

IN THE COURT OF APPEAL OF THE REPUBLIC OF SINGAPORE

[1993] SGCA 50

CA 104 /1992

Between

Ikumene Singapore Pte Ltd
Another

... Appellant

And

Leong Chee Leng (practising
under the style of Elizabeth
Leong & Co)

... Respondent

GROUND OF DECISION

Tort — Negligence — Duty of care; Tort — Negligence — Duty of care

This judgment is subject to final editorial corrections approved by the court and/or redaction pursuant to the publisher's duty in compliance with the law, for publication in LawNet and/or the Singapore Law Reports.

**Ikumene Singapore Pte Ltd and Another v Leong Chee Leng
(practising under the style of Elizabeth Leong & Co)**

[1993] SGCA 50

CA 104 /1992

Chao Hick Tin J; Karthigesu JA; Yong Pung How CJ

16 July 1993

1 Cur Adv Vult

2 This is an appeal by the plaintiffs against a decision of the High Court dismissing their claim for damages on account of professional negligence on the part of the defendant, the respondent.

3 The first plaintiff was incorporated on 29 December 1978 to trade in medical and surgical equipment. The second plaintiff was at all material times a substantial shareholder (holding 94%) of the first plaintiffs. Credit facilities were granted by the Far Eastern Bank Ltd (`the bank`) to the first plaintiff. The second plaintiff stood as guarantor for those credit facilities and had charged his personal fixed deposit of \$200,000 with the bank as security thereof.

4 We will first give a brief account how the second plaintiff came to be involved in the setting up of the first plaintiff (hereinafter referred to as `Ikumene`) and what gave rise to this action. The second plaintiff was formerly the managing director of certain Singapore companies. He returned to UK in retirement in 1973. One of his former colleagues and subordinates was one

James Kwok. Sometime prior to December 1978 the second plaintiff was sought by three persons, James Kwok, Raymond Heng and Foo Huat Kim, to join them in setting up a company to trade in medical and surgical equipment. The second plaintiff agreed and invested \$47,000 in Ikumene, the first plaintiff, holding 47,000 shares out of a total issued shares of 50,000. One thousand shares each were held by the other three persons. It was clear that the second plaintiff had confidence and trust in James Kwok who was, not long after the formation of the company (September 1979), given the primary task of managing Ikumene, as he was appointed its managing director. Before that Foo Huat Kim was in charge. The second plaintiff knew James Kwok very well. One Leong Chee Cheong, the brother of the defendant, was appointed the bookkeeper.

5 The defendant was formally appointed the auditor of Ikumene on 19 October 1981. However, it was obvious that the defendant was given the assignment sometime before then as the audited accounts of Ikumene for the year ended 31 December 1979 were prepared and reported on by the defendant on 20 October 1981, the day after her formal appointment. The accounts for the year ended 31 December 1980 were audited and completed on 12 February 1982 and for the year ended 31 December 1981 on 4 November 1982.

6 The 1979 audited accounts showed a loss of \$10,371.00. This was subsequently in the 1980 accounts adjusted upwards to \$25,850. The 1980 accounts showed a loss of \$28,788 resulting in an accumulated loss of \$54,638. For 1981 the accounts showed a profit of \$20,332, thus reducing the accumulated loss to \$34,306. The second plaintiff said he was pleased with the 1981 accounts as he thought the company had turned around.

7 In respect of those three sets of accounts, the defendant reported that the accounts were properly drawn up in accordance with the provisions of the Companies Act, that they gave a true and fair view of the state of affairs of Ikumene for those years and that the accounting and other records of Ikumene had been properly kept.

8 On 18 August 1983, the second plaintiff received a copy of a letter of demand from the bank addressed to the first plaintiff asking for the payment of \$193,623.98 within 14 days, failing which the same would be set off against the second plaintiff's fixed deposit charged to the bank.

