonchalantly accepted the sufficiency of such a management representation on Riggs' remuneration. Such a cavalier approach in pursuing a train of enquiry was rightly castigated in *Pacific Acceptance* ([51] *supra*) at 66, where the court held that:

> The auditor equally fails to do his duty if some irregularity or something unusual is discovered and he dismisses it, saying to himself, so far as he applied his mind to the matter, that there is no occasion to check further because there must be an explanation because there is no possibility of fraud …

107 The essence of an audit is to obtain and provide reasonable assurance that a company's accounts provide a true and fair view of the financial position of the company. The duty to verify and to be generally sensitive to the *possibility* of fraud is an inescapably inherent feature of an audit. We are of the view that the respondent failed to meet this essential responsibility in not only failing to adequately monitor the confirmation process, but also failing to adequately scrutinise the contents of the confirmatory e-mail to Cullen (see [105] above) to which it was undeniably privy. What was Cullen confirming? He certainly was not confirming that Riggs' remuneration as indicated in the accounts was correct. This flaw is significant given that the respondent is seeking to rely heavily on the *evidence of such confirmation* to support its alleged verification of Riggs' remuneration. While it must be acknowledged that there are often circumstances in which an auditor may justifiably be satisfied with and rely on letters of confirmation sent by the client, such a process needs to be adequately policed and appraised. Additional enquiries may sometimes be required to ensure the chastity of the verification process. A mere signature on financial statements cannot, in every case, be inevitably relied on by an auditor as confirming that all of its contents are either accurate or have been verified.

108 Finally, while the respondent now relies on a carefully woven tapestry of considerations which allegedly entered into its decisional matrix at the relevant time, we note that they were not documented in its audit working papers. SSA 9 (at para 6) provides that:

> **The auditor should record in the working papers information on planning the audit work, the nature, timing and extent of the audit procedures performed, the results thereof, and the conclusions drawn from the audit evidence obtained**. *Working papers would include the auditor's reasoning on all significant matters which require the exercise of judgment, together with the auditor's conclusion thereon. In areas involving difficult questions of principle or*

judgment working papers will record the relevant facts that were known by the auditor at the time the conclusions were reached. [emphasis added in italics]

109 In the circumstances, we find the respondent's purported reliance on Cullen's signature, without even a cursory attempt to draw his attention to the nature of the verification sought, somewhat dubious, given that none of the factors that allegedly impacted this decision were recorded in the audit working papers for three successive years.

110 It appears to us that the unquestioning deference and trust accorded to Riggs clouded the respondent's better judgment. Riggs' insidious influence and powers of persuasion not only extended to his employees and Cullen, but also tinged his relationship with the respondent. This is disturbingly manifested in the respondent's failure to pursue and obtain what it had initially considered and sought as sufficient appropriate proof of Riggs' authorised remuneration.

111 It is of paramount importance that auditors are not readily cowed or deflected by senior management of a company. They should not allow themselves to become mere rubber stamps by adopting an undue degree of deference to management representations. Subject to the practical limitations of an audit, items that can be directly verified should, whenever practical, be in fact directly verified; such verification goes to the core of an auditor's skill and competence and is a function of the appropriate degree of professional scepticism which all auditors must adopt. On the facts, the respondent had plainly accorded an indefensible degree of deference to Riggs, instead of assuming the burden of independent verification coupled with an attitude of professional scepticism that all auditors should typically stake their reputations upon.

112 That having been said, we remain fully cognisant of the commercial realities that require the accordance of a certain degree of sensitivity and outward deference to senior levels of management, who may, at times, be difficult and uncooperative. It should be reiterated, however, that at no time should the concern or fear of "biting the hand that feeds it" be a reason for compromising the integrity of auditing procedures or corporate governance standards. Prudence and integrity are the hallmarks of the accounting profession. At the end of the day, auditors must obtain sufficient and appropriate audit evidence to draw reasonable conclusions and to provide a basis for their opinion on the financial statements. Professionalism embellished with good interpersonal skills can go a long way towards achieving the right equilibrium without unduly jeopardising client relationships.

Failure to qualify audit reports

113 Even assuming that the respondent was genuinely unable to obtain sufficient and appropriate audit evidence, whether by Riggs' refusal to co-operate, the absence of records or otherwise, it was incumbent on the respondent to qualify its audit reports in the light of the various scope limitations experienced. Such a practice is mandated by SSA 8 (at para 18), which states as follows:

> When in substantial doubt as to a material financial statement assertion, the auditor would attempt to obtain sufficient appropriate audit evidence to remove such doubt. If unable to obtain sufficient appropriate audit evidence however, the auditor should express a qualified opinion or a disclaimer of opinion. [emphasis in original omitted]

114 In this regard, the appellant's expert, Chin, noted the lack of written comments regarding the issue of the non-availability of Riggs' employment contract, and concluded that the audit conclusion should have been qualified given that the absence of an employment contract constituted a scope limitation that required proper resolution before an unqualified opinion could be issued. The respondent repeatedly harps on the fact that whether or not a scope limitation exists is a matter for the auditor's

judgment. Admittedly, an audit allows abundant scope for discretion. However, whether or not such discretion is reasonably exercised is ultimately a matter for the court to determine. Liability will undoubtedly attach to a reckless or an indifferent failure to ask for information on matters which call for further explanation.

115 In the course of the trial proceedings below, John was cross-examined on the respondent's failure to obtain a certificate of remuneration in FY 1999 and was asked why this did not amount to a scope limitation. His response, which underscored the general thrust of the respondent's case, was as follows:

A: And you see in the box, "Directors' remuneration", and that figure refers to John Riggs. So although we did not receive back the confirmation from the man himself, we were very comfortable because when he sees [the financial statements] and he signs it, he acknowledges this amount. If it was terribly wrong, he would point out, "That's not my salary."

