

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO  
THE CHARTERED ACCOUNTANTS ACT**

**DISCIPLINE COMMITTEE**

**IN THE MATTER OF:** Charges against **J. DOUGLAS BARRINGTON, FCA, PETER D. CHANT, FCA, ANTHONY POWER, FCA** and **CLAUDIO RUSSO, CA**, members of the Institute, under **Rule 206** of the Rules of Professional Conduct, as amended.

**DECISION AND REASONS FOR DECISION**

(February 11, 2007)

1. This panel of the Discipline Committee of the Institute of Chartered Accountants of Ontario convened on January 11, 2005 to hear charges brought under Rule 206 of the Rules of Professional Conduct against J. Douglas Barrington, FCA; Peter D. Chant, FCA; Anthony Power, FCA; and Claudio Russo, CA.

**Preliminary Motions**

2. On January 11 and 12, 2005 the panel heard a motion for a stay of the proceedings. The motion was dismissed. On January 13 and 26, 2005 the panel heard a motion to prohibit the Professional Conduct Committee from adducing any evidence obtained by or through the investigators Allan Wiener and Stephen Held. The motion was dismissed. On January 27, 2005 the panel heard a motion for the production of documents. The motion was dismissed. The written reasons for dismissing the three motions are all dated October 13, 2005.

3. On June 16, 2005 Douglas Barrington brought a motion for a direction that Charge 1 be heard and determined before Charge 2 was heard. The motion was dismissed. The reasons for dismissing the motion are also dated October 13, 2005.

**June 27, 2005 and Thereafter**

4. The hearing reconvened on June 27, 2005 when the pleas of the members were taken. The panel heard evidence over 34 days, the last day of evidence being March 8, 2006. Counsel then prepared and filed lengthy written submissions as to whether or not the charges had been proven and made oral submissions on May 23, 24, and 25, 2006.

5. Thereafter the panel began its deliberations. The panel made it known that it would announce its decision at the same time as it gave its written reasons for the decision. In these reasons the panel sets out an overview of the proceedings, the relevant facts, the decision and the reasons for the decision.

## **The Parties and Counsel**

6. Throughout the 37 days of evidence and submissions the Professional Conduct Committee was represented by Brian Bellmore and Paul Farley. The investigators appointed by the Professional Conduct Committee, Allan Wiener C.A. and Stephen Held C.A. of Richter Usher & Vineberg, were present throughout.

7. Douglas Barrington was represented on the motion heard on June 16, 2005 and thereafter by Peter Griffin, who was assisted first by Jamie Spotswood and subsequently by Kris Borg-Olivier. Prior to June 16, 2005 Douglas Barrington was represented by John Lorn McDougall Q.C., and Brian Leonard.

8. Peter Chant was represented throughout the hearing by Robert Staley and Derek Bell.

9. Anthony Power and Claudio Russo were represented throughout the hearing by John Lorn McDougall Q.C. and Brian Leonard and they were assisted by Colleen Butler.

10. Formal attendance was not taken. While one or other of the members may have been absent from the hearing briefly on occasion, with one exception, generally the four members were present. Anthony Power, who resided in Ireland at the time of the hearing and who had been present on January 26 and 27, 2005, was not in Toronto and accordingly not present on June 27, 28, 29 or on July 12, 13, and 14, 2005.

11. The panel wishes to acknowledge and thank the parties for their diligent participation and for the patience they showed during a long hearing.

12. The panel also wishes to thank all counsel for the efforts they made to present their cases, for the work they did to assist the panel to understand the issues, for the comprehensive submissions they made, and for their courtesy to and co-operation with each other and the panel.

## **CHARGES**

13. On February 18, 2004, the Professional Conduct Committee made the following charge against Anthony Power, FCA, Claudio Russo, CA, Peter Chant, FCA and Doug Barrington, FCA:

1. THAT, the said Anthony Power, Claudio Russo, Peter Chant and Doug Barrington, in or about the period January 1, 1998 to March 27, 1998, while involved as "Lead Client Service" partner, "Audit Client Service" partner, "Advisory" partner and "Advisory" partner respectively with Deloitte & Touche in an engagement to perform an audit of the consolidated financial statements of Livent Inc. as

at December 31, 1997 ("Financial Statements"), and having attached to the Financial Statements an unqualified audit opinion, failed to perform their professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the CICA Handbook, contrary to Rule 206 of the Rules of Professional Conduct, in that:

- i) In accepting the client's recognition of \$9.2 million as revenue on the sale of naming rights of the existing Pantages Theatre and a new theatre to be constructed to AT&T Canada Enterprises Inc., they failed to ensure that the Financial Statements complied with generally accepted accounting principles since all significant acts under the agreement had not been completed;
- ii) In accepting the client's recognition of \$7.7 million as revenue on the sale of naming rights of the Oriental Theater in Chicago to Ford Motor Company, they failed to ensure that the Financial Statements complied with generally accepted accounting principles since all significant acts under the agreement had not been completed;
- iii) In accepting the client's recognition of \$5.6 million as revenue on the sale of density rights over the existing Pantages Theatre to Dundee Realty Corporation, they failed to ensure that the Financial Statements complied with generally accepted accounting principles since all significant acts under the agreement had not been completed;
- iv) In accepting the client's recognition of a loss of \$1.2 million on a transaction with First Treasury Financial Inc., they failed to ensure that the Financial statements complied with generally accepted accounting principles since the transaction should not have been accounted for as a sale when all the conditions required to account for the transaction as a sale were not met.

14. On February 18, 2004, the Professional Conduct Committee made the following charge against Anthony Power, FCA, and Claudio Russo, CA:

2. THAT, the said Anthony Power, FCA and Claudio Russo, CA, in or about the period January 1, 1998 to March 27, 1998, while involved as "Lead Client Service" partner and "Audit Client Service" partner respectively with Deloitte & Touche in an engagement to perform an audit of the consolidated financial statements of Livent Inc. as at December 31, 1997 ("Financial Statements"), and having attached to the Financial statement an unqualified audit opinion, failed to perform their professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the CICA Handbook, contrary to Rule 206 of the Rules of Professional Conduct, in that:
  - i) They failed to identify a change in accounting policy with respect to the amortization of preproduction costs and failed to

- ensure that there was disclosure of the change in this policy and the effect of the change on the Financial Statements;
- ii) In having failed to compare 1997 production budgets prepared by management in 1996 to actual results in 1997, they did not ascertain the reliability of management's budgets and accordingly, failed to obtain sufficient appropriate audit evidence to enable them to properly assess the recoverability of preproduction costs;
  - iii) In accepting an additional write-down of preproduction costs of specific shows totalling \$27.5 million after the audit was virtually complete, they failed to reassess management's representations made throughout the audit and accordingly failed to obtain sufficient appropriate audit evidence to enable them to express an unqualified opinion on the Financial Statements;
  - iv) Having determined that a selection of 22 items was an appropriate sample size in their search for unrecorded liabilities, they found errors but failed to re-evaluate the nature, extent and timing of planned audit procedures;
  - v) Having decided on a sample based testing of additions to fixed assets, they failed to obtain sufficient appropriate audit evidence for unsupported transactions;
  - vi) They failed to identify that the amortization policy for preproduction costs as explained in the significant accounting policy note to the Financial Statements was not in conformity with the method followed by the Company in computing the amortization;
  - vii) They failed to disclose that the policy with respect to the translation of the foreign currency denominated financial statements of the subsidiary companies was not in accordance with generally accepted accounting principles in that the foreign subsidiaries were not financially and operationally independent as required to treat them as self-sustaining operations;
  - viii) They failed to ensure, in respect of a transaction with First Treasury Financial Inc., that the Financial Statements disclosed the contingency that First Treasury Financial Inc. had recourse against Livent under certain circumstances.

## **THE PLEAS**

15. Claudio Russo entered a plea of not guilty to Charges 1 and 2. John Lorn McDougall entered a plea of not guilty on behalf of Anthony Power to both Charges 1 and 2. Douglas Barrington and Peter Chant entered pleas of not guilty to Charge 1.

## THE HEARING

16. This hearing is by far the longest hearing that a panel of the Discipline Committee has heard. The evidence is voluminous. The parties obtained daily transcripts of the *viva voce* evidence, the submissions in January and June 2005 and the submissions with respect to guilt or innocence in May 2006.

17. The panel was provided with electronic copies of many of the documents included in the 192 exhibits, many of which consisted of volumes of documents. In addition, counsel provided electronic copies of their submissions and the copies of the documents they referred to in support of their submissions.

18. As the transcripts of the proceedings are available, the panel concluded that a summary of the evidence given was unnecessary and would unduly lengthen these reasons. The panel also concluded that the reasons should set out who the witnesses were and when they gave evidence.

### The Witnesses

19. Allan Wiener, one of the two investigators, was accepted as an expert witness and gave evidence on behalf of the Professional Conduct Committee on June 27, 28, 29, July 12, 13, 14 and August 15, 2005. He was the only witness called by the Professional Conduct Committee.

20. Claudio Russo gave evidence on August 15, 16, 22, 23, 24 and September 7, 2005.

21. Martin Calpin, a retired partner of Deloitte & Touche, gave evidence on September 7 and 8, 2005. Martin Calpin was the National Risk Manager of Deloitte & Touche in 1997 and undertook the Lead Client Services Partner's role in the re-audit of the 1996 and 1997 financial statements of Livent in the fall of 1998.

22. Frank Kelly, an expert witness called on behalf of the members, gave evidence on September 8, 12 and 13, 2005.

23. David Yule, an expert witness called on behalf of the members, gave evidence on December 6 and 7, 2005.

24. Robert Wardell, a partner of Deloitte & Touche, gave evidence on December 7 and 8, 2005.

25. John Hanna, an expert witness called on behalf of the members, gave evidence on December 20, 2005.

26. Paul Cobb, a partner of Deloitte & Touche with responsibility for the audit of Dundee Realty Corporation, gave evidence on December 21, 2005.

27. Anthony Power gave evidence on January 10 and 11, 2006.

28. Peter Chant gave evidence on January 17, 18, 19, February 7, and 8, 2006. His evidence was interrupted on February 7, 2006 when counsel argued a motion with respect to whether or not the members were entitled, or would be permitted, to call a fourth expert witness.
29. Douglas Barrington gave evidence on February 8, 9, 15 and 16, 2006.
30. Garfield Emerson, who was the Chair of the Audit Committee of Livent (Audit Committee) in 1997, gave evidence on February 15, 2006 and returned to complete his evidence on March 2, 2006.
31. Keith Vance, the fourth expert witness called on behalf of the members, gave evidence on March 1, and again on March 2, 2006 after Garfield Emerson's evidence was concluded.
32. Allan Wiener gave evidence in reply on March 7 and 8, 2006.

### **MATTERS OF AGREEMENT**

33. At the conclusion of the submissions it was apparent that there were issues which the panel would have to determine, but it was also apparent that there were a number of issues on which the parties agreed.

#### **A Deloitte Audit**

34. Livent Inc. (Livent) appointed the firm, Deloitte & Touche, Chartered Accountants, as its auditors. The annual report of Livent for the year 1997 referred to the unqualified audit opinion of Deloitte & Touche as the "independent auditors' opinion". The audit was, as all counsel acknowledge, "a Deloitte audit". Under the *Chartered Accountants Act*, as it was in 1998, a firm could not be charged. In these reasons, "Deloitte" is used to refer to the auditors of Livent.

#### **Fraud at Livent**

35. All parties agreed that there was a massive fraud at Livent.
36. The determination of who is responsible for the \$100,000,000 fraud and what liability there is, if any, are yet to be determined by the civil and criminal courts. It was the position of the parties at this hearing that the senior management of Livent, including and in particular, Garth Drabinsky and Myron Gottlieb, who dominated the management of Livent, perpetuated the fraud. At the relevant time Garth Drabinsky was the Chairman and CEO of Livent and Myron Gottlieb was the President of Livent. Both were significant shareholders. It should be noted that neither Garth Drabinsky nor Myron Gottlieb are party to these proceedings.
37. In 1997 Livent described itself as the largest and fastest growing producer of live theatrical entertainment in North America with expanding international activities. According to its 1997 annual report, Livent combined three essential

aspects of the entertainment business to achieve growth and enhance profitability – “producing entertainment, developing theatres, maximizing assets.” The company increased its ancillary revenue through cast recordings, sales of merchandise, licensing of touring show productions, sponsorships and sale of one-time naming rights.

38. Livent was a reporting issuer in Canada and filed its annual reports, including its audited financial statements, with the Ontario Securities Commission (OSC). Livent was also a reporting issuer in the United States and filed its annual reports, including its financial statements with the Securities and Exchange Commission (SEC).

39. In 1996, Livent completed an equity offering in the United States whereby it raised approximately US \$40 million through the issuance of 3.7 million shares. In 1997, Livent raised a further US \$125 million in the United States through what was referred to at this hearing as the US \$125 million prospectus offering.

