THE DUTIES AND LIABILITIES OF AUDITORS UNDER SWISS LAW

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1. Introduction

Several recent decisions of the Swiss Federal Supreme Court (Bundesgericht) have expanded the liability of corporate auditors to corporations, shareholders and creditors. This article outlines the position, eligibility and duties of auditors, defines the prerequisites of liability, describes the assessment of damages, enumerates the persons entitled to sue, and delineates their rights of action [1].

2. Position, eligibility and duties of auditors

2.1. Position

The Swiss Code of Obligations (hereinafter cited as the Code, CO) [2] mandates three corporate organs [3]. The general meeting of shareholders adopts and amends the articles of incorporation, approves the issue of capital stock, and elects members of the other organs. The board of directors acts as an executive organ, responsible for managerial functions. The auditors examine the accounting procedures and calculations used in corporate reporting. Auditors are elected by the shareholders, pursuant to the Code, Art. 727 I, for terms of one to three years. The auditors may be re-elected indefinitely.

Additional organs may be established by means of the by-laws. Those additional organs, however, can be assigned no duties which, pursuant to the Code, belong to one of the three statutory organs.

2.2. Eligibility

Auditors may not be members of the board of directors or employees of the audited corporation. This is the only qualification required for most auditing

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positions. No expert knowledge is required and, in practice, many auditors are non-professionals [4].

Exceptions to this general rule exist for banks and certain large corporations. If a corporation has capital stock of five million francs or more, has issued bonds, or attempted to float a public issue, CO Art. 723 requires that the balance sheet be examined by independent professional auditors. Bank auditing can be done only by members of specially qualified professional auditory firms which have been certified by the Banking Commission.

2.3. Duties

2.3.1. General duties

Pursuant to CO Art. 728 I, auditors must conduct an examination to determine whether a corporation’s profit and loss statement and balance sheet conform with its books, whether the books are kept properly, and whether the business results and financial position represented in the financial statements comply with statutory requirements as to valuation. Auditors must also examine the corporation’s books to see whether they comply with any relevant special provisions of the articles of incorporation.

These statutory duties represent the minimum efforts required of auditors. They lack specificity and therefore must be interpreted by reference to corporate [5] and general bookkeeping rules [6]. In practice, a number of rules have emerged.

Auditing once involved little more than mathematical verification of bookkeepers’ computations [7]. For example, the Bundesgericht once held that auditors were not required to certify the accuracy of individual valuation claims [8]. Today, a mere bookkeeping check is not sufficient. Auditors must examine the propriety of the corporation’s bookkeeping system. For example, the Court recently declared that although auditors are not obliged to examine the value of every balance sheet entry, they must ensure that the most important assets are not valued at costs that exceed the original acquisition or production costs less adequate depreciation applicable under the circumstances [9].

In 1967 the Bundesgericht expanded the duties of auditors even further, BGE 93 (1967) II, at 22, by requiring auditors to ascertain whether the capital surplus entries were accurate in view of unrecorded depreciation. The auditor was also required to determine whether the valuation of inventory (the most important item on the assets side of the balance sheet in question) had been calculated according to the “principle of lowest value” laid down in CO Art. 666. According to this principle, raw materials must be recorded at the lowest value as determined by purchase price, manufacturing cost, or market value. The Court also required auditors to consult experts, if necessary.

Finally, the trend toward expansion of auditor’s duties is evidenced by the
1975 decision of the Zürich Commercial Court, affirmed by the Bundesgericht, holding auditors liable for damages for not drawing a fully consolidated balance sheet [10] and for not examining several credits or the financial situation of subsidiaries. Finally, a 1979 decision of the Zürich High Court (Obergericht) [11] held auditors liable for damages for relying on expert opinions of the valuation of a corporation’s real estate where the opinions were given by individuals closely connected with the corporation and instructed by it.

