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THE PROSPECTS OF A SUCCESSFUL CLAIM AGAINST AUDITORS IN FRAUD

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In the vast majority of professional liability cases involving erroneous financial statements, auditors are accused of negligence for failing to detect and report on accounting inaccuracies. Except where the plaintiff is the audited company, the allegation is not that the auditors owe the plaintiff a duty of care to carry out the audit properly, but rather that they owe a duty to deliver an auditor's report that can be reasonably relied upon.1 The action lies in negligent misrepresentation.

In a series of decisions culminating in Hercules Managements Ltd. et al v. Ernst & Young et al (1997), 146 D.L.R. (4th) 577 (S.C.C.), the courts have barred many claims against auditors based on public policy concerns over indeterminate liability.

Actions in Canada against auditors for deceit, also called fraudulent misrepresentation, are extremely rare.2 No doubt given recent high profile cases in the United States3, coupled with the restricted availability of negligent misrepresentation actions in Canada, plaintiffs' counsel will increasingly turn their minds to the option of an action in deceit.

The purpose of this article is to consider in the circumstances in which auditors may be subject to liability in deceit when a claim of negligent misrepresentation may be unavailable. This involves considering:

(a) whether Hercules can have any application to cases in deceit;
(b) what will normally be required to establish the requisite fraudulent intent; and
(c) which classes of potential plaintiffs can make out such a claim.

These questions will be considered in turn.

(a) Can Hercules have any application to cases in deceit?

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[1] Kripps v. Touche Ross & Co. (1997) 33 B.C.L.R. (3d) 254 at 281-282; [1997] 6 W.W.R. 421 at 448 (para. 95)

[2] There have been over 200 reported decisions in which the 1997 landmark ruling in Hercules Management Ltd. v. Ernst and Young has been considered. With the exception of the (now settled) case of Mondor v. Fisherman et al, infra, there appears to be no indication in any of them of an allegation of fraud.

[3] In 2001, Arthur Andersen became the first major accounting firm in decades to face a civil fraud complaint filed by the U.S. Securities and Exchange Commission (SEC), in which Andersen were accused of knowingly issuing false and misleading audit reports, allowing Waste Management Corp. to inflate its earnings by more than US$1.7 billion for the years of 1993-1996. In June 2002, Andersen agreed to accept an SEC antifraud injunction, along with a censure and a $7 million fine in the Waste Management case. In May 2002, Andersen agreed to pay U.S. $110 million to settle litigation by the shareholders of Sunbeam Corp. without accepting or denying blame. It was alleged that Andersen had signed off on Sunbeam's financial statements even after one of its partners had uncovered transactions that the SEC says were fraudulent. Andersen are also defendants in civil fraud cases in connection with their audits of both Enron Corporation and the Baptist Foundation of Arizona. In the Enron case, investors accuse both Enron officials and Andersen of defrauding them by manipulating figures to conceal Enron's debts before the bankruptcy of Enron. On March 14, 2002, the U.S. Department of Justice filed obstruction of justice charges against Andersen for shredding thousands of documents related to failed Enron Corporation; on June 15, 2002, Andersen was found guilty of obstruction of justice.

The standard audit report

According to the Handbook currently in use by the Canadian Institute of Chartered Accountants (the "Handbook"), the standard form in use for an unqualified or "clean" auditor's report reads as follows:

> In our opinion, these financial statements present fairly the financial position of the Company as at [date] and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.4

Hence it is the auditor's unqualified report and not the attached financial statements which contains the potentially actionable representation.5

Provided that the alleged misrepresentation is material, it can relate to any line item of the financial statements or the notes thereto. Examples include improper inclusions in income6; failure to disclose receivables in default7; failure to disclose accrued income tax liabilities8; inadequate allowances for doubtful accounts9.

Scenarios giving rise to a claim in deceit

Claims against auditors will rarely fall within the scope of traditional deceit claims. In the majority of reported Canadian decisions on deceit, the allegations arise from precontractual representations. The representations, whether oral or written, are alleged to have been made for the express purpose of inducing the plaintiff to purchase a property or business or to take some other steps in reliance thereon.10

In the case of audit reports, however, it will be extremely rare that auditors are accused of preparing the report for the express purpose of inducing the plaintiff to extend credit, purchase securities or take other measures ordinarily undertaken in the marketplace in reliance on financial statements.

More commonly, the auditors will be accused of signing their audit report although they were aware of significant accounting irregularities which render the audited statements, and hence the audit report, materially misleading.

