

WHO LEFT THE GATES UNLOCKED? RECONCILING THE DUTIES OF AUDITORS AND COMPANY DIRECTORS

In the context of annual statutory audits required of companies, this article explores the duty of care of statutory auditors, the standard of care expected of statutory auditors, causation, and the contributory negligence, if any, of the company's own directors and officers in failing to detect or prevent cases of fraud. This article considers these questions in light of two recent decisions of the Singapore Court of Appeal, and highlights key conclusions as well as unresolved issues that will be of interest not only to legal scholars and practitioners, but also to members of the accounting profession and company directors.

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I. Introduction

1 The requirement to conduct annual statutory audits is an inescapable fact in the life of a modern corporation. In the normal course of business, a company will engage auditors to perform a yearly audit to ensure, *inter alia*, that its accounts represent a true and fair view of the company's finances. Companies are also required to file the results of the audit conducted as part of their statutory reporting requirements under the Companies Act ("CA").¹

1 (Cap 50, 2006 Rev Ed) s 207.

2 The performance of the annual statutory audit is sometimes perceived as routine or even mundane by companies. A firm's top management would be expected to have its attention and energies focused on profit-maximisation or business development, and may be tempted to view the audit requirement as a bothersome or even unnecessary interruption to the firm's otherwise constant ebb and flow of transactions and earnings.

3 However, the occasion may arise when an annual statutory audit fails to reveal omissions or errors in a company's finances, or worse, a fraud that has been committed on a company. In terms of liability for the loss suffered due to a fraud committed by an employee or director of the company, difficult questions arise in relation to: (a) the duty of care of statutory auditors; (b) the standard of care expected of statutory auditors, (c) causation; and (d) the contributory negligence, if any, of the company's own directors and officers in failing to detect or prevent the occurrence of fraud.

4 These are critical questions that will be of interest not only to legal scholars and practitioners, but also to members of the accounting profession and company directors.

5 As such, it is particularly noteworthy that these issues were the subject of two recent decisions of the Singapore Court of Appeal,² in *PlanAssure PAC v Gaelic Inns Pte Ltd*,³ and *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong*.⁴ The Court of Appeal also considered the legal significance of professional guidelines and industry regulations, namely, the Singapore Standards on Auditing ("SSA") published by the Institute of Certified Public Accountants of Singapore ("ICPAS").

6 The above decisions of the Court of Appeal in *Gaelic Inns* and *JSI Shipping* addressed and clarified many of the uncertainties facing both auditors and company directors, and the legal import and significance of these decisions will be the subject of this article.

2 Both appeals were heard (separately) before Chan Sek Keong CJ, Andrew Phang Boon Leong JA, V K Rajah JA (V K Rajah JA delivering the judgment of the court). The decisions in both appeals were issued on 30 August 2007.

3 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 ("*Gaelic Inns*").

4 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 ("*JSI Shipping*").

II. Background and context of recent Court of Appeal decisions in *Gaelic Inns* and *JSI Shipping*

A. PlanAssure PAC v Gaelic Inns Pte Ltd

(1) *The conduct of the statutory audits*

7 GIPL is a company incorporated in Singapore that is an owner and operator of certain well-known pubs in Singapore. The company engaged a firm of certified public accountants to audit its accounts for the financial years (“FYs”) of 2001, 2002 and 2003. The audits had to comply, *inter alia*, with the terms of s 207 of the CA, and express an opinion as to whether GIPL’s financial statements gave a true and fair view of its profit and loss.⁵

8 The yearly audits for FYs 2001 and 2002 were completed without incident. Thereafter, GIPL retained the auditors’ services to conduct the yearly audit for FY 2003.⁶

(2) *Fraud by the company’s employee*

9 The dispute in *Gaelic Inns* essentially arose out of acts of fraud committed by one D, who was the group finance manager of GIPL. As GIPL was not able to fully recover misappropriated amounts from either D or from its insurers, a key question was whether and to what extent its auditors should be liable for the company’s losses.

10 From 2001 to 2004, D devised and carried out a scheme whereby she delayed banking in cash on the day of sales into GIPL’s bank account, and instead used the cash for her personal benefit. To make up for the resulting shortfall, D would bank in an equivalent amount of cash subsequently collected from later sales. For a period of time, D managed to avoid detection because she would subsequently bank in the same amount of money that she had taken out, using a method of misappropriation described by accountants as “teeming and lading”.⁷

5 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [5].

6 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [7].

7 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [9].

11 D's misappropriation of funds was eventually detected in May 2004. D was subsequently charged with and convicted on three counts of criminal breach of trust under s 408 of the Penal Code⁸. Six other similar charges were taken into consideration. According to the police investigations, D had misappropriated a total sum of S\$1,006,115.12. However, GIPL was only able to recover the sum of S\$8,929 from D, and an additional sum of S\$100,000 from its insurers.⁹

(3) *The High Court proceedings*

12 In July 2005, a year after D's misappropriation was discovered, GIPL commenced a suit against its auditors, seeking damages of close to S\$1m for negligence in respect of the audits performed by the appellant between 2002 and 2004. GIPL essentially pleaded that the auditors had failed to detect D's cash misappropriations during the audit of the accounts for FYs 2001, 2002 and 2003, thereby emboldening and enabling D to continue with her misappropriation.¹⁰

13 The first instance hearing in the High Court resulted in a finding that the auditors had failed to discharge their duty of care and were liable for the entire amount of losses in FY 2004, in the amount of \$775,266.02. However, the High Court dismissed GIPL's claim for losses in FYs 2001 and 2002 because of the GIPL's inability to show that there were losses suffered during this period, and held that GIPL was precluded from recovery in relation to the 2003 losses because of its own contributory negligence.¹¹ The auditors subsequently appealed against the decision of the High Court.