2.3.2. Duties of bank auditors

The duties of bank auditors exceed those of corporate auditors. Bank auditors must examine the soundness of valuation of assets and liabilities. Where necessary, they must conduct a comprehensive, independent verification of the bank’s assets and liabilities. They must also assess the legality of accounting methods used and any distribution of profits. Any irregularities that are discovered must be reported to the shareholders or board of directors, and a deadline must be set for the bank to correct any such problems. If necessary, the auditors are required to inform the Banking Commission [12]. In contrast, corporate auditors are not required to set a deadline or to inform any public authority.

3. The liability of auditors under Swiss law

Articles 752 through 761 of the Code enumerate the liabilities of members of the various corporate organs. The basic provision concerning the liability of auditors is CO Art. 754 I, which provides:

All persons appointed directors, managers or auditors are responsible to the company, as well as to the individual stockholders and creditors of the company, for the damage caused, intentionally or negligently, by default in their duties.

This provision enumerates both the elements necessary to establish liability (ie. damage, breach of duty, negligence) and the classes of potential plaintiffs (the company, its shareholders and creditors).

This section discusses the elements of liability. Section 4 will concentrate on the classes of plaintiffs and the conditions under which they may sue.

3.1. Damage

Damage, or the loss of pecuniary value, is a prerequisite to any liability, including, as specified in the statute, the liability of auditors. Where there is no damage, liability claims are absolutely barred, even where there has been a breach of duty.
The burden of establishing the existence and extent of damages falls on the plaintiff. The court may exercise its discretion to estimate the loss only where evidence of the exact numerical loss is impossible or unreasonably difficult to obtain. This estimate must be based on normal business practices and on the plaintiff's own efforts to mitigate the harm [13]. Even where the court makes its own estimate, however, the plaintiff has the burden of presenting whatever evidence he has on the issue.

Occasionally, a breach of duty causes profits as well as damages. In computing loss, such profits must be set-off against damages. Set-off is not allowed, however, for profits which arise by reason of the auditor's day-to-day performance of his duties. He is obliged to fulfill these duties at all times, and any resulting profits rightfully belong to the corporation. Using them to reduce the damage award would therefore amount to providing extra compensation to the auditor.

3.2. Breach of duty

Auditor liability is premised upon a breach, or default, of some duty. The articles on general corporate liability do not define the duties of auditors, which are covered by specific statutory provisions. Articles 728 through 730 of the Code outline three duties: the duty to examine the records [14]; the duty of confidentiality [15]; and the duty to submit at the general meeting of shareholders a written report containing a qualified or unqualified recommendation that shareholders either accept the balance sheet or return it to the board of directors. This report must also contain an opinion as to whether the board's proposals for distributing profits comport with the corporation's articles of incorporation or by-laws and the relevant statutory provisions [16].

Swiss courts have found each of the following acts and omissions to constitute a breach of duty [17]:

- the failure to report a consolidated balance sheet for a group of interdependent companies so closely related that they could be reliably evaluated only when considered together [18];
- the failure to evaluate whether capital assets have been properly valued according to the "highest valuation" principle, and to determine whether the necessary write-offs have been taken [19];
- the failure to examine the accuracy of the valuation of the most important assets [20];
- the failure to accord proper weight to expert opinions, and the failure to obtain independent experts when necessary [21];
- recommending the approval without qualification of the balance sheet despite stated or presumed valuation faults [22] or recognizable insolvency [23];
- accepting the position of auditor or continuing to act as auditor while failing to call in an expert despite the lack of necessary expert knowledge [24].
3.3. Negligence

As noted above, CO Art. 754 holds auditors liable for intentional or negligent breaches of duty. Even slight negligence creates liability under general principles of Swiss law. The degree of negligence is important, if at all, only insofar as it may justify a reduction of damage awards [25].

