



## Should Auditors Owe a Duty to Stakeholders?

Loganathan Krishnan\*

*Department of International Business, Faculty of Accountancy and Management,  
University of Tunku Abdul Rahman*

\*Corresponding author; email: loganathan@utar.edu.my

### ABSTRACT

*The traditional view in business law is that auditors should only owe their duties to a company since they are solely under a contractual relationship with the company. This is justified on the basis that it is the company which suffers loss if the auditors' report is untrue. Nonetheless, it is trite to declare that stakeholders may also suffer a loss if the auditors' report is untrue and it was relied upon. If the traditional view continues to be upheld, then the stakeholders will never be in a legally secured position as they cannot bring an action although the auditors' report is untrue, there is reliance on and loss is suffered by the stakeholders. With this revelation, the auditors should also bear in mind the rights and interests of the stakeholders. This is because the information revealed by the auditors in their report is of fundamental importance to the stakeholders. Hence, this study examines to whom auditors owe their duty under the current legal position. The examination will unfold as to whether the scope of to whom auditors owe their duty is restrictive. The study will then investigate whether the auditors should owe their duty to stakeholders and the legal justifications for attaching such a duty. Notably, many fraudulent activities and ventures can be planned with the ingenious work and plan of the auditors. Therefore, the guiding principles for auditors should be responsibility and accountability. Arguably, this responsibility and accountability must be owed to a wider circle of persons and bodies, that is, the stakeholders.*

**Keywords:** *auditors, duty, stakeholders*

### INTRODUCTION

This study examines the persons and bodies to whom auditors owe their duty. The examination will unfold whether the scope of to whom auditors owe their duty is restrictive. The study will then investigate whether the auditors should owe their duty to other categories of persons and bodies and the legal justifications for attaching such a duty.

### BACKGROUND OF STUDY

In the United Kingdom (UK), the S. 34-43 Joint Stock Companies Act 1844 required that every company must have an auditor. However, this was repealed in 1856. The requirement was then reintroduced in S. 21 Companies Act 1900. However, the legislature did not spell out as to whom auditors owe their duty (Lewis & Cheah, 1997).

Thus, the question of to whom auditors owe their duty was left to the courts to deal with. Observably, the legal position is based on cases which were decided over the last one hundred years. Therefore, judicial creativity was expected of the courts to undertake the role of developing the law on this area.

Nevertheless, in some cases, the legal position as to whom the auditors owe a duty is still unclear. Furthermore, in certain cases, the courts keep shifting their views on this matter. Nonetheless, since auditors have assumed diverse functions, this has exposed them to a greater risk of liability towards a larger range of people (Khoury, 2001).

As for the legal position in Malaysia, the Companies Act 1965 (CA 1965) does not spell out to whom auditors owe their duty. Hence, as is the position in the UK, the issue was left to the courts to deal with. Nonetheless, the concern is that there are very few cases which deal with this issue. Furthermore, the issue has not been dealt with in detail. Thus, analysis will be made on cases across jurisdictions, that is, in the UK, Australia and New Zealand.

## **DUTY TO STAKEHOLDERS**

Currently, auditors owe a duty to the company. Thus, stakeholders, that is, Board of Directors, audit committee, employees, creditors, guarantors, companies wishing to exercise takeovers and mergers, trustees, beneficiaries and the government are considered as third parties. This is because they are not parties to the contractual relationship between the auditors and the company. Nonetheless, a better way of looking at this matter is to consider that the relationship between the company and the auditor is only at the minimal level. There are other persons and bodies, that is, stakeholders who have an interest in the matter.

Be that as it may, ‘the Companies Act’ does not provide that auditors owe any duty to third parties (Hanrahan, Ramsay, Stapledon, Nariman & Bidin, 2002). Thus, it is difficult to establish duty in such cases. Nonetheless, the issue should not be dismissed based on the difficulty. This is because if the relationship between the auditors and the stakeholders is founded on a proper legal basis, the stakeholders will find that their rights and interests can be addressed. This is because the stakeholders wish to know whether loss can be recovered from the auditors (Sin, 1990).

The duties of auditors should not be merely confined to the company. This is because in reality, auditors’ relationship is not only with the company. It was rightfully pointed out in the dissenting judgment of Denning LJ in *Candler v Crane Christmas & Co Ltd*, that the law would fail to serve the best interests of the community, if it should hold that auditors owed a duty to no one but their clients, that is, the company.

