APPENDIX

A Summary of the Significant Legal Decisions

The Leeds Estate Building and Investment Company v. Shepherd (1887)

This case was decided by Mr. Justice Stirling in the Chancery Division on 9th August, 1887.

Held, that it was an auditor's duty to ascertain that the accounts he certifies are correct and that if he fails in this duty he is liable in damages for dividends wrongly paid out of capital.

The company was formed in 1869 under the Companies Act, 1862. In 1882 it went into voluntary liquidation and the action was brought by the company in liquidation against the directors, the manager, and the auditor, to make them liable in respect of certain sums paid out of capital as dividends, and for fees and bonuses to the directors and manager respectively.

The balance sheets, which were not shown to the shareholders as required by the articles, were found to be false and to have been prepared to enable the declaration of a dividend. They were prepared by the manager and examined by the auditor. The directors trusted these two officials and did not know that the accounts were inaccurate and that dividends were paid out of capital.

The Court found the directors liable to make good the several sums paid out of capital and that the manager and auditor were liable to the same amount; that the auditor must not confine himself merely to the task of ascertaining the arithmetical accuracy of the balance sheet, but must see that it was a true representation of the company's affairs; that it was no excuse that the auditor had not seen the articles; that the Statute of Limitations enabled the auditor's liability to be limited to dividends paid within six years of the commencement of the action.

Lee v. Neuchatel Asphalte Company Limited (1889)

This case was decided in the Court of Appeal on the 9th of February, 1889, when it was held that a company, if allowed by its articles of association, may provide for the distribution of profits arrived at before making good the depreciation of fixed assets.

Briefly, the facts of the case were these : The action was brought by a Mr. Lee, on behalf of himself and all the ordinary shareholders of the Neuchatel Asphalte Co. Ltd., against the company and the directors. The object of the action was to restrain the payment of a dividend proposed to be declared, because, as the plaintiff contended, proper provision had not been made for depreciation in respect of the wasting nature of the property. The assets of the company consisted chiefly of a concession to work at quarry, and other subsidiary rights taken over from previously existing companies, for which fully-paid shares in the respondent company had been allotted in payment. The accounts for the year ended 31st December, 1885, showed an excess of receipts over expenditure to the amount of £17,140 13s. 2d., out of which, after setting aside a sum of £1,000, in partial recoupment of a sum of £8,000 paid in 1878 for the renewal of the concession, it was recommended by the directors, and resolved by a majority of the shareholders, that a dividend on the preferred shares at the rate of 9s. per share should be paid.

The Court dismissed the appeal, refusing to grant an injunction to restrain the proposed dividend being paid.

Lord Justice Cotton, in the course of his judgment, said that in his opinion

> 'it was not necessary that the directors should set apart each year a sum to answer the supposed annual diminution of this property by reason of its wasting nature',

and that

> 'having regard to the nature and constitution of this mercantile company, he was not satisfied that a proper provision had not been made for depreciation by the establishment of a reserve fund, and considered that it would be wrong for the Court to interfere to prevent the payment of the proposed dividend'.

Lord Justice Lindley, in the course of his judgment, said :

> 'It has been very judiciously and properly left to the commercial world to settle how the accounts are to be kept. The Acts do not say what expenses are to be charged to Capital Account and what to Revenue Account. Such matters were left to the shareholders; they may or may not have a sinking fund or depreciation fund, the articles may or may not contain regulations on these matters; if they do, the regulations must be observed; if they do not, the shareholders can do as they like, so long as they do not misapply their capital. In this case one of the articles provides that the directors shall not be bound to reserve moneys for the renewal or replacing of any lease or of the company's interest in any property or concession.... But if a company is formed to acquire or work property of a wasting nature—*e.g.,* a mine, quarry, or patent—the capital expended in acquiring the property may be regarded as sunk and gone, and if the company retains assets sufficient to pay its debts, any excess of money obtained by working the property over the cost of working it may be divided among the shareholders; and this is true, although some portion of the property itself is sold, and in one sense the capital is thereby diminished. If it be said that such a course involves payment of dividends out of capital, the answer is that the Acts nowhere prohibit such a payment as is here supposed.... In the present case the articles say there need be no sinking fund; consequently, capital lost need not be replaced; nor, having regard to these articles, need any loss of capital by removal of bituminous earth appear in the Profit and Loss Account of the working of the company's property.'

Lord Justice Lopes, in his judgment, referred to the article providing that the directors should not be bound to reserve moneys for the renewal or replacing of any lease or of the company's interest in any property or concession and proceeded :

> 'Unless this article is *ultra vires* no question arises. Is the article *ultra vires*? I know of no obligation imposed by law or statute to create a reserve fund out of revenue to recoup the wasting nature of capital. Subject to any provision to the contrary contained in the articles, I believe the disposition of the revenue is entirely in the hands and under the control of the company.'

Bolton v. The Natal Land and Colonisation Company Limited (1891) (92 L.T. REP. 109)

This case was decided before Mr. Justice Romer in the Chancery Division on the 8th, 9th and 10th of December, 1891.

In 1882 the company in question, under peculiar circumstances, debited their Profit and Loss Account with £70,000 in writing off a certain bad debt, and *per contra*, credited the same Profit and Loss

Account with a sum of nearly £70,000 in respect of an increase in value attributed to their lands in South Africa above and beyond the cost price at which such lands previously stood in the books, the result being to make the profit and loss practically balance each other upon the year's accounts. The company having subsequently earned a working profit, declared a dividend thereout, in respect of the year 1885. Thereupon the plaintiff, in an action commenced in 1886 to restrain the payment of such dividend, contended that at the time the value of the lands was written up in 1882 they were valued, and now stood, at an amount considerably exceeding their true value, and that, before a profit could be deemed to have been made which would be properly available for the payment of a dividend, the lands in question must be written down to their true value, and the difference debited to Profit and Loss Account in the same way as the supposed increase had been credited to Profit and Loss Account for the year 1882.

It was held by Mr. Justice Romer that, assuming that a part of the capital had in fact been lost, and not subsequently made good, no sufficient ground was thereby afforded for restraining the payment of the dividend; that the fact of the company having written up the value of their land in 1882, and credited the increase to the profit of that year in the manner described, did not place them under any obligation to bring into account in every subsequent year the increase or decrease in the value of their lands; and that, having regard to the case of *Lee* v. *Neuchatel Asphalte Co. Ltd.*, it was not correct, in estimating the profits of a year, to take into account the increase or decrease in the value of the capital assets of the company.