With due respect, the respondent's constant refrain that Riggs and/or Cullen had signed the financial statements is redolent of a cavalier attitude. It cannot detract from or mask the glaring fact that the respondent itself had distinctly identified a satisfactory manner of verification, but later inexplicably abdicated this responsibility in favour of a mere signature on the financial statements (not specifically sought for this purpose), a methodology dictated and orchestrated by Riggs.

Negligence established

116 In the light of the foregoing analysis, we are persuaded that the respondent fell short of the standard of reasonable care legitimately expected of it in its conduct of the audits for FYs 1999 to 2001. It would be apposite to clarify, at this juncture, that the respondent's breach of duty relates solely to the failure to take reasonable care in adequately applying its professional skill and judgment to an essential element of the relevant audit process, *ie*, the specific verification of Riggs' entitlement to remuneration. This is altogether distinct from and should not be confused with the more generic failure to detect Riggs' defalcations.

117 Such negligent omissions often come to light only in situations after the loss has been realised and the fraudulent perpetrator has absconded. If the auditor has genuinely exercised reasonable care in verification and still fails to detect a fraud (*eg*, if the respondent had communicated to Cullen the specific purpose for which his signature was required or had qualified the audit conclusion), liability would not invariably attach, for the detection and prevention of fraud *per se* is not typically within the scope of an auditor's duty. However, liability may be imposed in the absence of such reasonable care if the negligent failure to obtain reasonable assurance regarding the accuracy of the accounts, which would or could have prevented the fraud, is attributable to a lack of skill and/or competence manifested by an auditor in the discharge of his duties.

118 In short, if auditors like the respondent casually rely not on their professional expertise acquired through years of training and experience, but upon representations or signatures of others (not even specifically sought for that purpose) for verification, how can they fairly say in good conscience that they have verified anything at all?

119 At the end of the day, every professional must achieve and discharge in the course of his work an acceptable minimal level of competence (*Ang Tiong Seng v Goh Huan Chir* [1969-1971] SLR 119). More specifically, it is necessary to appreciate the crucial importance of the duties performed by auditors in the commercial life of the community and to accept that it would be a disservice to the public to permit a departure from proper professional standards (*cf Re Kingston* ([37]

supra) per Lopes LJ at 288, which have, in any event, become increasingly exacting in the modern context (*cf* in *Thomas Gerrard* ([65] *supra*) per Pennyquick J at 475). In *Pacific Acceptance* ([51] *supra*) at 74, the contemporary stringency of standards was juxtaposed against the sampling procedures involved in an audit as follows:

> The changes in accepted auditing standards are evidenced in that now, for some decades, in appropriate cases the auditor, after due inquiry and testing, relies on the company's system of internal control and by this method may avoid the time and cost involved in endless "surface" checking of all transactions in favour of checking samples "in depth". While this approach dispenses with some of the plodding and mechanical checks by audit clerks of former years, *it calls for some care, skill and experience as the inquiries regarding the system and the selection, and to some degree the following through of appropriate samples, require an appreciation of the purpose of the procedures in relation to the company's system of carrying out its activities and documenting its dealings. In this sense it might be said that the modern procedures call for more sophistication and higher standards on the part of those who perform the work*. [emphasis added]

120 It is of singular importance to reiterate that statutory auditors, on whom shareholders are dependent for their skill, judgment and vigilance, should perform their duty with scrupulous care. The potential recourse to a negligence action reassures the public that professionals who hold themselves out as possessing a particular skill will not lightly breach the requisite standard of care expected of them. It is another measure through which discipline is imposed on the profession. Market confidence that errant professionals can be brought to book is an important feature of a mature financial centre.

121 On the facts, we find it difficult to excuse as mere carelessness the conduct of the respondent which, despite being statutorily and contractually bound as auditors to ensure that the appellant's accounts and underlying information reflected a true and fair view of the financial position, failed for three successive years to obtain reasonable assurances of Riggs' correct remuneration. The respondent simply assumed such remuneration to be accurate on the basis of what now plainly appears to be a largely dubious *ex post facto* attempt at rationalising, justifying and mitigating its glaring omissions. In the result, we would respectfully disagree with the trial judge and hold that the respondent has breached its duty of reasonable care in failing to exercise due care and skill in obtaining sufficient and appropriate audit evidence of Riggs' entitlement to remuneration.

122 Having disposed of the primary allegation of negligence, the second issue to consider is the appellant's contention that the respondent negligently failed to report abuses by Riggs of the cheque signing limit.

Failure to report Riggs' abuses of the cheque signing limit

123 There are two strings to the appellant's bow in respect of this part of its case: (a) the exercise of "splitting cheques", which the respondent failed to highlight as a "material [weakness] in the system of accounting and internal control" (see [6] above); and (b) the discovery of consecutive round-numbered cheques issued by Riggs, which should have alerted the respondent to the possibility of a weakness of an internal control.

124 The respondent contends that the practice of splitting cheques was not a "material weakness" which it was bound to highlight as:

> (a) its audit objective was to establish the validity and proper classification of the expenditure, and not to identify split cheques; and

(b) splitting cheques was a prevalent "operational issue" that the appellant was aware of and which the directors must have "acquiesced" in (see Singh's report at para 4.65.f).

125 In this context, we find it helpful to advert to the case of *Sasea Finance Ltd v KPMG* [2000] 1 All ER 676, where the English Court of Appeal held that it was an auditor's duty to warn either the directors or some relevant third party with a reasonable amount of promptitude of any irregularity or fraud likely to result in material loss to the company. In particular, the court observed that where the loss was incurred in a course of activity, the risk of which the professional was under a duty to warn against, the fact that similar irregularities had occurred in the past could hardly be used to narrow the scope of the professional's duties to his client.

126 In the same vein, we find the respondent's invocation of the prevalence of splitting cheques as a shield rather disingenuous. In addition to the respondent's specific contractual undertaking to report any material weaknesses in the system of accounting and internal control which came to its notice and which it thought should be highlighted (see [6] above], SSA 6 (at para 49)) requires an auditor to:

> [M]ake management aware, as soon as practical and at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control systems, which have come to the auditor's attention. [emphasis in original omitted]

127 The more pertinent issue which we must address is whether a reasonable auditor in the circumstances, faced with split and/or consecutive round-numbered cheques, would have considered it a material weakness in the appellant's internal controls which ought to be highlighted.