If the duty is only owed to the company, the duty is rather restrictive in nature. This is because the duty owed to the company does not include the rights and interest of the Board of Directors, audit committee, employees, creditors, guarantors, companies wishing to exercise takeovers and mergers, trustees, beneficiaries and the government.

The Indian court in *Controller of Insurance v H.C. Das (1957)* found that if the duty of the auditors is construed restrictively, then the report is not a source of security but a positive danger. It is a source of positive danger to third parties because in the event the auditors’ report is not true, action cannot be brought by the third parties since no duty is owed. This is because owing a duty is the basis for establishing liability. Furthermore, due to such a restrictive approach, third parties will have no legal avenues in scandals involving auditors such as Enron, World-com, One-Tel, HIH Insurance, Equitable Life Assurance Society, Pan-El, Parmalat, Tyco, Caisse d’Epargne, Societe Generale, Adelpia, Satyam, Ocean Capital, Megan, Southern Bank, Transmile and Oilcorp.

Fundamentally, in the English decision of *Andrew & Ors v Kounnis Freeman (a firm)* Jonathan Parker J remarked that the legal position of auditors is in a state of transition. It is developing pragmatically and

incrementally where the decision in every case is sensitive to the facts of each case. Thus, over the years there can be new categories of persons and bodies, auditors may owe their duty to and that is the present trend (Rohatgi, 1989).

Furthermore, the law must also consider the activities which may cause loss; the nature of the loss suffered; the relationship between the parties which caused the loss and the parties which suffered the loss; and finally, the current commercial standards of fair dealing (Arjunan & Low, 1995). In the context of auditors, the auditors' report can cause loss to the third parties and the loss is financial in nature. Furthermore, there is an assumption that the responsible party should avoid or prevent loss being incurred by the other party.

On the other hand, in the current corporate atmosphere, the term 'third party' is not appropriate. This is because the term 'third party' connotes that there is no relationship between the auditors and the third parties. Moreover, it also connotes that the third parties do not have any interests in the auditors' reports. It also connotes that the auditors need not take cognizance of who the third parties are. Rightfully, the third parties should be known as stakeholders so that their rights and interests are recognised.

It should be noted that the duty of the auditors to the company is viewed from a contractual point of view. Obviously then, it will not encompass the rights and interests of the stakeholders. Instead, the scope of to whom auditors should owe their duty should also be looked at from the company law point of view. In such a case, the stakeholders can be taken into account. This is because they have an interest in the auditors' report, that is, they have a stake in the matter. They should not be viewed as outsiders or third parties who do not have interests in the matter.

Additionally, they have a stake in the matter because they will be relying on the auditors' report. Furthermore, the law cannot ignore the fact that the reality of the share market requires stakeholders to place significant degree of reliance on auditors. This is because they have an interest in the viability of the company (Webb, 1991). They are the likely users of the auditors' report (Lee & Tweedie, 1975). The report is also vital for the stakeholders and thus, it is not just a matter between the auditors and the company.

Most importantly, auditors must bear in mind that their reports will be placed at the Companies Commission of Malaysia (CCM). This is a requirement of the Companies Act. Furthermore, since auditors hold a public office, they should reasonably know that their report will be relied upon since it is in the public domain.

It must also be borne in mind that the stakeholders have a risk involved. This is because they are unsure of the company's financial position. The only way to ascertain a company's financial position is to make a reference to the auditors' report. Thus, the importance of auditors' report is seen in managing their risk. Stakeholders cannot possibly be expected to undertake double risks, that is, risk of not knowing whether a company is financially sound and the risk of not being able to bring a claim especially where the auditors' report is untrue.

The stakeholders may peruse the audited accounts and rely upon them in making business, employment, legal or administrative decisions whichever the case may be (Lewis & Cheah, 1997). They need to make informed decisions. The stakeholders may not be able to make informed decisions had there not been an auditors' report. The decision to have dealings with a company will be different had there been no involvement of auditors in the first place. This is because the auditors' report is a source of information (Baxt, 1990). The disclosure of such information lies at the heart of corporate regulation (Arjunan, 1998). The stakeholders must be able to put faith in the report (Nobel, 2003). More often than not, the auditors' report is the only objective and independent source of information available to the stakeholders.