Lubbock v. The British Bank of South America Limited (1892)

This case was decided before Mr. Justice Chitty, in the Chancery Division, on 1st April, 1892, when it was held that, if a company's articles of association so provide, a profit made on the sale of a part of the undertaking is available for dividend.

The case was a motion by the plaintiff on behalf of himself and all the other shareholders of the defendant company to restrain the company from acting upon or carrying into effect a resolution passed by the directors of the company placing a sum of £205,000 to the credit of the Profit and Loss Account, and from dealing with or distributing the same as if it were the income of the company. The £20,000 in question was a realised profit made by the company on the sale of a part of its undertaking to another concern. The action was a friendly one, both parties being desirous of obtaining the opinion of the Court.

It was held by Mr. Justice Chitty that the £205,000 was plainly profit on capital, and not part of the capital itself, for that sum was the surplus ascertained on the assets aside after the liabilities and capital were placed on one side of the account and the assets on the other. Under the articles of the company the directors were justified in carrying over the £205,000 to a Profit and Loss Account, and having appropriated to the reserve fund so much of the sum as they thought fit they could distribute the remainder as dividends after an ordinary meeting called in pursuance of the articles had passed the requisite resolution.

Verner v. The General and Commercial Investment Trust Limited (1894)

This case was decided in the Court of Appeal on the 7th April, 1894. The decision was to the effect that an injunction to restrain a company from paying a proposed dividend out of current profits, on the ground that the capital of the company is not intact, must be refused if the company is solvent and is acting within its articles.

The facts were these : Mr. William Henry Verner, on behalf of himself and all other stockholders of the defendant company, other than the directors, sought an injunction restraining the defendants from declaring and distributing any dividend in respect of the financial year terminating on 28th February, 1894. The company's share capital amounted to £600,000, all of which had been received in cash. It had also received £300,000 as a result of an issue of debenture stock to that amount. There had thus come to the hands of the company £900,000, which had been invested in various securities authorised by the memorandum of association. The present market value of such investments was only £654,776, showing a depreciation of over £240,000, of which it was contended £75,000 was hopelessly lost. Apart from this there was an excess of income over expenditure amounting to £23,000. The question for the Court was whether, there being a loss of capital to the amount of £75,000, and an excess of income over expenditure of £23,000, a dividend could lawfully be declared and paid.

Lord Justice Lindley delivered the judgment of himself and Lord Justice A.L. Smith. He said :

> 'The broad question raised by this appeal is whether a limited company which has lost part of its capital can lawfully declare or pay a dividend without first making good the capital which has been lost. I have no doubt it can—that is to say, there is no law which prevents it in all cases and under all circumstances. Such a proceeding may sometimes be very imprudent, but a proceeding may be perfectly legal and may yet be opposed to sound commercial principles. We, however, have only to deal with the legality or illegality of what is complained of.... It is plain that there is nothing in the memorandum and articles which requires lost capital to be made good before dividends can be declared. On the contrary, they are so framed as to authorise the sinking of capital in the purchase of speculative stocks, funds and securities, and the payment of dividends out of whatever interests, dividends, or other income such stocks, funds, and securities yield, although some of them are hopelessly bad, and the capital sunk in obtaining them is lost beyond recovery. There is no suggestion of any improper juggling with the accounts, and there is no payment of dividend out of capital. There is no insolvency, and we have not to deal with a petition to wind up. Some capital is lost, but that is all that can be truly said, and that is not enough to justify such an injunction as is sought. The appeal is dismissed.'

Wilmer v. M'namara & Company Limited (1895)

This case was decided before Mr. Justice Stirling, in the Chancery Division, on the 26th April, 1895.

This was a motion on behalf of the ordinary shareholders of the defendant company asking for an injunction to restrain the directors from acting upon a resolution passed at a general meeting of the company that a sum of £5,816 12s. 6d. should be applied in payment of a dividend to the preference shareholders, and also from declaring and paying any dividend for the year ending 30th June, 1894. The real object of the action, which was a friendly one, was to ascertain whether or not the dividend in question could be lawfully paid, in view of the fact that a valuation made of the company's assets showed a figure very much below the amount at which the assets stood in the books. The company's business was that of general carriers of mails, parcels, goods, & c., and the assets consisted of goodwill, leasehold premises, horses, vans, plant, &c.

Mr. Justice Stirling, in the course of his judgment, said :

'It is necessary to consider whether the depreciation in goodwill and leaseholds is to be treated as loss of "fixed" capital or of "floating" of "circulating" capital, and on this point I am of opinion that it is to be treated as loss of "fixed" capital... I think that the Balance Sheet cannot be impeached simply because it does not charge anything against revenue in respect of goodwill. I feel much more doubt whether

£200 is a sufficient sum to allow in respect of depreciation of leaseholds, but I do not think under the circumstances that a case has been made out for an injunction, and the motion must be refused.'

In re the London and General Bank Ltd. (1895)

The first case brought under the misfeasance provision was *in re London and General Bank Ltd.* [1895]. The Court of Appeal had already decided in an earlier hearing of the summons in connection with this liquidation that the Auditor of a banking company was an officer within the meaning of the provision and therefore subject to misfeasance proceedings. The company was registered under the Companies Act, 1879, which provided for the compulsory audit of the accounts of banking companies, although an audit was not then required by statute in respect of companies carrying on other types of business.

The misfeasance alleged was the Auditor's neglect to bring to the notice of the shareholders the fact that the assets shown in the Balance Sheets of the company were over-valued, as a result of which dividends had been paid out of capital.