40. In the autumn of 1997, Deloitte were engaged to review and provide a comfort letter with respect to this US \$125 million prospectus offering.

41. Deloitte were the auditors of Livent for the fiscal years 1989 through 1997 and issued unqualified audit opinions on the financial statements for each of those fiscal years.

42. On August 10, 1998 Livent, under new management, announced that an internal investigation had revealed serious accounting irregularities in the company’s financial records. Concurrently, Livent, under the supervision of its Audit Committee, initiated an investigation.

43. Maria Messina began work on the audit file in 1992 as a Senior Manager for Deloitte. In May 1996, Maria Messina, who had been the Client Engagement Partner on Livent for the 1995 audit, joined Livent as the Vice-President of Finance.

44. Maria Messina, who became the Chief Financial Officer as well as the Vice-President of Finance for Livent in November 1996, cooperated with the new management of Livent in its investigation in the summer of 1998.

45. In March 2000, Maria Messina was found guilty of professional misconduct by another panel of the Discipline Committee of the Institute of Chartered Accountants of Ontario. According to the Agreed Statement of Facts filed at her hearing and the Reasons of the Discipline Committee released on November 9, 2000, Maria Messina was not aware that there were accounting irregularities at Livent for the first 15 months of her employment. Thereafter, she did become aware of some of the irregularities, however, she failed to dissociate herself from the on-going and material accounting irregularities and misstatements, including the fraudulent manipulation of the books and records of the company.

46. The Agreed Statement of Facts filed in the discipline proceeding against Maria Messina was filed as Exhibit 80, Tab 7 at this hearing. It stated that prior

to August 7, 1998 her knowledge of the accounting irregularities and manipulation of the books and records of Livent included the following:

- a. Unrecorded liabilities and expenses, which resulted in an understatement of assets and liabilities and/or an understatement of liabilities and an overstatement of income. Senior Management referred to unrecorded expenses as "expense rolls".
- b. Transfer of direct operating costs to balance sheet accounts (i.e. pre-production and/or fixed asset accounts), which thereby deferred current period expenses to future periods. Senior Management also referred to such transfers as "expense rolls".
- c. Transfer of pre-production costs from one show to another (i.e. show to show transfers), which thereby deferred current period amortization to future periods. Senior Management referred to such transfers as "amortization rolls" or "show to show transfers".

*Exhibit 80, Tab 7*

47. According to the Reasons of the Discipline Committee and the Agreed Statement of Facts, Maria Messina did attempt to minimize the irregularities at Livent under the old management. However, she did not disclose her knowledge of the fraud to Livent's Board of Directors, the Audit Committee or the auditors until new management, and in particular Robert Webster, the new CEO, was conducting his own investigation into the irregularities at Livent during the summer of 1998.

48. As a result of the internal investigation, Livent restated its 1996 and 1997 financial statements on November 18, 1998. Deloitte audited and issued an unqualified audit opinion on the restated financial statements for 1996 and 1997.

49. The re-audited Financial Statements included the following:

- a. The Retained Deficit at December 31, 1997 originally reported as \$27.6 million was restated at \$124.3 million.
- b. The 1997 after-tax loss originally reported as \$44.1 million on revenue of \$320.8 million was restated as a Net Loss of over \$98.6 million on revenue of \$294.7 million.
- c. The 1996 after-tax profit of \$11 million was restated as an after-tax loss of \$18 million.
- d. The cumulative effect of the accounting irregularities in the years up to December 31, 1995 reduced retained earnings by \$13.1 million.
- e. The assets at December 31, 1997 originally reported as \$386.5 million were restated as \$325 million.

- f. The liabilities at December 31, 1997 originally reported as \$285.9 million were restated at \$322 million.

*Exhibit 66, Tab 52*

*Exhibit 65, Tab 8*

50. The re-audit disclosed that:

- a. Preproduction costs (comprising approximately 18% of assets) were originally overstated by \$7.4 million and \$17.7 million at December 31, 1997 and 1996, respectively, as a result of the net effect of the following irregularities:
- operating expenses were improperly capitalized to preproduction costs,
  - preproduction costs were not properly charged to the appropriate production,
  - preproduction costs were improperly recorded to fixed asset and deferred cost accounts, and
  - preproduction costs were not properly recorded in the appropriate year.
- b. Fixed assets were originally overstated by \$23.9 million and \$6.2 million at December 31, 1997 and 1996 respectively, primarily as a result of improperly capitalizing amounts which should have either been charged to preproduction costs or expensed as incurred.
- c. Deferred costs were overstated by \$4.1 million and \$1.2 million at December 31, 1997 and 1996 respectively, primarily as a result of improperly including amounts in deferred costs which should have been charged to preproduction costs.
- d. Accounts payable and accruals were understated by \$19.4 million and \$9.3 million at December 31, 1997 and 1996 respectively, primarily as a result of not properly recording expenses, preproduction costs and fixed assets in the correct year.

*Exhibit 66, Tab 52*

*Exhibit 65, Tab 8*

### **A Standards Case – GAAP & GAAS**

51. Counsel for the Professional Conduct Committee made it clear in his opening statement on June 27, 2005 that this is a standards case, not a case alleging that the members should have detected fraud. Counsel further asserted that the professional misconduct alleged against the members did not involve moral turpitude. There was no suggestion that the members actually knew about the fraud.

52. Charge 1, which is made against all four members, was referred to throughout the hearing as the GAAP charge. It was Livent's obligation to present its financial statements in accordance with Canadian generally accepted accounting principles (GAAP). It was the auditors' obligation to conclude whether or not the financial statements complied with GAAP, as it was on

December 31, 1997. If the financial statements did not comply with GAAP the auditors ought not to have issued their unqualified audit opinion on the financial statements. The opinion, which it found in *Exhibit 65, Tab 2* reads:

*To the Shareholders of Livent Inc.*

We have audited the consolidated balance sheets of Livent Inc. as at December 31, 1997 and 1996 and the consolidated statements of income (loss), retained earnings (deficit) and changes in financial position for each of the years in the three-year period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for each of the years in the three year period ended December 31, 1997 in accordance with generally accepted accounting principles in Canada.

**"Deloitte & Touche"**  
Chartered Accountants  
Toronto, Ontario  
March 27, 1998

53. Charge 2, which is made only against Anthony Power and Claudio Russo, alleges that the auditors failed to comply with generally accepted auditing standards (GAAS). The essence of this charge, referred to throughout this hearing as the GAAS charge, is that the auditors did not have sufficient appropriate audit evidence on which to base the release of the unqualified audit opinion on the financial statements.

54. The Professional Conduct Committee bears the onus of establishing the allegations that the members failed to adhere to the standards of the profession and that any departure[s] from the standards of the profession, either individually or collectively, are so significant that the departure[s] constitute[s] professional misconduct.

## **Evidence**

55. The parties agreed that all of the evidence, the *viva voce* evidence of all of the witnesses and the exhibits filed were before the panel for consideration. While the Professional Conduct Committee has the obligation to satisfy the onus, it is entitled to rely on all of the evidence before the panel to meet the onus.

56. The parties agreed that it was the generally accepted standards of practice in effect at the relevant time against which the members' professional services are to be judged.

57. It was also agreed that the auditors should not be judged in the light of what hindsight revealed the facts to be, but rather on the facts and circumstances which the auditors knew – or should have known – at the time.

## **MATTERS OF DISAGREEMENT AND ISSUES**

### **The Relevant Period of Time**

58. The charges allege that the misconduct took place "in or about January 1, 1998 and March 27, 1998". The members take the position that their actions after March 27, 1998 do not fall within the period of the charges. They assert it is only their actions between January 1, 1998 and March 27, 1998 which should be considered. Douglas Barrington and Peter Chant both assert that they did not do anything on the file in the period from January 1, 1998 to March 27, 1998 which could give rise to a finding of professional misconduct.

59. The Professional Conduct Committee pointed out that the period of time specified in both charges reads: "in or about the period January 1, 1998 to March 27, 1998." The Professional Conduct Committee asserts that the period identified is expanded by the phrase "in or about the period". The Professional Conduct Committee also submitted that the release of the audit opinion on April 17, 1998 was clearly in or about the period set out in the charge.

### **The Relevance of the Number of Dollars Specified in the Particulars**

60. The members, particularly Douglas Barrington, assert that the amounts of money stipulated in the particulars of Charge 1 are incorrect, even if the particular is otherwise established. They also assert that particular iii) of Charge 1 is flawed in that the revenue recognized was not solely from the sale of density rights over the existing Pantages Theatre. The Professional Conduct Committee asserts that, as this is an allegation of professional misconduct and not a criminal indictment, the allegation is proven if the revenue recognized is materially overstated.

### **Reliance on Management's Representations**

61. A fundamental disagreement between the Professional Conduct Committee and the members was the extent to which the members were entitled

to rely on the representations made by management. The Professional Conduct Committee took the position that the members did not have sufficient appropriate audit evidence to rely upon the representations of management. Douglas Barrington, Anthony Power and Claudio Russo asserted that they were entitled to rely on management's representations.

62. On April 3, 1998 the members became aware of a document referred to in these reasons as the Put Side Agreement. In its submissions the Professional Conduct Committee took the position that the Put Side Agreement precluded Deloitte from relying upon the representations of management. Douglas Barrington, Anthony Power and Claudio Russo vigorously disagreed. Peter Chant's position was that, as a result of the Put Side Agreement, he asserted in April 1998 that Deloitte should dissociate itself from Livent.

### **Roles and Responsibilities**

63. One of the issues for the panel to determine is who was responsible for issuing the unqualified audit opinion on the consolidated financial statements of Livent for the year ending December 31, 1997. Anthony Power and Claudio Russo acknowledged that they were responsible for the audit including the release of the unqualified audit opinion on the financial statements. Douglas Barrington and Peter Chant asserted, for different reasons, that they were not responsible for the release of the audit opinion, and were accordingly not guilty of Charge 1, even if the financial statements did not comply with GAAP.

### **Investigative Approach**

64. The members were critical of the investigators for a number of reasons. They submitted that the investigators made up their minds without fully understanding the facts and adopted an inappropriately narrow view of the issues too early in the investigation.

65. It is not unusual in cases before the Discipline Committee, which last many days – when the members charged testify, when expert evidence is called, when counsel subject the evidence to insightful examination and cross-examination – that facts come out which were not previously known or well understood by the investigator[s] or the Professional Conduct Committee. This fuller appreciation of the relevant facts and issues is an apparent benefit of the adversarial process.

66. The investigators did not require Anthony Power, Douglas Barrington, or Peter Chant to confirm in writing that they had made all of the relevant documents available. Only Claudio Russo was requested to do so. It became apparent during the hearing that some documents, which were in desk files of the members and not in the working papers, were relevant.

67. When the investigators met with Douglas Barrington, Peter Chant and Anthony Power, they did not effectively review with them the basis for the tentative conclusions they had reached after interviewing Claudio Russo. At this hearing the members thought it was important to more fully set out the facts and

better explain the conclusions that they reached. The result, understandably, was a very lengthy hearing.

68. When a member who is charged testifies before the Discipline Committee, that member's evidence is usually crucially important to the outcome of the case. The evidence which was most damaging to the members in this case was the evidence they gave at this hearing, evidence which had not been previously disclosed to the investigators.

69. Whether the investigators did make up their minds too early may be a matter for debate. During the course of the hearing it became apparent that the investigation had not been wide ranging nor, did the investigators fully appreciate all of the issues which became apparent to the panel as the members presented their cases.

### **Professional Judgment**

70. The members assert that the impugned conduct involved the exercise of professional judgment. The members emphasize that the process which they followed allowed for the recognition of the appropriate audit risk. They insist that they took the necessary steps to address the issues and, in particular, that they applied an increased level of professional scepticism.

71. The Professional Conduct Committee took the position that the exercise of professional judgment means more than following a process and identifying the relevant issues. It requires the actual exercise of applying professional judgment correctly in arriving at conclusions in accordance with the standards of the profession.

72. The members assert that at the heart of the Professional Conduct Committee's case is the flawed opinion of one expert, Allan Wiener, who was not as experienced or qualified as Douglas Barrington, Anthony Power or Peter Chant.

### **STANDARD OF PROOF**

73. The parties disagreed, to some extent, with respect to the standard of proof which applies to this case before the Discipline Committee. The parties agree that findings of professional misconduct can only be made when the proof of that misconduct is clear and convincing and is based on cogent evidence.

74. The members assert that the standard of proof, while less than the criminal standard of proof beyond a reasonable doubt, is higher than the civil standard of proof on a balance of probabilities. The Professional Conduct Committee acknowledges that the standard may be higher than the civil standard if the professional misconduct alleged involves moral turpitude. As this case is a standards case and does not involve moral turpitude, the Professional Conduct Committee asserts that the standard applicable is the civil standard. The prosecution discharges the burden of the civil standard if the panel concludes that, on the evidence, it is more probable than not, that the allegations are true.