The creditors want to ensure that loans are only given to companies which are financially sound. The companies which wish to exercise takeovers and mergers would not want to bail out financially ailing companies. Instead, they want to make their own companies' financial position stronger. Investors want to be prudent too. They do not want to invest in companies which are financially ailing as they would want good financial returns. The employees do not want to be in organisations which are unable to ensure job security. Most importantly, the role, duties and obligations of the auditors serve no real purpose if the auditors' legal position is not in tandem with the interests of the stakeholders.

Therefore, due attention must be given to the interests of the stakeholders (Janice, 2001). This will produce better results than having a depersonalized market. Particularly, it should not be a case where the law disregards the interests of the stakeholders. Furthermore, it should not be a case where the auditors derive benefits at the expense of the stakeholders' loss (Harrington, 1996). The loss can be seen in situations where although there have been reliance on the auditors' report, the stakeholders are unable to make a claim. The benefits derived by the auditors can be seen in situations where they will receive their remuneration and continue auditing for the same companies if they are not removed. In cases where they are removed, they can still continue auditing, albeit other companies.

Notably, auditors are considered as delegates. This is because the Board of Directors has delegated the function of auditing to auditors. Delegation involves the placing of trust in the delegates (Loh, 2003). Where there is trust, confidence and credibility are also in place. In the Indian decision of Deputy Secretary to the Government of India, Ministry of Finance v S.N. Das Gupta (1956) Chakravarti C.J. observed that there is an element of trust and confidence placed by various parties on the auditors' report. This is because they have invested their time and money with the expectation that the auditors' report is true and accurate. If the trust and confidence are breached, a right to bring an action should arise.

Additionally, the issue must be looked afresh in the light of the emergence of regionalization, globalisation and internationalization of businesses. This is because there is much movement of employees, investors, creditors and companies wishing to exercise takeovers and mergers. Hence, the business world has become more aggressive. It was observed in the American case of Texas Tunnelling Co v City of Chattanooga (1962)

*“That there have been significant changes in the American society during the thirty years that have elapsed since the decision in Ultramares case. The continued growth and expansion of industry, the growth of population, the urbanization of society, the growing complexity of business relations and the growing specialization of business functions all require more and more reliance in business transactions upon the representation of specialists”.*

This is similar to the current corporate atmosphere in Malaysia. Hence, it will be difficult to attract foreign human capital, creditors, investors and companies wishing to exercise takeovers and mergers despite having attractive foreign policies. The current legal framework must work hand in hand with attractive foreign policies. This is because Malaysia cannot operate in a vacuum by not ensuring an adequate legal framework governing the stakeholders' rights and interests. Thus, the succeeding section will discuss whether duties should be owed by the auditors to each and every category of the stakeholders.

### **Duty to Audit Committee**

It should be noted that an audit committee is only required for public companies which are listed in the Malaysian Stock Exchange. Thus, the requirement of audit committee is not for all types of companies, that is, private companies and public companies which are not listed.

Under the Listing Requirements of the Malaysian Stock Exchange, it is compulsory for listed companies to establish audit committees. This is provided in Part C, Chapter 15 of the Bursa Saham Malaysia Bhd Listing Requirements. The requirement is intended to minimize the risk of financial collapse (Loh, 2003). This is because auditors can help to minimize the risk. It is also to reduce the pressure by the company's management on the auditors (Knapp, 1987).

An auditor is required to work together with the audit committee. This is provided in the Listing Requirements 15.13.1(a), (b) and (c). Thus, auditors are required to review the audit plan, the system of internal controls and the auditor's report together with the audit committee. Furthermore, Listing Requirements 15.18(d) requires an auditor to have direct communication channels with the audit committee. Sub-paragraph (f) requires an auditor, to have a meeting with the audit committee whenever deemed necessary. Hence, it is the duty of the auditors to report to the audit committee on the company's accounts. If the auditors find there is a discrepancy in the company's accounts, the auditors are under a duty to report this matter to the audit committee.

If the auditors were expected to make a qualified report but did not do so, it can have a drastic effect on the listed companies (Koh & Yeoh, 1999). It can affect the market price of the company's shares. Consequently, it can affect the existing and prospective shareholders' confidence. If the auditors discover that there are irregularities in the accuracy of the accounts but decided not to inform the audit committee, the audit committee will suffer. This is because the audit committee will be liable to the company for any loss suffered.