B. JSI Shipping(S) Pte Ltd v Teofoongwonglcloong

(1) *The conduct of the statutory audit*

14 The dispute in the *JSI Shipping* case arose out of acts of fraud committed by one R, who was a director of a Singapore company, JSPL. JSPL was a provider of international logistics and door-to-door freight-forwarding services to its mainly US-based customers.¹² The ultimate holding company of JSPL was a US company, JSISC.¹³

8 Cap 224, 1985 Rev Ed.

9 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [10].

10 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [11].

11 See generally, the decision of the Singapore High Court in *Gaelic Inns Pte Ltd v Patrick Lee PAC* [2007] 2 SLR 146.

12 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [3].

13 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [2].

15 The auditors were certified public accountants which conducted three statutory audits of JSPL accounts in respect of financial years (“FYs”) 1999, 2000 and 2001.¹⁴ The results of all three audits were unqualified.¹⁵

16 At the material time, the two directors of JSPL were R, who was based in Singapore as Asia Director to head JSPL, and one C, who resided in California and headed JSISC.¹⁶ As Asia Director, R had overall control and responsibility of JSPL’s day-to-day operations in Singapore and reported to C on all operational and business issues.¹⁷

(2) *Fraud by the company’s director*

17 R was eventually discovered to have misused funds belonging to JSPL.¹⁸ C confronted R, who resigned and confessed to the misappropriations.¹⁹

18 JSPL then engaged another firm of auditors, NLAD, to conduct a special audit to ascertain the full extent of R’s malfeasance.²⁰ The special audit concluded that R had misappropriated company funds amounting to \$1.808m during the relevant period. A second special audit also revealed that there was an overpayment of salary for R amounting to \$18,000 during the stated period, and that R had received non-approved sums of money for allowances and other benefits amounting to about \$174,000.²¹

(3) *The High Court proceedings*

19 At first instance, JSPL claimed that all its losses were caused by the auditors’ breaches of its contractual obligations and duty of care in relation to the three audits carried out for FYs 1999, 2000 and 2001.²² While the High Court accepted that an auditor had to use reasonable skill, care and caution, it held that what amounted to reasonable care

14 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [5].

15 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [6].

16 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [2].

17 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [4].

18 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [8].

19 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [9].

20 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [10].

21 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [11].

22 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [12].

depended on the circumstances of each case.²³ The judge found that the auditors had conducted the three audits in question without breach of duty or negligence.²⁴ JSPL subsequently appealed against this decision.

III. The duty of care of auditors in conducting an annual statutory audit

A. *The effect of disclaimers of limiting clauses contained in the auditors' letter of engagement*

20 The legal effect of disclaimers and limitations contained in the auditors' standard letter of engagement was considered by the Court of Appeal in *Gaelic Inns*.

21 In *Gaelic Inns*, the Court of Appeal considered the effect of the auditors' letter of engagement which contained a disclaimer that the company should not rely on the audit to disclose irregularities or fraud. However, the Court of Appeal held that such disclaimers or limitation clauses merely restated the degree of skill and care that was required of an auditor under the accepted professional accounting standards.²⁵ While a plain reading of the purported disclaimer appeared to exempt the auditors from liability in the event that fraud was not detected during an audit, it was not open to the auditors to seek to exclude or limit its liability in relation to GIPL for negligence or any other breaches of duty in this manner.²⁶ The court also stated that the role of a statutory auditor is not a perfunctory one, but is rather that of a reasonably competent auditor exercising the requisite skill and responsibility coupled with a healthy and reasonable dose of professional scepticism.

23 See *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 1 SLR 821 at [68] where the trial judge cited *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"), and 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".

24 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [25]; see also *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 1 SLR 821 at [75].

25 The Court of Appeal cited with approval the decision in *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30 at 53 where the terms of engagement expressly stated that the audit "should not be relied upon to disclose defalcations or other irregularities, but their disclosure, if they exist, may result from the audit tests undertaken", and was held to be insufficient to limit the auditor's liability.

26 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [29].