Under Swiss law, the standard of care for determining negligence is an objective one [26]. Thus, an auditor will be found negligent if he did not exercise the amount of care which would be exercised by a conscientious and reasonable man under the circumstances [27]. Subjective factors such as a particular individual's want of knowledge, inexperience, or lack of time are irrelevant [28]. Even the observance of *diligentia quam in suis* — of the care one takes with his own affairs — is not necessarily sufficient [29]. The actual circumstances and complexity of the duty, however, are relevant considerations in determining whether the auditor was negligent [30].

3.4. Causation

An action for damages will lie against an auditor who has negligently breached a duty only if this negligence was an “adequate” cause of harm. Thus, although causation-in-fact is necessary [31], it is not sufficient. There must also be a foreseeable tendency for the conduct to cause the type of harm which occurred. As explained by the Bundesgericht in BGE 93 (1967) 29, an event is considered:

> an adequate cause of an effect, if it was appropriate according to the normal way things go and to the experience of life, to cause a result like the one which occurred, so that the occurrence of this result generally seems to be favored by the event....

The threshold of adequate causation is not high in the area of corporate liability. Furthermore, the auditor’s breach of duty need not be the sole cause-in-fact of the harm. It is enough that the breach is a cause-in-fact. That other factors, such as the negligent conduct of a third person, contribute to the harm is therefore irrelevant [32].

Finally, it should be noted that adequate cause will not be found where it is clear from the facts that the proper exercise of the duty would not have prevented the harm. However, this does not mean that a negligent auditor can avoid liability by hypothesizing about what might have happened had he not breached his duty; for example, an auditor may not claim that if he had acted properly another organ would have acted negligently, thereby causing the harm. Thus, the court imposed liability on an auditor who failed in his duty to report, despite his plea that the board of directors would have ignored the report [33]. Likewise, liability was imposed on an auditor who failed to submit
a report to the shareholders' general meeting, although it was obvious that the sole shareholder and sole member of the board of directors would not have changed his conduct had the report been submitted [34].

3.5. Mitigation of damages

Although demonstration of any negligence on the part of the auditor is sufficient to give rise to a cause of action for damages, Swiss law recognizes that damages may be mitigated in cases involving only slight negligence. Swiss courts have reduced damage awards where the defendant's negligence was minor [35]. Damages may also be reduced in situations where a plaintiff's own negligence has contributed to his injury [36], but not in cases where a third party is found negligent [37]. Other, exceptional factors may also warrant a reduction of damages, e.g. the fact that the person liable would be subject to distress as a result of his payment of damages [38].

3.6. Joint and several liability

Many cases of corporate liability involve more than one defendant. In such cases, the law provides the plaintiff with a remedy which can be of striking severity to a defendant. Pursuant to CO Art. 759 I, defendants are jointly and severally liable for the total amount of damages owed. Thus, the plaintiff can demand full recompense from any defendant he chooses [39].

Because the principle of joint and several liability is applicable not only between members of the same corporate organ [40], but also, for example, between members of the board and auditors, such liability may result in serious and unjust consequences. For example, often the parties primarily responsible for the harm, corporate directors who have acted criminally, cannot be sued because they have moved abroad or because they lack adequate financial resources. In such cases, the auditors, whose negligence may have been very slight, can be liable for the entire amount of damages. The anomalous result in this situation is that the least guilty party pays fully for the acts of the more egregious offender, who suffers no penalty at all [41].

The practice of the Bundesgericht in applying this principle has exacerbated its inherent severity. Specifically, the Bundesgericht has refused to mitigate damages where several parties are jointly liable. Nevertheless, mitigation is allowed where there is only a single defendant. The paradox is clear: a single defendant, though considerably negligent and solely responsible for the harm, may enjoy mitigation of damages, whereas full damages may be demanded from the most innocent of a group of defendants. In many cases, recoupment will not prevent this injustice. Although a judge may apportion damages according to the relative degrees of negligence of members of a group of defendants [42], recoupment by one who pays the portions owed by others is
often unlikely because the other defendants have become insolvent or have left the country.