Furthermore, under the revised Code of Corporate Governance which came into effect in 2007, Part 2, BB.V, the audit committee must be kept informed of matters affecting the company. The matters affecting the company must be brought to the attention of the audit committee in a timely manner. Thus, it is the duty of the auditors to ensure when is the appropriate time to bring the matters affecting the company to the attention of the audit committee.

Hence, it can be seen that there is a meaningful relationship between the audit committee and the auditors. Due to the relationship, it can be concluded that the auditors owe a duty to the audit committee. Support for this argument can be also found in Australian decision of *Daniels v Anderson* (1995). The court found that the duty arose out of standard accounting procedures and the auditors' own manual. In the English decision of *Barings plc v Coopers & Lybrand* (1997) Leggatt LJ found that material irregularities will normally be brought to light by sound audit practices, one of which is the practice of pointing out weaknesses in internal controls. Therefore, if the auditors are aware that the internal auditing controls had failed but the audit committee has not discovered this, it would be unreasonable to state that the auditors do not owe any duty in such circumstances.

Nonetheless, it should be noted that the listing requirements only apply to public companies which are listed on the stock market. Public companies which are not listed on the stock market are not required to form an audit committee. In such a case, there is no duty owed by auditors to the audit committee. Rightfully, every public company should be required to form an audit committee regardless of whether it is listed. This is because if the importance of an audit committee is crucial to the sustainability of a company, the requirement of an audit committee should not be confined to listed companies. This is because fundamentally, an audit committee can ensure the independence of auditors (Low, 2002).

## **Duty to the Board of Directors**

In the English decision of *Re London & General Bank (No 2)* (1895) Lindley LJ established that it is not the duty of the auditors to offer advice to the Board of Directors as to how the company should be run. It is also not the concern of the auditors whether the company is running profitably or non-profitably. Thus, the auditors do not owe any duty to the Board of Directors (Pitfield & Hughes).

Nonetheless, in the Australian decision of *Daniels v Anderson* (1995) the court pointed that the auditors are under a duty to inform the company's Board of Directors of the irregularities and inaccuracies in the accounting records. Auditors should realize that they have a positive influence on the Board of Directors' decision-making. Their professional opinion and advice will be taken into account instead of making decisions solely on their own judgment. Notably, the Board of Directors is not obliged to accept the auditors' advice. Nevertheless, the Board of Directors need to know what risks lie ahead, being at the apex of decision-making for a company.

In the English decision of *Coulthard v Neville Russell* (1998) the court confirmed that given that the Board of Directors are likely to adopt a course which the auditors suggest, the court held that it was arguable that a duty is owed by the auditors to the company's Board of Directors. This is because it is foreseeable that the Board of Directors will suffer loss or damage which is separate and distinct from that which is caused to the company. The Board of Directors will be sued by the shareholders for failing to take the right and necessary course of action since the shareholders have reposed trust and confidence in the Board of Directors managing the company.

In the context of S. 174(1) of 'the Companies Act', the auditors are required to report to the members at the general meeting. Nonetheless, if the auditors discovered fraud, dishonesty or any wrongdoing, they should not wait until the general meeting to report the matter. The problem can become worse. Hence, they must report the matter to the Board of Directors as soon as possible. This was pointed out in the Australian decision of *Pacific Acceptance Corp Ltd v Forsyth* by Moffit J. If the auditors fail to do so, the Board of Directors might be of the view that there are no fraudulent or dishonest practices in the company. The English court in *Sasea Finance Ltd (in liq) v KPMG (a firm)* remarked that it should be made within reasonable time without having to wait until the accounts are signed off. Therefore, it is submitted that auditors should owe a duty to the company's Board of Directors on their auditors' report.

## **Duty to Employees**

The Shareholder ownership model is outdated. This is because a company cannot only think and be concerned of its shareholders although the shareholders provide the capital. This is because share capital alone is insufficient to generate a company.

There must also be a 'human element' to generate the operations of the company. Thus, human capital, that is, the employees are also important. Employees are among the most important players in a business (Blair, 1995). Many companies' profits owe more to their employees' abilities and efforts than to the physical assets (Handy, 1996). Core employees are the real citizens of the corporate community. This is because the employees put in the labour (Zingales, 1998), effort and skill in ensuring that the company achieves its goals.

