Audit supervision

A fictitious bank guarantee goes unnoticed

Par Teymour Brander le 28 March 2023

A start-up relies on a guarantee from a fictitious bank to carry out a capital increase of around CHF 30 million. The auditor in charge of checking the increase report detects nothing. The Federal Administrative Court (FAT) saw this as a manifest lack of critical thinking and confirmed the withdrawal of the bank's authorization – albeit with a reduced duration – in ruling B-2245/2021 of January 27, 2023 (now in force).

In 2016, Caroline – a certified auditor – was asked to check the report on a capital increase (from CHF 100,000 to CHF 29,000,000) for one of the subsidiaries of Swiss Space Systems (S3), a Payerne-based start-up specializing in suborbital shuttles. This capital increase was decided in order to stabilize S3's balance sheet, which was facing major financial problems.

An increase report is submitted to Caroline for verification, as required by art. 652f para. 1 of the Swiss Code of Obligations. This report indicates in particular that the capital increase – of around CHF 30 million – is fully guaranteed by a bank based in Singapore. In less than 24 hours, Caroline signs the report. In the end, the capital increase is not enough to save S3 ; the company is declared bankrupt in early 2017.

An investigation by a local media reveals that the bank purportedly issuing the bank guarantee did not in fact exist. S3's recapitalization was based on a fictitious bank guarantee. Following these revelations, the Swiss Federal Audit Oversight Authority (FSA) initiated administrative proceedings against Caroline, which ultimately resulted in the FSA withdrawing Caroline's license for a period of three years. On appeal by the party concerned, the Federal Administrative Court must determine (i) whether Caroline's shortcomings call into question the guarantee of an irreproachable auditing activity and, if so, (ii) whether the withdrawal of approval issued by the Federal Audit Office is proportionate.

A natural person is approved as an auditor on condition that he or she offers all the guarantees of irreproachable auditing (art. 4 para. 1 RAG). Compliance with the legal system – not only auditing law, but also civil and criminal law – is naturally one of the requirements (see ATAF 2011/43 on the various elements taken into account when examining this condition).

Let's now take a look at the topical provisions Caroline is accused of breaching. Art. 652f para. 1 CO makes the capital increase report subject to mandatory verification by an accredited auditor. As long as the report has not been audited, the Board of Directors may not carry out the capital increase.

More specifically, what are the auditing obligations of the réviseur agréé in this context ? First of all, the auditor must check that the report contains all the elements required by art. 652e of the Swiss Code of Obligations ; in other words, that the report is complete. What about the accuracy of the report ? Based on the Swiss Auditing Standards (NAS), and more specifically NAS 240 – on fraud – the TAF specifies that the auditor is obliged to obtain “reasonable assurance” that the report does not contain “material misstatements due to fraud or error”. To this end, the auditor has a duty to “exercise critical judgment throughout the audit”, it being understood that there will always be an unavoidable risk that fraud will go undetected.

In this case, it is not Caroline’s failure to detect the fraud that is being criticized, but her failure to carry out certain essential basic checks. In particular, she should first have verified the existence of the bank issuing the guarantee. In this respect, Caroline’s examination was limited to an Internet search which led her to the – also fake – website of the alleged bank. In reality, a simple additional search on the Singapore Financial Supervisory Authority’s website would have enabled her to realize that the bank was not on the list of authorized banking institutions. In addition, the ASR criticized Caroline for failing to check the solvency of the issuer of the bank guarantee, or the powers of the persons who had signed it. The circumstances cited by Caroline – in particular, that she had acted under time pressure – in no way justify these shortcomings.

Ultimately, Caroline’s validation of the increase report, on the basis of the incomplete information in her possession, constitutes a serious breach of her verification obligations. In the view of the TAF, the ASR was right to consider that Caroline could no longer guarantee an irreproachable auditing activity.

With regard to the proportionality of the measures taken by the RSA, the FAT confirms that the withdrawal of approval was the only appropriate measure, given the seriousness of the facts complained of. However, with regard to the duration of the sanction, the FAT considers it fair to take into account the unique nature of the breach in question. This is the first case in which Caroline has breached its auditing obligations, and there is nothing to suggest that it will repeat such misconduct in the future. The FAT therefore concludes that the ASR exceeded its broad, but not unlimited, discretionary powers, and the duration of the withdrawal of approval is reduced to two years.

In conclusion, this ruling highlights a number of requirements regarding the specific verifications expected of an auditor confronted with a bank guarantee. In particular, the prudent auditor must ensure that sufficient checks are carried out on the existence of the issuing bank, its solvency and the powers of the persons who have signed the guarantee.

Finally, on the question of the proportionality of the duration of the withdrawal of approval, let us mention the recent ruling B-5528/2019 of March 21, 2022, in which the duration of the measure pronounced by the ASR was reduced (from 4 years to 3 years) for reasons similar to those of the ruling commented on. The TAF probably has a Swiss sense of compromise.

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