9 On 8 February 1984, the second plaintiff received a letter of demand as guarantor from the bank asking for payment of the amount of \$198,215.12 owing by Ikumene. On 5 March 1984, the bank exercised its rights under the charge and set off the debt of Ikumene amounting to \$201,338.61 against the fixed deposit (with accrued interest) of the second plaintiff.

10 The plaintiffs alleged that the defendant had failed in her duty of care to the plaintiffs when she gave an unqualified audit opinion in respect of each of the years 1979, 1980 and 1981 and when she ought to have known that the balance sheet and profit and loss account for each of the years in question did not give a true and fair view of the state of affairs of Ikumene.

11 The plaintiffs further alleged that had the defendant discharged her duties as an auditor faithfully, Ikumene and/or the second plaintiff as the majority shareholder, would not have continued to allow James Kwok to manage Ikumene and would have at an early stage taken such proper or reasonable steps as might have been called for to investigate into or improve the

financial position of the first plaintiff or minimize the losses of the first plaintiff.`

12 In the meantime upon receipt of the bank`s letter of 18 August 1983, the second plaintiff appointed M/s Kwan Wong Tan & Hong (M/s Kwan Wong), a firm of professional accountants, to investigate the accounts of Ikumene. A report was submitted by M/s Kwan Wong on 20 March 1986 in respect of the three years ended December 1979, 1980 and 1981. The report highlighted the accounting records of Ikumene which were missing. In their opinion the 1979 accounts did not give a true and fair view.

13 At the trial the plaintiffs called one Andrew Hoa Hing (of M/s Kwan Wong) who investigated the accounts of Ikumene, to explain their report. The plaintiffs also called an expert, one John Curran, to testify as to the inadequate manner in which the defendant must have gone about undertaking the audit of the accounts in respect of those three years. John Curran said that in view of the fact that proper accounting records had not been kept by Ikumene, it was not possible for the auditor to say whether the accounts gave a true and fair view.

14 However, the defendant elected not to call any evidence to rebut the case of the plaintiffs. She submitted that on the evidence adduced by the plaintiffs, the plaintiffs had not made out a claim against her. The learned trial judge found that the defendant was negligent in the audit of the accounts of Ikumene but held that the defendant owed no duty of care to the second plaintiff in respect of the loss of \$201,338.61 under the guarantee. He further held that the plaintiffs had not proved that their losses were due to the defendant`s negligence. [See [1992] 2 SLR 890 .]

15 The issues raised in this appeal touch on all the three findings of the learned judge. The plaintiffs have submitted to us that the learned judge erred on the issues of duty of care and causation. By a respondent's notice the defendant has submitted that the learned judge was wrong to have held that the defendant was negligent in the audit of the three sets of accounts.

16 **Duty of care**

17 We do not propose to go into a historical survey of the development of the law on the subject as the law was recently authoritatively considered and declared by the House of Lords in *Caparo Industries plc v Dickman & Ors*. In that case the respondent owned shares of a public company, F plc, and bought more shares in the company in reliance upon the audited accounts for the year ended 31 March 1984. The respondent bought more shares in spite of the fact that the quoted share price dropped significantly after the accounts showed profit figures far short of the predicted amount. Eventually the respondent made a successful takeover bid for the company, F plc. Following the takeover, the respondents brought an action against the auditors of the company alleging that the audited accounts were inaccurate and misleading in that they showed a pre-tax profit of some £1.2m for the year ended 31 March 1984 when in fact there had been a loss of over \$400,000 and that the auditors had been negligent in the auditing of the accounts. The respondent alleged that the auditors owed them a duty of care either as potential bidders for the company because they ought to have foreseen that the 1984 results made F plc vulnerable to takeover bids or as an existing shareholder of F plc interested in buying more shares in the company. The House of Lords held that the three criteria for the imposition of a duty of care were foreseeability of damages, proximity of relationship and the reasonableness or otherwise of imposing a duty. The duty of care in tort does

not depend solely on the existence of the essential ingredient of the foreseeability of damage to the plaintiff. Lord Bridge made a brief survey of the development of this branch of the law and came down strongly in support of the following dissenting opinion of Denning LJ in **Candler v Crane, Christmas & Co Ltd** at pp 433-435:

(The professionals) owe the duty, of course, to their employer or client; and also, I think to any third person to whom they themselves show the accounts or to whom they know their employer is going to show the accounts, so as to induce him to invest money or take some other action on them ... The test of proximity in these cases is: did the accountants know that the accounts were required for submission to the plaintiff and use by him? ... Thirdly, to what transactions does the duty of care extend? It extends, I think, only to those transactions for which the accountants knew their accounts were required.

18 It seems to us that the principles established in **Donoghue v Stevenson** should be applied and extended with care. **Donoghue v Stevenson** was concerned with a duty of care to avoid causing injury to the person or property of others. It was not concerned with the question of causing purely economic loss to another. This distinction is crucial. In **Caparo Industries** Lord Oliver dealt with the point at p 587 as follows:

The damage which may be occasioned by the spoken or written word is not inherent. It lies always in the reliance by somebody on the accuracy of that which the word communicates and the loss or damage consequential on that person having adopted a course of action on the faith of it. In general, it may be said that when any serious statement, whether it takes the form of a statement of fact or of advice, is published or communicated, it is foreseeable that the person who reads or receives it is likely to accept it as accurate and to act accordingly. It is equally foreseeable that if it is inaccurate in a material particular the recipient who acts on it may suffer a detriment which, if the statement had been accurate, he would not have undergone. But it is now clear that mere foreseeability is not of itself sufficient to ground liability unless by reason of the circumstances it itself constitutes also the element of proximity (as in the case of direct

physical damage) or unless it is accompanied by other circumstances from which that element may be deduced.

19 Lord Reid explained the need to treat words differently from acts in these terms in ***Hedley Byrne & Co Ltd v Heller & Partners Ltd*** (at pp 613-614):

The reason for some divergence between the law of negligence in word and that of negligence in act is clear. Negligence in word creates problems different from those of negligence in act. Words are more volatile than deeds. They travel fast and far afield. They are used without being expended and take effect in combination with innumerable facts and other words. Yet they are dangerous and can cause vast financial damage. How far they are relied on unchecked ... must in many cases be a matter of doubt and difficulty. If the mere hearing or reading of words were held to create proximity, there might be no limit to the persons to whom the speaker or writer could be liable.

20 Like the Law Lords in ***Caparo Industries***, we think these words of Brennan J in the Australian High Court in ***Sutherland Shire Council v Heyman*** at pp 43-44 bear repeating:

It is preferable in my view that the law should develop novel categories of negligence incrementally and by analogy with established categories, rather than by a massive extension of a prima facie duty of care restrained only by indefinable considerations which ought to negative, or to reduce or limit the scope of the duty or the class of persons to whom it is owed.

21 It seems to us that outside contractual or fiduciary relationship, for there to be a duty of care owing by one person to another to ensure the accuracy of any statement which that one party makes and which the other party may foreseeably rely to his economic detriment, there must be that degree of proximity or special relationship between the two parties: see the dissenting opinion of Denning LJ in ***Candler v Crane, Christmas & Co Ltd***, which opinion was approved by the House of Lords in ***Hedley Byrne***. The effect of ***Hedley Byrne***

22 4 was summarized by Lord Oliver in **Caparo Industries**, as follows (at p 589):

*What can be deduced from the **Hedley Byrne** case, therefore, is that the necessary relationship between the maker of a statement or giver of advice (the adviser) and the recipient who acts in reliance on it (the advisee) may typically be held to exist where (i) the advice is required for a purpose, whether particularly specified or generally described, which is made known, either actually or inferentially, to the adviser at the time when the advice is given, (2) the adviser knows, either actually or inferentially, that his advice will be communicated to the advisee, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose, (3) it is known, either actually or inferentially, that the advice so communicated is likely to be acted on by the advisee for that purpose without independent inquiry and (4) it is so acted on by the advisee to his detriment. That is not, of course, to suggest that these conditions are either conclusive or exclusive, but merely that the actual decision in the case does not warrant any broader propositions.*