In the course of his judgment Lindley, L.J., said :—

> "It is no part of an Auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An Auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably' or unprofitably; it is nothing to him whether the dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. 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 such 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 of the company themselves show the company's true position. He must take reasonable care to ascertain that they do. Unless he does this, his duty will be worse than a farce....
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> "His first duty is to examine the books, not merely for the purpose of ascertaining what they do show but also for the purpose of satisfying himself that they show the true financial position of the company. An Auditor, however, is not bound to do more than exercise reasonable care and skill in making enquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position on the company's affairs; he does not guarantee that his balance sheet is accurate according to the books of the company. If he did, he would be responsible for an error on his part, even if he were himself deceived, without any want of reasonable care on his part—say by the fraudulent concealment of a book from him. His obligation is not so onerous as this.
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> "Such I take to be the duty of the Auditor; he must be honest—that is, 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 is any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion, very little enquiry will be reasonable and quite sufficient; and in practice, I believe business men selected a few cases haphazard, see that they are right, and assume that others like them are correct also. When 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 ....

> "A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them, or some of them, to ask for more. Information and means of information are by no means equivalent terms.... an Auditor who gives shareholders means of information, instead of information, in respect of a company's financial position, does so at his peril, and runs the very serious risk of being held, judicially, to have failed to discharge his duty.
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> "In this case I have no hesitation in saying that Mr. Theobald did fail to discharge his duty to the shareholders, in certifying and laying before them the balance sheet of February, 1892, without any reference to the report which he laid before the directors, and with no other warning than is conveyed by the words, 'The value of the assets as shown on the balance sheet is dependent upon realisation.' The most important asset on the balance sheet is put down as 'Loans to Customers and other Securities £346,975,' and on these a full and detailed report was made to the directors showing the very unsatisfactory state of these loans and securities.... It is a mere truism to say that the value of loans and securities depends upon their realisation. We are told that a statement to that effect is so unusual that the mere presence of those words is enough to excite suspicion. But, as already stated, the duty of an Auditor is to convey information, not to arouse enquiry, and although an Auditor might infer from an unusual statement that something was seriously wrong, if by no means follows that ordinary people would have their suspicions aroused by a similar statement if, as in this case, its language expenses no more than any ordinary person would infer without it."

The following remarks are from the judgment of Rigby, J.L.:—

> "The Articles of Association cannot absolve the Auditors from any obligation imposed on them by statute....
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> "The words 'as shown by the books of the company' seem to me to be introduced to relieve the Auditors from any responsibility as to affairs of the company kept out of the books and concealed from them, but not to confine it to a mere statement of the correspondence of the Balance Sheet with the entries in the books. Now, a full and fair Balance Sheet must be such as to convey a truthful statement as to the company's position. It must not conceal any known cause of weakness in the financial position, or suggest anything which cannot be supported as fairly correct in a business point of view.
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> "It was the duty of the Auditors to convey in direct and express terms to the members any information which they thought proper to be communicated.... It is no part of the Auditors' duty to consider what is good or what is bad policy. They have only to examine into facts and see that the members have their opinion as to the Balance Sheet showing the state of the affairs of the company. The Balance Sheet, as it stands, would have given no hint to any ordinary reader of the critical position. In reporting this Balance Sheet without explanation, the Auditors were, in my judgment, guilty of a misfeasance."

The Auditor was ordered to pay in to the company's funds the amount of one of the dividends wrongfully paid, together with interest.

[The words "full and fair Balance Sheet" constituted part of the formula of the normal audit report prior to 1900, the words being used in the clause of Table A stating the duties of the Auditor, when one was appointed under the Articles.]

In re the Kingston Cotton Mill Co. Ltd. (1896)

In the *Kingston Cotton Mill* [1896] case, dividends had been actually paid out of capital on the faith of Balance Sheets which showed available profits by reason of the over-valuation of the stocks on hand. The manager of the company had for several years fraudulently bolstered up the Balance Sheets to make the company appear flourishing instead of the reverse. The Auditors took the value of the stock-in-trade at the end of each year from the Stock Journal which contained a number of accounts and a summary of all the accounts showing the total value; the summary was signed by the manager, and the value was adopted by the Auditors and entered in the Balance Sheet with the note "as per manager's certificate." The summary always corresponded with the accounts summarised and the Auditors checked this, without however examining further into the accuracy of the accounts summarised.

In an earlier summons in the case of this company the Court of Appeal had held that the Auditor was an officer, notwithstanding that an audit was not compulsory by statute; the audit was prescribed by the Articles, but it was considered that no distinction arose between the case of the company and that of the *London and General Bank*.]

During the course of his judgment Lindley, L.J., said :—

> "I protest against the notion that the Auditor is bound to be suspicious, as distinguished from being reasonably careful. To substitute the one expression for the other may lead to serious error.... The Auditors did not profess to guarantee the correctness of this item [the stock]. They assumed no responsibility for it. They took the item from the manager, and the entry in the Balance Sheet showed that they did so. I confess I cannot see that their omission to check his returns was a breach of their duty to the company. It is no part of the Auditor's duty to take stock. No one contends that it is. He must rely on other people for details of the stock-in-trade in hand. In the case of a cotton mill he must rely on some skilled person for the materials necessary to enable him to enter the stock-in-trade at its proper value in the Balance Sheet....
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> "The question is whether, no suspicion of anything wrong being entertained, there was a want of reasonable care on the part of the Auditors in relying on the returns made by a competent and trusted expert relating to matters on which information from such person was essential. I cannot think that there was."

From the judgment of Lopes, L.J :—

> "It is the duty of an Auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably competent, careful and cautious Auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of each case. An Auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom, but in the absence of anything of that kind, he is only bound to be reasonably cautious and careful.... 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."

The famous metaphor of Lopes, L.J., as to the duty of the Auditor that "He is a watch-dog, but not a bloodhound," has been criticised and expanded from time to time in the judgments of various Courts. Thus in the Canadian case, *International Laboratories Ltd.* v. *Dewar and Others* [1932], it was said :—

> "As I understand it, the useful work of a watch-dog is based on the fact that he is expected, particularly if he be in the dark, to raise an alarm whenever he sees or hears anything unusual, and, if a possible marauder appears to be approaching, to continue his combined protests and threats with two objects in view : (1) that the cause of the fancied threat may be withdrawn; and (2) that his master may be aroused to his danger; and only when one of these objects has been accomplished will he be considered to have discharged the duties of the position which he assumed. He will not have performed the functions of his office if after one howl he retreats 'under the barn', or if he confines his protest to a fellow watchdog."

In re City Equitable Fire Insurance Co. Ltd. (1926)

In this case [1924], charges were made against the Auditors of the company of negligence in respect of the audit by them of the accounts of the company for certain years. It was sought to make them liable to pay to the liquidator compensation for the loss sustained by reason of the alleged negligence.