75. In *Dr. Q v. College of Physicians and Surgeons of British Columbia*, [2003] 1 S.C.R. 226, the Supreme Court of Canada, in a case where the professional misconduct alleged involved moral turpitude, referred to the clear and cogent standard applied by the tribunal and accepted as the applicable standard by the courts in British Columbia as an intermediate standard, a standard lying between the civil standard and the criminal standard.

76. As the Discipline Committee has applied a clear, cogent and convincing standard for years, without explicitly reserving it to cases involving moral turpitude, it may be that the appropriate standard of proof in standards cases is something that should be revisited. However, the panel does not think this is the appropriate case to revisit the issue and concludes that in this case the clear, cogent and convincing standard, which the Supreme Court of Canada referred to as an intermediate standard, will apply.

77. The overriding principle is that the more serious the consequences the more certain the tribunal must be. There is no doubt the consequences of a finding of guilt is a matter which would have serious consequences for the members and one which they take very seriously. Accordingly, the panel is unwilling to make findings, whether of facts alone or with respect to what the standards of the profession required in 1998, on a balance of probabilities, where the test the panel applies is expressed as: "Is it more likely than not?" The panel is only willing to make a finding when it is convinced by clear and cogent evidence that a finding is required.

78. As noted above, the parties agreed that all of the evidence given at this hearing, the evidence adduced by the Professional Conduct Committee and the evidence adduced by the members and the experts they called, is before the panel and capable of satisfying the burden of proof.

## **THE RELEVANT FACTS**

79. The panel sets out hereafter the facts which it finds to be relevant. It follows that the panel did not accept evidence which differs from the facts set out, or did not find such evidence relevant. Many of the facts are not in dispute. For the most part, the dispute related to the appropriateness of the conclusions which the auditors reached on the evidence they had. A most significant issue was whether or not the auditors were entitled to conclude that they had sufficient appropriate audit evidence to dispel their suspicions about what was referred to as the "put" in April 1998. As this issue is fundamentally important to the panel's decision with respect to guilt or innocence, the relevant evidence and the standards of the profession are set out in some detail.

80. Deloitte presented its 1997 audit plan to the Audit Committee of Livent on November 3, 1997. The audit plan and the underlying assumptions, concerns and risks can best be understood in light of the audits of previous years and events in 1997.

## **Unique Revenue Generating Transactions**

81. Deloitte's 1997 audit planning memo identifies as an engagement risk pervasive to the audit that: "Livent enters into a number of material and unique revenue generating transactions. Management's selection of a reporting method may be aggressive."

82. Livent proposed to recognize as revenue in 1997 the present value of the payments that were to be received pursuant to three such revenue generating transactions in 1997; these three transactions are the subject of particulars i), ii), and iii), of Charge 1.

### **Charge 1, particular ii) - Ford**

83. Livent filed with the SEC a US/Canadian GAAP reconciliation for fiscal 1996. "SEC services" of Deloitte US, sometimes referred to in the hearing as "Wilton", had to sign off on the reconciliation. Wilton, in the course of reviewing the 1996 audited financial statements of Livent, did not immediately agree that it was appropriate to recognize the revenue from the sale of the right to name the Lyric Theater in New York in 1996, the year the agreement was signed. This issue was addressed by Wilton and Deloitte in the months of March to July of 1997.

84. Livent had previously applied the accounting principle it desired, namely to recognize the present value of the payments to be received under an agreement as revenue in the year the agreement was made. In 1994 Livent sold to Ford the right to name theatres in North York (Toronto) and Vancouver. The theatre in North York was open to the public in 1994, prior to the sale of the naming rights. The theatre in Vancouver had not been completed and was not open to the public in 1995.

85. The North York naming rights fee of \$7.5 million was included in Livent's 1994 revenue at its then net present value. The Vancouver naming rights fee was included in the same fashion in Livent's 1995 revenue. The OSC and SEC questioned and then accepted the recognition of the revenue in 1994 for the theatre that came to be known as the Ford Centre for the Performing Arts in Toronto (North York). The OSC and SEC did not raise questions about the inclusion of the revenue for the naming rights of the Vancouver theatre in 1995.

86. Livent entered into two contracts with Ford in 1996 and proposed to recognize the present value of the payments it would receive pursuant to the contracts as revenue in fiscal 1996. The first contract, made on September 13, 1996, provided Ford with the right of first refusal to name any theatre in the world owned or controlled by Livent. In return, Livent received US \$2,000,000 from Ford on January 3, 1997, US \$1,000,000 on October 31, 1997 and was to receive US \$1,000,000 from Ford on each of October 31, 1998 and October 31, 1999. The second contract, dated November 4, 1996 gave Ford the naming rights to the Lyric Theater in New York and to the Oriental Theater in Chicago. The total compensation Livent was to receive for each theatre was US \$7,500,000. The payments were to be made by instalment on October 1<sup>st</sup> commencing in 1998 and continuing annually until 2006. The first three

payments were to be for US \$500,000 and the remaining six payments on each theatre were to be in the amount of US \$1,000,000.

87. By letter dated February 26, 1997, Kevin Duke, of the office of General Counsel for Ford in Dearborn Michigan, wrote to Jerald Banks, the Secretary and General Counsel of Livent, pursuant to the request he received from Livent, confirming that Ford regarded the two agreements dated September 13, 1996 and November 4, 1996 as "related parts of a single sponsorship arrangement".

88. Robert Wardell, an experienced audit partner, had been responsible for the quality assurance review process in the 1995 audit. He became the Lead Client Service Partner for the 1996 audit. He had been transferred to the national office in 1996. National office partners were not typically Lead Client Service Partners, but nevertheless, he filled that role for the year 1996.

89. The issue of whether or not it was appropriate to recognize the revenue from the naming rights agreement in New York and Chicago in 1996 was a matter of internal discussion and some disagreement at Deloitte. A manager in Deloitte's national office did not think it was appropriate to recognize the revenue but thought instead it should be deferred and amortized.

90. In March 1997, Myron Gottlieb made it clear to Robert Wardell that, if Deloitte were not prepared to accept the accounting policies which Livent adopted, then Livent would reconsider its relationship with Deloitte.

91. Ultimately, Robert Wardell was satisfied that it was appropriate to recognize the revenue on the sale of the naming rights to the Lyric Theater in New York in 1996. At first he was of the view that it was not appropriate to recognize the revenue until the construction of the theatre was complete but, after visiting the theatre and reviewing the state of the construction, he concluded there was reasonable assurance that the theatre would be completed and open to the public as scheduled, and he agreed that the policy of recognizing the revenue in 1996 fell within GAAP.

92. With respect to the revenue from the Oriental Theater in Chicago, Robert Wardell concluded that, as Livent did not have all the necessary approvals to construct the building as of December 31, 1996, it was not appropriate to recognize the revenue from the sale of the naming rights for that theatre in 1996, the year the agreement was entered into.

93. When Wilton continued to resist the recognition of the revenue from the Lyric Theater in New York for fiscal 1996, Robert Wardell asked Peter Chant (who was recognized both within the firm and in the Canadian profession as an expert in GAAP) to assist in resolving the issues with Wilton. Douglas Barrington, the group managing partner of the national office in Toronto, was asked by Bruce Richmond, the Vice-Chair of Deloitte, to make sure that Peter Chant would have the time to assist Robert Wardell and Wilton resolve the issues.

94. Peter Chant determined that Wilton did not accept all of the assertions made by Livent. He obtained and reviewed the two Ford contracts and the letter

from the office of Ford's General Counsel of February 26, 1997 and analyzed the issue. Peter Chant's memorandum to the file of May 20, 1997 was regarded by Deloitte as a definitive analysis and was referred to throughout the hearing as the "Chant memorandum".

### **The Chant Memorandum**

95. At page 12 of the memorandum, Peter Chant addressed the accounting issues. His analysis was referred to repeatedly in the hearing by the members and the experts. It reads as follows:

*The accounting issues.* The substantive issue here is one of revenue or gain recognition. The criteria for revenue recognition, which are also appropriate for recognizing gains, are expressed in CICA Handbook s. 3400. It states:

Revenue from sales and service transactions should be recognized when the requirements as to performance set out in paragraphs 3400.07 and .08 are satisfied, provided that at the time of performance ultimate collection is reasonably assured. [OCT.1986]

.07 In a transaction involving the sale of goods, performance should be regarded as having been achieved when the following conditions have been fulfilled:

(a) the seller of the goods has transferred to the buyer the significant risks and rewards of ownership, in that all significant acts have been completed and the seller retains no continuing managerial involvement in, or effective control of, the goods transferred to a degree usually associated with ownership; and

(b) reasonable assurance exists regarding the measurement of the consideration that will be derived from the sale of goods, and the extent to which goods may be returned. [OCT. 1986]

To satisfy 3400.07(a), it must be established 1) what has been sold and 2) when the conditions for revenue recognition permit the inclusion of the proceeds in income.

Legally, it is the right to "name" the building that has been sold, although ancillary rights have also been sold. Ignoring the latter for the moment, the right to name a building presumably exists when a right to build the building exists, but does not require the building itself to exist. This observation is demonstrated by the fact that the contract signed by Ford for the New York theater specifically recognizes that the theater is under construction and renovation at the time the contract is signed. Nonetheless Ford has already attached its name to the New York site and is receiving recognition for it prior to the completion of the building. For the Chicago site, Livent had not obtained the right to construct a building before December 31, 1996. Thus no recognition was given to the contractual provisions relating to the sale of the naming rights for the Chicago theater.

This suggests that the "significant acts" identified in section 3400 have been completed when Livent itself acquires the right to name a building, which is notionally when the site is assembled. It is recognized that the payment for the naming rights may be deferred if Livent fails to complete the building by a stipulated point in time. This suggests that perhaps the recognition of the revenue should be deferred until an unconditional right exists to the money, that is, the building is built and open to the public.

The item that is sold, however, is not the building, it is the right to name the site and the building. The right to attach the name to it is not conditional on the physical existence of the building (in fact Ford is currently being associated with the site and receiving benefits of having its name attached to the site in the press). Furthermore, the right to the payment still exists if Livent misses the deadline; it is simply deferred if Livent does not open as scheduled (or, in fact, until a year after it is scheduled to open). That is, failure of Livent to open the building and provide the benefits of a name on a functioning building at a specific future time will result in a penalty, being the deferral of the payment. But the right to collect such payments will still exist.

*Exhibit 65, Tab 10*

96. Before concluding his memorandum with a section on financial statement presentation, Peter Chant concluded the section on the principles which apply with respect to naming rights as follows:

It should be noted that both the O.S.C. and the S.E.C. reviewed revenue recognition of the naming rights for the North York (Toronto) facility in 1994 and accepted the accounting treatment followed at the time. The 1994 agreement with Ford was essentially the same as the 1996 agreement and had the same ongoing requirements elaborated above. Our conclusion at that time was that these requirements were de minimus in the context of Livent's normal operations. Nothing has occurred in the intervening period to cause us to change this position.

*Exhibit 65, Tab 10*

97. During the course of his work, Peter Chant asked Robert Wardell to provide evidence about the attendance requirements of the agreement with Ford and concluded that there was reasonable assurance that the attendance requirements would be satisfied.

98. In a memorandum dated July 9, 1997, Wilton confirmed it accepted that the revenue from the sale of the naming rights to the Lyric Theater could be recognized in 1996, even before the construction was completed.

Ford has acquired the right to name the NY and Chicago theaters currently under construction by Livent as well as the right of first negotiation to name future theaters. Ford has agreed to pay \$7.5 million for each theater and \$5.0 million for the right to name future theaters. The agreement is in perpetuity and payments to be made over a ten year period. Livent has

various de minimus obligations it must fulfill to be in accordance with the agreement. We believe that revenue may be recognized at the present value of the cash flows as of the date of the agreement for the NY theater and for the right to name the future theaters. [We also believe that revenue may be recognized for the Chicago theater at the date that a contract for a building site is signed.]

*Exhibit 108*

99. Livent obtained the title to the building site and Oriental Theater in Chicago in the first quarter of 1997. Accordingly, given the review of this issue which took place during the process to reconcile US/Canadian GAAP in March to July of 1997, Livent proposed to recognize the revenue for the sale of the right to name the Oriental Theater in 1997.

**Charge 1, particular iii) - Dundee Realty Corp.**

100. Livent and Dundee Realty Corp. (Dundee) entered into a multifaceted arrangement which included the sale of density rights over the Pantages Theatre complex to Dundee. It also provided for a joint development through a corporation to be owned by both Dundee and Livent. One of the provisions of the arrangement allowed Dundee to require Livent to take over Dundee's obligations and return Dundee's investment. Throughout the hearing this provision was referred to as the "put", and in these Reasons is referred to as the Put. Livent wanted to recognize the revenue that it would receive under this arrangement in the quarter ending June 30, 1997 (Q2, 1997). Deloitte concluded it was not appropriate to recognize the revenue from the Dundee arrangement as long as there was a Put in existence.