However, on the part of the employees, they are interested in attractive salaries and good financial returns, that is, bonuses. Furthermore, in this age of globalization and internationalization of businesses, people are willing to move across borders in search of better financial and employment prospects. They

are willing to do so although it may be a new environment with diverse race, ethnicity, colour, language or nationality.

Hence, one of the ways for employees or prospective employees of an organization to determine whether a company is financially healthy and sound is to refer to the auditors' report. The auditors' report may state that the company is financially sound. This will make the employees continue serving the organization. On the other hand, the auditors' report may state that the company is financially unsound. The employees may have taken this to be the truth. In actual fact, it could have been a case where the company is financially sound but do not wish to declare so.

As regards to prospective employees, they may decide to seek employment in the particular organization if the auditors' report were to declare that the particular company is financially healthy. In actual fact, the company could have been not financially healthy.

In both cases, the auditors have conspired with the company's management to commit fraud. In such cases, the employees or the prospective employees must be given due legal protection since there was reliance on the auditors' report. It is submitted that auditors should owe a duty to the employees and prospective employees of a company to provide true and correct information about the company's financial standing. In such a case, employees or prospective employees will be able to make informed decisions based on the report. On the other hand the auditors will be more responsible in preparing their reports. It is submitted thus, although there is no legal provision or cases to support such a submission.

### **Duty to Trustees and Beneficiaries**

In the English decision of *Law Society v KPMG Peat Marwick* (2000) the defendants were asked to audit the accounts of a particular firm of solicitors. Later the Law Society began investigation on the legal firm and found that a substantial fraud has taken place. As a result, three hundred clients made claims on the Law Society's Compensation Fund for the fraud committed by the legal firm. The Law Society's Compensation Fund paid £8.5m to the clients of the firm. The Law Society then brought an action against the auditors on the basis that the latter owed them a duty. The Law Society claimed that it is the trustee of the Compensation Fund. The Law Society alleged that the defendants should have qualified the report. The Court of Appeal, upholding the decision of Scott V-C decided that a duty is owed by the defendants.

The decision shows that the auditors owe their duty to persons or bodies acting as trustees. Although the auditors were engaged by the legal firm, the auditors must ensure that the failure to detect fraud can have impact on other persons and bodies.

It should be noted that auditors may not only owe a duty to trustees. They may also owe a duty to beneficiaries. This can be seen in the Indian decision of *Institute of Chartered Accountants of India v P.K. Mukherjee* (1968). In this case, an auditor was appointed to check the accounts of the Employees' Provident Fund maintained by a company. The court found that he owes his duty not merely to the company but also to the beneficiaries of the fund. Thus, he will be responsible to them for professional misconduct if he fails to report that the trustees have allowed irregular loans to the company out of the fund.

It should be noted that the above situations are not addressed by 'the Companies Act' of Malaysia. Such situations have not arisen in Malaysia. Nonetheless, the principles laid down do make legal sense. Thus, arguably a duty should be owed if such situations arise.

## **Duty to Creditors and Guarantors**

Auditors owe no duty to the creditors unless they know beforehand that those accounts are to be used for a special , for example, to calculate the price of shares for the purpose of a buy-out.

In *Al Saudi Banque v Clark Pixley* (1989) the English court affirmed that the auditors owed no duty to a bank which lent money to a company because there was no sufficient proximate relationship between the auditors and the bank necessary to give rise to the degree of proximity necessary to establish a duty. This was so even though it was foreseeable that a creditor may rely on the accounts of the company. The same was held by the High Court of Singapore in *Standard Chartered Bank v Coopers & Lybrand* (1993). In the context of the Australian legal position, the High Court found the same in *Spies v The Queen* (2000). As regards to the position of the debenture holders, S. 175(1) of ‘the Companies Act’ provides that auditors of a borrowing corporation are obliged to furnish the trustee for debenture holders with specified reports, certificates or documents. If they fail to do so, they are subjected to a penalty of RM1000.

Furthermore, S. 175(2) of ‘the Companies Act’ requires auditors to send by post, a report in writing to the borrowing corporation and to the trustee for debenture holders within seven days of becoming aware of any matter which in their opinion is relevant to the exercise and performance of the powers and duties imposed by ‘the Companies Act’ or by any trust deed upon any trustee for the debenture holders. Thus, the auditors are expected to safeguard the interests of the debenture holders.