The charges came under the three following heads :—

(*i*) Their misdescriptions in the Balance Sheets of the debts of Ellis & Co. and Mansell, by including them under "Loans at call or short notice" or "Loans" or in the case of part of Ellis & Co.'s debt, under the heading of "Cash at bank and in hand," and their consequent failure to disclose to the shareholders the existence of those debts.

[Mansell was the general manager of the company and Ellis &Co. were the company's stockbrokers. G.L. Bevan was the chairman and driving force of the company and was also the principal partner in Ellis & Co. He was convicted of fraud in relation to the company's balance sheets and sentenced to penal servitude.]

(*ii*) Their failure to detect the fact that much larger sums were in the hands of Ellis & Co. at the date of each of the balance sheets than were so included. Just before the end of each of the years in question large blocks of Treasury Bills were purchased and as much as possible borrowed against them; immediately after each year-end the securities were sold and the loan paid off.

(*iii*) Their failure to detect and report to the shareholders the fact that a number of the company's securities, which were in the custody of Ellis & Co., were being pledged by that firm to its customers.

In the Chancery Division the Auditor was considered to have been guilty of misfeasance only under the third head above but was able to claim protection under an immunity clause in the Articles. [Such clauses are now void under section 205, Companies Act, 1948.] The Court of Appeal entirely approved the findings as regards the first two points, but there was some doubt expressed by two members of the Court as to whether there had actually been negligence in relation to the securities; but as it was definitely decided that the Auditor was in any case immune under the Articles the matter was not further discussed.

As to the misdescriptions, the general conclusions were that "even if the misdescriptions did amount to negligence, it caused no damage to the company."

As to the "window-dressing" the view was that if the Auditor's duty had been confined to the Treasury Bills Account the suggestion that he should have detected the arrangement would be understandable;

but considering the magnitude of the task each year the suggestion of negligence could not be maintained.

In regard to the securities the Auditor had obtained certificates from the stockbrokers as to the securities held by them. As to this it was said in the Chancery Division judgment :—

> "An Auditor is not in my judgment ever justified in omitting to make personal inspection of securities that are in the custody of a person or company with whom it is not proper that they should be left. Whenever such personal inspection is practicable, and whenever an Auditor discovers that securities of the company are not in proper custody, it is his duty to require that the matter he put right at once, or, if his requirement be not complied with, to report the fact to the shareholders, and this whether he can or cannot make a personal inspection. The securities retained in the hands of Ellis & Co. for periods long beyond the few hours in which securities must necessarily be from time to time in the possession of the company's stockbrokers were not in proper custody. That Ellis & Co. were at all material times regard, and reasonably regarded, by Mr. Lepine [the Auditor] as a firm of the higher integrity and financial standing is not to the point. A company's brokers are not the proper people to have the custody of its securities, however respectable and responsible those brokers may be. There are, of course, occasions when, for short periods, securities must of necessity be left with the brokers, but the moment the necessity ceases, the securities should be lodged in the company's strong room or with its bank, or placed in other proper and usual safe keeping. In my judgment, not only did Mr. Lepine commit a breach of his duty in accepting, as he did from time to time, the certificate of Ellis & Co. that they held large blocks of the company's securities, but he also committed a breach of his duty in not either insisting upon those securities being put in proper custody or in reporting the matter to the shareholders."

In the Court of Appeal this view was not entirely accepted as may be seen in the following passages from the judgments :—

> "What I think the witnesses meant to express was this : Banks in ordinary course do hold certificates of securities for their customers; it is part of their business, and therefore certificates in the hands of bankers are in their proper custody, and if then the bank is a reputable bank, a bank which holds a high position, you may legitimately accept the certificate of that bank.... But the fact that it calls itself a bank does not seem to me to conclude the matter either one way or the other.... It is going too far to say that under no circumstances may you be satisfied with securities in the hands of a stockbroker, because... in the ordinary course of business you must from time to time, and you legitimately may, place in the hands of stockbrokers securities for the purpose of their dealing with them in the course of their business.... I think he [an Auditor] must take a certificate from a person who is in the habit of dealing with and holding securities, and who he on reasonable grounds rightly believes to be, in the exercise of the best judgment, a trustworthy person to give such a certificate."

The duty of an Auditor was described by Lord Justice Sargant as "verification and not detection," and by Lord Justice Warrington in the following words :—

> "The duty of an Auditor is to verify the facts which it is proposed to state in the Balance Sheet and to verify them using ordinary and reasonable care and skill."

In re Westminster Road Construction and Engineering Co. Ltd. (1932)

This case [decided 1932] was concerned largely with the matter of work-in-progress as disclosed on the Balance Sheet, as a result of the over-valuation of which item, and the understatement of the liabilities, a dividend was paid out of capital and commission on profits was paid to a director.

On behalf of the Auditor it was put forward *inter alia* that his duty was to be performed by an examination of the books, and he was not responsible for liabilities or other matters not in the books and not reasonably brought to his notice; that he was entitled to rely on information and explanations from a responsible official if there were no reason to doubt their accuracy and that he was not bound to take any further step to verify this matter even though known means of doing so existed; and that it was not his duty to go through the minutes, letter books, or files (which would have disclosed information as to the inflation and omissions), to see whether there might be evidence of liabilities or other material matters not disclosed in the books.

It was decided that the Auditor had failed in his statutory duty; his duty with regard to unrecorded liabilities must depend on the facts of each particular case, the nature of the business, and the practice of the suppliers of the company as regards sending out invoices. It was the Auditor's duty to make specific inquiries as to the existence of liabilities for which invoices might not have been received, and to go through the invoice files to see that none were omitted. It was also the Auditor's duty to see that nothing was included in work- in-progress which had actually been done after the date of the accounts. The liquidator of the company was entitled to recover the amount improperly paid away, together with interest and costs.

In re Allen Craig & Co. (London) Ltd. (1934)

This case raised an attempt to extend the duties of Auditors under section 134(1), Companies Act, 1929. The liquidator of the company took out a summons for misfeasance against the former managing director and the Auditors asking for a declaration that such parties were liable for the debts of the company incurred after 30th June, 1925. The Court held that the director was liable for the debts incurred after 1st November, 1929 (when section 275, Companies Act, 1929, as to fraudulent trading came into operation), but discharged the Auditors.