128 In his report, the appellant's expert did not view the practice of splitting cheques as particularly significant and characterised it as a mere failure to accord with "best practices". On the other hand, the respondent's expert concluded that cheque splitting was not a material weakness as an auditor was primarily interested in the validity of expenditure, *ie*, whether the person was authorised to incur that expenditure and whether it was paid to the right person. On the facts, this had been duly verified. In addition, there was no loss arising from the two instances of split cheques which could, in any event, have been used for progress payments. In the absence of cogent contrary expert opinion, we are reluctant to disagree with the conclusion arrived at by the respondent's expert.

129 We would therefore agree with the trial judge that the existence of round-numbered cheques *per se*, a relatively common occurrence, was not an indication of fraud. The audit process was clearly not designed to identify round-numbered cheques. We are not convinced that any particular reasons existed for the respondent to suspect that these cheques were improper, unauthorised or fraudulent, and dismiss the appellant's contentions accordingly.

Failure to properly verify the renovation expenses of Ten-Up Hong Kong and the appellant's Singapore warehouse

130 The final allegation of breach deals with the respondent's alleged failure to properly verify the renovation expenses of Ten-Up Hong Kong and the appellant's Singapore warehouse, as encapsulated in invoices. The appellant submits that this should have induced suspicion and further scrutiny, which in turn would inevitably have led to the discovery of several irregularities.

131 On the facts, we find that the particular transactions involved were not *prima facie* questionable and did not require the degree of scrutiny which the appellant had in mind, *ie*, delving

into allegedly suspicious addresses, improbable descriptions and consecutive serial numbers. As adverted to earlier, any breach of duty must be assessed in the light of the circumstances reasonably known to the auditors at the material time and not *ex post facto* after the invoices have been placed under a microscope (see above at [69]).

132 We agree with the trial judge that the audit verification procedures undertaken for the payments made on behalf of Ten-Up Hong Kong, in particular, verification of the total receivable balance due, were sufficient in the circumstances. It was clearly not the responsibility of the respondent to satisfy itself that Ten-Up Hong Kong had expended the monies properly. Moreover, the appellant's special audit accountant, Steven Teo ("Steven"), affirmed the procedural propriety of the foregoing, while the appellant's expert, Chin, did not express a view on this matter. In the absence of any apparent reason to suspect impropriety or fraud, we find the respondent's scrutiny and verification of the invoices conducive to the requisite standard of reasonable care.

Whether the respondent's negligence caused the losses suffered by the appellant

133 Having concluded that the respondent breached its duty of reasonable care, the next issue to consider is the extent of loss *caused* by its negligent failure to properly verify Riggs' entitlement to remuneration.

134 The appellant's claim is for the entire extent of Riggs' misappropriations amounting to a total sum of $1,718,061.55. For ease of analysis, these losses can be categorised into three separate categories which mirror the allegations of breach above (see [28]), *viz*, losses attributable to: (a) payment to Riggs of excessive or unauthorised remuneration; (b) encashment by Riggs of fraudulent or unauthorised cheques; and (c) payments authorised by Riggs for fictitious office renovation expenses. The claim for damages is premised on the recovery of all defalcations perpetrated by Riggs that could allegedly have been prevented if the respondent had properly performed its duty, or, in the alternative, the loss of chance to recover the sums already misappropriated and to prevent further misappropriations. Several clarifications are called for.

Misappropriation and loss

135 As a prelude to our discussion on causation, we first examine the respondent's preliminary contention that the appellant's claim fails *in limine* due to the failure to discharge its burden of proof to establish Riggs' alleged misappropriation and the actual losses suffered.

136 In the proceedings below, the appellant relied primarily on:

(a) a handwritten note allegedly written by Riggs dated 28 June 2002 (see [9] above);

(b) the special audit reports prepared by NLA dated 5 August 2003 and 8 February 2006 (see [10]–[11] above);

(c) alleged overpayment by Riggs to himself, based on evidence given by Cullen, Sandy and Laili; and

(d) alleged wrongdoings pertaining to RNF Services Unlimited, RNF Services Pte Ltd and Starwin Century Pte Ltd, companies allegedly used by Riggs to facilitate his misappropriations.

137 A perusal of the record of proceedings reveals that the primary evidence relied on as proof of loss was the special audit reports commissioned for this very purpose. Whilst the respondent has

adverted to myriad failings about the credibility and admissibility of these reports, alleging, *inter alia*, breach of the hearsay rule, internal inconsistencies, the lack of objective and unequivocal evidence of Riggs' entitlement and the unreliability of the information proffered by Cullen, Sandy and Laili, we find, upon closer analysis, that the attempts to cast aspersions on the relevant evidence are somewhat overstated.

138 In relation to the alleged breach of the hearsay rule and the disputed admissibility of the special audit reports, we find, that contrary to the respondent's submissions, Steven's personal knowledge of Riggs' alleged impropriety was not a precondition to the admissibility of the reports in question. As the person having final authorship of the report, Steven had verified the work done by reviewing the working papers and was clearly entitled to rely on the work of his staff, although the weight that we should give to the report is another matter altogether (*Wellform Construction Pte Ltd v Lay Sing Construction Pte Ltd* [2001] SGHC 12 at [20]).

139 Likewise, we dismiss the respondent's attempts to persuade us to disregard altogether the clearly corroborative testimonies of Cullen, Sandy and Laili as to Riggs' misappropriations purely on the basis that they are unreliable or interested parties. The duty of the court is to assess the admissible evidence as a whole, ascertain the weight to be attributed to the same and thereafter make the necessary inferences of misappropriation and loss. The respondent's vigorous assertions in relation to the appellant's inability to prove its claim for damages suffered recedes into obscurity when we assess the combined effect of the special audit reports and the corroborative testimonies of the appellant's employees.