Two recent Canadian cases illustrate the kinds of claims which are anticipated to be raised against auditors in the future. Both cases were at the interlocutory stage and were subsequently settled out of court. In Mondor v. Fisherman et al11, Cummings J. of the Ontario Court of Justice declined to strike claims for damages against auditors Parente, Randolph, Orlando, Carey & Associates and Deloitte & Touche LLP based on allegedly erroneous audit reports of the financial statements of YBM Magnex International, Inc. While they did not expressly allege that the auditors had been intentionally dishonest or fraudulent, the plaintiffs asserted that :

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[4] Handbook of Canadian Institute of Chartered Accountants, Assurance, Volume 1, p. 5400.16
[5] Kripps, *supra*, paras. 94-95.
[6] Haig v. Bamford (1976) 72 D.L.R. (3d) 68 (S.C.C.). See also Dixon v. Deacon Morgan McEwen Easson et al (1989) 41 B.C.L.R. (2d) 82, 64 D.L.R. (4th) 441.
[7] Kripps, *supra*.
[8] Hongkong Bank of Canada v. Touche Ross & Co. [1987] B.C.J. No. 218
[9] Capital Community Credit Union Ltd. v BDO Dunwoody [2000] O.J. No. 65
[10] See, for example, Wandinger v. Lake (1977), 16 O.R. (2d) 362 (H.C.); System Contractors Ltd. v. 2349893 Manitoba Ltd. [1994] 4 W.W.R. 488 (Q.B.); and the cases referred to by Perell, supra, at pp. 28-9.
[11] [2001] O.J. No. 4620

> The defendants' conduct, when coupled with their immediate pecuniary interests, was such as to constitute knowledge in law or such as to be considered reckless or wilfully blind, thereby making them in law ... liable in damages for ... misrepresentation ... 12

They further alleged that the auditors' "Representation" that "YBM was a legitimate business with income only from legitimate activities" was made "recklessly, caring not whether it was true or false, intending that [the class] rely upon the Representation".13

In Sun Life Assurance Company of Canada et al v. Peat Marwick et al14 and related cases, Shaw J. of the Supreme Court of B.C. approved the amendment of two plaintiffs' pleadings to incorporate allegations that the defendants:

> ...fraudulently, or alternatively negligently and in breach of their duty of care owed to [the Plaintiff], performed the audits giving rise to their audit opinions for [the Company] for their fiscal years ended March 31, 1988, 1989, 1990 and 1991, and fraudulently, or alternatively negligently and in breach of their duty of care owed to [the Plaintiff], misrepresented the financial position of those companies by rendering and delivering audit opinions ... without qualification, ... when they either knew that the said audit opinions were materially false or misleading, could not have had an honest belief in the truth of the said opinions or were reckless or wilfully blind thereto, or alternatively were negligent with respect thereto, by reason of material inaccuracies ... as set out hereinafter. 15

Of the many alleged inaccuracies in the audited companies' financial statements, the plaintiffs singled out a certain number which, they said, the defendants knew to render their audit opinions materially misleading, or were reckless or wilfully blind thereto, namely:

* Including in income amounts which did not qualify as such under GAAP, having been generated at year-end by a series of artificial transactions;

* Improperly recording transfers of amounts from unearned income to income on account of "initial direct costs" and "BDR (Bad Debt Reserve) Offsets" which resulted in a material overstatement of income and assets in specified years, and a permanent material overstatement of equity;

* Materially misdescribing the companies' true accounting policies in the notes to the financial statements;

* Concealing the diversion of corporate assets to related parties;
* Concealing material breaches of margin and debt/equity covenants contained in the companies' lending agreements;

* Failing to report specified related party transactions;

* Concealing large write-downs in the value of specified assets.16

In SunLife, it was alleged that the defendants had committed these instances of deceit for the following motive, typical of allegations raised in recent high-profile U.S. cases17:

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[12] Mondor,supra, at para. 28.
[13] Ibid, at para. 38.
[14] S.C.B.C., Vancouver Registry, Nos. C983165, A981682 C983166 and C995103
[15] .. Ibid, Orders of Shaw J. dated February 20, 2001 in Action No. C995103, Schedule A, para.40; and in Action No. C983166, Schedule A, para 17.
[16] Ibid
[17] Supra, note 3

> ...they failed to maintain their independence as auditors by reason of the magnitude of their billings to [the Company] for services rendered to [its] Chairman ... personally, and to related persons and entities, and permitted the conduct of the audit to be influenced by the need to maintain those billings.18

