

## IN THE MATTER OF THE PRISCILLA TRUST

### POSITION PAPER FOR GOOD FIGURES AUDITORS

1. This Paper sets out the position of Good Figures, auditors of Jollybadfellow Ltd.

#### **FACTUAL BACKGROUND:**

2. Jollybadfellow Ltd is an English private company in retail business. In 2000 it had a value of £100 million.
3. Over the past 8 years Mr Belrose, a shadow director of the company and one of the trustee shareholders, used the company to commit letter of credit frauds against a number of UK banks. Mr Bassenger, the sole director *de jure*, was warned about Mr Belrose's activities 2 years ago but chose to take no action. Good Figures did not detect Mr Belrose's fraud.
4. The UK banks are now suing the company and, if they are successful, this will render the company insolvent.

#### **LIABILITY:**

5. Before anybody can allocate blame or assess loss, it is clear that there are three questions that need answering:
  - (i) First - what loss has been caused by the fraud?
  - (ii) Secondly - to what extent could and should the fraud have been detected?
  - (iii) Thirdly - is there a limitation of liability?

#### **The Loss:**

6. The company was worth £100 million, but that is not necessarily the loss caused by the fraud. A considerable amount of this loss could well have been caused by poor trading results over the past 9 years.

#### **Detection:**

7. An auditor is not an insurer and does not guarantee the accuracy of the company's books in general or the balance sheet in particular - rather an audit is simply a 'reasonable assurance' that the financial statements of the company are collectively free from 'material misstatement'; see SAS 100. Nor is an auditor required to be a detective and seek out fraud; *re Kingston Cotton Mill Co (No.2)* [1896] 2 Ch 279. Rather, it is the duty of the **directors** to prepare the financial statements, and the auditor simply expresses an opinion on them. Only when there are suspicions of fraud does the auditor become under a duty to investigate and 'drill down' on the issue. Simply because there has been fraud does not automatically mean that there are grounds to be suspicious. Nor does its non-detection indicate that an auditor was negligent. So on any basis Good Figures is not liable until non-detection became unreasonable.
8. A standard letter of credit fraud will be exposed within a short time because the paying bank will start investigations on not being reimbursed by its customer. Here, the fact that letter of credit frauds managed to continue for **8 years** without the banks noticing shows that this was a sophisticated fraud which could reasonably escape detection.

9. The first time there might be some suspicion arising, and therefore potential liability, was 2 years ago when Mr Bassenger was warned. But, despite his duties, he did nothing. This is not Good Figures fault, nor are they liable for his breaches of duty.

**Limitation of liability:**

10. When was the last time you found an auditor who did not limit their liability or operate through an LLP?

**DEFENCES:**

11. Even assuming that there might have been negligence in auditing the accounts at any time in the past 8 years, the only person who can claim against Good Figures is the company. The problem for the company is that it was the fraudster and the maxim *ex turpi causa non oritur actio* applies.
12. The usual rule in Hampshire Land against the attribution of knowledge of fraud will not apply here for two reasons:
  - (i) First - in reality Jollybadfellow Ltd was a 'one man' company, where Mr Belrose was the *de facto* guiding mind and effective owner of this company. Mr Bassenger was merely a cat's paw for Mr Belrose. The reality is that the company was used to the commit the fraud and was not a victim of it, and therefore the exception to the Hampshire Land rule expressed in Moore Stephens (a firm) v Stone & Rolls Limited (in liquidation) [2009] UKHL 39 applies.
  - (ii) Secondly - Good Figures was as much a victim of Mr Belrose's fraud. We were induced to act on the basis of accounts which were fraudulently prepared by him.
13. In any event, we would be entitled to bring contribution claims against Mr Bassenger, for his failure to pass on the concerns of the employee over 2 years ago, and for his general breaches of duty *qua* director.