The company (capital £10,000) made a loss in each year of its existence, and there was as deficiency of assets to meet liabilities of over £40,000. In submitting the accounts for the year to 30th June, 1924, the Auditors sent a letter to the company drawing attention to the serious position of the company, this being quite apart from the normal audit report. In 1927 in submitting the accounts for the years to 30th June, 1925 and 1926 respectively, the Auditors sent further letters, showing that there was a deficiency as regards creditors of nearly £11,000.

The following passages from the judgment are of interest:—

> "Whether these letters [referred to above] were, or were not, received at the time it was plain beyond dispute that they were in the hands of Mr. Allen by 20th December, 1929.
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> "No other conclusion was possible than that Mr. Allen was liable under section 275 of the Companies Act in respect of debts incurred.... No complaint was made of the skill with which they [the Auditors] audited the accounts. If they were liable under the Companies Act it was merely because they did not know of the obligations imposed upon them by the Act. Before it could be held that a man was guilty of breach of duty it must be possible to define the duty.... The important section was 134 of the Companies Act of 1929 which provided that 'every Auditor shall

make a report to the members on the accounts examined by them'.... In respect to these two balance sheets [1925 and 1926], what was the duty of the Auditors? All the Auditors did with them was to send them to the secretary of the company. They never got beyond the secretary of the company. The directors never caused a general meeting of the company to be held for the purpose of considering these two balance sheets and the reports annexed thereto.... The members of the company never saw the reports of the Auditors on these balance sheets.

"Did the statute impose on Auditors the duty of making their report to every member of the company? It the words of section 134(*1*) was given their plain meaning it would seem that that obligation was imposed. It could not have been the intention of the Legislature to impose that duty on Auditors and it certainly never had been the practice... Mr. Christie.... said 'members of the company' meant all members of the company, but that these were represented by members present in general meeting. Therefore, if the report were presented at the general meeting the duty was complied with. If, on the other hand, there was no general meeting called by the directors, then Mr. Christie argued that members of the company meant all the members, because the section did not say the words meant less.... The words must have some one meaning throughout. The meaning of them could not be changed according to whether or not the directors chose to call a general meeting. If would not be possible to hold that members in section 134(*1*) meant all the members, because it could not be that Auditors were to be at the expense and trouble not merely of sending their reports through the post, but of delivering them to every member of the company. If the duty were absolute, sending copies through the post might not be sufficient. Therefore, circumstances made it necessary to limit the meaning of the word members as found in the section. The limitation that ought to be placed upon them was 'members assembled in general meeting.'

"The next thing was to decide whether the Auditors were under some duty that it might be impossible for them to perform. It could not be right to say that. If the duty were to report to members in general meeting, it was not possible to say that it was the duty of Auditors to make that report themselves—unless they could themselves call a general meeting or compel somebody else to call a general meeting. There were no means by which Auditors could themselves convene a general meeting. Nor were there means by which they could compel others to do so.... All these considerations forced one to the conclusion that the duty of Auditors, having affixed their signature to the report attached or annexed to the balance sheet, was confined to sending that report to the secretary of the company, leaving the secretary or the directors to perform the statutory duty of convening a general meeting to consider the report. It was the duty of directors to see that the Auditor's report was read at such meeting.

".... The statute compelled directors to convene a meeting of shareholders once a year. It compelled the directors to present reports to the general meeting of shareholders. It compelled the directors to have the Auditors' reports read to the meetings. If the shareholders had not the will or the determination to exercise their rights that did not seem to be any reason for enlarging the duties of Auditors."

In re S.P. Catterson and Sons, Ltd. (1937)

No broad principal arose in *re S.P. Catterson and Sons, Ltd.* [1937], but the case is of interest in that the judgment contains some important observations on the responsibility of the directors. A further point is that whilst the defalcations on which the summons was based related to the years 1929 to 1932

and were discovered in the latter year, no action was suggested against the Auditor until after the company had been in liquidation for a year; in fact, after the discovery the Auditor was twice re-appointed, so that it is evident that the directors and/or shareholders had not considered the Auditor to have been negligent.

The misfeasance alleged against the Auditor was negligence in failing to discover misappropriations by a show-room employee of the company of moneys received in respect of cash sales.

> ". . . . the primary responsibility for the accounts of a company is with those who are in control of the company, that is to say, the directors. . . . It is their duty in the first place to keep the company's accounts, and to prepare the accounts which have to be submitted to the company in general meeting. . . . It is for the directors to manage the business in the way in which they think best in all the circumstances of the case, including in the management of the business the system of accounting to be employed."
>
> ". . . . once a fraud has been discovered it is extraordinarily easy to see indications of its sticking out everywhere. . . indications which are not always apparent, or not necessarily apparent, to a man who is dealing with another on the footing that that other is not a dishonest man. . . ."

The learned judge then proceeded to deal with the defects in the cash sales system, mixed up as it was with sales on short-term credit, which had made the defalcations possible, and that the "so-called system of keeping a record of the transactions done on credit by turning down the invoice was known to the directors and had been known to them for years."

> "What is charged against them [the Auditors] first of all is that they omitted to provide an efficient system of verifying the cash received. . . . in respect of sales from the company's showroom. . . . It is clear that [the Auditor] did want an alteration in the system which was employed. . . . and [the managing director] objected because either it was too expensive or it was too cumbersome. . . . The unsatisfactory system employed was present to the mind of [the accountant] and . . . it was called by him to the notice of the directors. . . they preferred to continue the system as it was. I am not prepared to hold, in those circumstances and on those facts, that there was any duty upon the Auditors to insist upon that system being changed. It is not their business to tell the directors how to carry on and conduct their accounting system; they make their recommendations, and if they are not acceded to, the responsibility is not the Auditor's responsibility, but it is the responsibility of the directors."

"The primary responsibility for finding out the defalcation. . . lies upon the shoulders of the man whose duty it was, as a director of the company, to collect from [the person responsible for the defalcations] the cash that he received;. . . it is those people who have failed to discharge the duty they owed to the company, and not the Auditors".

