DENTONS

Beyond the numbers: Evolving risks in auditor and accounting liability

June 25, 2025

Moderator:

Sara Hart
Partner, Edmonton, Canada
+1 780 423 7376
sara.hart@dentons.com

Speakers:

Deepshikha Dutt
Partner, Toronto, Canada
+1 416 863 4550
deepshikha.dutt@dentons.com

Christy Lee
Partner, Calgary, Canada
+1 403 268 6354
christy.lee@dentons.com

Michael Schafler
Partner, Toronto, Canada
+1 416 863 4457
michael.schafler@dentons.com

Contents

The evolution of auditor liability

No Tort Duty (1930s)

- If liability for negligence exists, a thoughtless slip or blunder, the **failure to detect** a theft or forgery beneath the cover of deceptive entries, **may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class**. *Ultramares Corporation v. Touche*, 255 N.Y. 170 (1931)

Knowledge-based Tort Duty (1960s/70s)

- The statements were for benefit and guidance in a business transaction**, the nature of which was known to the accountants**. **The accountants were aware** that the company intended to supply the statements to members of a **very limited class**. Haig was a member of the class. It is true the accountants did not know his name but … I do not think that is of importance. I can see no good reason for distinguishing between the case in which a defendant accountant delivers information directly to the plaintiff at the request of his employer … and the case in which the information is handed to the employer who, to the knowledge of the accountant, passes it to members of a limited class (whose identity is unknown to the accountant) in furtherance of a transaction the nature of which is known to the accountant. *Haig v. Bamford* [1977] 1 S.C.R. 466

The evolution of auditor liability

Purpose-based Duty based on Anns

- A *prima facie* duty of care will arise on the part of a defendant in a negligent misrepresentation action when it can be said (a) that **the defendant ought reasonably to have foreseen that the plaintiff would rely on his representation** and (b) that **reliance** by the plaintiff, in the circumstances, **would be reasonable**. Even though, in the context of auditors' liability cases, such a duty will often (even if not always) be found to exist, the problem of indeterminate liability will frequently result in the duty being negated by the kinds of policy considerations already discussed. Where, however, indeterminate liability can be shown not to be a concern on the facts of a particular case, a duty of care will be found to exist. *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165

Anns Canadianized - Cooper

- While *Hercules* remains binding authority governing an auditor's duty of care in relation to a statutory audit, the framework by which that duty is imposed has since been refined. In … *Cooper* and *Edwards* …, this Court revised the *Anns* test by distinguishing more clearly between foreseeability and proximity, and by placing greater emphasis on a more demanding first stage of the two-stage analysis … . While, therefore, we rely on *Hercules* for the general proposition that an auditor may owe its client a duty of care in relation to a particular undertaking, it is the *Anns/Cooper* framework to which we must have reference in identifying a principled basis for imposing liability. And, properly applied, that framework will rarely, if ever, give rise to a *prima facie* duty of care that could result in indeterminate liability. *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63

The evolution of auditor liability

Stage one: prima facie duty = foreseeability + proximity.

- In cases of pure economic loss arising from negligent misrepresentation or performance of a service, two factors are determinative in the proximity analysis: the defendant's undertaking and the plaintiff's reliance. Where the defendant undertakes to provide a representation or service in circumstances that invite the plaintiff's reasonable reliance, the defendant becomes obligated to take reasonable care.
- Any reliance on the part of the plaintiff which falls outside of the scope of the defendant's undertaking of responsibility — that is, of the purpose for which the representation was made or the service was undertaken — necessarily falls outside the scope of the proximate relationship and, therefore, of the defendant's duty of care
- It follows that an injury to the plaintiff will be reasonably foreseeable if (1) the defendant should have reasonably foreseen that the plaintiff would rely on his or her representation; and (2) such reliance would, in the particular circumstances of the case, be reasonable … . Both the reasonableness and the reasonable foreseeability of the plaintiff's reliance will be determined by the relationship of proximity between the parties; a plaintiff has a right to rely on a defendant to act with reasonable care for the particular purpose of the defendant's undertaking, and his or her reliance on the defendant for that purpose is therefore both reasonable and reasonably foreseeable. But a plaintiff has no right to rely on a defendant for any other purpose, because such reliance would fall outside the scope of the defendant's undertaking.