The provision shows that the auditors’ duties are over and above those provided under S. 174(1) of ‘the Companies Act’. This means that there are possibilities of certain matters or issues which are of special interest to the trustee for the debenture holders. Notably, this duty does not fall within the purview of S. 174(1) of ‘the Companies Act’ since the intention of the legislature is to deal with the matter separately. In such situations, the auditors must bring the matter to the attention of the debenture holders which is separate from matters or issues that have to be brought to the attention of other persons or bodies, that is, the company, Board of Directors, existing shareholders and others.

Thus, it is submitted that due to S. 175(1) and (2) of ‘the Companies Act’, auditors owe a duty to the debenture holders. The approach taken by the legislature is different from those cases as discussed above. A point to be noted is whether the auditors owe duties to prospective debenture holders. S. 46(1) of ‘the Companies Act’ provides that a person can be liable if he has authorized or caused the issue of a prospectus which contains an untrue statement or an omission. The person is liable to any person who has relied on the faith of the prospectus to purchase debentures in a company. The key requirement is reliance on the prospectus. One of the persons who may have authorized or caused the issue of a prospectus is the auditors.

Thus, auditors owe a duty to prospective debenture holders. The auditors must ensure that the statements in the prospectus are true or there is no willful non-disclosure therein. Otherwise, they have to compensate for any loss or damage suffered by the prospective debenture holders.

As regards to auditors in the banking sector, S. 40(15)(d) of the Banking and Financial Institutions Act 1989 (BAFIA) provides that an auditor must report to Bank Negara Malaysia (BNM) if he is unable to confirm that the claims of creditors are covered by the assets of the financial institution. A similar provision is found in S. 128(1) of the Capital Market and Services Act 2007 whereby the auditor is under a duty to report to the Securities Commission (SC) if he is unable to confirm that the claims of creditors are covered by the assets of the company. It should be noted that although the provisions do not expressly provide that auditors owe a duty to the creditors, they are required to consider the interests of the creditors. Thus, it is submitted that a duty is owed by the auditors to the creditors.

As regards to the company's guarantors, the Singapore Court of Appeal in *Ikumene Singapore (Pte) Ltd v Leong Chee Leng* (1993) noted that the auditors owe no duty to them. This is because the accounts are not made and prepared for the purpose of enabling a guarantor of the company to determine what steps he should take to safeguard his guarantee. Furthermore, the court asserted that the scope of an auditor's duty should not be widened to include losses that may be suffered by a guarantor of a company. Notably, the guarantee was given before the auditors were appointed. Thus, it is right for the court to establish that no duty is owed.

Nevertheless, the decision is confined to its own facts. This is because there could be situations where a guarantor or a creditor gives a guarantee or credit respectively on the basis of the auditors' report before entering into a transaction with a company. In such a case, there is reliance on the report. In such a case the auditors have to ensure that the report is true and accurate.

This is because suppose a company is ailing financially, the company will seek a loan from a creditor. However, the auditors' report may suggest that the company is financially strong in order to influence the creditor in giving a loan. Due to the creditworthiness of the company, the creditor will grant a loan. The creditor will not grant a loan if it knew the real financial position of the company. Subsequently, the creditor discovered that the auditors' report is a fraud. Based on the present law, the creditor has no recourse against the auditors who had assisted the company to obtain a loan. This is not right especially in cases where there is evidence to show that the auditors have assisted in the commission of fraud. Even if there is no commission of fraud, auditors must ensure that the report is true and not misleading.

### **Duty to Companies Wishing to Exercise Takeovers and Mergers**

In the case of *Scott Group Ltd v McFarlane* (1978) the New Zealand Court of Appeal established that auditors owed a duty to persons whom they knew or ought to have known would rely on the lodged accounts which they had audited. The auditor ought reasonably to have been aware that a takeover may occur and in such an event, the lodged accounts would be relied upon. Thus, when audited accounts are filed at a public registry, a reasonable foreseeable takeover bid even if unknown to the auditors will give rise to a duty.