22 It is thus significant that the duty of care owed by auditors to their clients is not merely limited to the express terms of the letter of engagement. The Court of Appeal held that “[i]n any case, the insertion of the subject disclaimer did not confer upon the appellant free rein to limit its liability”;²⁷ and that “[i]t is beyond peradventure that the appellant remains under an implied duty to exercise reasonable care and skill in the course of the audit even though this is not explicitly stated in the terms of its engagement ...”²⁸ The Court of Appeal also thus rejected a “wholly contractual analysis” of the auditors’ duties.²⁹

23 The approach taken by the courts is reflected in the statement by the Court of Appeal in *Gaelic Inns* that “a court will be extremely slow in sanctioning an auditor’s attempts to wholly exclude liability for professional negligence”.³⁰ Thus, notwithstanding any disclaimers or limitations of liability contained in the auditors’ terms of engagement, it will be extremely difficult, if at all possible, for auditors to exclude or limit their liability by way of contract. Rather, the court will hold the auditors to an external, objective standard of “a reasonably competent auditor exercising the requisite skill and responsibility coupled with a healthy and reasonable dose of professional scepticism”.³¹

B. *The distinction between an annual statutory audit vis-à-vis a special or forensic audit*

24 In *Gaelic Inns*, the Court of Appeal distinguished between (a) an annual statutory audit; and (b) a special or forensic audit intended to detect fraud. However, it ultimately held that auditors conducting an annual statutory audit still have a duty to detect fraud.³²

25 Noting that there are substantial and practical differences between statutory and forensic audits, the Court of Appeal in *Gaelic Inns* accepted that “the scope of a statutory audit is comparatively limited in comparison to a forensic audit. A statutory auditor need only comply with less onerous obligations, and may use samples on a test basis instead of performing a 100% audit of all transactions”.³³

27 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [30].

28 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [30]. The Court of Appeal also cited with approval a passage from *Jackson & Powell on Professional Liability* (Sweet & Maxwell, 6th Ed, 2007) at para 17-022.

29 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [30].

30 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [31].

31 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [29].

32 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [33].

33 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [34].

26 Nonetheless, the Court of Appeal emphasised that a statutory auditor is not entitled to take a casual view of his functions. The Court of Appeal cited *In re London and General Bank (No 2)*,³⁴ and *Fomento (Sterling Area) Ltd v Selsdon Fountain Pen Co Ltd*,³⁵ affirming that a statutory auditor remains obliged to remain alive to the possibility of fraud being committed. Thus, even though a statutory auditor may not set out looking specifically for fraud, the statutory auditor is still required to be on guard against possible instances of fraud which may be detected during the course of the annual statutory audit.

C. *The court's review of the Singapore standards on auditing*

27 Both appeals also demonstrated how the courts are willing to consider and have regard for professional guidelines and industry regulations in the form of SSAs published by the ICPAS. The Court of Appeal in *Gaelic Inns* noted that the SSA 11 and SSA 240 specifically provide that an auditor must “consider the risk of material misstatements in the financial statements resulting from fraud or error” when planning and performing audit procedures. As such, the court held that auditors will not be exempted from their duty to detect the existence of fraud and error.³⁶

34 [1895] 2 Ch 673. The Singapore Court of Appeal cited with approval the opinion of Lindley LJ in *In re London and General Bank (No 2)* [1895] 2 Ch 673 at 682–683, that an auditor was duty-bound in the following terms:

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 this 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.

35 [1958] 1 WLR 45. The Court of Appeal also cited the observations of Lord Denning in *Fomento (Sterling Area) Ltd v Selsdon Fountain Pen Co Ltd* [1958] 1 WLR 45, that:

An auditor is not to be confined to the mechanics of checking vouchers and making arithmetical 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 his 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.

36 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [29]. The Court of Appeal cited with approval the observations of Moffitt J in *Pacific Acceptance Corporation Ltd v Forsyth* [1970] 92 WN (NSW) 29 (“*Pacific Acceptance*”) at 63–64.

28 In reviewing the SSAs, the Court of Appeal in *Gaelic Inns* outlined the duties of an auditor in performing a statutory audit:³⁷

- (a) to perform his duties with an attitude of professional scepticism;³⁸
- (b) to remain alive to the possibility of fraud;
- (c) to approach his task with an inquiring mind and remain constantly alert to the fact that a mistake or oversight could actually be the thin end of a wedge; and
- (d) to pursue the matter and make further inquiries where reasonable suspicion would typically have been excited.³⁹

29 At the same time, the Court of Appeal in *Gaelic Inns* acknowledged practical limitations and constraints as outlined under SSA 1, such that “[s]ufficient leeway is thus given to statutory auditors in the discharge of their duties to verify financial statements”:⁴⁰

- (a) the use of testing;
- (b) the inherent limitations of any accounting and internal control system; and
- (c) the fact that most audit evidence is persuasive rather than conclusive.

30 Similarly, the Court of Appeal in *JSI Shipping* also observed that “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.’”⁴¹

37 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [48].

38 Citing SSA 1 at para 6.

39 The Court of Appeal cited with approval a passage from *Clerk & Lindsell on Torts* (Sweet & Maxwell, 19th Ed, 2006) at para 10-189, that:

[I]n general, an auditor must ‘make a reasonable and proper investigation of accounts and stock sheets, and if a reasonably prudent man would have concluded on that investigation that there was something wrong call his employer’s attention to that fact’. He is not obliged, however, to ‘draw the accounts, not to turn every stone and open every cupboard’. He is of course not liable for failing to find irregularities that would not have been found by a reasonably competent auditor.

40 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [49], citing SSA 1 at para 9.

41 *JSI Shipping (S) Pte Ltd v Teofoongwongloong* [2007] 4 SLR 460 at [39].