Hercules and the spectre of indeterminate liability

The availability of an action to recover losses for an erroneous audit opinion was severely restricted by a series of decisions culminating in Hercules, supra. Those cases focused on the potential for indeterminate liability of auditors and, to avoid it, require plaintiffs to prove not only that they were within the reasonable contemplation of the defendant auditors, but further, that they used the financial statements for "precisely the purpose or transaction for which" the statements were prepared.19

La Forest J., writing for the court, summarized the policy consideration as follows:

> As Cardozo C.J. explained in Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y.C.A. 1931), at p. 444, the fundamental policy consideration that must be addressed in negligent misrepresentation actions centers around the possibility that the defendant might be exposed to "liability in an indeterminate amount for an indeterminate time to an indeterminate class".20

After considering arguments of commentators for and against circumscribing this prospective liability, La Forest J. noted at 594:

I ... agree with their assessment of the possible consequences to both auditors and the public generally if liability for negligently prepared audit reports were to go unchecked.

As noted below, the court ultimately concluded that the concerns over indeterminate liability would be best dealt with under the second branch of the Anns/Kamloops test21, namely as a policy consideration which may negative the scope of the duty of care, rather than in the establishment of a prima facie duty inherent in the first branch.

Application of Hercules to fraud claims

A key question for the courts to address is whether Hercules will have any application whatsoever to claims of fraud against auditors.

At first blush, it would appear that fraud would not be subject to the Hercules barrier.

In Hercules, La Forest J. applied the two-fold test from Anns v. Merton London Borough Council [1978] A.C. 728 (H.L.) and Kamloops (City) v. Nielsen [1984] 2 S.C.R. 2, 10 D.L.R. (4th) 641 to actions in negligent misrepresentation. That test was as follows:

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[18] See for example the Second Amended Statement of Claim of The Mutual Life Assurance Company of Canada filed April 8, 2001 in Action No.C983166, para. 17(p).
[19] Ibid, at D.L.R. 599
[20] Hercules, at 592 (D.L.R.)
[21] See infra. This is set out at p. 586-7 of La Forest J.'s judgment in Hercules.

> (1) Is there a sufficiently close relationship between the parties (the [defendant] and the person who has suffered the damage) so that, in the reasonable contemplation of the [defendant], carelessness on its part might cause damage to that person? If so,
>
> (2) Are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed or (c) the damages to which a breach of it may give rise?22
>
> The court's reasoning, as expressed by Laforest J., was that, for the purposes of establishing the duty of care, negligent misrepresentation cases should be treated in the same manner as negligence cases:
>
> I see no reason in principle why the same approach should not be taken in the present case. Indeed, to create a "pocket" of negligent misrepresentation cases (to use Professor Stapleton's term) in which the existence of a duty of care is determined differently from other negligence cases would, in my view be incorrect.23

The entire ensuing analysis by the court is expressed in the context of the "proximity" or "neighbourhood" concepts inherent in negligence cases.24 The court in Hercules recognized that in modern commercial reality, it will be relatively easy to establish a prima facie duty of care in most negligent misrepresentation cases against auditors. The main inquiry, as noted above, is on the second test, namely "whether that duty, if it exists, is negatived or limited by policy considerations".25 The primary policy consideration is the problem of indeterminate liability, and the court's judgment was formulated by weighing the "deterrence of negligent conduct" against "the socially undesirable consequences to which the imposition of indeterminate liability on auditors might lead."26

An action in deceit, however, is a distinct tort which has existed long before the tort of negligent misrepresentation was first recognized by the House of Lords in 196427. As noted by Paul Perell in his article, False Statements28, the result in Hedley Byrne & Co. v. Heller & Partners Ltd.29 "was not an enlargement of the tort of deceit, but rather was the recognition of another tort with its own criteria". The discussion in Spencer Bower, The Law of Actionable Misrepresentation30 is of similar effect.