The evolution of auditor liability

Stage two: **Residual Policy Considerations**.

- … principles that were traditionally considered at the second stage of the *Anns* test in cases of negligent misrepresentation, such as (1) whether the defendant knew the identity of the plaintiff or the class of plaintiffs who would rely on its representation; and (2) whether the reliance losses claimed by the plaintiff stem from the particular transaction in respect of which the statement at issue was made … , are no longer considered at the second stage. This is because … these factors arise from the relationship between the parties and are, therefore, properly accounted for under the first stage proximity and reasonable foreseeability analysis...
- What, then, remains to be considered at the second stage of the *Anns/Cooper* framework? In *Cooper*, this Court identified factors which are external to the relationship between the parties, including (1) whether the law already provides a remedy; (2) whether recognition of the duty of care creates "the spectre of unlimited liability to an unlimited class"; and (3) whether there are "other reasons of broad policy that suggest that the duty of care should not be recognized" … . In this way, the residual policy inquiry is a normative inquiry. It asks whether it would be better, for reasons relating to legal or doctrinal order, or reasons arising from other societal concerns, not to recognize a duty of care in a given case.

Notable decisions since Livent

- *Lavender v. Miller Bernstein LLP,* 2018 ONCA 729:
  - Motions judge on a summary judgment application found that an auditor owed a duty of care in negligence to the clients of a securities dealer in the preparation of a regulatory form used by a securities regulator to police securities dealers and protect clients whose investments and savings were held by the dealer.
  - The ONCA reversed the decision of the motions judge. It held that the auditor did not owe a duty of care to the clients of a securities dealer, as no relationship of proximity was established. The defendant made no representations to the plaintiff class, most of whom never knew of its existence or its involvement with the securities dealer, and the defendant did not undertake to assist the class in making investment decisions.
- *Whitehouse v. BDO Canada LLP,* 2021 ONSC 2454:
  - Certification application for an intended class proceeding by investors who lost their life savings when a mutual fund company, Crystal Wealth Management Systems, failed.
  - The Ontario Superior Court of Justice upheld a finding by the motions judge that settled law on auditor liability precluded a finding that the defendant owed a duty to unitholders of funds for which the defendant provided clean audit opinions from 2007 to 2015. Without a pleaded basis for the defendant having undertaken to the unitholders to provide audit reports for their personal investment decisions, the Court found there could be no basis for the necessary proximate relationship set out in *Hercules*, *Livent*, and *Lavender*.

What can auditors do to better protect themselves?

Insulating against a duty

Consider when drafting your EL…

1. Who is the client?
2. Who will receive the opinion?
3. Who will use the opinion?
4. For what purpose? Can the purpose change? Who decides?
5. May the recipient pass the opinion to third parties?
6. Fees – limitation on liability.
7. Consider where possible private arbitration to avoid reputational risk.

Limitation of liability clauses

RINC Consulting Inc. (Roustan Capital) v Grant Thornton, 2019 ONSC 7775; upheld by the Ontario Court of Appeal, 2020 ONCA 182. Clause not enforced because it did not apply when the accounting firm terminated the contract (it applied only when third parties sued the accountant who could then claim over against the client).

The Court applied the *Tercon* test:

1. As a matter of contract interpretation, does the exclusion clause apply to the circumstances as established by the evidence in the case?
2. If the exclusion clause applies, was the clause unconscionable at the time the contract was made, as might arise from situations of unequal bargaining power between the parties?
3. If the exclusion clause is found to be valid and applicable, should the court nevertheless refuse to enforce the clause because of the existence of an overriding public policy concern?