Newton v. Birmingham Small Arms Co. Ltd. (1906)

The case of *Newton* v. *Birmingham Small Arms Co. Ltd.* [1906] mainly concerned a proposal to restrict the statutory powers of the Auditors of the company by an amendment of the Articles, but incidentally to this the subject of secret reserves and their propriety was dealt with at length.

The company by special resolution amended its Articles by introducing provisions as to an internal reserve fund; it was provided that the directors should disclose all the facts as to this reserve fund to the Auditors, who were not, however, to be permitted to disclose any information in regard to it to the shareholders. It was held that the Article was *ultra vires* to the extent that it restricted the powers of the

Auditor, since such restriction was contrary to the Companies Act provisions as to Auditors. In the course of the judgment it was said:—

> "The concluding sentence . . . requires that the Auditor shall state whether the Balance Sheet exhibits a true and correct view of the state of the company's affairs as shown by the books. [It was] argued that these words are satisfied if the Auditors report that the Balance Sheet does not exhibit a true view and that the statute does not, in these words, say that they shall report what is the true view. . . .But . . . words earlier in that section . . . provide that the Auditors are to report to the shareholders on the accounts. A report upon the accounts involves a report of the result of the accounts. . . . the statement of a Balance Sheet or the equivalent of a Balance Sheet . . . to the accuracy of which the Auditors shall speak. The special resolutions in the present case provide that the Balance Sheet shall not disclose the internal reserve fund. It must therefore omit. . . the assets which make up . . . the fund and the *contra* item . . . on the liability side. The result will be to show the financial position of the company to be not so good as in fact it is. If the Balance Sheet be so worded as to show that there is an undisclosed asset, the existence of which makes the financial position better than shown, such a Balance Sheet will not, in my judgment, be necessarily inconsistent with the Act of Parliament.
>
> "Assets are often, by reason of prudence, estimated, and stated to be estimated, at less than their probably real value. The purpose of the Balance Sheet is primarily to show that the financial position of the company is at least as good as there stated, not to show that it is not, or may not be, better. The provision as to not disclosing the internal reserve fund in the Balance Sheet is not, I think, necessarily fatal to the special resolutions. . . . But the special resolution do not stop there. They provide that it shall be the duty of the Auditor not to disclose any information with regard to this fund to the shareholders or otherwise. It is, I think, inconsistent with the Act of Parliament that the Auditor shall be bound, even when he thinks that the true state of the company's affairs is affected by facts relating to the internal reserve fund, to withhold all information with regard to the same from the shareholders. If, for instance, the directors had invested the internal reserve fund upon investments which might involve the company under certain circumstances in enormous loss, the Act, I think, requires that the Auditor shall be at liberty and be bound to report that fact. In reporting upon the accounts submitted to them the Auditors do not, of course, report as to the details of the accounts to which they find no cause to take exception. Their duty is to call attention to that which is wrong, not to condescend upon all the details of that which is right. It is, I think, competent to the statutory majority of the shareholders to say that as to particular items of their business, it is to the interest of the corporation that there shall be secrecy and that the Auditors, who must for the purpose of their audit know all such details, shall not, unless their duty under the statute requires it, disclose such details to the members. There is no suggestion in this case that these clauses are intended to be used for any other than a legitimate purpose. Those who are engaged in commerce are familiar with the fact that undue publicity as regards the details of their trade or as to the financial arrangements, may often be injurious to traders, having regard to the rivalry of competitors in trade, to complications sometimes arising from strained relations between capital and labour, and the like. There are legitimate reasons for ensuring secrecy to a proper extent. It is not, I think, necessary, nor, having regard to the great utility of these Acts, is it desirable, to expose persons who trade under these Acts to the necessity of a publicity from which their competitors are free, unless such publicity is required to ensure commercial integrity. I am not disposed to look too closely for reasons why I should find clauses such as these to be inconsistent with the Act if I see that the true purpose of the Act is satisfied. I think, however, these special resolutions go too far. Any regulations which preclude the Auditors from availing themselves of all the information to which,

> under the Act, they are entitled as material for the report, which, under the Act, they are to make as to the true and correct state of the company's affairs, are, I think, inconsistent with the Act."

The validity of the observations in this case as to the propriety of the *maintenance* of secret reserves does not appear to have been affected in any way by the judgment in *Rex* v. *Kylsant and Another* [1931], which in respect of this matter dealt with the non-disclosure of the *protracted utilisation* of such reserves.

Spackman v. Evans

The case of *Spackman* v. *Evans* [1868] primarily concerned the placing of the names of shareholders on to the list of contributories on a liquidation, but the position of the auditors was also discussed in the judgments in the House of Lords. The following are relevant observations :—

> "It was said that all the facts must have been known to the Auditors, and that they being appointed by the shareholders must be treated as their agents. The Auditors may be the agents of the shareholders so far as relates to the audit of the accounts. For the purpose of the audit the Auditors will bind the shareholders and. . . it may be said that any special matter contained in their report as to the state of the accounts and the assets of the company must be considered as having come to the knowledge of every shareholder.
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> ". . . the two Auditors (after the first two) are to be appointed by the shareholders at an annual general meeting. It seems to me that it would be an unreasonable conclusion, from this mode of appointment of these officers, that they were thereby constituted agents so as to conclude the shareholders by their knowledge of any unauthorised acts of the directors. It would be no part of their office to inquire into the validity of any transaction appearing in the accounts of the company."

London Oil Storage Company Limited v. Seear Hasluck and Company

Action against Auditor—Shortage in steadily increasing cash balance not discovered—Omission to verify the assets 'cash-in-hand'—Breach of duty of Auditor—Nominal damages.

This case was decided before the Lord Chief Justice and a special jury, in the King's Bench Division, on the 1st June, 1904.

It was held to be the duty of the auditor of a company to take proper steps to verify the existence of assets stated in the Balance Sheet.

The case consisted of an action for damages for alleged negligence in auditing the plaintiff company's accounts. The defendants denied that they had been guilty of negligence, and said that the alleged loss of £760 had been caused by negligence on the part of the directors of the plaintiff company in entrusting so much money to their cashier.