The principle of joint and several liability as practiced by the Bundesgericht has elicited severe criticism [43]. The Court, however, continues to support it, stressing that joint and several liability is designed to guarantee complete satisfaction of the plaintiff's claim [44].

4. Persons entitled to sue

As noted above, CO Art. 754 I establishes not only the liability of auditors, but identifies the persons entitled to sue them, namely the corporation, its shareholders and creditors. As will be demonstrated, the statute has differentiated the right of action, depending upon the plaintiffs and circumstances involved.

4.1. The corporation

The corporation is entitled to sue if it suffers any loss by reason of a negligent or willful breach of duty by the auditor. The loss does not have to be so great that it causes the company to go into bankruptcy.

It is up to the board of directors to bring suit against the auditors on behalf of the corporation. Their decision to sue does not require special authorization or ratification by the shareholders [45]. The shareholders may prevent suit by the corporation, however, by granting the auditors a valid release [46]. The release is only valid against actions which actually were known or could have been known to the shareholders [47]. Normally, however, the board of directors does not bring a breach of duty to the shareholders' attention. Thus, a general release is often invalid because the shareholders are not sufficiently informed.

4.2. The shareholders

The law allows shareholders to sue for proximate (direct) as well as mediate (indirect) damages [48], although the right of action differs. A shareholder is proximately injured if his shares are seized illegally or if his quota of a dividend or liquidation is not paid. Shareholders are mediately injured where the company suffers proximate damages. Normally, shareholders suffer mediate damages as a result of an auditor's breach of duty.

In the case of proximate damages, each injured shareholder may sue, irrespective of potential claims for damages by other stockholders, creditors, or the corporation. Neither bankruptcy nor the granting of a release will bar this right of action [49].
In the case of mediate damages, the shareholder’s right of action varies depending on whether the company is bankrupt. If the company is not declared bankrupt, the shareholder has only a claim for damages to be paid to the corporation. He therefore obtains compensation only indirectly and only in proportion to his share in the corporation. Thus, a small shareholder will receive only a fraction of the damages awarded. A small shareholder will rarely sue for mediate damages because, should he lose the case, he would have to pay all the court costs and attorneys’ fees for both parties.

In the case of bankruptcy or liquidation receivership, the shareholder’s right of action is considerably restricted. He cannot claim mediate damages individually; rather, the receiver must assert the claim [50]. Only if the receiver waives the right to sue can the shareholder demand assignment of the claim and the right to sue independently.

The granting of a release by the general meeting of stockholders waives the right of action for mediate damages only for those stockholders who consented to that resolution or who subsequently acquired shares with knowledge of the resolution. For the remaining stockholders, the right of action remains but the statute of limitations is shortened to six months [51].

4.3. The creditors

The creditor’s right to sue also varies depending on whether the claim is for proximate or for mediate damages. The proximately damaged creditor can sue individually in the same way proximately damaged stockholders can [52].

The right of action for mediate damages varies depending on whether the corporation is in bankruptcy. As long as the corporation has not been declared bankrupt, the corporation’s creditors cannot claim their right of action under the CO Art. 758. The reasoning is that as long as the company is able to discharge its liabilities, the creditors have suffered no injury.

In the case of bankruptcy, the creditor’s right of action is essentially the same as that of a shareholder [53]. Creditors, however, are usually more interested in raising claims for damages than are shareholders. Creditors’ claims must be satisfied first; only the surplus which remains after full compensation of creditors is distributed to the shareholders [54].