Consider:

- Make sure that the limitation of liability clause covers all possible claims, like breach of contract or negligence.
- Make sure formulas for calculating liability limits are clear and easy to understand, avoiding confusing or vague methods.
- Do not attempt to exclude liability for losses that are legally non-excludable, such as fraud or regulated activities
- Draw special attention of the client to the clause and keep a detailed record of any discussions or negotiations about engagement terms. This documentation can serve as evidence of fair dealing if a dispute arises

Managing regulatory risk

Complaint and discipline process for accountants

- The accounting profession in Canada is provincially regulated. Regulators include Chartered Professional Accountants of Alberta (CPA Alberta), Chartered Professional Accountants of Ontario (CPA Ontario), etc.
- A key purpose of the regulators is to protect the public interest.
- The rules in relation to the complaint and disciplinary process are set out in provincial legislation and bylaws such as the Chartered Professional Accountants Act, SA 2014, c. C-10.2 or the Bylaws of the Organization of Chartered Professional Accountants of British Columbia.
- Generally speaking, if a complainant feels that the service received from a member or firm, or the conduct of a member or firm has been unprofessional, unethical, or incompetent, a written complaint may be sent to the provincial regulator.
- After the complaint has been made, the regulatory body will correspond with both the complainant and the respondent (the party being complained about) to gather relevant facts.
- The complaint will be reviewed to determine whether it should be dismissed, whether there needs to be further investigation, or whether a disciplinary hearing is required.
- The provincial regulatory frameworks will also indicate whether and how decisions made at various points during the complaint, investigative and disciplinary process can be appealed. It will be important in these cases to be mindful of (i) who is a party to the appeal; and (ii) the standard of review.

Chartered Professional Accountants of Alberta v. Mathison, 2024 ABCA 33

- Mathison was the CFO of Canada Pump and Power Corporation from April 2012 to December 2015, when Canada Pump terminated his employment for cause.
- Mathison became the subject of a complaint of unprofessional conduct made to his regulating body, the Chartered Professional Accountants of Alberta. He was found guilty of unprofessional conduct and a two-year suspension was imposed by the Discipline Tribunal. The Appeal Tribunal upheld the finding of unprofessional conduct and increased the sanction, cancelling Mathison's registration as a CPA.
- In a split decision, a majority of the Alberta Court of Appeal found that the Appeal Tribunal erred in concluding that the Discipline Tribunal erroneously limited its own discretion to order cancellation. The Appeal Tribunal's statement that "it is appropriate to recognize a legitimate public expectation that a CPA who choose to engage in the intentional and wrongful taking of a client or employer's money should no longer be a CPA" went too far in relation to Mathison. The findings that were made by the Discipline Tribunal did not support Mathison's conduct as being "the intentional and wrongful taking of a client or employer's money."
- *Mathison* is an important professional regulatory case dealing with the standards a professional regulator must adhere to before depriving a regulated member of the right to practice a profession and earn a livelihood.
- The case is also valuable because it addresses applicable standards of review, the discretion afforded to various decisionmakers, and potential considerations when regulatory complaints and civil claims intersect.

Practice points for responding to complaints

- A cooperative and transparent approach to dealing with the provincial regulator is paramount.
- Deal with bad facts head-on – but proceed with caution.
- Remember that a key concern of the regulatory body is the protection of the public interest. Responses to complaints should have this as a primary focus.
- Litigation holds to preserve records are critical. The litigation hold may not simply be over those records of the respondent or the subject of the complaint.
- Take the time to undertake as thorough an investigation of a complaint as possible at the outset (including of any document production and any interviews required). The best possible outcome is one in which the complaint does not advance past an investigation stage.
- “Showing” is more powerful than “telling”. References should be made frequently to any contemporaneous records that support the response to the complaint.

What is the equitable remedy of rectification?

- The equitable doctrine of rectification, like its equivalent in the civil law, is intended to address situations where parties have agreed on contractual terms, but through inadvertence, their written contract does not reflect these terms. In Canadian tax law, tax consequences generally flow from the legal effect of the governing documents. As a result, where there is an error in a legal document, that error may lead to unintended tax consequences even where it is contrary to the intention of the parties.
- The leading case on rectification is *Canada (Attorney General) v. Fairmont Hotels Inc.,* 2016 SCC 56
  - Fairmont sought to avoid tax liability by rectification of the directors' resolutions and both the application judge and the Court of Appeal granted that rectification on the basis of the parties' intended tax neutrality.
  - The SCC reversed the Court of Appeal and said that a taxpayer cannot obtain a rectification order simply by demonstrating an intention to achieve tax neutrality. A tax payer has to establish:
    - a prior agreement existed, with definite and ascertainable terms;
    - the agreement was in effect at the time the written instrument under review was executed;
    - the written instrument under review does not accurately record the prior agreement; and
    - the instrument, if rectified, would carry out the prior agreement of the parties.