101. Myron Gottlieb was adamant that this revenue should be recognized in Q2. Robert Wardell and Peter Chant refused to accept this position. Deloitte's position with respect to the Put is summarized in a memorandum from Robert Wardell to the file dated August 8, 1997. The memorandum sets out what Peter Chant and Robert Wardell told Myron Gottlieb, Maria Messina and Gordon Eckstein, the Executive Vice-President of Livent, on August 1, 1997:

Gain recognition would not be appropriate with respect to the sale of the density rights for cash of \$2.5 million and a receivable of \$4.9 million as long as Dundee Realty had the right to "Put" all its investment in shares and debentures of the newly formed Development Company (i.e., the entity created to develop the project) to that Development Company at which time majority ownership would then revert to Livent (in the absence of a new, yet unidentified, investor).

*Exhibit 125, Tab 19*

102. The memorandum also included reference to two subsequent discussions.

I was subsequently informed by Maria Messina that Myron was apparently pushing to have a significant gain (i.e. \$6 million) on the Pantages transaction reflected in Livent's second quarter results and to have no disclosure relative to such inclusion.

On Wednesday August 6, 1997, I called Myron to inform him that I was extremely concerned that he would even consider this course of action in that:

- (1) the transaction clearly was not a second quarter transaction;
- (2) I was skeptical as to the quantum of the so-called gain; and
- (3) non-disclosure was not acceptable under GAAP.

I advised him that if the second quarter results were to include a material gain on the Pantages transaction, we would not be in a position to provide any comfort to any regulators, underwriters or audit committee members as to the interim financial statement's conformity with GAAP.

*Exhibit 125, Tab 19*

103. Peter Chant had a lengthy telephone conversation with Myron Gottlieb on the evening of July 31, and the early morning of August 1, 1997. At one point, Myron Gottlieb had Rodney Seyffert, of the law firm Smith Lyons and legal counsel to Livent, join the conversation. In this conversation, Myron Gottlieb instructed Rodney Seyffert to remove the Put from the agreement.

104. Despite the above instruction Myron Gottlieb continued to insist that it was appropriate to recognize the revenue in Q2, 1997. On August 13, 1997 Livent announced its financial results for Q2 in a press release and included, as revenue, income from the arrangement with Dundee. Deloitte believed the interim financial statements for Q2, 1997 were materially misstated. Robert Wardell consulted with Peter Chant and both reviewed the matter with Douglas Barrington.

105. In a continued effort to satisfy Deloitte that the revenue should be recognized, Myron Gottlieb had Rodney Seyffert and Michael Cooper, the CEO of Dundee, speak with Mr. Chant. Both attempted to assist Myron Gottlieb to persuade Deloitte that the revenue should be recognized in Q2, 1997. At the time, Myron Gottlieb was a director and the chair of the audit committee of Dundee's parent, Dundee Bancorp Inc.

106. Deloitte were not persuaded and demanded a meeting with the Audit Committee because they were of the view that the interim financial statements as at June 30, 1997 were materially misstated. Deloitte were aware that Livent was raising a substantial amount of money and that Deloitte would be asked to associate itself with a US \$125 million prospectus offering which was to be finalized in October 1997.

#### **Meetings with the Audit Committee in August 1997**

107. Douglas Barrington, Peter Chant and Robert Wardell met with the Audit Committee on August 26, 1997. Peter Chant was the main spokesperson, Robert Wardell took notes and Douglas Barrington was present as a senior partner of the firm to make it clear that Peter Chant was expressing the opinion of

the firm and to support him in that regard. Insofar as Deloitte were concerned, as Douglas Barrington testified, the matter was quite straight forward - if there was a Put, the revenue could not be recognized.

108. At this meeting Livent had an opinion from its legal counsel, Rodney Seyffert, to the effect that there was a binding agreement as of the end of June, 1997. Deloitte agreed that they would review that opinion and a second Audit Committee meeting was scheduled for August 29, 1997. Rodney Seyffert had written a letter to Livent dated August 26, 1997 in which he opined on certain matters relating to the arrangement between Livent and Dundee (DRC). Included in his letter, is a paragraph numbered "7" which includes the following:

In this regard it is my understanding (I was out of the country at the time) that in considering the requirement of GAAP (Canadian) with respect to the two accounting issues (treatment of the gain and equity accounting) further lessening of the governance entitlement and accounting overview was recommended as well as removal of the put and shotgun buy-sell. I understand that this was agreed to by DRC. The removal of the put in particular, was, if anything, of advantage to Livent. Inasmuch as DRC apparently did not require any financial restructuring to give up this right, one could reasonably conclude that DRC had become more comfortable with the project as it conducted its due diligence and had determined that the put was no longer material.

*Exhibit 94*

109. Further, by letter dated August 27, 1997 Rodney Seyffert wrote: "At your request, for greater certainty and further to my opinion letter dated August 26, 1997 re the Livent Inc. sale to Dundee Realty Corporation, I am confirming in writing my opinion with respect to certain matters discussed with Mr. Peter Chant of Deloitte & Touche on Tuesday evening August 26, 1997." Rodney Seyffert confirmed his opinion with respect to four numbered points. The third numbered point reads:

The Master Agreement and Contract for Sale ("Master Agreement") which established the effective date of June 30, 1997 in all material respects agrees with the May 22, 1997 letter agreement. Without any compensation therefore, the put which was included in the letter agreement for the benefit of Dundee Realty was removed from the Master Agreement at the request of Livent Inc to conform to Livent's intended accounting treatment of the transaction;

*Exhibit 66, Tab 14*

110. Livent also obtained a letter from Dundee, dated August 27, 1997 in which Michael Cooper, the CEO of Dundee said among other things:

The Master Agreement and Contract for Sale, which established the effective date of June 30, 1997, in all material respects agrees with the May 22, 1997 letter agreement. Without any compensation thereof, the put which was included in the letter

agreement for the benefit of Dundee Realty was removed from the Master Agreement at the request of Livent Inc.

*Exhibit 66, Tab 15*

111. Douglas Barrington testified that he understood from Myron Gottlieb that the Put had been cancelled. He was asked his understanding of the Put at the time of the Audit Committee meeting on August 26, 1997:

Q. And what was your understanding going into that meeting in terms of the existence of a Put, right and the -

A. Our understanding going into the meeting on the 26<sup>th</sup> is that the Put had been removed for no consideration by mutual agreement between Livent and Dundee Realty

Q. And had you heard that directly from Mr. Gottlieb or someone from Dundee?

A. I heard it directly from Mr. Gottlieb. I had not heard it at that point in time directly from someone at Dundee.

Q. And when did Mr. Gottlieb confirm that to you?

A. It would have been in the course of the...discussions probably -- on and I'm trying to remember when I met with Mr. Gottlieb.

I think the face-to-face meeting was on the Friday, previous Friday and there were phone conversations that I was party to, tos and fros, and my sense is there would have been -- it would have been in that as well.

Q. The previous Friday would have been August the 23<sup>rd</sup>?

A. Friday is the 22<sup>nd</sup>.

Q. August 22<sup>nd</sup>?

A. Yes.

Q. So you had heard that directly from Mr. Gottlieb that date.

A. It--certainly prior to coming into the meeting on the 26<sup>th</sup> I had heard, I believe directly from Mr. Gottlieb, that -- his assertion that the Put had been removed.

*Transcript, Barrington, P.4865, Qs. 14979 - 14984*

112. The Master Agreement dated August 15, 1997, signed on behalf of Livent by Myron Gottlieb, and signed on behalf of Dundee by Michael Cooper, says on its face that section 3.03 was "Intentionally Deleted". Peter Chant, who had seen an earlier draft of the proposed Master Agreement, noted that section 3.03 which was the Put had been deleted when he saw a copy of the executed Master Agreement.

113. At the Audit Committee meeting of August 29, 1997, neither Livent nor Deloitte were prepared to accept the position of the other. Peter Chant knew that it was important to Livent that their accounting policies be seen to comply with US GAAP as well as Canadian GAAP. He believed at the time that under US GAAP, in particular FAS 66, the transaction would be recognized in Q3. He suggested Livent assert that it would follow US GAAP and restate the interim financial statements of June 30, 1997. Livent needed Deloitte to be associated with these interim financial statements for the US \$125 million prospectus offering. Deloitte would not be associated with the statements unless they were restated. Livent agreed. Livent issued a News Release dated Tuesday September 2, 1997. Two of the paragraphs read as follows:

Toronto, Ontario – Livent Inc. announced today that in contemplation of a possible issuance of US \$100 million debt securities in the United States, it has adjusted its accounting treatment for non-theatre real estate transactions in order to be consistent with U.S. GAAP. This adjustment, which has no effect on prior years' income, will result in the recognition of income before income taxes of \$4.8 million (\$0.17 per share) in the third quarter of 1997 rather than in the second quarter, as previously announced. The adjustment is in connection with the sale by the Company of air rights to a real estate developer pursuant to a binding contractual arrangement in place prior to the end of the second quarter. The report to shareholders to be mailed this week will contain the revised statement of income for the second quarter of 1997.

The adjustment to conform to U.S. GAAP will not have any effect on the Company's fiscal 1997 year-end results.

*Exhibit 128*

#### **Charge 1, particular i) - AT&T, Pantages Place**

114. An agreement to sell AT&T the right to name the "entertainment complex" known as Pantages Place was executed on November 14, 1997. It covered the entirety of the complex, including the existing 2200 seat Pantages Theatre and an adjacent new theatre of approximately 1400 seats which was expected to be constructed in 2000.

115. The AT&T agreement provided for a naming fee of \$12,500,000 payable in 12 instalments, the first due November 10, 1997, which was paid. The agreement was similar in many respects to the Ford Naming Rights Agreement but less onerous on Livent as there was no attendance requirement, no provision in the agreement that payments would be deferred or otherwise tied to the construction of the second theatre. There was no provision in the agreement for AT&T to receive any refund in the event that the second theatre was not completed.

116. Livent wanted this income recognized in Q3 of 1997. In fact, Myron Gottlieb discussed the issue of recognizing the revenue from the planned transaction in early September with Peter Chant. Deloitte thought it was a Q4 transaction. Ultimately, when both Livent and Deloitte had received opinions

from Ernst & Young and Price Waterhouse that the revenue could be recognized in Q3, although Deloitte still disagreed, they did not object to the inclusion of the income in Q3.

### **Charge 1, particular iv) - First Treasury**

117. During 1997, Livent transferred to First Treasury all the amounts receivable from Ford relating to the sale of the North York and Vancouver theatre naming rights agreement, a portion of the amounts receivable from Ford relating to the sale of the New York and Chicago naming rights agreement, and all of the amounts receivable from Ford relating to the agreement to sell the right of first refusal to name theatres.

118. Livent accounted for these transfers as sales of receivables and recognized a loss of approximately \$1.2 million. Of that total, \$274,128 was apportioned to the Chicago theatre transaction.

119. Livent continued to assume the foreign exchange risk under the agreements to transfer the Ford receivables to First Treasury. EIC-9 Transfer of Receivables (Exhibit 69, Tab H) describes under what conditions it would be appropriate to reflect the transfer of receivables as a sale and recognize a loss rather than reflecting the transfer as a financing arrangement, in which case no loss would be recognized. EIC-9 lists foreign exchange risk as one of the examples of the significant risks and rewards of ownership that should be transferred before the transfer may be recognized as a sale.

120. Allan Wiener's evidence was that if the transfer had been treated as a financing, and not a sale, the \$274,128 loss with respect to the Oriental Theater in Chicago may not have been material. However, he also testified that the liability of \$3.7 million, which would have been the result if the transfers had been treated as a financing and not a sale, would have been in excess of one percent of liabilities and would have been material.

### **Changes in the Audit Team**

121. Given the events of August 1997 and the fact that Livent was forced to restate the Q2 financial statements, it was not surprising that there was a request by Livent for a change in the audit team. Myron Gottlieb was not happy with the services provided by Robert Wardell. While he did meet with Douglas Barrington to discuss the audit team and request a change, the change of the audit team was not solely effected by Myron Gottlieb.

122. In August or September 1997, Garfield Emerson, the then relatively new chair of the Audit Committee, was unhappy with the services provided by Deloitte. He wanted a more forceful Lead Client Service Partner who would be more independent and speak clearly to the Audit Committee. He wanted the auditors to be represented at meetings of the Audit Committee and he wanted the auditors to communicate directly with him with respect to the relevant issues. Garfield Emerson expressed his unhappiness to a Deloitte partner he knew. Subsequently, he met with Thomas Cryer, the Chairman of Deloitte, and a change in the audit team was effected.

123. The changes made to the audit team in October, 1997 are set out in a letter dated October 29, 1997 written by Thomas Cryer to Garfield Emerson. He summarized the changes as follows:

- Tony Power, one of our senior Partners, will be the lead client service partner and will have the overall direct responsibility for the servicing of Livent Inc. He will be supported by Claudio Russo who will have day-to-day responsibility for the audit services and Peter Chant who will be an advisor to the service team in complex accounting and SEC reporting matters.
- Deloitte & Touche will be extended an invitation to the quarterly Audit Committee meetings.
- Tony Power will regularly meet with you to ensure we understand your expectations as Chairman of the Audit Committee.