The defendant had been the auditor of the company from the first, and it was his duty under the articles to audit the accounts and 'to certify the correctness of the financial statement' for the purpose of the yearly Balance Sheet, in which there appeared a sum representing cash-in-hand, and it was in reference to that sum that the plaintiffs alleged that Mr. Hasluck, through his clerks, had been guilty of negligence. One of the officials of the company had been a Mr. Frederick R. Clarke, who had been taken over from Mrs. Ingall when the company was formed, and who had at first been book-keeper and

cashier, but was later also appointed secretary at the city office. At that office a Petty Cash Book was kept, in which the cash balance appeared, and Mr. Hasluck's clerks entered in the Balance Sheet the amount of petty cash that appeared in the Petty Cash Book, but they never troubled to find out whether Mr. Clarke had that balance in hand or not. Till 1902 nothing was suspected, but Mr. Clarke was then seized with a paralytic stroke and had ever since been in a pitiable state, and could not be called as a witness. His duties were taken over by Mr. Hubble, who found in the cash box about £30, though the Petty Cash Book showed a balance of £796, the balance having gradually increased from £21 in 1897 to £796 in 1902.

The jury returned a verdict to the effect that there was a breach of duty in 1899, 1900, 1901, and 1902, and that there was damage to the extent of £5 5s. The jury added that they considered that the directors had been guilty of gross negligence.

In the course of his judgment, the Lord Chief Justice said :

> '. . . I would call attention to the fact that the jury have, I think rightly, limited their finding to the years 1899, 1900, 1901, 1902, when the asset was a substantial sum of money not less than £470 in the first year . . . . I am bound to say that I think that there was a very grave and substantial question to be fought and tried, which the jury have answered, in my opinion, absolutely rightly, that there was not a sufficient fulfillment of his duty in ascertaining whether that asset really existed. I particularly desire to avoid using the words "counting the cash". I do not think that is a true statement of the duty of an auditor, although it is one way of putting it. Anything may be "counting cash", if you ascertain it is there; but, as I tried to point out to the jury, there may be cases in which the actual counting of the sovereigns is not even the best way of vouching or ascertaining the amount. Therefore I think the jury did take the view properly that there was not a proper discharge of his duty by his clerk—nothing morally wrong in the least, but not a sufficiently careful supervision by Mr. Hasluck's clerk of the asset which was believed to exist, and which was shown by the books to exist, because that the audit was most carefully performed I have not a shadow of doubt apart from this. I think there was a substantial issue properly raised by the plaintiff and properly defended by Mr. Hasluck, if he determined to fight the battle on the ground on which he did fight it, that there was no duty on an auditor to ascertain the existence of an asset, assuming the books showed that asset ought to have been in existence. Therefore, I think a substantial question had to be tired, and that entirely makes it impossible for me to say that there was not an issue before the jury as to breach of duty, and, if it were a breach of duty, at any rate there must be nominal damages.'

Armitage v. Brewer and Knott (1932)

Detailed Audit contracted for—Defalcations in petty cash transactions and time-sheets not detected in Audit—Auditors held negligent.

Decided by Mr. Justice Talbot in the King's Bench Division on 15th December, 1932.

This was an action by Mr. Joseph Armitage, an architectural designer and sculptor, against Messrs. Brewer and Knott, a firm of chartered accountants, for alleged negligence in auditing as a result of which defalcations of over £1,400 were not detected.

A lady employed by the plaintiff (Miss Harwood) was prosecuted in December, 1931, pleaded guilty and was sentenced to 15 months' imprisonment. Miss Harwood became secretary, book-keeper and cashier to Mr. Armitage in April, 1929, and he then ascertained to his surprise that the defendants had only

been balancing the books and getting out the accounts for income-tax purposes, but had not been auditing. A periodic audit with a master audit at the end of the year was then arranged for at a fee of 50 guineas, and Mr. Armitage was willing to pay that fee to protect him against irregularities and loss.

The chief trouble was fraudulent time sheets which comprised most of the defalcations of £1,400. In addition, there were petty cash irregularities, caused by duplication of entries of some £60.

Mr. Justice Talbot, in the course of his judgment, pointed out that Mr. Armitage had to conduct his studies and a large business and he must have a way of escape from the distraction and annoyance of uneasiness as to whether his accounts were properly kept. The documents showed that the defendants would vouch all payments with receipts in petty cash, check calculation and additions of all wages sheets, check totals of wages sheets into wages book and check weekly totals with other detailed provisions, and accountants undertaking duties of that kind could not be heard to excuse themselves on the ground that this or that was a small matter; they undertook a rigorous check, and they did so because that was what their client wanted. He told them he wanted protection against petty frauds. The defendants knew uncontrolled powers were committed to the person in the office Miss Harwood filled. They did not refuse the audit because of a risk of employing one woman in that kind of position. What was required of them in the circumstances entailed more laborious work and more vigilance. They undertook that work and the reassurances Mr. Armitage frequently asked for, they gave. That was a sufficient account of the duty they undertook.

Had it been performed with the care they owed the plaintiff and which could be expected under their retainer from competent and upright professional people ? His lordship thought the answer was that it had not. However much it might be wrapped up, the defendants' case came to this, that systematic fraud for 2½ years by one person, could not be detected by the exercise of reasonable care of the accountants. His lordship did not like to use strong language, but that appeared to him to be bordering closely on nonsence. On the evidence it was an allegation which did not bear a moment's examination. It was doubtless true that to detect required minute examination of a large number of documents, but that was exactly what the defendants undertook to do. To examine only a sample of the time sheets his lordship thought contrary to the terms of the statement he had indicated. But the point was that to the vouchers they did examine, the defendants did not bring proper care. It was no use looking at documents unless one did it with scrupulous accuracy. The suggestion that something was the kind of thing a junior clerk would have passed was an unjust imputation on junior clerks. But if junior clerks could not do the work, they must be got rid of; auditors could not get rid of their responsibility by delegating it to junior clerks.

In the matter of the duplication in the petty cash of Cole's disbursements, there was no suggestion against Cole of dishonesty, but a very moderate amount of inquiry and care should have detected these double entries when they began. That a multitude of time sheets were fraudulent was admitted. His lordship was satisfied that if the defendants has done their duty before the time sheets came into the case, Miss Harwood would have gone and there would have been an end of her frauds. It was clear that a good many documents were suspicious on their face and called for inquiry. The defendants seemed to have been content to treat the time sheets as simply a matter in respect of workman and foreman—to guard against fraud there—but the time sheets turned out to be the largest part of the money frauds Miss Harwood committed.