Latest word on rectification from the COA

Pyxis Real Estate Equities Inc. v. Canada (Attorney General), 2025 ONCA 65

- This case involved four corporations (each a Holdco) and an individual (the Owner) connected through a chain of sole shareholder-subsidiary relationships. The Owner was sole shareholder of the ultimate parent Holdco. The Owner and his accountants planned to pay tax-free capital dividends up through all four corporations in order to pay out CA$1.4M to the Owner. Unfortunately, in determining the amounts to be paid up from each Holdco, the Owner’s accountants were unaware that one of the Holdcos (hereafter DeficitCo) had a capital dividend account (CDA) deficit. CRA reassessed Part III tax against DeficitCo for paying a capital dividend in excess of its CDA balance and the Holdcos sought rectification to correct the documents and nullify the invalid payout.

- The application granted rectification on the basis of a memorandum that the accountants had sent to the respondent’s lawyer which outlined the proposed plan including the four dividends that would be paid up the corporate chain, each of which was identified as a $1.4 million tax-free capital dividend. The judge felt it showed an agreement to pay a tax-free capital dividend to the Owner which was the ultimate objective.

- The Court of Appeal over turned the application judge and said that, rectification is available to correct a document that fails to accurately record the parties' true agreement, but not available to correct an improvident bargain or to fill a gap in the parties' true agreement even where the gap defeats the intended objective. A court may not change the agreement in order to salvage an objective. Rectification aligns the document with what the parties agreed to do, and not what, with the benefit of hindsight, they should have agreed to do to achieve their objective. Rectification is not available to assist simply because an agreement failed to achieve an intended effect, typically to avoid tax liability.

On the other side..

691734 Ontario Inc. et al. v. 1840671 Ontario Limited (1691734 Ontario Inc.).

- In this case, two corporations amalgamated through a short-form horizontal amalgamation under the OBCA. Prior to the amalgamation, the shares of both predecessor corporations were transferred by two individuals to the same corporate shareholder (Holdco). Consequently, pursuant to subsection 177(2) of the OBCA, Holdco should have been the sole shareholder of the amalgamated corporation (Amalco). However, the post-amalgamation records of Amalco erroneously recorded the two individuals, rather than Holdco, as the shareholders of Amalco. As a result, the correct shareholder was omitted, and the incorrect shareholders were named, in the registers and records of Amalco.

- In this case Justice Black granted rectification and determined that a mistake was made at the time of preparing the corporate records, erroneously identifying the individuals rather than Holdco as the shareholders. Black J was satisfied that Holdco was intended to be sole shareholder and that the two individuals were never intended to be identified as shareholders. The record included affidavits from the impacted individuals, contemporaneous documents, and evidence that the parties conducted themselves following the amalgamation on the assumption that Holdco was correctly named shareholder, including paying dividends from Amalco to Holdco. The Ontario Superior Court granted rectification of Amalco’s registers and records to reflect the true shareholder of the corporation under section 250.

What to do when various forums of law intersect?

Tips and tricks

- Manage your document production
- Manage the timing of the various proceedings
- Consider implications of findings in various forums
- Consider allocation of costs and resources
- Consider options for a stay

Thank you

Sara Hart
Partner, Edmonton, Canada
+1 780 423 7376
sara.hart@dentons.com

Michael Schafler
Partner, Toronto, Canada
+1 416 863 4457
michael.schafler@dentons.com

Deepshikha Dutt
Partner, Toronto, Canada
+1 416 863 4550
deepshikha.dutt@dentons.com

Christy Lee
Partner, Calgary, Canada
+1 403 268 6354
christy.lee@dentons.com