31 The court in *Gaelic Inns* also noted that the auditors' letter of engagement made reference to the SSAs,⁴² and concluded that "[t]he appellant was therefore obliged to apply its mind to how best it could prudently discharge its obligations under the SSAs. In expressing an opinion as to the accuracy of the accounts, the appellant was duty-bound to ensure that no material inaccuracies existed, in so far as such inaccuracies could have been detected on the basis of adequate sampling and the appellant having exercised reasonable care in the audit".⁴³ Thus, the SSAs, particularly those in force at the material time of the dispute, and the question of whether or not the auditors were in compliance with the provisions contained therein, will be relevant factors in a court's determination as to the duties of auditors.

D. Other factors examined by the court

(1) *Not exculpatory: The satisfactory outcome of previous audits*

32 The satisfactory outcome of previous audits is unlikely to excuse auditors from their duty to maintain an attitude of professional scepticism upon the commencement of the audit for a new financial year.

33 This was clarified by the court in *Gaelic Inns*, which observed that the fact that the previous audits for FYs 2001 and 2002 had proven satisfactory "did not exculpate the appellant from its breach of its duty of professional scepticism by wholeheartedly reposing its trust in [D's] integrity or in the accuracy of the [GIPL's] books".⁴⁴ This therefore suggests that statutory auditors are expected to approach each new yearly statutory audit with a consistent degree of professional scepticism, regardless of whether or not the previous audits were free of incidents or suspicious circumstances.

(2) *Not exculpatory: The remuneration received by the auditors*

34 The duty of auditors to ensure that their clients' accounts are free of material misstatements is not affected by how much (or little) remuneration the auditors are receiving.

42 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [36].

43 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [37].

44 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [38].

35 The Court of Appeal in *Gaelic Inns* held that “the comparatively low remuneration received by the appellant cannot detract from the scope of its duty to ensure that the respondent’s accounts were free of material misstatements. If this were the case, statutory auditors would be given *carte blanche* to discharge their functions in a wholly superficial manner, especially where they have been engaged pursuant to a long-term arrangement and/or for insubstantial remuneration”⁴⁵.

36 The court in *Gaelic Inns* thus observed that the question is whether the detection of misstatements or fraud falls within the scope of auditors’ duty, and distinguished a situation where the omission of the auditors was in an area outside the scope of their work.⁴⁶ The court found that “the appellant was duty-bound to detect material misstatements arising from fraud, defalcations or other irregularities in the respondent’s accounts”⁴⁷.

37 It was also suggested by the court in *Gaelic Inns* that it was open to the auditors to negotiate for an increase of its fees if it appears necessary for the auditors to carry out procedures not originally anticipated in the scope of the usual audit.⁴⁸ It may not be entirely clear, in practice, how much room there may be for auditors to bargain for a fee increase in relation to the kind of volume-intensive low-fee work that characterises the market for annual statutory audits, particularly in the case where a firm’s clients’ may comprise mainly small and medium-sized businesses. Interestingly, the court also went further to comment that “it would be wholly untenable from the viewpoint of policy and market discipline if the appellant were to be held to a lower standard simply on the basis that it had not been remunerated sufficiently for its services”⁴⁹.

45 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [38].

46 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [38], distinguishing the decision of the Manitoba Court of Appeal in *International Laboratories Ltd v Dewar* [1933] 3 DLR 665 in support of this contention, and citing the opinion of Dennistoun JA at 676:

To check and uncover frauds of this type is beyond the scope of auditors whose contract is for part-time work in the verification of a balance sheet, with special attention to cash, notes, securities, payrolls, and bank deposits, and not a contract to make a detailed audit of every entry in the book, with a scrutiny of delivery slips, invoices (both out and in), inventories, and all other records of a large business. Such an audit would have cost many times the sum of \$350 which these auditors were receiving, with occasional extra sums for special work.

47 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [40].

48 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [41].

49 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [41].

- (3) *Possibly exculpatory: A confluence of the identities of the directors and the shareholders*

38 One underlying rationale for the statutory audit is to ensure that the company's shareholders are kept apprised of the company's financial position. However, in the case of a very small company, where all the shareholders are also directors, the Court of Appeal in *Gaelic Inns* acknowledged that "[a]dmittedly, a persuasive case may be made for the imposition of a less extensive duty where there is a fortuitous confluence of identity between the shareholders and the directors of the company being audited. This becomes evident when we consider the underlying rationale for the statutory audit".⁵⁰

39 Thus, it appears that the court has left the door open for a less extensive auditors' duty.⁵¹

Since a statutory audit serves to apprise shareholders of the company's affairs, a pragmatic and more flexible approach may be justified where a congruence of identity exists. Under such circumstances, the shareholders would be fully aware of the company's affairs and the statutory audit may, in certain exceptional circumstances, be a mere formality.

40 However, the court in *Gaelic Inns* did not allow for this exception on the facts of that case, noting that:⁵²

50 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [42], citing with approval a passage from *Jackson & Powell on Professional Liability* (Sweet & Maxwell, 6th Ed, 2007) at para 17-002:

Ownership by the shareholders is separated from management and day-to-day control by the directors. The latter are accountable for the conduct of the company's affairs to the shareholders who may exercise their collective powers to reward, appoint or remove the directors. To that end, shareholders are entitled to an annual report from the directors as to their conduct of the company's affairs. Shareholders are also entitled to a report from independent auditors in order to ensure, so far as possible, that financial information as to the company's affairs prepared by the directors accurately reflects the company's position.