*Exhibit 150, Tab 4*

124. Anthony Power made it a condition of accepting the Lead Client Service Partner role that Claudio Russo be the Audit Engagement Partner. He also asked Douglas Barrington to be an Advisory Partner. Neither Anthony Power nor Claudio Russo had experience auditing a client in the live entertainment industry.

### **The Audit Plan**

125. In the autumn of 1997, immediately after being appointed to the Livent engagement team, Claudio Russo reviewed the US \$125 million prospectus offering being made by Livent. This review included the 1996 working paper files and the interim results for the first six months of 1997. After conducting the review, Claudio Russo developed the 1997 audit plan.

126. Anthony Power reviewed some of Livent's revenue generating transactions, including the Ford, AT&T and Dundee transactions, in preparation for discussions of those transactions in early November 1997.

127. One of the first discussions Anthony Power had was with Peter Chant. When Peter Chant subsequently checked FAS 66 he realized that the Dundee arrangement would not comply with US GAAP without an increase in the down payment, and advised Livent of this. Livent decided that it would recognize the revenue in accordance with Canadian GAAP. Peter Chant thought this was inconsistent with the decision made in late August and announced in the press release of September 2, 1997. Anthony Power, however, was not prepared to make an issue of this with Livent and as Lead Client Service Partner did not pursue it. When Peter Chant subsequently raised his dissent on the matter with Douglas Barrington, he was told that there had been a miscommunication between himself and Anthony Power and that it should not happen again.

128. Anthony Power approved the audit plan which was presented to the Audit Committee on November 3, 1997. Anthony Power, Claudio Russo and Peter

Chant attended the Audit Committee meeting on November 3, 1997. One of the topics discussed, at length, was preproduction costs.

129. Deloitte working papers disclosed that they were fully aware that this was a high risk engagement. The details of the risks and the response of the auditors are summarized in two boxes which appear in the planning memorandum in the audit working papers. They read:

Details of Risk	
1	The Company is a public entity as both an SEC and OSC registrant. The Company, its financial reports and management historically have attracted a high level of scrutiny and public observation. Management is sensitive to reported net earnings levels.
2	The valuation of preproduction costs is subject to management estimation and financial projections. Resultant amortization and or write-offs of preproduction costs can have significant impact on net earnings.
3	The Company has entered into a number of material and unique revenue generating transactions. Management's selection of reporting methods may be aggressive.
4	The Company faces both internal and external business and industry risks based on the success of its own theatrical productions and the general health of the live theatrical consumer market.

	Response	Comments/Ref
1	Ensure that the assigned audit partners and staff have the requisite experience, skills, and expertise	The client service team includes senior partners of the firm with the requisite skills (Tony Power, Doug Barrington, Peter Chant, U.S, National Office partners).
2	Increase the professional scepticism of all personal involved in the audit engagement	Articulated to audit staff
3	Increase involvement of engagement management at all stages of the audit engagement to ensure that the appropriate work is planned and its performance is properly supervised.	Tony Power, Claudio Russo, Jamie Barron and Michelle Magwood will be involved with all significant audit and financial reporting issues upfront with regard to planning and their audit and resolution.

*Exhibit 88, Tab 8*

130. After completion of the Audit Plan which was presented at the November 3, 1997, Audit Committee meeting, Claudio Russo selected the audit field team consisting of a manager, a senior and two audit assistants, supervised the preparation of the detailed audit program, and reviewed the planned audit approach for each significant account balance.

131. As documented in the Audit Planning Memorandum, (Exhibit 88, Tab 12), planning materiality of \$2,000,000 had been calculated and overall a control reliance audit strategy was planned. Accordingly, the detailed audit plans included both control testing (procedures to test key internal controls) and

substantive testing (procedures conducted to test for dollar amounts of errors or fraud and other irregularities directly affecting the correctness of financial statement balances). Under a control reliance approach, the planned audit testing decisions must be revisited if control testing does not support the conclusion that controls operated effectively throughout the audit period.

132. The control reliance approach is consistent with Deloitte's conclusion that Livent had good accounting systems. Claudio Russo testified,

I'll comment about the computer systems and systems in general, if you like. Our overall conclusion was that the company had very strong systems. In terms of the things that we review, the quality of the personnel that they had overseeing the systems, controls such as segregation of duties, the processing of the transactions, the company - - and it just never changed anywhere throughout the audit - -the company had very good systems in place.

*Transcript Russo, P. 1169, Q. 3130*

### **Field Work**

133. The field work started a week or two later than was originally planned and took two to three weeks to complete. Claudio Russo explained the late start in his testimony:

We were originally scheduled to start I believe towards the end of February. The company asked us to put off to the first week of March. The explanation was that they just weren't ready. They hadn't had a chance to close the books and prepare the package that we would normally need going in to be able to do our work. So it was delayed either a week or two I believe.

*Transcript, Russo, P. 1282, Q. 3338*

134. Claudio Russo testified that he personally accumulated between 200 and 250 hours on the Audit. This was substantially more hours than was contemplated when Deloitte set the fee for the audit. The services he provided included participating in all of the meetings with the client on internal controls; as well as budgeting and forecasting; reviewing all of the agreements related to the revenue generating transactions; preparing a number of working papers; preparing summary memoranda and a memorandum dated January 20, 1998 which set out an overview of the issues identified prior to the audit.

135. Anthony Power attended the Audit Committee meetings, reviewed key memoranda, attended the key meetings with management at year end relating to the valuation of preproduction costs and the revenue generating transactions. He prepared issues memoranda including a memorandum dated February 19, 1998 which documented the development of a number of issues including the matters which give rise to particulars i), ii) and iv) of Charge 1.

**Charge 2, particulars ii) and iii) - Audit of Preproduction Costs**

136. Claudio Russo described the audit plan for preproduction costs in his testimony.

Q. I want to turn to some records of this process, at least what I understand to be, Exhibit 89, Tab 7.

A. Yes.

Q. Let's start on the first page. What is this?

A. The first page is the audit program for pre-production costs.

Q. What is - - what is the audit program?

A. It's set out at the bottom of that page. The items numbers 1, 2, and 3.

Q. Right.

A. So the first step is to test the additions for the year to support the documentation. We wanted to make sure that the items that were being capitalized to pre-production costs were appropriate and that they were being charged to the correct show. That was the first step.

The second step, test the amortization of the pre-production costs for reasonability. Actually, in this particular case, instead of reasonability test, we actually re-calculated - - re-performed all of the amortization expense calculations.

And item 3, test the carrying value of pre-production costs by testing the show forecasts for selected shows on a show-by-show basis. So this is referring to the work that we did and the build-up of the budgets and the forecast.

Q. All right. Turn over to the third page. What is this? Does this relate to the topic under consideration.

A. Yeah. This - - this - - these four pages just provide some background as to what's included in pre-production costs, how they're amortized, and just talks a little bit about some of the controls in place with respect to budgeting.

Q. All right. Then go over to DT35783.

A. Yes.

Q. What is this?

- A. This working paper actually combined with all the working papers in tab 8, which is where we've documented the work that we did in terms of testing the individual shows to make sure that the budgets, the revenues and the costs were reasonable. Sorry. Got the wrong page there.
- Q. Pardon me?
- A. I'm sorry. I got the wrong item there. This particular test, this is the test of additions to pre-production costs. Sorry.
- Q. And over the page?
- A. So the next eight pages all refer to that particular test.  
*Transcript, Russo, P. 1443, Qs 3722 - 3730*

137. The 1996 Points Forward Memorandum, (Exhibit 66, Tab 29), recommended that the actual results for 1997 be compared to management's budget for 1997. This comparison was only completed for the first nine months of 1997. In his evidence Claudio Russo explained that the comparison for the entire year was not completed because it was known that Livent's costs had increased and the business changed significantly between 1996 and 1997, and continued to change in 1997. The business had become more of a touring operation than a single city operation and the budgets prepared by management in 1996 for 1997 were considered outdated and irrelevant to the audit process.

*Exhibit 66, Tab 29*

*Exhibit 89, Tab 7*

138. Claudio Russo testified that he went through the budget show-by-show comparing the budgeted revenues to the preproduction costs and, in doing so, assessed how the recoverability of preproduction costs would be impacted if revenue for the show were changed by 10%.

139. On March 28, 1998 the auditors had a meeting to review preproduction costs with senior management which included Garth Drabinsky. Deloitte's Report to the Audit Committee of April 9, 1998 devoted two pages to preproduction costs. The introductory paragraph and the concluding paragraph read as follows:

Our objectives with respect to preproduction costs were to ensure that preproduction expenditures were appropriately capitalized and amortized and that they were not carried at amounts in excess of net recoverable amounts.

Given the uncertainty and degree of judgment required in valuing preproduction costs, and the fact that preproduction costs include amounts in respect of productions in various stages of development the future success of which is difficult to estimate in advance, management has represented that it will establish an additional provision against its preproduction costs. This provision would be in addition to any specific adjustments

required to reduce specific costs to their estimated net recoverable amount and would represent provisions against unidentified losses that may be inherent in the portfolio of productions. We support this practice and believe it is an effective means of addressing measurement uncertainties in the valuation of the overall portfolio.

*Exhibit 81, Tab 11*

140. In fact, Deloitte wanted an additional provision not specific to particular shows for 1997. Management adamantly refused to make such a provision. Deloitte concluded that while the estimate was aggressive, and towards the outer margins of what would be considered reasonable, they could not say that it was wrong or did not comply with GAAP.

#### **Charge 2, particular iv) - Audit of Accounts Payable**

141. The audit team selected a sample as part of the audit work with respect to accounts payable and accrued liabilities and, in so doing, they identified five errors in the sample selected for testing. The number of samples was not extended as a consequence of discovering these errors.

142. There was no extrapolation performed of the five errors and no such extrapolation was taken to the Summary of Unrecorded Differences (SUDS). While notations on the working papers indicate the intention was to take the errors to SUDS, a notation on the working paper that summarizes the errors reads:

Note: All these items have now been adjusted by the client.  
Therefore, no errors.

*Exhibit 66, Tab 33*

143. When errors are detected during tests of details, Deloitte's audit manual provides:

Misstatements are acceptably small for this purpose if, when extrapolated to the population as a whole and combined with other likely misstatements, they would not result in a material misstatement of the financial statements.

*Exhibit 66, Tab 34*

144. The investigator and other experts all agreed that the amount computed by extrapolating the errors to the population as a whole, as provided by the Deloitte audit manual, would not have been material in and of itself.

145. Claudio Russo testified he did break the total error down between capital and expense and performed a simple extrapolation in his head, however, this was never documented.

#### **Charge 2, particular v) - Audit of Fixed Assets**

146. In a test of additions to fixed assets, five additions were not supported by original documentation. When Livent could not locate the supporting invoices, representations by Gordon Eckstein, the Vice-President of Operations, were

accepted as support for four of the five additions. The fifth undocumented addition was an allocation of costs incurred by Garth Drabinsky in New York.

147. Of the five unsupported additions in the test of additions to fixed assets, three were from the same supplier, F&D Scene, a related party. F&D Scene was not contacted to provide copies of the invoices or work orders and evidence of payment was not examined.

148. This test was one of the tests of controls upon which Deloitte based their conclusion that controls over purchases, payables and disbursements operated effectively throughout 1997.

149. These tests of controls are summarized in the Top Down Controls working paper which included the following:

Tests of Controls:

During the audit, all the selections of additions for preproduction costs, fixed assets, and subsequent disbursements were reviewed to ensure proper authorization and supporting documentation was attached. Garth and Myron receive weekly the A/P sub ledger and invoices to be paid, always asking questions regarding justification of payment. Maria and Myron discuss and plan cash flow and disbursements on a weekly basis.

Results and Conclusions:

Controls over purchases, payables and disbursements have operated effectively throughout the course fiscal year.

*Exhibit 82, Tab 11*

**Charge 2, particular vi) – amortization of preproduction costs**

150. The audit plan for preproduction costs included testing of the calculation of the amortization expense. The preproduction costs were amortized based on the number of weeks the production was expected to run during the particular year in question, over the total number of weeks contemplated for the run of the production, subject to a maximum of five production years.

**Charge 2, particular vii) – foreign operations**

151. In 1995, Livent, at the behest of the SEC, reviewed its foreign operations and concluded they were self-sustaining. The auditors knew the foreign operations continued to be self-sustaining in 1997. However, there was no documentation in the working papers for 1997 which confirmed that they had considered the issue.

## Concluding the Field Work

152. Claudio Russo reviewed and signed off on the working papers. Anthony Power did not review the working papers. Claudio Russo confirmed on cross-examination, the answers that he had given to the investigators.