23 In two recent cases which were heard together - **Smith v Eric S Bush (a firm)**; **Harris v Wyre Forest DC** - the House of Lords applied the same principle. In those two cases, the plaintiffs purchased properties in reliance on valuations of the properties made by surveyors on the instructions of mortgagees who proposed to advance money to the plaintiffs to enable them to effect the purchases. However, the surveyors' fees were paid by the plaintiffs. It transpired that the inspections and valuations were not properly carried out as the properties were seriously defective. As a result the plaintiffs suffered financial losses. In the two cases, it seems quite clear that the surveyors were fully aware that the advice or information would be communicated to the plaintiffs directly or indirectly and knew that it was very likely that the plaintiffs would rely on that advice or information in deciding whether or not to enter into the transactions in contemplation. Realistically in those two cases, the valuations could be regarded as provided by the valuers to the purchasers/plaintiffs.

24 We must emphasize that for the special relationship to exist, it must be found that the maker of the statement was, or ought to have been, aware that his advice or information would in fact be made available to and be relied on by a particular person or class of persons for the purposes of a particular transaction or type of transaction.

25 We now turn to consider the rationale of the Companies Act in requiring that the accounts of a company be audited. Section 207(1) of the Act requires an auditor to `report to the members on the accounts required to be laid before the company in general meeting and on the company`s accounting and other records relating to those accounts.` The auditor shall in his report state, *inter alia*, whether the accounts are in his opinion properly drawn up so as to give a true and fair view of the matters required by s 201 to be dealt with in the accounts and whether the accounting and other records required by the Act to be kept by the company, have been, in his opinion, properly kept in accordance with the Act, and if he is not so satisfied on those matters he must state his reasons. There cannot be any doubt that these provisions `established a relationship between the auditors and the shareholders of a company on which the shareholder is entitled to rely for the protection of his interest` - see Lord Bridge in ***Caparo Industries*** , at p 580. His Lordship then went on to make the following observations:

But the crucial question concerns the extent of the shareholder`s interest which the auditor has a duty to protect. The shareholders of a company have a collective interest in the company`s proper management and in so far as a negligent failure of the auditor to report accurately on the state of the company`s finances deprives the shareholders of the opportunity to exercise their powers in general meeting to call the directors to book and to ensure that errors in management are corrected, the shareholders ought to be entitled to a remedy. But in practice no problem arises in this regard since the interest of the shareholders in the proper management of the company`s affairs is indistinguishable from

the interest of the company itself and any loss suffered by the shareholders, eg by the negligent failure of the auditor to discover and expose a misappropriation of the funds by a director of the company, will be recouped by a claim against the auditor in the name of the company, not by individual shareholders. I find it difficult to visualize a situation arising in the real world in which the individual shareholder could claim to have sustained a loss in respect of his existing shareholding referable to the negligence of the auditor which could not be recouped by the company. But on this part of the case your Lordships were much pressed with the argument that such a loss might occur by a negligent undervaluation of the company's assets in the auditor's report relied on by the individual shareholder in deciding to sell his shares at an undervalue. The argument then runs thus. The shareholder, qua shareholder, is entitled to rely on the auditor's report as the basis of his investment decision to sell his existing shareholding. If he sells at an undervalue he is entitled to recover the loss from the auditor. There can be no distinction in law between the shareholder's investment decision to sell the shares he has or to buy additional shares. It follows, therefore, that the scope of the duty of care owed to him by the auditor extends to cover any loss sustained consequent on the purchase of additional shares in reliance on the auditor's negligent report. I believe this argument to be fallacious.