This position is supported, with little analysis, by Cumming J. of the Ontario Superior Court of Justice in Mondor v. Fisherman et al, supra. After reviewing the application of Hercules and issues of reliance to the negligent misrepresentation allegations, Cumming J. expressed the following conclusion:

> The plaintiffs also allege that the defendants were reckless in their negligent misrepresentation, not caring whether it was true or false. That is, they did not care whether the "Representation" they made was true or false. While this is not a claim of fraud, it is an allegation that the defendants' Representation was tantamount to a fraudulent misrepresentation. Derry v. Peek (1889), 14 A.C. 337 (H.L.) at 374; Parna v. G & S Properties Ltd. (1971), 15

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[22] Kamloops, supra, at 10 (S.C.R.), restated in Hercules at p. 587 (D.L.R.)
[23] Hercules, at p. 587 (D.L.R.)
[24] Ibid, pp. 587-597 (D.L.R.)
[25] Ibid, p. 587
[26] Ibid., p. 594.
[27] Hedley Byrne & Co. v. Heller & Partners Ltd. [1964] A.C. 465 (H.L.)
[28] (1996) 18 Adv. Q. 232
[29] Ibid., note 27
[30] London, Butterworths, 1974. The editor of this edition does not link the torts of negligent and fraudulent misrepresentation, instead referring to the former, at p. 420, as a "new field of tortuous liability - liability for negligence consisting of saying something, at the suit of persons to whom the speaker (or writer) was not bound in contract, nor yet by any fiduciary relationship imposing on him a duty in respect of his utterance."

> D.L.R. (3d) 336 (S.C.C.) at 343-4. The concern as to indeterminate liability expressed in Hercules has no application to a claim of fraudulent misrepresentation.31

It is argued below that the Supreme Court's discussion of duty of care in Hercules may actually make fraud claims against auditors easier to establish than they were prior to this landmark decision.

Elements of fraud claim

Derry v. Peek (1889) 14 A.C. 337 (H.L.) remains the key early authority on fraud. Lord Herschell stated at p. 374:

> I think the authorities establish the following propositions. First, in order to sustain an action for deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.32

It is well settled that a false statement can amount to fraud not only if it is made (a) knowingly, but also (b) with wilful blindness, or (c) recklessly, careless whether it be true or false.33 The ultimate distinction between negligence and fraud is whether the defendant honestly believed what was said to be true.34

However, Lord Herchell's comments with regard to intention have not been followed in this country. It is clear that in Canada, an "intention to deceive" is a necessary element of any claim in deceit, as stated succinctly by Southin J.A. in BG. Checo International Ltd. v. British Columbia Hydro & Power Authority (1990) 4 C.C.L.T. (2d) 161 (B.C.C.A.) at 183 and 187:

> It is essential to a claim of fraud that the plaintiff prove a dishonest intention.
> In a claim of fraud ... [t]he first issue is whether the speaker or author or the person who authorized them, intended them to deceive. Did he use or cause them to be used dishonestly?
> ...
> [A] conscious intention to deceive, i.e. mens rea, is a necessary ingredient of the tort of deceit ...

This requirement, and its application by the Court of Appeal, were expressly approved on appeal to the Supreme Court of Canada.35

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[31] Ibid, at para. 70.
[32] Derry v Peek, at 374
[33] In addition to the famous words of Lord Herschell in Derry cited above, see De Vall v Gorman, Clancey & Grindley Ltd. (1919), 53 S.C.R. 259 at 265, Redican v Nesbitt [1924] S.C.R. 135 at 154, 157, Graham v. Saville, [1945] O.R. 301 (C.A.) at 309, Francis v. Dingman (1983), 43 O.R. (2d) 641 (C.A.)
[34] See in this regard the excellent discussion of Paul Perell, The Fraud Elements of Deceit and Fraudulent Misrepresentation, supra, at pp. 24-27.
[35] (1993), 99 D.L.R. (4th) 577 at 581. See, to the same effect, Rainbow Industrial Caterers Ltd. v Canadian National Railway (1988), 46 C.C.L.T. 112 (B.C.C.A.) at __, TWT Enterprises Ltd. v. Westgreen Developments (North) Ltd. [1992] 5 W.W.R. 341 (Alta. C.A.) at 348.

Establishing the "intention to deceive"

What is less clear is what must be proved for this mens rea to be made out. Must the defendant have actually intended to cause harm to the plaintiff (or to the specific class that the plaintiff forms part of); and under what circumstances will the intention to deceive be presumed?

As noted above, in even the boldest of fraud allegations, it is unlikely that the auditors will be accused of having actually made a false report with the desire to mislead investors, creditors or others. The accusation is normally that the auditors, in an effort to satisfy their client and to obtain future audit and other work from the client, have turned a blind eye to accounting inaccuracies which the auditors were aware did not "present fairly the financial position of the company" or comply with GAAP.