51 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [43], citing with approval a passage from *Halsbury's Laws of Singapore* vol 6 (LexisNexis, 2006 Reissue) at para 70.331:

In order to understand the true significance of the auditors' functions, it is necessary to appreciate the practical distinction between the owners of the company on the one hand and the management and directors on the other. In very small companies, the owners of the company (namely, the members) are also usually the directors. They run the company and are responsible for its business. The statutory audit becomes a formality under these circumstances, since the owners are fully aware of what is going on.

52 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [45].

We would, however, be loath to make a definitive pronouncement in relation to this for the purposes of the present appeal, given that the requisite congruence of identity has not been made out. While Crowhurst, Lew and Shaw held concurrent appointments as directors and shareholders of the respondent, we note that Crowhurst's and Lew's wives also owned shares in the respondent as well.

41 In view of the position taken by the court, it may be expected that the court in future cases may apply the above exception on a fairly restrictive basis, if at all. Nonetheless, the question remains open whether an audit of hypothetical company, where a director holds, say, 9,999 shares and his wife holds one nominal share, would qualify for this exception.

E. A summary of the scope of the auditor's duty of care

42 The court in *Gaelic Inns* thus characterised its findings on the scope of an auditors' duty of care as being a "measured response", and commented that "it is not contemplated that an auditor must detect each and every material misstatement or instance of fraud in the discharge of his duties".⁵³

43 The court in *Gaelic Inns* thus concluded that "statutory auditors have a duty to be alive to the possible existence of fraud",⁵⁴ and referred to its observation in *JSI Shipping* that:⁵⁵

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.

44 The court in *JSI Shipping* also observed that a multitude of factors come into play when assessing the nature and extent of an auditor's professional duties:⁵⁶

53 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [47].

54 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [50].

55 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [120].

56 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [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 ... (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 ... In short, it is an amalgam of considerations that almost invariably permutate and should, therefore, be specifically assessed in accordance with each factual matrix.

45 In summary, the nature and scope of an auditor's professional obligations will be assessed by a composite review of the following factors:⁵⁷

- (a) the precise obligations that have been contractually undertaken;
- (b) the duties imposed by statute;
- (c) the auditing standards reflected in the SSAs;
- (d) the expert evidence adduced in relation to the conduct of the audit; and
- (e) there is no single all-embracing rule or criterion that consistently or exclusively predominates.

IV. The standard of care expected of statutory auditors

A. *The role and effect of industry standards*

46 After determining the scope of the duty of care of an auditor, the court then has to assess whether the conduct of the auditor has fallen below the reasonable standard of care.

47 The Court of Appeal in *JSI Shipping* identified the relevant industry guidelines and standards issued by the ICPAS that the courts will look to in relation to auditors' duties:⁵⁸

- (a) the SSAs;
- (b) the Singapore Auditing Practice Standards;
- (c) the Singapore Standards on Review Engagements; and
- (d) the Singapore Standards on Assurance Engagement.

⁵⁷ *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [35].

⁵⁸ *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [34].

48 As for the legal effect of such standards, the Court of Appeal in *JSI Shipping* surmised that “[w]hilst 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”.

49 The court in *JSI Shipping* also cited with approval the observations of the High Court in the first instance decision of *Gaelic Inns*.⁵⁹

[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.

50 Thus, while not a complete shield from liability, auditors would be well-advised to adhere to the accounting standards issued by the ICPAS, as a way to guard against possible accusations of misconduct.

B. The meaning of “reasonable care and skill”

51 The court in *JSI Shipping* conducted a review of the case law on the auditors’ standard of care,⁶⁰ and summarised what it means for an auditor to take “reasonable care and skill”:⁶¹

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.

59 *Gaelic Inns Pte Ltd v Patrick Lee PAC* [2007] 2 SLR 146 at [11].

60 The Court of Appeal considered, *inter alia*, *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30; *In re Kingston Cotton Mill Company (No 2)* [1896] 2 Ch 279; *Barings plc v Coopers & Lybrand* [2003] Lloyd’s Rep IR 566; *Leeds Estate, Building and Investment Company v Shepherd* (1887) 36 Ch D 787; *In re London and General Bank (No 2)* [1895] 2 Ch 673; *Fomento (Sterling Area) Ltd v Selsdon Fountain Pen Co Ltd* [1958] 1 WLR 45; *United Project Consultants Pte Ltd v Leong Kwok Onn* [2005] 4 SLR 214 and *Caparo Industries plc v Dickman* [1989] 1 QB 653, [1990] 2 WLR 358.

61 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [47].