26 We would, therefore, respectfully endorse the views of Lord Oliver in **Caparo Industries** (at p 598) that there was 'no reason in policy or in principle why it should be either desirable or appropriate that the ambit of the special relationship required to give rise to liability in cases such as the present should be extended beyond those limits which are deducible from the **Hedley Byrne** case and **Smith v Eric S Bush** . '

27 It seems to us that the purpose for which the auditor's certificate is made is to provide those entitled to receive the report with the necessary information to enable them to exercise in conjunction those powers which their respective proprietary interests confer on them. That duty of care of the auditor is one owed to the shareholders as a body and not to individual shareholders. The accounts are not made and prepared for the purpose of enabling a person who has stood

guarantee for the credit facilities of a company to determine whether he should continue with the guarantee or what steps he should take to safeguard his guarantee. If such a guarantor is serious in wanting to safeguard his interest, he should make the necessary arrangements with the company.

28 In the instant case, the second plaintiff was a majority shareholder. He controlled the company. He put James Kwok in charge of the company. James Kwok let him down in not maintaining proper records. We would in passing mention that it was not shown what was the cause of Ikumene's loss which in turn led to the second plaintiff's loss under the guarantee. Of course, the defendant knew that the second plaintiff had provided a guarantee to the bank to secure Ikumene's facilities. But the defendant could not have known that the second plaintiff would be relying on the audited accounts to determine what action he would take to protect his interest under the guarantee. If he was so minded, there were undoubtedly many methods the second plaintiff could have adopted to safeguard his interest as a guarantor. He was after all the majority shareholder and a director. We do not think we should widen the scope of duty of an auditor to include the losses that may be suffered by a guarantor of a company; that is not a purpose for which the accounts are prepared.

29 The second plaintiff's position cannot be better than that of a bank which lends money to a company on the basis of the audited accounts. In ***Al Saudi Banque v Clark Pixley (a firm)***, Millett J rejected the claim that a duty of care was owed by the auditors to a bank lending money to a company, irrespective of whether the bank was an existing creditor of the company making further advances or was only a potential creditor of the company.

30 In the premises, we hold that the second plaintiff has failed to show that the defendant owed him (as guarantor) a duty of care. Accordingly, the claim of the second plaintiff for the loss on account of the guarantee furnished by him must fail. We would add that even if the second plaintiff is able to overcome the problem relating to the duty of care, he still has to show that the losses suffered by him on account of the guarantee arose as a result of the breach of duty on the part of the defendant. He has failed to discharge this burden. The guarantee was furnished long before the defendant was appointed the auditor of the company. The question of causation will be further discussed in the next few paragraphs when we deal with the losses of the company.

31 **Causation**

32 The second plaintiff also claimed for the loss of his investment (\$47,000) in Ikumene. It seems to us clear that this claim should be made by the company and not by an individual shareholder. In the words of Lord Bridge, which have been quoted above, it is `difficult to visualize a situation arising in the real world in which the individual shareholder could claim to have sustained a loss in respect of his existing shareholding referable to the negligence of the auditor which could not be recouped by the company.`

33 Ikumene is a party to this action, being the first plaintiff. In para 10 of the statement of claim it is averred that:

The first plaintiff has incurred losses which it would not otherwise have incurred and lost profits which it would otherwise have made but is unable until after discovery to furnish full particulars of the damages it has or will suffer.

34 The learned trial judge has found that:

... the plaintiffs have not shown that the losses were due to their relying on the reports. Neither have they shown that if qualified or adverse reports had been given, the losses could or would have been avoided.

35 In fact, up till the conclusion of the trial no evidence had been tendered to show what specific losses were incurred by the company which were caused by the neglect of the auditor in not qualifying the accounts.

36 It has been submitted for Ikumene that the losses which Ikumene suffered after October 1982 could have been avoided if the defendant had not been negligent. It is contended that if the respondent had done the audit properly, steps would have been taken by the company to prevent or minimize future losses. It is suggested that the 1983 and 1984 accounts showing losses of Ikumene (\$104,487 and \$28,260 respectively) could be used as a basis for computing damages.