Numerous Canadian and U.K. authorities cite the defendant's intention that the plaintiff act on the representation as a necessary element of the tort.36 In Bradford Third Equitable Benefit Building Society v. Borders [1941] 2 All E.R. 205, the House of Lords went so far as to rule that the representation "must be made with the intention that it should be acted upon by the plaintiff, or by a class of persons which will include the plaintiff, in the manner which resulted in damage to him" 37. Graham v. Saville [1945] O.R. 301 (C.A.); Francis v. Dingman (1983), 43 O.R. (2d) 641 (C.A.) are to similar effect.

Halsbury's38 provides this guidance to proving intent:

> It follows from the meaning of fraudulent misrepresentation that, given absence of actual and honest belief by the representor in the truth of the misrepresentation, his motive in making the misrepresentation is wholly irrelevant ... provided there was an absence of actual and honest belief in the truth of his assertion, the misrepresentation is accounted fraudulent, and no proof of any wicked or other intention (other than an intention to induce) on the part of the representor is required by the law; or if it is necessary to establish an intention to deceive or injure, that intention is immediately and irrebuttably presumed in law from the mere act of making the misrepresentation without such belief.39

Spencer Bower, The Law of Actionable Misrepresentation40, similarly distinguishes between intent and motive:

> It is a sine qua non of fraud that the representor intend that the representee should act upon the representation in the way in which he did eventually act...
>
> Here it is sufficient to observe that although fraud necessarily involves an intention on the part of the representor that the representee shall act in the way in which he does eventually act, yet there is no necessity to prove any intention further or more remote than this - and certainly the motive of the representor is quite irrelevant. It is immaterial that the plaintiff may or may not be able to show, for instance, that the representation was made with the intention or motive of damaging the representee, or of benefiting himself, or a third person; or even that it is shown that his intention or motive was possibly even to benefit the representee, but that the scheme went awry. A

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[36] Graham v. Saville [1945] O.R. 301 (C.A.); Francis v. Dingman (1983), 43 O.R. (2d) 641 (C.A.); Bradford Third Equitable Benefit Building Society v. Borders [1941] 2 All E.R. 205 (H.L.)
[37] Bradford, supra, at 211.
[38] 31 Hals. (4th ed) para. 759.
[39] 31 Hals. (4th ed.), para. 759.
[40] Supra, note 30

> false representation made without honest belief in its truth will be fraudulent if made with intention that the representee act upon it, even if it be made without any demonstrable motive or intention whatever. 41

In considering the intention to deceive, it is essential to bear in mind the principle that the defendant will be presumed to intend the natural consequences of his or her actions. This principle was stated as follows by Lindley L.J. in Arnison v. Smith42:

> ... in considering whether there has been actual fraud reference must be had to the intention which the law imputes to every one to produce those consequences which are the natural result of his acts, and if a man uses language which taken in its natural sense conveys a wrong impression, he cannot be heard to say that he did not intend to deceive.

Similarly, in Smith v. Chadwick43, the Earl of Selbourne stated:

> I conceive that in an action of deceit ... it is the duty of the plaintiff to establish two things: first, actual fraud, which is to be judged of by the nature and character of the representations made, considered with reference to the object for which they were made, the knowledge or means of knowledge of the person making them, and the intention which the law justly imputes to every man to produce those consequences which are the natural result of his acts.

Who will qualify as a "representee"?

A further factor which the courts will consider in determining the existence of an intention to deceive is whether the plaintiff's conduct was within the reasonable contemplation of the representor at the time the representation was made. Halsbury's defines the potential plaintiff in the following terms:

> A representee in law includes (1) any person to whom the representation was physically and directly made, or any principal or partner of such person; (2) any specific person, not coming within the description under head (1) above, but whom the representor, either actually or in contemplation of law, intended the representation to reach and influence; and (3) any individual member of the public, or of a class, who has acted upon a representation addressed to the public or the class.44

The second class is further defined by Halsbury's in the following terms:

> A second class of case arises where one person makes a representation to another person, either with an express direction or authority to repeat it to a third person, or with intent that it shall come to the third party's notice and be acted upon by him. Such an intent is presumed in law on proof of the fact that the representor contemplated at the time that the person to whom the representation was made would pass it on to the third person for him to act upon, or subsequently, but before the third person acted upon it, knew that the person to whom it was made had in fact so passed it on to the third person for that purpose. In any such case the third person is a representee.45

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[41] Ibid, at 118-9.
[42] (1889), 41 Ch.D. 348 (C.A.) at 372
[43] (1884), 9 A.C. 187 (H.L.) at 190

[44] Halsbury's, supra, para. 735.
[45] Ibid, para. 737

In considering these classes of case, the Queen's Bench Division in Swift v. Winterbotham46 adopted the following observation of Pollock, C.B. in Bedford v. Bagshaw 29 L.J. Ex. 59:

> Generally a false and fraudulent statement must be made with a view to deceive the party who makes the complaint, or, at all events to deceive the class to whom he may be supposed to belong, although he may not be individually and particularly intended. There must always be evidence that the person charged with the false statement and the fraudulent conduct had in his contemplation the individual making the complaint, or at all events that the individual making the complaint must have been one of those whom he ought to have been aware he was injuring or might injure by what he was doing.
> ...
>
> In the present case it has been proved to be the usage amongst bankers to make inquiries of this kind on behalf of their customers, and we think, therefore, that when the [branch manager] wrote the letter ... he must necessarily be considered to have known and contemplated that it would or might be communicated to the customer of the Sheffield Bank (if any) on whose behalf the information was sought.47

The Swift reasoning was adopted by Lord Denning in McInerny v. Lloyds Bank [1974] 1 Lloyd's Law Reports 246 at 253, and both were then cited with approval by the Ontario High Court in V.K. Mason Construction Ltd. v. Courtot Investments Ltd. (1980) O.J. No. 1842.48

Application to auditors' reports

It is important to note that, in Hercules, the court accepted the concept of reasonably foreseeable reliance as being inherent in the auditors' function, accordingly giving rise to a prima facie duty of care in favour of the reader of the audited statements. La Forest J said at p. 592:

> The general area of auditors' liability is a case in point. In modern commercial society, the fact that audit reports will be relied on by many different people (e.g., shareholders, creditors, potential takeover bidders, investors, etc.) for a wide variety of purposes will almost always be reasonably foreseeable to auditors themselves. Similarly, the very nature of audited financial statements - produced, as they are, by professionals whose reputations (and, thereby, whose livelihoods) are at stake - will very often mean that any of those people would act wholly reasonably in placing their reliance on such statements in conducting their affairs.

And at p. 597:

> The foregoing analysis should render the following points clear. A prima facie duty of care will arise on the part of a defendant in a negligent misrepresentation action when it can be said (a) that the defendant ought reasonably to have foreseen that the plaintiff would rely on his representation and (b) that reliance by the plaintiff, in the circumstances, would be reasonable. Even though, in the context of auditors' liability cases, such a duty will often (even if not always) be found to exist, the problem of indeterminate liability will frequently result in the duty being negated by the kinds of policy considerations already discussed.

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[46] (1873) L.R. 8 Q.B 244, varied on other grounds (1874) L.R. 9 Q.B. 301

[47] Swift, supra, at 253.

[48] sub nom V.K. Mason Contruction Ltd. v. Bank of Nova Scotia, varied on other grounds, (1982) 39 O.R. 2d 630 (Ont. C.A.); aff'd [1985] 1 S.C.R. 271.

Indeed, the definition of a "user" of financial statements is found within a provision of the CICA Handbook outlining the very objective of financial statements:

The objective of financial statements is to communicate information that is useful to investors, members, contributors, creditors and other users ("Users") in making their resource allocation decisions and /or assessing management stewardship.49

In the case of an audit report which an auditor knows to be false, or about which the auditor is wilfully blind or reckless as to its truth or falsity, the auditor's reasonable contemplation as accepted in Hercules would appear sufficient to meet the Halsbury's test, applied in Swift, so as to render almost any user of financial statements a "representee" and to bestow upon that representee the status of one "whom [the auditor] ought to have been aware he ... might injure by what he was doing".

Conclusion

This article considers the rare case of an auditor who signs a materially false audit report knowing it to false, with wilful blindness, or recklessly without regard to whether it be true or false. In any case, the auditor signs the report without an honest belief in its accuracy.

Auditors' reports containing significant qualifications, or based on accounting practices other than GAAP, are relatively uncommon and are, by their very nature, unlikely to be the subject of a claim in deceit. It is the unqualified or "clean" report which will be used by readers to make resource allocation decisions which might give rise to injury and this fact is within the reasonable contemplation of the auditor preparing the report.

The auditor's knowledge of any materially false statement, coupled with his or her reasonable contemplation of potential loss, will be sufficient for the law to impute to the auditor the intention to deceive necessary to ground a claim in fraud.

So long as the loss is sustained in reliance on the accuracy of the statements, by a person whom the auditor may have reasonably had in contemplation, that user will be a "representee" and have a valid claim in deceit against the auditor. That claim will not be defeated by policy concerns over indeterminate liability.

[49] CICA Handbook, Assurance, Volume 1, p. 1000.15