The granting of a release by the shareholder has no effect on the claims of creditors. The importance of a release is therefore almost completely emasculated by the rule that, if the company goes bankrupt, the receiver may sue based on the creditor’s right of action, even if the company’s own right of actions is extinguished because of a release. Therefore, in the case of bankruptcy, a release is largely ineffective.
5. Conclusion

The number of liability actions instituted against auditors in Switzerland has increased remarkably during the past several years. Unfortunately, the present state of the law governing the liability of auditors has brought about arbitrary results in these cases. Frivolous cases are routinely asserted in bankruptcy cases, for example, whereas meritorious actions for mediate damages are not brought by creditors because of procedural limitations, nor by individual shareholders because of the risk of paying court costs. In addition, once a lawsuit is brought, a single defendant may enjoy mitigation of damages despite considerable negligence, whereas the least negligent of a group of defendants may have to pay full damages.

Legal reform should therefore aim toward two ends. Initially, bona fide claims outside of bankruptcy should be facilitated, easing procedural restrictions against creditors. Second, unreasonable and arbitrary damage awards should be avoided by allowing for liability based on degrees of negligence, even in cases involving more than one defendant.
Notes

[1] The following recent works are cited hereafter by author’s name and, sometimes, by key word:


[2] Swiss Corporation Law, together with the Law of Torts, Contract Law, and the Law of other companies and partnerships is contained in the Swiss Code of Obligations (CO). The CO, together with the Civil Code (CC), constitutes the entire body of Swiss Private Law. Although a revision of Swiss Corporation Law is underway, it is unlikely that any new provisions will take effect before the end of the decade.

[3] See Forstmoser/Meier-Hayoz 15 ff; Patry 221 ff; Steiger 180 ff.

[4] Allowing oneself to be elected auditor without expertise sufficient to properly perform one’s duties, however, can constitute a breach of duty, as is pointed out, infra at note 24.


[10] This was surprising because Swiss law does not require such consolidation except in the banking area.

These special rules are outlined in Bodmer/Kleiner/Lutz: Kommentar zum Bundesgesetz über die Banken und Sparkassen (Zürich 1976, mit Nachträgen) to Art. 19 ff.

For a detailed outline of the case law, see Forstmoser N 557 ff.

For example, between auditors or between members of the board of directors.

This was illustrated in a decision published as BGE 99 (1973) II 176. There, a member of a company's board of directors was held liable for damage suffered by the company when he invested 80% of its assets in highly speculative securities which soon became worthless. In this investment the director utilized the same care as he exercised in his own affairs; he also invested his own funds in the same securities and suffered a personal loss three times greater that that suffered by the company.

See Forstmoser N 210 ff.

See Oftinger, p. 340 f; Bättig 119; Forstmoser N 259 ff.

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As an example, a decision of the Supreme Court cited in Blätter für zürcherische Rechtsprechung 1976. Nr. 21. See generally Forstmoser N 271 ff.

This is discussed in detail in Oftinger 348 ff. See also, Hirsch, organe de contrôle 200.

See generally, Meier-Wehrli 45 ff., Bür 470 f; Hirsch, Responsabilité 267; Schiess 52 ff and Heinz Reichwein: Ueber die Solidarhaftung der Verwaltungsräte der AG..., Schweiz Juristenzeitung 64 (1968) 129 ff, recommending that the federal courts reverse their position on this issue. See also Forstmoser N 285 ff.

BGE 93 (1967) II 322, 97 (1971) II 416. One cational (state) court has recently refused to follow the practice of the Bundesgericht and reduced damage awards against defendants who were only slightly negligent, see Schweizerische Juristenzeitung 78 (1982) 380 ff.

Blätter für zürcherische Rechtsprechung 42 (1943) Nr. 8 S. 17; Meier-Wehrli 48; Bürgi/ Nordmann Art. 753 f N 100; Forstmoser N 9.

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[48] For this distinction, see Schiess.
[50] CO 756 I.
[51] CO 757. Normally, the statute of limitations runs for five years from the date on which the aggrieved party first learned of the damage and of the person responsible, but in no case for more than ten years from the date of the transgression. CO 760.
[53] For circumstances where this is not the case, see Forstmoser N 88 ff.
[54] See Bürgi/Nordmann Art. 756 N 22.

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