The English court in *JEB Fasteners v Marks, Bloom & Co* (1983) found that the auditors knew that the company needed outside financial support. Therefore they ought to have foreseen that a takeover was a possible means of finance and that the person offering the takeover will rely on the accounts. Hence, the auditors owe a duty to the companies wishing to exercise a take over. In *ADT Ltd v BDO Binder Hamlyn* (1996) the auditors were held to owe a duty to the company which exercised a takeover. The same was held in *Electra Private Equity Partners v KPMG Peat Marwick* (2000) because the auditors knew that the audited information will be used by the company wishing to exercise a takeover. In *Morgan Crucible Co plc v Hill Samuel Bank Ltd* (1991) it was found that there is a duty owed by the auditors to companies wishing to exercise a take-over. This is so especially where a company is vulnerable to a take-over. The court also found that since the bidders will usually rely on the auditors' report before making their bid that is enough to establish that a duty is owed. This is so even if the bidder is an existing shareholder of the company. Sometimes it may persuade the bidder to increase its bid. In *Galoo Ltd v Bright Grahame Murray* (1994), the court pointed out that if the auditors are expressly made aware that the particular identified bidder will rely on the audited accounts, the auditors will be under a duty owed to the bidder.

However, in *James McNaughton Paper Group v Hicks Anderson* (1991) it was decided that even if the auditors knew that the audited accounts will be used by a bidder as the basis of a bid, they will not be liable if they reasonably believed and were entitled to assume that the bidder will also seek the advice of

his own accountant. However, this assumption is untenable and in such a case it is unreasonable to expect the bidder to seek independent advice. Seeking independent advice should not absolve the auditors from owing a duty and ensuring that the report is true and accurate.

In *Twomax Ltd & Goode v Dickson, McFarlane & Robinson* (1982) and *Gordon v Dickson, McFarlane & Robinson* (1982) the plaintiff acquired a controlling shareholding in a private company. It was found that the acquisition was in reliance of the auditors' report. The court found that the auditors owe a duty to the company which exercised an acquisition.

Thus, there seems to be conflicting cases on this point. However, in view of a more principled approach and the current trends of expecting a more exacting duty of auditors, it is submitted that auditors should owe a duty to companies wishing to exercise takeovers and mergers.

### **Duty to Government**

There can be situations where the government, that is, Federal Government, State Government or Local Government refers to the auditors' report of a company before making any decisions as regards to the company. For instance, it could be a situation where the government wishes to enter into a contract or award a tender to a particular company. However, the government is unsure whether the company is financially sound to undertake the project. In such a situation it is reasonably foreseeable that the government will refer to the auditors' report.

Pempena Sdn Bhd which was established in 1976 is an investment and holding arm of Tourism Malaysia. The Tourism Ministry has directed PricewaterhouseCoopers, a review on Pempena to determine the future direction of the company as well as to probe allegations of corrupt practices in the company (New Straits Times, 2008). Thus, the report will highly be relied upon by the government in making certain key decisions. This is because Malaysia has recorded 12.9 million foreign tourists up to July 2008. The government cannot afford to lose this revenue due to any corrupt practices.

In *Andrew & Ors v Kounnis Freeman* (a firm) the English Court of Appeal had to decide whether the auditors owe a duty to the local authorities. The local authorities had to refer to the auditors' report before making a decision whether to renew the license for the company. The court found that the auditors ought to have been aware that the authority will take audited accounts and use them as a basis for its decision. It was a reasonable inference. Thus, a duty should be owed to the government in such circumstances.

It should be noted that there are no local cases on this point and further 'the Companies Act' does not address this issue. However, the principles laid down are sound in law and thus it is submitted that a duty should be owed.

### **CONCLUSION**

The traditional view in company law is that auditors should only owe their duty to the company since they are under a contractual relationship with the company. This is justified on the basis that the company suffers loss if the report is untrue. Nonetheless, it is trite to declare that others may also suffer a loss if the report were to be untrue (Chan, Cheah & Heng, 2003) If the traditional view continues then stakeholders will never be in a secured position. The auditors should not be solely concerned with the company. The auditors should also bear in mind the interests of the stakeholders. It is not practicable for stakeholders to engage their own auditors before taking any steps. This is because the company may not be willing to

disclose its financial information to external parties. Thus, the information revealed by the auditors is of primary importance to the stakeholders. Many fraudulent activities and ventures can be planned with the ingenious work and plan of the auditors. Therefore, the guiding principles for the auditors should be responsibility and accountability. This responsibility and accountability must be owed to a wider circle of persons and bodies, that is, the stakeholders.

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