The law on causation

140 Causation is often a thicket of complex factual, legal and policy issues which give rise to difficulties, primarily in the consistent application of principle to the infinite permutations that may arise (see generally *Sunny MetalSunny Metal & Engineering Pte Ltd v Ng*Khim Ming *Eric* [2007] SGCA 36). The perennial problem is to establish whether one or more putative causes provide the required link in law between the duty breached and the loss claimed (*Jackson & Powell* ([32] *supra*) at para 17-064). This problem is compounded by the wide variety of losses which may result from a breach of duty by auditors. Indeed, the present multitude of claims and possibilities only serves to vindicate the astute observations of Lord Steyn in *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1997] AC 254 at 284 to the effect that there is no single satisfactory theory of causation capable of solving the infinite variety of practical problems confronted by the courts. Ultimately, the appropriate measure of loss and the types of loss recoverable will depend on the facts of each case and the application of principle infused with informed pragmatism.

141 By way of introduction, we must clarify that the "but for" test is a necessary but sometimes insufficient litmus test. It is but an exclusionary test serving to filter out non-causal occasions for the loss (John G Fleming, *The Law of Torts* (The Law Book Company Limited, 9th Ed, 1998) at p 220; Harvey McGregor, *McGregor on Damages* (Sweet & Maxwell, 17th Ed, 2003) at para 6-008). Therefore, the respondent's failure to verify Riggs' remuneration may survive this test, but may still not qualify as an "*effective cause*" or "*proximate cause*", a concept used to determine whether it is fair to hold the negligence responsible for the loss where other factors have contributed to or intervened in the chain of causation (AM Dugdale & KM Stanton, *Professional Negligence* (Butterworths, 3rd Ed, 1998) at para 18.01; *Chitty on Contracts* vol 1 (Sweet & Maxwell, 29th Ed, 2004) at para 26-029). The elusiveness of such a concept was incisively alluded to by Andrews J in *Helen Palsgraf v The Long Island Railroad Company* (1928) 248 NY 339 at 352, where he opined that "proximate" means that "because of convenience, of public policy, of a rough sense of justice, the

law arbitrarily declines to trace a series of events beyond a certain point. This is not logic. It is practical politics".

142 Some guidance can be gleaned from the recent case of *Kuwait Airways Corpn v Iraqi Airways Co (Nos 4 and 5)* [2002] 2 AC 883 (applied by Evans-Lombe J in *Barings* ([38] *supra*) at [721]), where Lord Nicholls of Birkenhead authoritatively explained (at [71]) that the court will first apply a simple "but for" test, and then go on to make a value judgment:

> In most cases, how far the responsibility of the defendant ought fairly to extend evokes an immediate intuitive response. This is informed common sense by another name. Usually, there is no difficulty in selecting, from the sequence of events leading to the plaintiff's loss, the happening which should be regarded as the cause of the loss for the purpose of allocating responsibility. In other cases, when the outcome of the second inquiry is not obvious, it is of crucial importance to identify the purpose of the relevant cause of action and the nature and scope of the defendant's obligation in the particular circumstances. What was the ambit of the defendant's duty? In respect of what risks or damage does the law seek to afford protection by means of the particular tort?

143 Framed in simple terms, a claimant has to prove that he has suffered loss and that the loss falls within the scope of the duty of care (*South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191 at 211). A proper characterisation of the ambit and nature of the respondent's duty and its corresponding breach would, therefore, pave the way for a more structured and coherent determination of the extent of loss attributable to the respondent's breach.

Was the respondent's breach an "effective cause" of loss?

144 As previously established (see [116] above), the respondent's breach of duty relates solely to the failure to adequately verify Riggs' entitlement to remuneration, and should not be conflated with the failure to detect fraud by verifying all the alleged false invoices and the split and round-numbered cheques. In any event, the audit was conducted on a sample basis and it would be impossible to verify every single transaction or cheque with a supporting invoice. On the contrary, the sampling of cash cheques and selected transactions were duly carried out and the actual samples were duly verified to be legitimate. Our conclusion might have been starkly different if we had found the respondent in breach of the standard of reasonable care in relation to the verification of cheques or other transactions subsequently discovered to be fraudulent.

145 In this context, we find the respondent's failure to verify Riggs' entitlement to remuneration an insufficiently "effective cause" of the latter two categories of losses occasioned by the fraudulently encashed cheques and forged invoices, the detection of which was not sufficiently within the "scope of duty" envisioned. Indeed, the attribution of the entire extent of Riggs' misappropriations to the respondent appears intuitively unfair as it imposes seamless causal liability for all consequential losses flowing from a single technical breach. This seems wholly disproportionate to the respondent's error of judgment and would in effect turn the respondent into insurers for the appellant.

146 Admittedly, this line of reasoning can be met with the commonsensical objection that the respondent's negligent failure to verify Riggs' entitlement to remuneration *deprived the appellant of the opportunity to discover, prevent or recover the entire extent of Riggs' defalcations*. From this perspective, an assessment of damages can be undertaken by reference to the value of the chance of a particular hypothesis being fulfilled, *ie*, the economic opportunity which has been lost.

Doctrine of "loss of chance"

147 The doctrine of "loss of chance" was comprehensively discussed in the case of *Asia Hotel Investments Ltd v Starwood Asia Pacific Management Pte Ltd* [2005] 1 SLR 661 at [47] which endorsed the tripartite framework established by Stuart-Smith LJ in *Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 WLR 1602 at 1609–1611, 1614 for analysing the issue of causation in a situation of loss of chance, the relevant portions of which merit reproduction:

> [W]here the plaintiffs' loss depends upon the actions of an independent and third party, it is necessary to consider as a matter of law what it is necessary to establish as a matter of causation, and where causation ends and quantification of damage begins.
>
> (1) What has to be proved to establish a causal link between the negligence of the defendants and the loss sustained by the plaintiffs depends in the first instance on whether the negligence consists of some positive act or misfeasance, or an omission or non-feasance. …
>
> (2) ***If the defendant's negligence consists of an omission, for example to provide proper equipment, [give] proper instructions or advice, causation depends, not upon a question of historical fact, but on the answer to the hypothetical question,*** *what would the plaintiff have done if the equipment had been provided or the instruction or advice given?* ***This can only be a matter of inference to be determined from all the circumstances.*** *The plaintiff's own evidence that he would have acted to obtain the benefit or avoid the risk, while important, may not be believed by the judge, especially if there is compelling evidence that he would not. …*
>
> ***Although the question is a hypothetical one,*** *it is well established that the plaintiff must prove on balance of probability that he would have taken action to obtain the benefit or avoid the risk. …*
>
> (3) In many cases the plaintiff's loss depends on the hypothetical action of a third party, either in addition to action by the plaintiff, as in this case, or independently of it. In such a case, does the plaintiff have to prove on balance of probability … that the third party would have acted so as to confer the benefit or avoid the risk to the plaintiff, or can the plaintiff succeed provided he shows that he had a *substantial* chance rather than a speculative one, the evaluation of the substantial chance being a question of quantification of damages? …
>
> …
>
> ***[T]he plaintiff must prove as a matter of causation that he has a real or substantial chance as opposed to a speculative one****.* If he succeeds in doing so, the evaluation of the chance is part of the assessment of the quantum of damage, the range lying somewhere between something that just qualifies as real or substantial on the one hand and near certainty on the other. …
>
> [emphasis added in bold italics]

148 Translated into the context of the present case, the appellant needs to prove on a balance of probabilities that if the respondent had in fact taken adequate steps toward verification of Riggs' remuneration and/or qualified the audit reports, the appellant in turn would have taken the necessary steps to investigate Riggs' misappropriation *vis-à-vis* the unauthorised cheques and forged invoices. While the appellant need not prove the eventual success of the inquiries on a balance of probabilities, it does have to prove that it would in fact have investigated the matter so as to "put it on track to secure the benefit of that chance" (see Lee Yeow Wee David, "Proving Causation in a Claim for Loss

of Chance in Contract" (2005) 17 SAcLJ 426 at 452, para 69).

149 The "balance of probabilities" standard requires a balancing of the evidence tendered by both parties. The standard was described by Denning J (as he then was) in *Miller v Minister of Pensions* [1947] 2 All ER 372 (at 374) as follows: "If the evidence is such that the tribunal can say: 'We think it more probable than not', the burden is discharged, but, if the probabilities are equal, it is not." On the facts before us, we are of the view that the appellant's claim for the loss of chance to discover the unauthorised cheques and forged invoices cannot be sustained on a balance of probabilities.

150 As a starting point, we observe that Cullen unreservedly trusted and relied on Riggs completely. He adopted an informal approach on the issue of Riggs' entitlement to benefits and liberally approved specific expenses that were outside the latter's employment contract. We are not persuaded by the adduced evidence that Cullen would have vigorously pursued the requisite investigative efforts in relation to the unauthorised cheques and forged invoices in response to an innocuous remuneration verification request from the respondent. Cullen may even have resolved this issue amicably with Riggs given his complete reliance on him (Riggs) and Riggs' apparent success in building up the Singapore operations.

151 Second, Cullen's passivity in failing to immediately terminate Riggs' employment and take positive steps to promptly report the matter to the authorities so as to facilitate recovery of the moneys allegedly stolen, when confronted with the allegations of fraud and misappropriation, casts doubt on his purported resolve to unflinchingly investigate, discover and prevent further misappropriations. We note that the time taken permitted Riggs to abscond. It should also be highlighted that Cullen *did not even read the audit reports* which he now so enthusiastically disparages as depriving the appellant of a substantial chance of total recovery.

152 On the facts, we are convinced that it was in fact the combined effect of Cullen's general indifference, laxity in management and failure to properly carry out his fundamental obligation to oversee and monitor the appellant that unfortunately coalesced to catalyse Riggs' defalcations.

153 Consequently, we find that the appellant has failed to discharge its burden of proving causation on a balance of probabilities in relation to the latter two categories of loss enumerated (above at [134]), *ie*, the appellant has not shown that the respondent's failure to adequately verify or seek reasonable assurance regarding Riggs' remuneration materially deprived it of the chance to discover the unauthorised cheques and forged invoices. Such a chance is largely speculative, and the appellant's argument omits many missing links in the causative chain. As such, it cannot ground a claim for the *entire extent* of Riggs' misappropriations, in particular, the losses occasioned by the unauthorised cheques and forged invoices.

154 Several other analogous cases support this measured approach. In *Ikumene Singapore Pte Ltd v Leong Chee Leng* [1993] 3 SLR 24 (CA), the claimant was denied recovery of damages for losses from the auditors because he "could not say what action he would [have taken] if he had known that the accounts were materially 'inaccurate'" (at 33, [34]). In addition, the court specifically noted that "the fact that the defendant did not qualify her report did not necessarily mean that whatever subsequent loss that [the plaintiff] suffered must be caused by that unqualified report" (at 32, [33]). Similarly, in *Gaelic Inns* ([34] *supra*), the claimant's attempt to establish liability on the part of the auditor for the loss of chance to recover misappropriated cash was dismissed due to the paucity of the evidence adduced by the claimant on the matter and the speculative nature of its claim. At this juncture, we must reiterate that it is not the loss of practically any chance which will give rise to a remedy (*Bank of Credit and Commerce International SA v Ali (No 2)* [1999] 4 All ER 83).

155 On the evidence, we are simply not persuaded that the proper verification of Riggs' entitlement to remuneration *per se* would, on a balance of probabilities, have resulted in a realistic chance of:

(a) *discovery* – in that the appellant would have commissioned a comprehensive forensic investigation into other transactions undertaken by Riggs;

(b) *prevention* – in that Riggs would have been deterred from carrying out his other defalcations; and

(c) *recovery* – in that the appellant would have taken the requisite steps to recover moneys misappropriated by the fraudulently encashed cheques and forged invoices.