52 Similarly, the court in *Gaelic Inns* reaffirmed the “common law test which holds that an auditor would have discharged his duty by exercising the reasonable skill and care of an ordinary skilled person performing the same engagement”.⁶²

53 The Court of Appeal in both *Gaelic Inns* and *JSI Shipping* was mindful of the danger of a court being subject to the “scapegoat effect” that magnifies *ex post facto* the plausible culpability of the auditors. The court in *Gaelic Inns* emphasised that:⁶³

[I]n evaluating whether there is an irregularity which would have put the auditor in question on inquiry, the court should guard against using its *ex post facto* knowledge of the existence of fraud to impute on the auditor a level of inquiry that would have been unreasonable in the circumstances. The court should refrain from assessing the situation with the benefit of hindsight, and should instead place itself in the shoes of a reasonably skilled auditor at the time the audit was conducted.⁶⁴

54 Similarly, the court in *JSI Shipping* emphasised that the acid test is “not one of retroactive plausibility”.⁶⁵

62 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [52], citing with approval the observations of Lindley LJ in *In re London and General Bank (No 2)* [1895] 2 Ch 673 at 683:

Such I take to be the duty of the auditor: he must be honest – *ie*, 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. Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient, and in practice I believe businessmen select a few cases at haphazard, see that they are right, and assume that others like them are correct also. Where suspicion is aroused more care is obviously necessary; but, still, an auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion, and he is perfectly justified in acting on the opinion of an expert where special knowledge is required.

63 Citing with approval the opinion of Moffitt J in *Pacific Acceptance Corporation Ltd v Forsyth* [1970] 92 WN (NSW) 29 at 62–63:

Once fraud is revealed and has been investigated it is easy to connect earlier manifestations of it. The natural inclination after the event to do so is apt to mislead. Therefore, if the conduct of the auditor is reviewed after the event and at the same time as the fraud demonstrated, as happens of necessity in a case such as this, the inclination must be consciously guarded against. The auditors’ conduct must be examined in a practical way upon the matters as they then presented themselves to them, with at least an initially unsuspecting state of mind, or as they ought to have presented themselves to them in such a state of mind ... [I]t would be unreasonable to expect [the auditor] to connect matters in the fashion that one would expect as on a special investigation or by one whose suspicions have already been aroused.

64 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [54].

65 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [69].

[I]t 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.

C. *The application of the Bolam/Bolitho Test in the face of conflicting expert evidence*

55 The Court of Appeal in both *Gaelic Inns* and *JSI Shipping* clarified that the *Bolam/Bolitho* Test was applicable to questions concerning the auditors’ standard of care:⁶⁶

... It can now be confidently stated that the application of the *Bolam* test is necessarily subject to and qualified by Lord Browne-Wilkinson’s statement in [*Bolitho v City and Hackney Health Authority* [1998] AC 232 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.

56 It is interesting to note that the court at first instance in *Gaelic Inns* did not expressly consider the applicability or effect of the *Bolam/Bolitho* Test, but it was nonetheless considered and applied by the Court of Appeal in *Gaelic Inns*, which essentially harmonised the applicability of the standard with that in *JSI Shipping*.⁶⁷

⁶⁶ *JSI Shipping (S) Pte Ltd v Teofoongwonglclong* [2007] 4 SLR 460 at [50]; see also *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [81].

⁶⁷ *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [81].

57 In addressing the problem of conflicting opinions of the parties' experts (as is often the case),⁶⁸ the Court of Appeal emphasised the "supervisory judicial responsibility to ensure, at a minimum, that the expert opinion is defensible and grounded in logic and plain common sense".⁶⁹ As such, it is clear that, while the court will give weight to the expert opinions that will inevitably accompany any dispute in relation to auditors' duties, it is the court, and not the accounting experts, who will have the final say over whether the auditors met the standard of reasonable care and skill.

V. Directors' duties and the auditor's defence of contributory negligence

A. *The responsibility of the executive or managing director(s)*

58 The issue of contributory negligence took a central role in both appeals. When the company's losses were occasioned by the acts of a third party, the court will look at the circumstances of each case to apportion the loss as between the company and its auditors.

59 The Court of Appeal in *Gaelic Inns* set out two broad situations where the contributory negligence of the company may arise:⁷⁰

- (a) where the company has, by its acts, positively prevented or hindered the auditor from carrying out his duty with due skill and care;⁷¹ or

68 The court had to deal with conflicting, and in some instances, diametrically opposed expert opinions in both appeals, see *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [14] and [82]; see also *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [15]–[24] and [54]–[64].

69 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [51]. The Court of Appeal also cited with approval the observations of Moffitt J in *Pacific Acceptance Corporation Ltd v Forsyth* (1970) 92 WN (NSW) 29 ("*Pacific Acceptance*") at 75, as cited by Belinda Ang Saw Ean J in *Gaelic Inns Pte Ltd v Patrick Lee PAC* [2007] 2 SLR 146 at [11]:

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.

70 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [118].

71 The court cited in *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [123] the example of *Craig v Anyon* 208 NYS 259 (1925), and observed that:

... this aspect of contributory negligence has hitherto been confined to situations where the company in question had made a positive representation to the auditors that the embezzler could be trusted.

(b) when there has been such negligence that the company may be found to have failed to look after its own interests even though it has appointed an auditor.⁷²

60 Contributory negligence is an important defence that will almost invariably arise in cases involving fraud or misfeasance by a company's directors or employees. After all, if statutory auditors act as an *ex post* check on the company's dealings for a particular financial year, the company's directors may well be hard pressed in most cases to explain how they allowed the fraud to take place under their watch, in the day-to-day management of the company's affairs.

