



# SMSF Association National Conference 2019

Auditor best practice - a workshop  
examining our responsibilities in light  
of McGoldrick and Baumgartner

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**SMSF**  
ASSOCIATION

## 1 Cam & Bear Pty Ltd v McGoldrick [2018] NSWCA 110

### 1.1 Facts

- (a) The appellant, Cam & Bear Pty Ltd (**Cam & Bear**), was the corporate trustee of a self-managed superannuation fund (**SMSF**), which was set up for the benefit of Dr Lance Bear and Ms Jennifer Campbell. Dr Bear and Ms Campbell were also directors of Cam & Bear.
- (b) The SMSF's investments were managed by Lewis Securities Ltd (**LSL**), a company owned by Mr Lewis, a friend of Dr Bear, pursuant to a custodian authority.
- (c) When Dr Bear deposited cash into the SMSF bank account, LSL did not hold onto the cash or invest it in listed equities. Instead, the cash were lent on an unsecured basis to LSL Holdings Pty Ltd, a related entity owned by Mr Lewis.
- (d) However, these unsecured loans were not revealed to Dr Bear, who believed that his cash contributions were invested in secured products, which could be accessed and retrieved at any time. Furthermore, the payments to LSL Holdings Pty Ltd were recorded as "Cash-LSL Holdings P/L" in the SMSF's financial statements.
- (e) The respondent, Mr McGoldrick, was the auditor of the SMSF between 2003 and 2007. He had queried the cash descriptions on the financial statements but did not proceed to qualify the fund's financial accounts. Mr McGoldrick did not bother to examine the entries or inform Dr Bear that he may not be able to recover the monies in question.
- (f) In September 2008, Dr Bear was unable to withdraw cash from the SMSF as his contributions had been used for unsecured loans. In November 2008, Mr Lewis' company went into voluntary administration, which resulted in a \$950,000 loss for the SMSF.
- (g) As a result, Cam & Bear sued Mr McGoldrick for damages for negligence, and misleading and deceptive conduct.
- (h) The Supreme Court of NSW found that Mr McGoldrick had breached his duty of care and made false and misleading statements in relation to the SMSF's accounts. However, his conduct did not cause Cam & Bear any loss. Instead, it was the inappropriate level of trust Dr Bear, as director of the trustee company, placed in LSL that resulted in the loss.
- (i) Subsequently, Cam & Bear brought an appeal in the NSW Court of Appeal (**CoA**). The judgement was handed down on 23 May 2018.

## 1.2 Decision

- (a) The CoA held that the primary judge was correct in concluding that Dr Bear would not have acted differently if the descriptions in the financial statements were changed to ‘loans’ instead.
- (b) However, this did not mean that the breaches by Mr McGoldrick did not cause the loss suffered by the appellant.
- (c) Mr McGoldrick breached his duty of care because he failed to qualify his audit certificate. He was required to make proper enquiries as to the recoverability of the cash amounts held by LSL Holdings Pty Ltd and to report the results of those enquiries to the trustee.
- (d) According to Dr Bear’s evidence, if he had known that there was no guarantee of the repayment of loans, he would have withdrawn his investments.
- (e) Based on Dr Bear’s evidence, the CoA held that Mr McGoldrick’s negligence caused the loss as it resulted in Dr Bear’s continuous contributions to Mr Lewis’ companies, which would not have been made otherwise.
- (f) Mr McGoldrick’s negligence was also found to be of “significantly greater importance” in causing the loss than the conduct of the SMSF’s trustee.
- (g) This is because Mr McGoldrick was a highly skilled accountant and auditor. He was also especially employed for the purpose of protecting the fund and its trustee against financial risks that included the very risk that eventuated.
- (h) As a result, the CoA concluded that Mr McGoldrick did cause the loss suffered by the appellant and was liable for the majority of the SMSF’s loss.
- (i) The CoA apportioned 90% of the loss to Mr McGoldrick, taking into account the contributory negligence of the corporate trustee.
- (j) The CoA noted that the parties had not addressed the quantification of the appellant’s loss, and held that the parties should be afforded the opportunity to resolve those issues.