37 We would observe that the fact that the auditor did not qualify her report does not necessarily mean that whatever subsequent losses the company suffered must be caused by that unqualified report. John Curran (PW3) did not say that the accounts did not, in fact, give a true and fair view of the affairs of Ikumene but only that based on the records available to the defendant, she could not say if the accounts gave a true and fair view of the affairs of the company. The complaint was that if the defendant had done her work properly she would have qualified her report. It is obvious that a company may suffer losses for a variety of reasons. There is nothing to show that the losses suffered subsequently by Ikumene were not genuine commercial losses which had nothing to do whatsoever with the fact that the defendant had not qualified her reports. The burden was on Ikumene to show all that, which they have failed to do.

38 We do not think it is sufficient for the plaintiffs to merely show that the defendant did not carry out the audit with the degree of care expected of her as a professional auditor. Specific losses must be proved and those losses must also be proved to have been caused by the negligence of the defendant: see ***Sykes v Midland Bank Executor Co.***

39 8 It is significant to note that when asked if he could tell if the losses of Ikumene were attributable to the `inaccurate accounts`, the second plaintiff replied that he could not. He also could not say what action he would take if he had known that the accounts were materially `inaccurate`.

40 The case ***Chaplin v Hicks***, relied upon by the plaintiffs is quite different. There the defendant, a theatrical manager, agreed with the plaintiff that if she would attend a meeting at which he intended to interview 49 other actresses, he would select 12 of them for remunerative employment. He breached the contract with the plaintiff by failing to give her a reasonable opportunity to attend the interview. The Court of Appeal held that the denial of such a chance of being selected was not remote and that damages were assessable though the court recognized that the calculation was `not only difficult but incapable of being carried out with certainty or precision` :per Vaughan Williams LJ at p 791.

41 The instant case is not of the same nature. It was for the plaintiffs to show what damages Ikumene suffered as a result of the breach of duty on the part of the auditor in not qualifying the report or what specific damages could have been avoided if the reports had been qualified. It is trite law that for a plaintiff to succeed in a claim for negligence, be it in contract or in tort, both breach of duty and damages must be proved: see ***JEB Fasteners Ltd v Marks,***

Bloom & Co; Alexander & Ors v Cambridge Credit Corporation Ltd & Anor
, and *Bonnington Castings Ltd v Wardlaw* .

42 Was there a breach of duty?

43 Before we conclude we would just briefly refer to the point raised in the respondent's notice. The finding of the learned judge that the defendant/respondent was negligent in carrying out the auditing of the account is a finding of fact. The main complaint of the defendant appears to be that the learned judge erred when he said that he was bound to accept the evidence of PW3. But nowhere did the learned judge say that he was bound to accept the evidence of PW3. He considered the evidence of PW3 before accepting it. The defendant had elected not to call any evidence on her behalf to counter the evidence adduced by the plaintiffs. The learned judge must have found the evidence of PW3 to be credible. If the defendant had, in fact, done more work than what was shown in her working papers, then she, having heard the evidence of PW3, should have taken the stand and explained things to the court. Yet she chose to remain silent. We are unable to see how this finding of the learned judge could be disturbed on this ground or the other grounds raised in the respondent's case.

44 In the result the appeal is dismissed with costs. As the respondent has not succeeded on the point raised in the respondent's notice we think she should only be entitled to 85% of the costs of this appeal. The security deposit shall be paid out to the respondent's solicitors to account of the respondent's costs.

45 Appeal dismissed.

Ikumene Singapore Pte Ltd and Another v Leong Chee Leng (practising under the style of Elizabeth Leong & Co) [1993] SGCA 50

Chao Hick Tin J
Karthigesu JA
Yong Pung How CJ

Lim Chor Pee and Loy Wee Sun (Chor Pee & Co) for the appellant
Ronnie Quek (Allen & Gledhill) for the respondent