61 Three directors sat on GIPL's board of directors at the material time of the various audits for FYs 2001, 2002 and 2003: Crowhurst, Managing Director; Lew, Non-executive Director; and Shaw, Non-executive Director.⁷³

62 In finding GIPL to be "contributorily negligent by reason of its own patent failure to safeguard its own interests",⁷⁴ the Court of Appeal found that "... Crowhurst, Lew and Shaw had been guilty of serious maladministration of the company's affairs, with the result that [GIPL] failed to detect [D's] defalcations until May 2004".⁷⁵

63 As to the precise factors that led to the Court of Appeal's opinion that a "serious maladministration" gave rise to contributory negligence on the part of Gaelic Inns, the court was cognizant of the trial judges' findings that "there was ample justification for being critical of the management's shortcomings".⁷⁶

72 The court cited with approval P S Marshall and A J Beltrami, "Contributory Negligence: A Viable Defence for Auditors?" (1990) LMCLQ 416 at 421 and the decision of the High Court of Australia in *Astley v Austrust Ltd* (1999) 197 CLR 1 at [30]:

The duties and responsibilities of the defendant are a variable factor in determining whether contributory negligence exists and, if so, to what degree. In some cases, the nature of the duty may exculpate the plaintiff from a claim of contributory negligence; in other cases the nature of that duty may reduce the plaintiff's share of responsibility for the damage suffered; and in yet other cases the nature of the duty may not prevent a finding that the plaintiff failed to take reasonable care for the safety of his or her person or property. Contributory negligence focuses on the conduct of the plaintiff. The duty owed by the defendant, although relevant, is only one of the many factors that must be weighed in determining whether the plaintiff has so conducted itself that it failed to take reasonable care for the safety of its person or property.

73 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [8].

74 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [125].

75 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [125].

76 *Gaelic Inns Pte Ltd v Patrick Lee PAC* [2007] 2 SLR 146 at [38].

(a) The managing director was responsible for the day-to-day running of the company. He confirmed receiving monthly bank reconciliation statements but never bothered to look at them.

(b) The managing director had (under cross-examination) admitted to not monitoring the company's banking procedures which were breached over time.

64 Similarly, in *JSI Shipping*, the Court of Appeal observed that it was “[C’s] indifference, laxity in management and failure to properly carry out his fundamental obligation to oversee and monitor the appellant that permitted [R’s] defalcations”.⁷⁷ The Court of Appeal also observed that s 199(1) and s 201(15) of the CA “unequivocally state that the financial statements of a company are the responsibility of its directors”.⁷⁸

65 As such, it is fairly certain that the courts will look first to the conduct of those managing or executive directors who supervise and are responsible for the day-to-day management of the company. The management shortcomings of such persons will have a direct impact on a court's determination as to contributory negligence on the part of the company.

B. The responsibility of the non-executive director(s)

66 One interesting question that arose in *Gaelic Inns* was the responsibility of the non-executive directors, namely, Lew and Shaw. The Court of Appeal in *Gaelic Inns* emphasised that “the mere fact that ... non-executive directors ... took a backseat in the management of the company did not exempt them from the need to exercise a modest level of scrutiny as to the goings-ons in the respondent”.⁷⁹

67 As such, the Court of Appeal held that non-executive directors, regardless of whether or not they received copies of the company's accounts in the regular course of business, remained under a duty to ensure that the company's accounts were in order.⁸⁰

77 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [169].

78 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [169].

79 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [130].

80 The Court of Appeal also cited its prior decision in *Vita Health Laboratories Pte Ltd v Pang Seng Meng* [2004] 4 SLR 162 (“*Vita Health*”) at [14]:

[E]very director of a company, regardless of whether he has an executive or non-executive designation, has fiduciary duties and legal responsibilities to his company.

The nub of the issue is whether they remained under a duty to take positive steps to ensure that the accounts were in order (at least on their face), despite their designation as non-executive directors. This question ought to be answered in the affirmative.⁸¹

68 As such, not only is it clear that non-executive directors are under a duty to take positive steps to ensure that a company's accounts are in order, but that their failure to do so may support a court's finding that the company was contributorily negligent for the loss, as part of the "cumulative lapses" on the part of both the managing director and non-executive directors which constituted "serious management failure and ought to be treated as fault for the purposes of a defence of contributory negligence".⁸²

C. *The effect, if any, of a change or transitional period in the company's management*

69 At the first instance hearing in the *Gaelic Inns* case, the trial judge found that the company was not contributorily negligent for losses in 2004, because of "major management changes taking place in early 2004", which included Crowhurst's decision to step down as managing director.⁸³

70 On appeal, the auditors argued that internal management changes did not excuse the company from contributory negligence. The Court of Appeal reversed the decision of the trial judge in this regard, and held that:

Notwithstanding the change in management, the respondent remained liable to ensure that the handover process was performed as seamlessly as possible, without compromising the management's oversight of the company's affairs.⁸⁴

81 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [130].