## 1.3 Comment

- (a) Auditors have a duty to ensure that financial statements are accurate and a duty to advise trustees about the recoverability of investments.
- (b) There is a very high standard of care expected from auditors as professionals when giving recommendations to SMSF trustees, especially when the trustees are not financially sophisticated.

## 2 Ryan Wealth Holdings Pty Ltd v Baumgartner [2018] NSWSC 1502

### 2.1 Facts

- (a) In 2006, Ms Trudy Crittle established a SMSF. The plaintiff, Ryan Wealth Holdings Pty Ltd (**RWH**), was the trustee of the SMSF and Ms Crittle was the sole shareholder and director of RWH.
- (b) After establishing the SMSF and appointing RWH as the trustee, Ms Crittle transferred \$7 million to a financial planning firm known as Moylan Retirement Solutions Pty Limited (**MRS**). This was in accordance with Mr Moylan's advice. Mr Moylan was the director, shareholder and authorised representative of MRS who was referred by Ms Crittle's solicitor, Mr Hill.
- (c) The \$7 million was invested by MRS into several unsecured loans pursuant to a series of facility agreements as well as two unit trusts. The loans were made in order to finance the development of several projects of entities that are closely connected to Mr Moylan and Mr Hill.
- (d) Mr Moylan acted as the accountant and tax agent for the SMSF starting from 2006 through his other company, Moylan Business Solutions Pty Ltd (**MBS**). He also acted as auditor of the SMSF for the 2006 financial year.
- (e) Between 2012 and 2014, various persons and entities connected to the property ventures in relation to the loans and investments were placed into bankruptcy or liquidation.
- (f) Furthermore, at the start of 2013, MRS and MBS's professional indemnity insurances lapsed. MRS was deregistered and MBS was liquidated.
- (g) Ms Crittle was contacted by a unit holder in mid-2013 who expressed concerns about the financial position of one of the trusts and its assets. Following the communication, the plaintiff engaged a forensic accountant and a firm of solicitors to assist her in investigating the situation.
- (h) Subsequently, the plaintiff took steps to recover the loans and investments of the SMSF by taking legal actions against the solvent borrowers, guarantors and third parties. Ms Crittle was successful in claiming a portion of the SMSF's proceeds, amounting to \$3,277,785.
- (i) The defendant, Baumgartner, was the auditor of the SMSF between 2007 and 2009. The plaintiff initiated proceedings against Baumgartner for failure to detect irregularities in the SMSF for many years and the consequence of the plaintiff losing the opportunity to recover monies.
- (j) The plaintiff relied upon five breaches of duties and contract and common law, as follows, being that the defendants:

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- (i) failed to inquire into and report accurately as to whether the loans and investments of the SMSF were made in accordance with an investment strategy that had regard to all of the circumstances of the SMSF and the matters set out in Regulation 4.09 of the Superannuation Industry (Supervision) Regulations 1994;
  - (ii) failed to audit the SMSF so as to be able to reasonably form the opinion as to whether there had been compliance, in all material respects, with the requirements of the SIS Act and SIS Regulations;
  - (iii) failed to bring to the plaintiff's attention, by notation, qualification or other communication, serious misdescriptions and misstatements in the financial statements of the SMSF and other facts and circumstances which any competent auditor would bring to the plaintiff's attention;
  - (iv) failed, acting reasonably, to form and express certain opinions; and
  - (v) failed to exercise due care and skill in a number of respects beyond the failure admitted by the defendants.
- (k) The case was heard in the Supreme Court of NSW and judgement was handed down on 8 October 2018.