Q. [Reading the transcription of the interview]  
Then questions 28: Were you solely responsible for the decisions regarding GAAS on the 1997 Livent engagement?

Answer, No

If not, which other partners were involved in making decisions about GAAS on the 1997 Livent engagement?

Answer: Tony and Peter brought into certain aspects. Day-to-day management, Claudio Russo.

Q. Is that accurate?

A. It may be what I've said, but I don't believe that Peter was involved with any of the GAAS issues.

Q. Fair enough. So you're correcting that, if that is what you said.

A. Yes.

Q. And then Mr. Held has noted:  
No. I would say, to different extents, Anthony Power and Peter Chant. Overall, Claudio Russo managed file. We had discussions re vouching, et cetera, but I did not consult with him, say the number.

Discussed approach with Anthony Power. Anthony Power involved in discussions re audit of pre-production costs. Claudio Russo was responsible for execution. Sample sizes, Claudio Russo. Day-to-day management, Claudio Russo.

Q. Is that an accurate record of what - -

A. I believe so.

Q. Just to finish this off, question 29: Did any other partner review any sections of the audit working-paper files? And the answer was no.

A. That's correct.  
*Transcript, Russo, P. 1609, Qs. 4431 - 4435*

153. After the field work, Claudio Russo and Anthony Power jointly prepared the 28 page memorandum dated March 26, 1998 dealing with, among other items, all of the transactions particularized in Charge 1.

### **The Put Agreement of August 15, 1997**

154. The Audit Committee was scheduled to meet on April 9, 1998 and receive the auditors' report on the financial statements. The auditors had arranged to meet with management on Saturday, April 4, 1998 to review the financial statements.

155. On April 3, 1998 suspicions arose that the Put, which was taken out of the Master Agreement of August 15, 1997, had become a side agreement which was hidden from the auditors.

156. A three page document dated August 15, 1997 (the Put Side Agreement) came to light during the audit of Dundee. On April 3, 1998 the existence of the Put Side Agreement was brought to the attention of Claudio Russo by Bob Savaria, the Deloitte audit partner for Dundee. This Put Side Agreement was signed by Myron Gottlieb on behalf of Livent and by Michael Cooper on behalf of Dundee. It contained a confidentiality provision which reads as follows:

Section 3.01 Confidentiality: Each of the parties hereto covenants and agrees to refrain from disclosing the existence or contents of this Agreement to third parties or any other officers or employees of any of the Parties hereto, save and except that the existence and contents of this Agreement may be disclosed to the senior management and board of directors of each of the Parties hereto and as may be required by law.

*Exhibit 66, Tab 13*

157. The Put Side Agreement was not listed in the Index of Closing Documents which Livent made available to its auditors. The Put Side Agreement was listed in the Index of Closing Documents which Dundee made available to its auditors and remained relevant to Dundee in April of 1998.

158. As a result of this discovery there was a meeting at Deloitte in the late afternoon of April 3, 1998. Among those who attended the meeting were Anthony Power, Claudio Russo, Peter Chant, Douglas Barrington, Paul Cobb, Bruce Richmond, Martin Calpin (the then National Risk Manager of Deloitte), Debbie Matz (internal counsel), and John Lorn McDougall Q.C. (external counsel).

159. In his examination-in-chief Anthony Power spoke of how and why the meeting was called:

Q. You mentioned, in looking at the June 5th memo, the matter of the Put. Did you attend a meeting on April the 3rd, 1998, where the subject of the meeting was the Put?

A. Yes, I did.

Q. How did that come about, to your recollection?

- A. April the 3rd is the Friday meeting at the Deloitte premises. Claudio Russo had engaged in dialogue with the audit partner of Dundee, who happened to be another client of ours, and Claudio advised me that the partner had come across documentation that could possibly suggest that the Put was still alive and well and had not been removed back in August of 1997.

Claudio, after this discussion with Mr. Savaria, came and spoke to me. I engaged in a conversation with Mr. Savaria and asked him to send me a copy of this Put agreement, which he did. On receipt of that -- and it gets a little blurry who I spoke to, but the result of that evidence, a meeting was called to establish if -- really to establish if the client had lied to us and was sufficient ground -- and if they had, was sufficient grounds to consider resigning from the account.

*Transcript, Power, P. 3414, Qs.10426 - 10427*

160. Douglas Barrington, in his examination-in-chief, was asked about the purpose of the meeting.

- Q. And if it's not clear from what I've asked you, might I ask you this: Why was the meeting called?

- A. The meeting was called to basically deal with, I think, three issues: one, how do we deal with the information that has now come to our attention, which is the executed agreement; what are the implications and answers with respect to that information in terms of the financial statements for the year ended December 31<sup>st</sup>, 1997; and what are the implications with respect to the continuing relationship between Deloitte & Touche and Livent as a result of this information.

- Q. Can you tell us, then, what discussion ensued with respect to those matters?

- A. Well, each of those matters were discussed. The first one was discussed and resolved in the sense of saying that we had the information in hand and we had to deal with it.

With respect to the other two, it became clear that we had a very limited amount of information at that time with respect to what we had found and that what we needed to do was in fact go and get the information, potential explanations, to understand fully and completely what it is that we had in hand.

- Q. To that end, what decision was made as to what further steps would be taken?

- A. Well, the decision of the meeting was that the next immediate step would be for Tony and I to go and meet with Garth Drabinsky, for Bruce Richmond to go and

meet with Gar Emerson, and for Paul Cobb to go and meet with Michael Cooper.

*Transcript, Barrington, P.4566, Qs. 14083 - 14085*

161. Paul Cobb testified that he met with Michael Cooper on April 3, 1998, after the meeting of the Deloitte partners. Their meeting was brief. Just as it started, Michael Cooper received a telephone call from Ned Goodman, the Chairman of Dundee. Immediately after the call, Paul Cobb testified:

Mr. Cooper came back, sat down, said something to the effect "that was Ned, there is no Put". At which point in time I said "okay, is there - you are clear?" "That is the situation, absolutely."

*Transcript, Cobb, P.3276, Q.9841*

162. Douglas Barrington and Anthony Power met Garth Drabinsky after the meeting of the partners of Deloitte on April 3, 1998. Garth Drabinsky said he had no knowledge of the Put Side Agreement and asked that Myron Gottlieb be invited to join the meeting. In his examination-in-chief, Douglas Barrington's testimony was as follows:

Q. That is what happened?

A. Yes. Mr. Gottlieb joined the meeting. We went fundamentally through the same brief statement of facts. Mr. Gottlieb's statement is that -- was at that time the put had been cancelled as he had advised us and as has been confirmed to us. He did not understand why the matter was in front of us in terms of any impression being created that the put was still in place.

We told him that in part -- and I hadn't made that observation, but in part we had understood that Dundee was saying that they still had access to a put, which was the other factor in terms of consideration.

Q. And have you told us, then, what the response was of Mr. Gottlieb to all of what you told him?

A. He said that the put has absolutely been cancelled and he would take -- he would get ahold of the folks at Dundee and he would make sure that we were given appropriate evidence to confirm again that the put has been cancelled and is not in force.

Q. And how did that meeting then conclude, Mr. Barrington?

A. We agreed we would meet again the next day, time was of the essence - he had an Audit Committee meeting coming up fairly quickly - and that he was going to start making the calls immediately to be able to get in a position to meet with us the next morning with all the evidence, all the proof that would

demonstrate to our satisfaction the facts as he had said them to us.

*Transcript, Barrington, P.4573, Qs. 14103 - 14105*

163. Anthony Power left a voice message for Martin Calpin after the meeting. Martin Calpin's memorandum to file with respect to the voice message included the information that Anthony Power advised Bruce Richmond about the meeting with Garth Drabinsky and Myron Gottlieb before Bruce Richmond met with Garfield Emerson. It also said: "apparently on the Dundee side they unloaded on Savaria for disclosing the confidential agreement". The memorandum included the following three paragraphs:

Garth Dobrinski [sic] denied any knowledge of the side agreement and then called in Myron.

Myron agreed that there was a side agreement but it was only temporary, a bridging situation. He said that when he talked to Cooper about removing the Put, Cooper agreed that they didn't need it but that he couldn't make the decision on his own, that it would have to go to his CEO for clearance. Therefore he suggested the temporary side agreement to protect himself.

Myron said that Cooper came back to him later and said that he had received clearance and said "the agreement doesn't exist; it was never there; so tear it up". So Myron tore it up "it was as simple as that, I swear to God." We will now get documentation of this position from both sides.

*Exhibit 144*

164. Bruce Richmond was not called as a witness. Garfield Emerson testified that he made and retained notes of his meeting on April 3, 1998 with Bruce Richmond, who had already been briefed about the meeting that Douglas Barrington and Anthony Power had with Garth Drabinsky and Myron Gottlieb. Garfield Emerson testified that his meeting with Bruce Richmond lasted about an hour. Among the points he read from his notes of what Bruce Richmond told him, was the following:

Myron, on August 15<sup>th</sup> Dundee said it wanted a side agreement until something sorted out – Myron kept 'side letter' to himself. Couple of month's later Dundee said things were sorted out.

*Transcript, Emerson, P.5424, Q.16610*

165. Garfield Emerson called Myron Gottlieb after the meeting with Bruce Richmond. Garfield Emerson also made and retained notes of that conversation and, with reference to those notes, testified it was Myron Gottlieb's understanding that Douglas Barrington said Deloitte would be satisfied with a letter confirming that the Put didn't exist in August 1997. Garfield Emerson's notes include the comment "with letter Doug [Barrington] is finished. Tony to review draft financials with Maria [Messina] tomorrow".

#### **April 4 – Douglas Barrington’s Speaking Notes**

166. After hearing the representations made by Garth Drabinsky, Myron Gottlieb and Michael Cooper on April 3, 1998, Douglas Barrington prepared speaking notes for the meeting that he and Anthony Power were to have with Garth Drabinsky and Myron Gottlieb during the morning of Saturday, April 4, 1998. The seriousness with which Deloitte took this matter is reflected in the speaking notes, which are entitled “Deloitte & Touche’s Business Philosophy” (Exhibit 79). These notes were provided to the investigator in 2002. The notes included these thoughts for Livent with respect to the arrangement with Dundee, the issue of the Put and the US \$125 million prospectus offering.

Had your view held [with respect to recognition of gain on the sale of density rights in Q2], the June statements not been changed and the facts revealed today, you would be facing a resignation from our firm as we would be associated through the prospectus with misstated financial statements, arising from the fact that senior management had not provided us with material facts that were within their knowledge. Livent and its financial statements credibility would have been dealt a very, very serious blow. This is an absolutely intolerable situation.

*Exhibit 79*

167. Douglas Barrington’s speaking notes leave little doubt that Deloitte had other concerns about documentation supporting other important transactions as well as Deloitte’s expectations for the accounting activities of publicly traded companies. The speaking notes include the following points Douglas Barrington made to Livent on April 4, 1998:

It is not acceptable to reflect important transactions based on verbal agreements such as the AT&T sale, when dealing with the timing of recognition in quarterly reporting. Timing is an equally important consideration to quantum. You are far too casual in this respect. Transactions are all subsequently documented but there is little real evidence to establish the valid timing and there should be such evidence.

It is not appropriate to have an Audit Committee in place that is uninformed. We know they are not informed. Garfield Emerson has no idea about the last quarter. We would also suggest that it is not right that the demands are on just two outside directors since Andrew Sarlos was not replaced.

Finally it is not good practice to discuss income recognition issues after the fact when you have decided, discussed or in the worst case, presented the results. Good businesses don’t let that happen.

The last element of quality is the quality of your earnings, your balance sheet and your disclosure. Your disclosure is better and now meets the norms of good businesses. We will discuss more fully but in summary your balance sheet is not as conservative as we would like to see and the quality of your earnings, and

here I am referring to the quantum, is not where it has to be to retain our association with it.

We will discuss finalization of the year end and then return to how we can go forward from here, if that is your choice.

*Exhibit 79*

168. Douglas Barrington's speaking notes for the meeting of April 4, 1998 included four specific conditions which Livent was to satisfy before Deloitte would accept the verbal explanation received on the evening of April 3, 1998 about the elimination of the Put. The conditions were, in effect, the audit plan to deal with the suspicions about the Put. These terms were:

1. Be provided a copy of the Put agreement signed on August 15, 1997,
2. Receive directly a confirmation in writing that the Put agreement was cancelled by the parties in the third quarter and a copy of this must be provided to Dundee's auditor,
3. Receive an opinion from the company's legal counsel that this document does in fact constitute an effective cancellation of the Put agreement in the third quarter. Counsel may want to re-issue its letter to you, and provided to us, as part of the second quarter debate,
4. Have full disclosure of all these facts to the Audit Committee in our presence.

*Exhibit 79*

169. Douglas Barrington testified that the points in the speaking notes were used, although not necessarily in the order he wrote them. At the early part of the meeting, when Myron Gottlieb was not present, Garth Drabinsky expressed extreme disappointment with Myron Gottlieb and informed Douglas Barrington and Anthony Power that he was negotiating with new investors who would have an important role in management.