82 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [130], citing views of Evans-Lombe J in *Barings plc v Coopers & Lybrand* [2003] Lloyd's Rep IR 566 at [908]:

It is the responsibility of a company's board of directors to manage all aspects of the company's business. The board will delegate many aspects of that task to individuals or committees, either within or (more rarely) outside the company. But if the delegates fail in their tasks, such that the company fails to take proper care of its own interests, their failure is to be attributed to the company and its board of directors. Where the company is a claimant, and its management failures are relevant to an issue of negligence or breach of contract, those failures are to be treated as fault for the purposes of a defence of contributory negligence.

83 *Gaelic Inns Pte Ltd v Patrick Lee PAC* [2007] 2 SLR 146 at [39].

84 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [135].

71 While directly applicable to the dates of the events in question, the court in *Gaelic Inns* also had regard for SSA 700 in relation to the duties of directors in relation to financial statements.⁸⁵

Directors' Responsibility for the Financial Statements

The Company's directors are responsible for the preparation and fair presentation of these financial statements in accordance with the provisions of the Singapore Companies Act, Cap 50 ... and [the] Singapore Financial Reporting Standards. This responsibility includes: 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; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

72 Similarly, the court in *JSI Shipping* was of the view that "the very recent amendments to SSA 700 ... [are] clearly indicative of the inevitable trend towards reinforcing the integrity of corporate governance by co-emphasising directors' responsibilities".

D. Finding contributory negligence under s 391 of the CA

73 It appears that the auditors in *JSI Shipping* did not plead the defence of contributory negligence.⁸⁶ Nonetheless, on appeal, the court in *JSI Shipping* exercised its discretion under s 391 of the CA to hold the company liable for 50% of the loss.

74 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 if the auditor "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".⁸⁷

75 While acknowledging that the court's discretion under s 391 should be exercised with restraint, the Court of Appeal in *JSI Shipping* nonetheless gave some guidance as to when it would be willing to exercise such discretion in future cases:⁸⁸

85 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [131].

86 The Court of Appeal noted, in *JSI Shipping (S) Pte Ltd v Teofoongwongcloong* [2007] 4 SLR 460 at [164], that:

... [the defence of contributory negligence] is a plea that we find sorely lacking in the present case, thus mandating recourse to [s 391 of the CA].

87 *JSI Shipping (S) Pte Ltd v Teofoongwongcloong* [2007] 4 SLR 460 at [159].

88 In analysing s 391 of the CA, the Court of Appeal also cited with approval the Australian case of *Maelor Jones Investments (Noarlunga) Pty Ltd v Heywood-Smith* (cont'd on the next page)

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.⁸⁹

76 As such, the Court of Appeal held it would exercise its discretion under s 391 of the CA to attribute the fault between the auditors and the directors of the company.⁹⁰

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.

77 While a plea under s 391 of the CA may save an auditor from bearing some or all of the loss in a particular case, it should be emphasised that such relief lies at the discretion of the court. It would appear from the court's observations in *JSI Shipping*⁹¹ that, if there appears to be some negligence on the part of the company, an express plea of contributory negligence should still be made, regardless of whether or not a separate plea is also made under s 391 of the CA. In any event, the Court of Appeal in *JSI Shipping* appears to have decided the s 391 point based on similar considerations as would have been applicable to an express defence of contributory negligence.

VI. Conclusion: Striking a balance amidst commercial realities

78 In *Gaelic Inns*, the Court of Appeal reversed the trial judge's findings on contributory negligence and held the company 50% contributorily negligent.⁹² In *JSI Shipping*, the Court of Appeal reversed the trial judge's findings on liability, and held the auditors were liable in negligence, but nonetheless held the auditors to be liable for only 50% of the losses on account of the company's own negligence.⁹³

(1989) 54 SASR 285 at 294–295 (which considered s 365(1) of the Companies Act 1962 (Cth)), and also the English cases of *Barings plc v Coopers & Lybrand* [2003] Lloyd's Rep IR 566 and *Re D'Jan of London Ltd* [1993] BCC 646 at 649 (which both considered the effect of s 727 of the Companies Act 1985 (UK)).

89 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [163].

90 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [170].

91 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [164].

92 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [139] and [141].

93 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [181].

79 While the precise apportionment of damages on the basis of contributory negligence will inevitably turn on particular facts and the court's determination of what is "just and equitable",⁹⁴ it is clear from these two decisions that both directors and auditors have a shared responsibility in safeguarding the interests of a company.

80 While the duties of "an auditor to check on management and the board remain paramount", such a duty "blends with the corresponding duties of directors to exercise due supervision and oversight over the management of the company".⁹⁵ When there has been negligence on the part of both the company and its auditors, the courts will undertake a balancing exercise, based on the particular circumstances of each case, to apportion liability for the losses suffered by the company. This is a fair approach. Even as auditors assume a professional duty to take care in scrutinising their clients' financial statements, directors are not allowed to completely abdicate their responsibility of supervision and oversight to their employees or auditors.

94 *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] 4 SLR 513 at [138], citing s 3(1) of the Contributory Negligence and Personal Injuries Act (Cap 54, 2002 Rev Ed) which states:

Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage.

95 *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460 at [176].