## 2.2 Decision

- (a) Walton J held that the defendants had a "significant ability" to prevent the kind of loss that eventuated and thus were liable for the loss incurred by the plaintiff.
- (b) Baumgartner were aware that the loans and investments made by MRS were to entities connected to Mr Moylan and Mr Hill and were highly risky. They would have also considered the high possibility that the investments may all fail.
- (c) In addition, Baumgartner was conscious of the fact that the pension from the superannuation fund was Ms Crittle's only source of income.
- (d) Nevertheless, Baumgartner failed to perform their duties. For the three years, the defendant failed to qualify their audit reports. They did not bring up their concerns in relation to the loans nor highlight the shortcomings of the loans to Ms Crittle.
- (e) Walton J found that, in carrying out the audits under the retainers for each of the relevant financial years, Baumgartner breached the audit contracts and their common law duties to take reasonable care in the performance of their engagement to provide the audit reports for the relevant financial years.
- (f) Baumgartner also failed to confirm whether the SMSF's investment strategy had given enough consideration to risk, return, liquidity and diversification as per Regulation 4.09 of the

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Superannuation Industry (Supervision) Regulations 1994. They did not check whether the fund's investments were made in line with the SMSF's investment strategy.

- (g) The Court found that Baumgartner were negligent in, *inter alia*, failing to exercise reasonable care in the preparation of the audit reports (including and beyond the admissions), failing to inquire and report into whether the investments were made in accordance with an investment strategy that had regard to all the circumstances of the SMSF, and failing to report serious misdescriptions and other circumstances to the plaintiff.
- (h) Because of Baumgartner's failures, Ms Crittle was unaware of the deficiencies in the accounts and operations of the SMSF.
- (i) This also delayed Ms Crittle in bringing any actions she would have taken. Had Ms Crittle known of the nature of the loans, she would have taken action earlier. The Court was satisfied that, on the balance of probabilities, had a qualified audit report been issued in 2008 or in subsequent years, Ms Crittle would have "called in" the loans and investments so far as it was available to her to do so at the relevant time. Walton J noted there would have been a greater probability of the loan proceeds being retrieved, and the losses suffered by Ms Crittle would have been to a lesser degree or prevented.
- (j) The Court held that the breaches of contract and duty, and misleading and deceptive representations, were a cause of Ms Crittle's failure to discover the true position regarding the SMSF and, thus, a cause of loss.
- (k) The Court agreed that what Ms Crittle had lost was the chance of making recovery in respect of the investments. It held that once the existence and loss of a chance have been established, damages are to be assessed by reference to the Court's assessment of the degree of likelihood that the commercial opportunity would have yielded success had it been pursued. The value of an opportunity that has been lost is to be ascertained by reference to the "degree of probabilities or possibilities".
- (l) The Court found that Ms Crittle suffered the loss of a chance or opportunity to make recoveries for amounts she did not, in fact, recover, and loss of a chance or opportunity to obtain the benefit of recovering earlier in time recoveries actually made. Seeing Baumgartner's failure was the cause of the plaintiff's loss, the plaintiff was awarded damages from the defendant for a sum of \$2,260,140 exclusive of any claim for interest from 31 August 2017.
- (m) The award of damages was apportioned 90% to Baumgartner and 10% to the plaintiff to take into account the contributory negligence of the trustee.
- (n) The above amount was further apportioned 80% to Baumgartner and 20% to MBS for the proportionate liability of MBS. MBS as the accountant and tax agent in charge of preparing the financial reports for the SMSF had a lesser degree of culpability than the defendant.
- (o) The Court held that the basic duty of an auditor has always been to audit accounts with reasonable care and skill, citing *Pacific Acceptance Corporation* at 73-74, and that Baumgartner

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owed a common law duty to exercise reasonable care and skill in the performance of his engagement to provide an audit report in each of the relevant financial years.

- (p) The Court held that ‘It is true the auditor is not a guarantor of a fair presentation of the financial reports *per se.*’ However, the defendants had admitted that the SMSF’s financial statements were materially inaccurate and did not present fairly the financial position of the SMSF.

## 2.3 Comment

- (a) Because auditors hold themselves out as practising a highly skilled and exacting profession, they will be held accountable if they do not meet their professional standards.
- (b) Auditors have the responsibility to make adequate enquiries as to the nature of suspicious investments and to qualify accounts when necessary. Failure to do so may lead to liability for the losses incurred by the client.
- (c) Auditors also have a duty to communicate with trustees directly if any concerns are raised in the auditing procedure and to discuss the potential impact on the accounts and auditor reports.

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