### **The Evidence Received in Response to the Conditions**

170. With respect to the first condition, Livent did not provide Deloitte with a copy of the Put Side Agreement.

171. With respect to the second condition, Myron Gottlieb provided Deloitte with a copy of a letter written to him from Ned Goodman, the Chairman of Dundee, dated April 4, 1998 which read:

This letter is to confirm a verbal agreement that you and I had during August 1997, whereby the Put agreement between Dundee and Livent relating to the Pantages Place Project, was cancelled.

I regret that because of the pace of business and travel, Michael Cooper was never informed of our agreement. I hope that you have not been terribly disadvantaged.

*Exhibit 66, Tab 16*

172. With respect to the third condition, Deloitte received a copy of a letter from Rodney Seyffert of Smith Lyons addressed to Livent Inc., to the attention of Myron Gottlieb, dated April 5, 1998. A copy of this letter was sent directly to Anthony Power. The one and one half page letter refers to Ned Goodman's letter of April 4, 1998, and to Rodney Seyffert's letters to Myron Gottlieb of August 26, 27 and 28, 1997. Rodney Seyffert's letters of August 27 and 28, 1997 refer to the letters from Michael Cooper of Dundee to Livent dated August 26 and 27, 1997.

*Exhibit 94*

173. With respect to the fourth condition, the evidence is not entirely clear. Anthony Power was asked in cross-examination about the fourth condition set out by Douglas Barrington.

Q. The number 4, "Full disclosure of all facts to the audit committee in our presence."

A. Yes.

Q. And did that happen?

A. Yes, it did

Q. Did they tell the audit committee about Mr. Gottlieb giving Deloitte's the two letters of August 27, 1997?

A. Our discussion with the Audit Committee is set out in our audit report of April the 8<sup>th</sup> and that addresses the Put and that's what we discussed at the meeting.

Q. That's the entirety of the discussion about the Put, the April 8<sup>th</sup> report - -

A. I may or may not have had more discussion - -no - - yes, that would be correct.

*Transcript Power, P.3640, Qs, 11347-11350*

174. The Report to the Audit Committee makes no reference to the audit opinion being contingent on an explanation of the Put Side Agreement being made to the Audit Committee. The minutes of the Audit Committee meeting of April 9, 1998, do not refer to a discussion about the Put Side Agreement.

175. It is clear that Garfield Emerson, the chair of the Audit Committee, was told about the Put Side Agreement by Bruce Richmond. Anthony Power also spoke with Garfield Emerson after April 3, 1998 and prior to the Audit Committee meeting of April 9, 1998. They spoke about the Report to the Audit Committee, including the question of the preproduction costs.

176. Garfield Emerson asked that a formal agreement referring to the Put Side Agreement and confirming that it was not in effect be drafted and executed by Dundee and Livent. He saw a draft of the agreement, however, the draft was not finalized and executed by the parties.

**Deloitte's Conclusion with Respect to the Put**

177. Anthony Power confirmed that on the basis on Ned Goodman's letter of April 4, 1998, and Rodney Seyffert's letter of April 5, 1998 Deloitte's concerns had been addressed.

Q. So based on the Goodman letter of April 4, the Seyffert letter, did you and Mr. Barrington come to a conclusion as to whether the concerns that had been addressed at the April 3 meeting at your offices that Mr. Chant was there had been satisfactorily resolved?

A. We came to that conclusion.

Q. So you decided to proceed to sign off on the audit on April 9<sup>th</sup>. That was your initial intention following that meeting

A. We decided to continue, yes.  
*Transcript, Power, P.3642, Qs. 11357 - 11358*

178. Douglas Barrington was asked about the evidence with respect to the Put which he accepted. He was asked:

Q. Did it occur to you that Mr. Gottlieb had misled Deloitte with respect to the existence of the Put agreement?

A. No, because what I understood Mr. Gottlieb to tell us at the end of August was that the Put was cancelled. What I understood Mr. Cooper to tell us was that the Put was cancelled. What I understood from Mr. Seyffert's documentation and communication was that the Put was cancelled and what I understood from Mr. Goodman's communication was that the Put was cancelled. So there was a consistency in terms of whether or not the Put had been cancelled.

*Transcript, Barrington, P. 4787, Q. 14733*

179. With reference to Rodney Seyffert's letter of April 5, 1998 Douglas Barrington was asked:

Q. And when you read this letter and didn't see the reference to the August 15th Put agreement and realized that Myron Gottlieb was the recipient of this letter and had given instructions to the lawyer with respect to this letter, it didn't occur to you to scratch your head and say maybe this isn't sufficient audit evidence that Deloitte was not lied to by Mr. Gottlieb?

- A. The letter speaks for itself in terms of the opinion that Mr. Seyffert has expressed. And I was satisfied -- Tony Power was satisfied as well in terms of the two of us looking at this, that this gave us the comfort that Livent had in hand, evidence that the Put, in fact, had been cancelled.
- Q. You didn't need much comfort, did you?
- A. It met the requirements of professional standards in terms of appropriate audit evidence to justify my audit conclusion. An opinion which has also been supported by the investigator.
- Q. And you say that's sufficient audit evidence as a professional to satisfy your professional scepticism as an auditor?
- A. In terms of sufficient audit evidence to satisfy me and to satisfy Tony Power in terms of how we dealt with this, I believed that we had in hand sufficient appropriate audit evidence to indicate that the Put had been cancelled and was not in force as of December 31st, 1997.
- Q. Did you think that you had sufficient audit evidence that you had not been lied to by Mr. Gottlieb?
- A. Yes.  
*Transcript, Barrington, P.4808, Qs, 14816 - 14819*

### **Peter Chant's Conclusion with Respect to the Put**

180. Peter Chant testified that the meeting of April 3, 1998 took place at about 5:00 p.m. He wanted to go with Bruce Richmond to meet Garfield Emerson but it was decided that he would not. In this regard, Douglas Barrington testified that he thought Peter Chant had "too much skin in the game" to be objective, and took the lead in denying Peter Chant's suggestion that he accompany Bruce Richmond.

181. In his examination-in-chief, Peter Chant testified that after his suggestion that he accompany Bruce Richmond had been denied, when he heard the discussion "migrate to speculation as to why the Put might not be valid", he became upset because he thought "we were trying to find a solution to an obvious problem rather than deal with the problem."

182. A little later in his examination-in-chief his counsel asked him if he had expressed a view at the meeting as to whether or not Deloitte should resign from the audit.

- Q. And in the course of the meeting did you express any view as to whether or not Deloitte should resign from the Livent audit?

- A. Yes, after the discussion that occurred, I realized -- I came to the conclusion in a moment that this was not proceeding, this matter was not proceeding in a manner that I thought was acceptable and I stated, as I recollect, that I could not believe the discussion, the tenor of the discussion. That these people, being Livent, had lied to us three times. That if we were the U.S. firm we would have been gone long before that. That, in my view, we should -- and at this point I had reached the conclusion that I was no longer going to be in this meeting, so I stood up from my seat and said I believed we should be out of there -- the meeting. We should have nothing more to do with this client. I think I repeated we should be out of there. And I said, "I'm out of here," and I left the meeting.

*Transcript, Chant, P. 4000, Q. 12292*

183. Douglas Barrington considered Peter Chant's assertion that Deloitte should sever its relationship with Livent as "merely an expression of frustration and anger. It wasn't a very thoughtful comment" (Transcript, February 9, 2006, page 4719). Anthony Power recalled that Peter Chant was outspoken, agitated and annoyed at the meeting however, he could not recall what he said. Claudio Russo recalled that Peter Chant vigorously expressed the view that Deloitte should resign from the audit.

184. On Monday or Tuesday of the next week, Peter Chant listened to and made notes of his telephone voice messages. With reference to those notes he testified that at about 6:45 p.m. on Friday, April 3, 1998, he received a voice message from Douglas Barrington, which he believed was broadcast to all the partners who had been at the meeting a few hours earlier. His note of this message included the phrase "Put subsequently eliminated".

185. On Wednesday April 8, 1998, Peter Chant received a memorandum and draft financial statements for the year ending December 31, 1997, from Claudio Russo which confirmed that Deloitte were proceeding with the audit. When Peter Chant learned that Claudio Russo wanted him to review the financial statements, he responded that he wanted nothing to do with the audit. As a result, Douglas Barrington became involved.

186. The evidence of Peter Chant and Douglas Barrington conflicts with respect to what Peter Chant told Douglas Barrington in the days following April 3, 1998. Peter Chant testified that he thought it might be necessary to resign from the firm and consulted legal counsel in this regard. He also testified that he advised Douglas Barrington of this concern. Douglas Barrington does not recall this. Peter Chant did not set out his concerns in writing at this time. His evidence changed with respect to when he advised Douglas Barrington that the matter was so serious that he had given thought to resigning as a partner.

187. There are at least two points on which both agree. Firstly, Douglas Barrington heard on April 3, 1998 that Peter Chant thought Deloitte should resign from the audit. Secondly, on April 8, 1998, Douglas Barrington knew that Peter Chant did not wish to do any more work on the Livent audit. Claudio Russo

telephoned Douglas Barrington after speaking with Peter Chant on April 8, 1998. Douglas Barrington then telephoned Peter Chant and spoke with him. In his examination-in-chief, Douglas Barrington testified as follows:

Q. And did you receive a telephone call on that day, April the 8th, from Mr. Chant?

A. I recall placing a call to Mr. Chant as a result of a call from Claudio Russo. Claudio indicated that he needed to have some work done, that Peter had indicated he wasn't doing any further work on Livent, and Claudio asked my help in terms of getting Peter to provide the support that he needed.

I called Peter with that message in mind. Peter indicated to me in very strong terms that did he not want anything more to do with Livent. I said I understood that, but this was an issue of supporting a partner not Livent, and could he please give you a -- Claudio a call and arrange to do the work Claudio was asking for. And Peter said he would do that.

*Transcript, Barrington, P. 4592, Q. 14156.*

188. When cross-examined by Peter Chant's counsel with respect to this telephone conversation Mr. Barrington said:

What transpired in the conversation, as I recall it, is fundamentally limited to a discussion of his requirement not to be involved anymore unless demanded to do so, and that's fundamentally what I did do. I made him an offer he couldn't refuse in terms of supporting Claudio, which he accepted and did.

*Transcript, Barrington, P. 4751, Q.14593*

189. The partners and advisors who assembled on April 3, 1998 did not meet again to collectively consider the evidence which had been gathered and determine whether or not Deloitte would continue with the audit. Douglas Barrington and Anthony Power concluded that they had sufficient audit evidence to dispel the suspicions about the Put.

### **The Audit Committee Meeting – April 9, 1998**

190. The value attributed to the preproduction costs had been a matter of concern and discussion by the Audit Committee in August and November 1997. Garfield Emerson testified that he and Martin Goldfarb, another member of the Audit Committee, had come to the conclusion prior to the meeting of April 9, 1998 that there should be a write-down of the preproduction costs. Garfield Emerson did not have a specific amount in mind prior to the Audit Committee meeting.

191. Douglas Barrington, Anthony Power and Claudio Russo went to New York for the April 9, 1998 meeting of the Audit Committee of Livent. Before they actually met with the Audit Committee they were advised by Myron Gottlieb and Maria Messina that management was proposing an additional \$27.5 million write-

down of the preproduction costs. The explanation given was that the discussions and negotiations with the new investor were proceeding and the new investor insisted on this write-down. Anthony Power testified that he was greatly relieved by the decision to have a write-down of the preproduction costs.

192. Deloitte told the Audit Committee meeting on April 9, 1998 that they would have to review the proposed write-down before they could say whether it was appropriate or not. Claudio Russo undertook this task. He was satisfied that the write-down could be supported.

193. During cross-examination, Claudio Russo confirmed that the planned auditing procedures, including the detailed cut-off testing of additions to preproduction costs and fixed assets, were not revisited following management's request for a \$27.5 million write-down of preproduction costs on April 9, 1998.

Q. The fact that management had represented to you that they had \$27.5 million more of preproduction costs than they ultimately advised you of on that April 17 meeting didn't cause you to say maybe some of the other representations we've been making may have been off base?

A. Again, when we were reviewing preproduction costs, we knew that, as we've talked many times, it's very subjective, very sensitive to estimation. We had identified a number of shows in the Audit Committee presentation which were of higher risk, which were a number of the write-down, large portion of the write-down was allocated for that, so we were comfortable with it. And I think I mentioned before we actually forced them to take some write-downs to get within what we considered to be an acceptable range. This moved them from the aggressive end of the range to the conservative end of the range.

Q. So you have a range in GAAP that would be a range of some 13 times materiality?

A. Yes.

Q. And you would change your audit opinion -- you would change your assessment of the preproduction costs based on this representation that there was a new investor in the offing that didn't particularly like the way the financial statements looked and they should increase the write-down by 27 and a half million dollars?