156 In contrast, we have no hesitation in finding the respondent's failure to adequately verify or seek reasonable assurance regarding Riggs' remuneration to be a sufficiently "effective" cause of the losses occasioned by Riggs' undiscovered receipt of excessive or unauthorised remuneration. These losses amount to a total of $546,771.30 (including excessive remuneration received by Riggs in FY 2002), and are objectively ascertainable from Riggs' employment contract and other documents to the same effect. In our view, however, the award of damages flowing from such breach is subject to the broad judicial discretion conferred by s 391.

The respondent's counterclaim

157 Before the trial judge, the respondent alleged that it was induced by the fraudulent representations of the appellant's employees into expressing an unqualified opinion that the financial statements were true and fair for each year of the audit, and accordingly initiated a counterclaim for the full amount of its liability to the appellant. These arguments were similarly canvassed before us. They can be summarily disposed of.

158 The respondent has not only failed to satisfy the constitutive elements of fraudulent misrepresentation (*Panatron Pte Ltd v Lee Cheow Lee* [2001] 3 SLR 405), but more importantly, has premised its counterclaim by relying on representations which were precisely what it, as auditor, was duty-bound to verify and ascertain by the procurement of sufficient appropriate audit evidence (*Reeves v Commissioner of Police of the Metropolis* [2000] 1 AC 360, applied in *Barings* ([38] *supra*) at [748] and [767]). It would make nonsense of the existence of such a duty if we were to hold that the falsity of the representations which ought to have been detected by the respondent negatived the losses flowing from such breach.

Section 391 of the CA

159 Section 391 of the CA confers a broad discretion on the court to relieve, *inter alia*, auditors either wholly or partly from liability for any negligence, default or breach in the following terms:

Power to grant relief

391. —(1) If in any proceedings for negligence, default, breach of duty or breach of trust against a person to whom this section applies it appears to the court before which the proceedings are taken that he is or may be liable in respect thereof but that he has *acted honestly and reasonably and that, having regard to all the circumstances of the case including those connected with his appointment, he ought fairly to be excused for the negligence, default or breach the court may relieve him either wholly or partly from his liability on such terms as the*

court thinks fit.

…

(3) The persons to whom this section applies are —

…

(b) persons employed by a corporation as auditors, whether they are or are not officers of the corporation …

[emphasis added]

160 The effect of this particular section was comprehensively considered in the recent case of *Barings* ([38] *supra*), where the court considered the effect of s 727 of the Companies Act 1985 (UK), which is identical in its effect to s 391 of the CA. The auditors involved contended, *inter alia*, that the section could be invoked in the apportionment and quantification of fault, thereby permitting the court to also take into account the fault of employees of the Barings companies. Although this particular point was not eventually determined, the court made a number of pertinent observations on the interpretation of the relevant section. These are helpful in so far as they elucidate the scope, thrust and *raison d'etre* of the provision.

161 The court noted (*Barings* ([38] *supra*) at [1128]) the "obvious paradox" in the wording of the exculpatory section as it allowed a defendant who had been found liable for negligence to be excused wholly or partially on the grounds that he had acted "honestly and reasonably" and, in the light of all the circumstances of the case, "ought fairly to be excused". In response to this particular concern, the court made reference to the observations of Hoffman LJ (as he then was) in *Re D'Jan of London Ltd* [1993] BCC 646 at 649 as follows:

> It may seem odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy a court that he acted reasonably. Nevertheless, the section clearly contemplates that he may do so and it follows that conduct may be reasonable for the purposes of [s] 727 despite amounting to lack of reasonable care at common law.

162 The court also adverted (at [1130]) to the Australian case of *Maelor Jones Investments (Noarlunga) Pty Ltd v Heywood-Smith* (1989) 54 SASR 285, which considered a substantially similar provision, namely, s 365(1) of the Companies Act 1962 (Cth). Olsson J declared in that decision at 294–295:

> I should add also that the provision in section 365 is that the person seeking the benefit of the section must have acted reasonably, there being no limitation as to the field in which he must act reasonably. It is not, for example, limited to acting reasonably in the actual discharge of his duty of care. There seems no reason why, when he comes to be excused, his conduct generally so far as it is relevant should not be looked at to see whether he acted reasonably. …
>
> … Whilst it may well be that, in a particular situation, the very circumstances which give rise to a finding of negligence may be so pervasive and compelling as also to demand a conclusion that a person had acted unreasonably for the purposes of the exculpatory section, nevertheless that section is to be taken to directing its attention to a much wider area of concern - both in point of scope and time frame.

163 After stressing the "unfettered judicial discretion" involved in applying the section and the restraint to be exercised in doing so, Olsson J concluded (at 295) that the court ought not to shrink from giving effect to its intuitive sense of fairness and justice. In our view, we agree that the court should not hesitate, in a proper case, to relieve a person from a harsh and oppressive consequence arising from the strict application of the law, particularly in an instance where the person had acted honourably, fairly and in good faith as judged by the standards of others of a similar professional background.

164 Relying on this body of established case law, the court in *Barings* ([38] *supra*) opined at [1133] that s 727 of the UK Companies Act could be relied on if the auditors had acted "honestly and reasonably", and observed that the auditors may have acted reasonably for the purposes of the section, even though they were found to have acted negligently, if they had acted in good faith and if their negligence had been technical or minor in character, and not "pervasive and compelling". It was further emphasised that the court had a wide discretion as to whether the auditors ought to be fairly excused as long as these threshold tests were met, subject to the caveat that the application of the section should not negate the basic principles of liability so as to relieve the culpable auditor from liability merely because the negligence was not particularly gross. More pertinently, the court noted that the attribution of fault between the company and the auditor in that particular case had already been adequately taken into account by admitting a defence of contributory negligence. However, this is a plea that we find sorely lacking in the present case, thus mandating recourse to this section.

Contributory negligence

165 Notwithstanding that this point was not directly addressed by the court in *Barings* ([38] *supra*) and that the exculpatory provision does not seem to be primarily directed towards the apportionment of fault, we find the statutory wording sufficiently broad and permissive enough to allow partial relief from liability by attribution of fault, despite the lack of a contributory negligence plea. Several reasons can be offered.