His lordship entered judgment for the plaintiff for £1,250.

Rex v. Kylsant and Morland (1931)

Criminal proceedings were taken against the chairman and the auditor of the Royal Mail Steam Packet Co., Ltd., under the Larceny Act, 1861, the allegation being that the chairman had issued false annual reports to the shareholders *with intent to deceive,* and that the auditor had been guilty aiding and abetting in the issue of such false reports. Both the chairman and the auditor were acquitted of this charge, but the chairman, on a further charge, was found guilty of publishing a prospectus which he knew to be false in a material particular.

For some years the Royal Mail Co. had incurred actual trading losses, but their published accounts revealed considerable profits available for dividend. This position was largely brought about by the utilisation of taxation and other reserves created in past years and no longer required for the purposes for which they were made. These reserves were secret reserves, inasmuch as they were not disclosed in the accounts, and the only indication of the fact that such reserves were being transferred to the profits of the years in question were the words "after adjustment of taxation reserves" included in the omnibus item of income shown to the credit of the published Profit and Loss Account. It was shown that during the years 1921-1927 no less than £50,00,000 taken by the company to the credit of its Profit and Loss Accounts was the result of drawing upon secret reserves or taking credit for such non-recurring items as bonus shares received. It was alleged by the prosecution that the result of such adjustments was to cause shareholders to believe that the company was trading profitably, whereas in fact it was making losses.

In the course of his opening remarks the Attorney-General said that when an auditor signed accounts, and stated "to the best of my information this Balance Sheet is properly drawn up so as to exhibit a true and correct view of the company's affairs as shown by its books" he was stating something upon which the ordinary investor was entitled to rely.

The auditor was charged under section 84, Larceny Act, 1861, with aiding and abetting in the circulation of a written statement or account which he knew to be false in a material particular. In this connection, Wright, J said, in the course of his summing-up—

> "What exactly does that mean ? The conclusion I have arrived at is this — that it is not limited to a case where you point to a written statement or account and say, 'Here are certain figures and words which are false.' I think that is to narrow unduly the words 'in any material particular'. If it is true in that way it would shut out the type of fraud in connection with written documents and accounts which may be of the utmost importance—*the type of fraud where you have a document, not fraudulent in the sense of what is states, but in the sense of what it conceals or omits.*
>
> "I think the language which is used means more than that. It will cover the case where you have a written statement or account which is false in no specific words or figures which it contains, but which is false in the way in which it may be formed.
>
> *"You may say, referring to every word and every figure, there is nothing false about this or that, but the document as a whole may be false, not because of what it states, but because of what it does not state and because of what it implies.*
>
> "Of course, that type of falsity, which is indeed the type of falsity in question here, is more difficult to establish than a case where you can point to a specific false word in a sentence. Where the falsity consists in fraudulent design to create a false impression you have got to show affirmatively that there was a deliberate attempt to create a false impression.

> "If you have a definite falsehood then that speaks for itself."

Mr. Justice Wright pointed out that the section involved three things—a false written document, knowledge of the falsity by the person who put it forward, and intent to deceive.

Little was said at the trial about the Balance Sheet of the company, the main allegation being that the Profit and Loss Account contained information which was false in that it included "old" reserves without that fact being disclosed.

In his summing-up Wright, J.; made the following remarks in connection with secret reserves—

> "We have heard a great deal about the keeping of secret reserves, and we have heard a great deal about the commercial troubles which may flow from that practice. We have heard a great deal about what is often done in practice, and it may be reasonably and properly done, but the question may arise some day, and possibly will arise, in some appropriate proceeding, in order to find out and elucidate these very special matters. It was said by a learned judge on one occasion, by way of observation and not by judgment, that a company, that is to say the shareholders, could not complain if the position of the finances of the company was better than the accounts disclosed. That has been quoted from time to time as a justification for this method of keeping reserves secret. But there may be very great evils if those who have the control and management of companies, and who control and manage companies for the benefit of the shareholders who entrust their moneys to companies, have very large portions of the company's assets left in a secret disposition of the managing authority. It may work very well in many cases; to doubt it does. It is a practice which is being followed, no doubt, by many concerns of the highest standing. On the other hand, it may be the subject of almost intolerable abuse. Such a system may be used to cover up negligences, irregularities and almost breaches of faith. It is said to be a matter of domestic concern between the company and the shareholders, but if shareholders do not know and cannot know what the position is, how can they form any view about it at all?"

With regard to the use of the words "adjustment of taxation reserves" Mr. Justice Wright said—

> "Is this phrase sufficient ? Is it a proper intimation to the shareholder in the year 1926 of what has been going on in the company's affairs, in order to produce year by year, not only debenture interest and the interest, discounts and other things, but the preference dividend and the ordinary dividend?.....I am reminding you, although I am sure you have it in your minds, that it is my duty to remind you of what appears to me to be the first question you have to consider, granting all this, was it false and misleading in all the circumstances to put forward to all the shareholders in the Balance Sheet* merely these words 'adjustment of taxation reserves,' as a warning that these enormous sums were being drawn from these funds, the nature of which I must consider a little later ?"

In connection with the auditor's position in regard to secret reserves, the Judge said—

> "If the accounts from which the dividends were being paid or the expenses were being met were being fed by undisclosed reserves, it seems very difficult to see how an auditor could discharge his duty of giving a true and accurate view of the correct state of the company's affairs without drawing attention to those facts, which were vitally important.
>
> "No doubt an auditor in his important and delicate duties must use a certain amount of discretion, but whatever discretion he may feel, justified in exercising, he must remember he is under statutory duty, and he may come under the penalties of law, if he fails in *that* duty...

"The auditor is not concerned with questions of policy, but if he sees that there is something in the accounts to which he ought to draw the attention of the shareholders it is his duty to do so. Either he will not sign the certificate at all or he will sign it with some qualifications such as circumstances require.

"The question is not whether the two defendants or either of them have committed any breach of duty to the company, either as chairman or auditor. If a breach of duty has been committed in connection with the accounts, if there has been any negligence, anything for which he directors or auditor may be liable to the company, then that is a matter directly and entirely beyond your purview and consideration.

"You are not here dealing with questions of civil liability. For civil liability the appropriate remedy is an action for damages."