166 To begin with, the foregoing observations are reconcilable with the position in the local context, in which our courts have emphasised thata paramount consideration in the exercise of the court's discretion under s 391 is whether the person who seeks the court's indulgence has acted honestly and in good faith (*Hytech Builders Pte Ltd v Tan Eng Leong* [1995] 2 SLR 795). In addition, our courts have similarly alluded to the possibility of granting relief for technical breaches in the case of *Tokuhon (Pte) Ltd v Seow Kang Hong (No 2)* [2003] 4 SLR 414 (at [59]) as follows:

> [I]f we had found that Mrs Seow [the second defendant] had technically committed any breach of duty and that breach could be said to have caused loss to TPL [the plaintiff], we would have been inclined to grant her relief under the said s 391(1). On the facts of this case, there was really a free and even contest between the three partners. Mrs Seow had acted openly and fairly. The judge below found her actions reasonable in all the circumstances. TPL's loss of distributorship was inevitable. *If fault is to be attributed, all three partners must bear it*. [emphasis added]

167 Returning to the wording of s 391, relief from liability must be underpinned by the presence of the three elements of honesty, reasonableness and fairness. In relation to the first element, we find that the respondent had been undisputedly honest throughout the conduct of the audit. Its transgressions related to an error of judgment, *ie*, its failure to follow up on an inquiry due to a misguided reliance on the alleged oversight and control exercised by the parent company (JSISC).

168 Regarding the second element, we are persuaded by the foregoing *dicta* in *Re D'Jan of London Ltd* ([161] *supra*) to the effect that auditors *can* undoubtedly be held to have acted reasonably for the purposes of the exculpatory section, notwithstanding that they are found to be negligent. In any event, the consideration of fault attribution would justifiably affect, as in this case, the degree to which the auditors can be said to have acted *reasonably* (by relying on the oversight, review and control exercised by the directors). The determination of reasonableness for the purposes of this section is not to be limited by the specific breach, but can encompass wider considerations such as the nature of the audit and other relevant circumstances. In particular, we note the views of the authors of a leading treatise to the effect that the court is required to take into account all relevant circumstances in considering whether an auditor ought fairly to be excused, an analysis which, in their words "ought surely to include the conduct of the directors" (*Jackson & Powell* ([32] *supra*) at para 17-083).

169 We had earlier observed that it was Cullen's indifference, laxity in management and failure to properly carry out his fundamental obligation to oversee and monitor the appellant that permitted Riggs' defalcations (see [152] above). Sections 199(1) and 201(15) of the CA unequivocally state that the financial statements of a company are the responsibility of its directors. In our view, the contributory negligence of Cullen and Hora in exercising oversight and control, in particular, in reviewing the financial statements of the appellant, can legitimately and fairly be taken into account in partially relieving the respondent from liability, to the extent that the respondent cannot be fairly held to be *completely* responsible for the losses sustained. On this note, it bears highlighting that counsel for the appellant himself could not but acknowledge, during the appeal, that his client was not completely blameless in this regard.

170 Having regard to all the circumstances of the case, we find this an appropriate case for an exercise of the discretion conferred by s 391, which was duly pleaded by the respondent, and partially excuse the respondent from liability flowing from the failure to adequately verify Riggs' entitlement to remuneration. The present allocation of responsibility under the auspices of s 391 remains consistent with the basic "principles of liability" (above at [164]) by fairly attributing the fault between the auditors and the directors of the appellant, both of whom were negligent, in accordance with the respective degrees of culpability of these parties. From a broader perspective, this emphasises the dual responsibility imposed on auditors and directors to scrupulously adhere to the standard of care in the fulfilment of their occasionally overlapping duties. Effective corporate governance requires both sets of professionals to assiduously discharge their responsibilities.

171 As an aside, we note the very recent amendments to SSA 700 that are postulated on a director's responsibilities specifically including "*designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error*" [emphasis added]. These amendments are directed at aligning the form of the auditor's report with contemporary international standards. Whilst the revised SSA 700 is not directly applicable in the context of the present case, given that it only applies to auditors' reports dated on or after 31 December 2006, it is clearly indicative of the inevitable trend towards reinforcing the integrity of corporate governance by co-emphasising directors' responsibilities.

172 While s 391 does appear to provide an alternative platform for the court to partially excuse the respondent and to attribute liability in a manner somewhat akin to a plea of contributory negligence, it must be highlighted that s 391 requires the respondent's conduct to be both honest and reasonable, requirements which are clearly not prerequisites to a plea of contributory negligence. If the respondent fails to satisfy these mandatory statutory prerequisites, the court will be powerless to partially excuse the respondent under the section, notwithstanding any culpability attributable to

the directors or to management. In view of the different and higher threshold requirements mandated by s 391, it would clearly be prudent, as a matter of practice, to plead both contributory negligence as well as s 391.

173 Throughout our ruminations, we remained cognisant of the reluctance of the court in *Pacific Acceptance* ([51] *supra*) to partially relieve the auditors from liability on the basis that the directors and management were also at fault. In particular, the court observed at 125 that:

> To excuse an auditor because the directors or management were also at fault, and in particular to excuse him when he failed to perform his duty with independence and to check on management and the board, would be to apply s 365 [of the Australian Companies Act] to negate a fundamental reason for the appointment of the auditor. If there is a complaint that other officers of the company also failed in their duty and contributed thereby to the loss, then the proper course is to take such action, if any, as in the circumstances is open to the auditor, for contribution from the officers at fault so that the company's loss can be shared between those proved at fault after precise allegations and proper investigation, rather than being cut down or excused to the detriment of the company because others as well as the auditor were at fault.

174 With all due respect, we disagree with Moffitt J in *Pacific Acceptance* ([51] *supra*) that the application of the s 391 model to partially excuse the respondent would "negate a fundamental reason for the appointment of the auditor". In particular, we see no reason in principle to justify the approach that the auditors should separately seek a contribution from the negligent directors, instead of relying on the defence of contributory negligence. Indeed, the oft-cited passage by Denning LJ (as he then was) in *Jones v Livox Quarries LD* [1952] 2 QB 608 comes to mind, wherein he held at 615 that:

> A person is guilty of contributory negligence if he ought reasonably to have foreseen that, if he did not act as a reasonable, prudent man, he might be hurt himself; and in his reckonings he must take into account the possibility of others being careless.

175 Our views find similar expression in academic circles. We also note that the views of Moffitt J in *Pacific Acceptance* ([51] *supra*) have been similarly criticised by PS Marshall and AJ Beltrami, "Contributory negligence: a viable defence for auditors?" (1990) LMCLQ 416, where it was incisively observed at 421:

> It is undoubtedly correct that the defence of contributory negligence must receive a narrow application. The widespread availability of such a defence would devalue the auditor's responsibilities and duties and would penali[s]e many companies whose only fault was to rely on their auditor to produce an accurate report. However, this need not lead to a conclusion that the defence can never be raised. Having regard to the nature of the auditor's duty, the fact that an auditor is employed to report whether the accounts show a true and fair view of the company's financial position does not in itself mean that the company should be absolved from the responsibility to look after its own interests. Just because there is a watchdog on the premises, it does not follow that the occupants can safely forget to bolt the doors and omit to switch on the burglar alarm.

176 We fully agree. The duties of an auditor to check on management and the board remain paramount. However, such a duty blends with the corresponding duties of directors to exercise due supervision and oversight over the management of the company. These duties, while distinct, do invariably overlap and, in our view, equally take centre stage in the context of defalcations perpetrated by a co-director of a company, when the company itself appears to have failed to take

reasonable steps to look after its own interests. Indeed, it was Evan-Lombes J in *Barings* ([38] *supra*) who alluded to the level playing field between the directors and the auditor, and held (at [1059]) that:

> [T]here is nothing special about auditors which requires of them a special standard of skill and judgment in their investigation of an audit client's affairs over other professional men and, *in particular, over the directors and officers of the commercial companies they audit*. [emphasis added]

177 As Cullen's failure to "bolt the doors and [omission] to switch on the burglar alarm" (see [175] above) has been established, the difficult task we are now faced with is the ascertainment and attribution of the fair and just extent of losses for which the respondent should be held responsible. Section 391 is apt to facilitate this objective, subject, of course, to satisfaction of the statutory prerequisites therein.

178 We are comforted that our views are consonant with those of Rogers CJ in *AWA Ltd v Daniels* (1992) 7 ACSR 759 at 854–856, who held that s 1318 of the Australian Corporations Law (Cth) (*in pari materia* with s 391, save for the requirement of reasonableness) was an appropriate provision for allocation of fault. In particular, it was observed at 856 that:

> For present purposes it is sufficient to say that, if I were wrong in the view that I have expressed as to the availability of a defence of contributory negligence by the auditors, the same facts, in my view, would enliven the operation of the provisions of the section. *The section is appropriate to operate as a provision for the proper allocation of fault.* This view of course is in conflict with what was said by Moffitt J in *Pacific Acceptance* … With all proper deference, the solution suggested by his Honour that relief be sought by the auditors by way of contribution from other persons who may have been negligent is not always appropriate to yield the desired result. It is unnecessary to make longer this already over-lengthy judgment by examination of the circumstances which, following the view embraced by Moffitt J would entitle plaintiffs, whose employees were negligent, to full recovery and leave out of pocket an auditor who may have been blameworthy only in a relatively minor respect so far as the damages are concerned. … The expression "having regard to all the circumstances of the case" in s 1318 is all-embracing and it is not clear to me what advantage to the proper administration of the law is to be had from denying full scope for its operation.[emphasis added]

179 The respondent, as auditor, was undoubtedly negligent, but a blanket refusal to take into account Cullen's culpable neglect (in the absence of a plea of contributory negligence) would be inapposite and evocative of an unduly technical and dogmatic approach to the attribution of liability. Having considered the circumstances of the case and, in our view, the satisfaction of the prerequisites to s 391, we are not disposed to allowing the entirety of the losses to fall on the respondent and would apportion liability accordingly.

180 Finally, we must emphasise that s 391 may not invariably be relied on as an alternative to a plea of contributory negligence when parties other than those seeking relief under the section are at fault. The circumstances of the case and, in particular, the threshold requirements of honesty, reasonableness and fairness remain paramount.

181 In the circumstances, we award 50% of the losses occasioned by the respondent's failure to verify Riggs' entitlement to remuneration, amounting to a total sum of $273,385.65, as damages to the appellant. They are entitled to interest on this sum at 3% per annum with effect from 29 October 2004, the date on which the writ was filed.

Conclusion

182 We would, accordingly, allow the appeal in part. The appellant is to be awarded the costs of the appeal and half of the costs of the proceedings below.

183 We would like to make one final observation. Our review of the facts in this matter and in *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] SGCA 41 has caused us some anxiety about the prevailing professional standards of public accountants in Singapore. Both the established accounting firms concerned were responsible for what can rightly be said to be rather elementary and obvious lapses. The partners involved were certainly not accounting tyros. We had hoped that these lapses were not reflective or symptomatic of general standards within the accounting profession. However, after we arrived at our decisions in these two matters, our attention was drawn to a very recent public report published by the Accounting and Corporate Regulatory Authority in July 2007 (see "Practice Monitoring Programme Public Report 2002" <http://www.acra.gov.sg/news/pmp_summary.html> (accessed on 29 August 2007) pursuant to its "Practice Monitoring Programme". This report contains both revealing and sobering conclusions. Only one third of the 110 public accountants monitored under this programme from April 2005 to March 2007 received a "good" rating. A "satisfactory" rating was received by another third and the final third, were required to undertake immediate remedial steps. In the light of all this, it is important that the accounting profession promptly takes collective steps to address existing shortcomings in the application of its prescribed standards.