A. Again, subject to us doing the work in the following days to get comfortable with it.

Q. So you did the work and confirmed that, in fact, the write-down should have been made?

A. That it was supportable.

Q. It was supportable. And that didn't suggest to you that perhaps management had misled you the first time around with respect to the preproduction costs?

A. No.

Q. Did it cause you to reconsider the information you'd been given by Mr. Connors and Mr. Topol about the cost of the, of moving from city to city?

A. No.

Q. Did it cause you to consider your work you had done on these cut off areas?

A. No.

Q. Or the fixed assets?

A. No.

Q. You just check the \$27.5 million, felt comfortable with it and issued your opinion?

A. By that time we had sunk \$500,000 into this audit. It wasn't just a matter of check and moving on.

Q. So you had at that point in time been hit with this 27 and a half million dollar write-down, a week before you had the put issue, and the discovery of a put that in effect management had signed, signed by Mr. Gottlieb, correct?

A. Yes.

Q. And you took all that into account and you didn't scratch your head and say maybe now that we've confirmed that management was off by 27 million on the preproduction costs, maybe we should look at some of the other representations?

A. No.

*Transcript, Russo, P.1952, Qs. 6106 - 6116*

194. Deloitte advised the Audit Committee at their meeting of April 17, 1998 that they would accept the write-down and agreed to issue the unqualified audit opinion on the financial statements.

195. The minutes of the Audit Committee meeting of April 9, 1998 expressly state that the write-down was not conditional on the proposed investment. The relevant part of the minutes read as follows:

Discussion ensued and the Committee agreed that an additional \$27.5 million of amortization of preproduction costs be taken as

a permanent charge against Q4 income, independent and irrespective of the subject investment opportunity, and that accordingly the assets at December 31, 1997 reflect preproduction costs of \$67,309,479.

*Exhibit 156*

196. Douglas Barrington, Anthony Power and Claudio Russo did not think management had changed their opinion about the recoverability of preproduction costs. They concluded that the reason management recommended the write-down was solely to accommodate the potential investor and as such, had merit. Therefore, Deloitte saw no reason to conclude that a more thorough review of the representations made by management was necessary.

197. Deloitte also knew, however, that the Audit Committee devoted considerable time at its meetings in 1997 to preproduction costs and that the Chair of the Audit Committee thought there should be a write-down independent of and irrespective of the investment opportunity. Despite being aware of this opinion, and realizing that management proposed a significant write-down only weeks after insisting such an adjustment was unnecessary, Deloitte still did not believe that a review or reconsideration of the representations of management was appropriate.

### **The Management Representation Letter**

198. Deloitte's Report to the Audit Committee of April 9, 1998 concluded as follows:

#### **Outstanding Matters**

We have received substantially all of the information and explanation which we have required. Subject to the resolution of certain outstanding matter, we are prepared to give our unqualified opinion on the consolidated financial statements of Livent. The principal outstanding matters include:

- Letter of representation
- Outstanding confirmations
- Finalization of our review of financial statements and disclosures
- Finalization of our review of the Company's MD&A

*Exhibit 81, Tab 11*

199. The management representation letter which contains specific references to preproduction costs and the completeness of the agreements that are subject of the charges was signed by Myron Gottlieb and Garth Drabinsky but not until May 1, 1998, thirteen days after the unqualified audit opinion was released. The management representation letter was not signed by the Chief Financial Officer, Maria Messina (as was the norm) or by the internal legal counsel.

### **Quality Assurance Review**

200. The Audit Plan provided that there would be: "An independent review of financial statements and discussion of the issues with our Quality Assurance

Review Partner” (Exhibit 88, Tab 7). Deloitte required an independent review by Wilton and a local Quality Assurance Partner when a client filed with the SEC. There had been two such reviews when the prospectus was filed in November of 1997.

201. Anthony Power kept John Cawthorne, who had the overall responsibility for the Quality Assurance Review (QAR) informed of the issues on an ongoing basis so that he would be informed when it came time to sign off. However, John Cawthorne was not available when the sign off was required. Hugh Bradford was asked to complete the QAR and sign off. Anthony Power testified that he recalled discussions with Hugh Bradford, who was impressed with the staffing of the audit and, in particular, with the fact that Peter Chant and Douglas Barrington had been involved.

202. Claudio Russo actually signed off on the QAR for the file. Anthony Power acknowledged that this was not the best practice. There was no memorandum in the working papers from John Cawthorne or Hugh Bradford explaining why they themselves had not signed off, or, confirming that Claudio Russo was to have signed off for either of them with their concurrence. The working papers did not document the issues around the Put Side Agreement or the steps taken with respect to it on and after April 3, 1998.

## **ANALYSIS AND CONCLUSIONS**

### **Good Faith of Management & Professional Scepticism**

203. The role and importance of the good faith of management and the professional scepticism of the auditor is set out in the “Introduction to the audit of financial statements” set out in section 5090 of the *CICA Handbook*. At the relevant time, sections 5090.04, 5090.05 and 5090.06 read as follows:

The auditor performs the audit with an attitude of professional scepticism, and seeks high, though not absolute assurance, hereinafter referred to as reasonable assurance, whether the financial statements are free of material misstatement. The auditor normally designs auditing procedures on the assumption of management's good faith, and exercises professional judgment in determining the nature, extent and timing of those procedures, in evaluating their results and in assessing determinations made by management. Absolute assurance and auditing is not attainable as a result of such factors as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the evidence available to the auditor is persuasive rather than conclusive in nature.

The assumption of management's good faith is a fundamental auditing postulate. This assumption is normally necessary for an audit to be economically and operationally feasible. This assumption means, in the absence of evidence to the contrary, the auditor can accept accounting records and documentation as genuine and representations as complete and truthful. The

assumption of management's good faith is not a source of audit evidence, nor a substitute for the requirement to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the content of the auditor's report.

An attitude of professional scepticism means the auditor assesses the validity of evidence obtained and is alert to evidence which contradicts the assumption of management's good faith. For example, the auditor is alert to evidence which may indicate accounting records and documents have been altered or representations are false. It does not mean the auditor is excessively sceptical or suspicious. Without an attitude of professional scepticism, the auditor may not be alert to circumstances which should lead to him or her to be suspicious and he or she may then draw inappropriate conclusions from the evidence gathered.

### **The Audit Plan**

204. The *CICA Handbook* includes as part of generally accepted auditing standards the examination standards of the profession. At the relevant time the first paragraph of section 5100.02 read as follows:

*The work should be adequately planned and properly executed using sufficient knowledge of the entity's business as a basis. If assistants are employed they should be properly supervised.*  
[July 1996]

205. One of the essential aspects of an adequately planned audit is an assessment of audit risk. In this regard, at the relevant time; section 5130.30 read:

*The auditor should make preliminary decisions as to materiality and the components of audit risk at the planning stage of the engagement. If evidence obtained during the engagement indicates that these decisions are no longer appropriate, they should be revised and the nature, extent and timing of the auditor's procedures should be reconsidered.* [Nov. 1988]

206. The working papers identify and document the engagement risk. Deloitte knew and considered the risk factors. The engagement risk was identified as greater than normal. Two of the major items on the financial statements; the valuation of preproduction costs and the revenue from unique revenue generating transactions, are identified as dependent on the representations and estimates of management. Among the factors identified are that Livent was a public entity as both an SEC and OSC registrant; Livent faced internal and external business pressure; and management was sensitive to reported net earnings and attracted a high level of public scrutiny. Deloitte knew management was dominated by the Chairman and CEO, Garth Drabinsky, that he and the President, Myron Gottlieb acted as a team, were major shareholders, and were known to be demanding, tough and aggressive.

207. Deloitte did not question the integrity or good faith of management. Rather, Deloitte concluded that it could rely on the integrity of management when it developed the audit plan.

208. The essence of Deloitte's response to the identified engagement risk was to ensure that the assigned audit staff had the requisite experience, skills and expertise, were advised of the risk and told to increase their professional scepticism.

### **An Experienced Audit Team**

209. The panel concluded that the audit team was experienced and competent. Anthony Power, the Lead Client Service Partner, was a senior and seasoned auditor, with many years of experience auditing public companies including a major bank. He insisted that a partner with experience auditing public companies, who he knew, respected and trusted, Claudio Russo, be the Client Engagement Partner. Whatever motive Myron Gottlieb had for requesting a change in the audit team, the reason that Deloitte made the change was to ensure that the chair of the Audit Committee got the strong, independent Lead Client Service Partner he wanted.

210. The advisory partners, Peter Chant and Douglas Barrington, were both senior partners with years of experience of service to clients who were registrants with the OSC and SEC. Peter Chant was recognized both in Canada and the United States as a GAAP expert. Further, he had first hand knowledge of the client and had dealt directly with management in the spring and summer of 1997 on unique revenue generating transactions. Douglas Barrington was the group managing partner of the national office where, by reason of his position in the firm, he could ensure that the appropriate resources would be provided for the audit as circumstances required.

211. Anthony Power and Claudio Russo familiarized themselves with the client and the issues that they would have to deal with prior to the Audit Committee meeting of November 3, 1997 when the proposed audit plan was presented. Claudio Russo reviewed the US \$125 million prospectus offering Livent was filing.

212. Anthony Power analyzed the accounting issues in the naming rights contracts and the Dundee transaction and reported to the Audit Committee on these transactions by letters dated November 3, 1997 and November 11, 1997. Anthony Power's letter of November 3, 1997 advised the Audit Committee that the auditors had not agreed with management on two of the transactions. His letter of November 11, 1997 confirmed that agreement had been reached. This was the kind of professional service the chair of the Audit Committee expected. Deloitte thought the AT&T transaction was a fourth quarter transaction, however, in light of the opinions of Ernst & Young and Price Waterhouse that the transaction could be recognized in the third quarter, Anthony Power did not insist that Deloitte's view be followed.

213. The Professional Conduct Committee suggested that Deloitte yielded to pressure from Livent's management, changed the audit team to accommodate

Myron Gottlieb and accepted overly aggressive accounting policies. The panel concluded that this was not the case. The evidence was that, with respect to the CIBC, Dewlim and Pace transactions, Anthony Power, supported by Douglas Barrington, withstood management's pressure. While Deloitte did accept management's position that AT&T was a third quarter transaction, reluctantly accepting the position of management, supported by the opinion of two international firms, one of which Deloitte retained, is not evidence of the auditors being overly compliant.

### **Confirm or Dispel Suspicion of Misstatements**

214. It is not sufficient for auditors to identify the risks and make appropriate plans to deal with them. The audit must be properly executed. As is set out in CICA Handbook s. 5090.06 above, the auditor must be "alert to evidence which contradicts the assumption of management's good faith."

215. Two of the provisions of Section 5135 of the *CICA Handbook*, "Auditor's responsibility to detect and communicate misstatements" are apposite. Section 5135.06 and section 5135.14 read:

*An audit of financial statements should be performed with an attitude of professional scepticism.* [Sept.1991]

*The auditor may encounter circumstances which make him or her suspect the financial statements are materially misstated. In that event, the auditor should perform procedures to confirm or dispel that suspicion.* [Sept.1991]

216. The members accept that they were required to be professionally sceptical and assert that their scepticism was high. Anthony Power said that he used the term "sky high" as a manner of style when describing Deloitte's professional scepticism with respect to the one-off transactions, financial statement disclosure and dealings with management. Douglas Barrington, Anthony Power and Claudio Russo assert that they had appropriate audit evidence to dispel their suspicions about the Put Side Agreement dated August 15, 1997 which was discovered on April 3, 1998. They assert they had no reason to question the integrity of management and were entitled to rely on management's representations.

### **Deloitte's Four Conditions – Not Fulfilled**

217. The panel has set out in paragraph 168 the audit plan to deal with the suspicions about the Put, the four terms Douglas Barrington said Livent would have to satisfy before Deloitte would accept the explanation given by Myron Gottlieb on April 3, 1998. The panel concluded that this audit plan was not fully followed, the evidence obtained was not carefully considered and obvious problems with the evidence were ignored.

218. There was no evidence that Livent provided Deloitte with a copy of the Put Side Agreement.

219. Deloitte accepted the letter of Ned Goodman to Myron Gottlieb dated April 4, 1998, as satisfying the second condition. The letter is set out in paragraph 171 of these reasons. The letter confirms a verbal agreement between Ned Goodman and Myron Gottlieb in August 1997 cancelling the Put and apologizes for the fact Michael Cooper was never informed about the arrangement.

220. Ned Goodman's explanation was inconsistent with the representations previously made to Deloitte. Michael Cooper had told Myron Gottlieb and Peter Chant in August 1997 that the Put had been cancelled as his letter of August 27, 1997 makes clear. He asserted that it had been taken out of the Master Agreement. Yet the Put Side Agreement, setting out the Put which was in the earlier drafts of the Master Agreement, was included in the Index to Dundee's Closing Documents and not in the Index of Livent's Closing Documents.

221. Myron Gottlieb's explanation on April 3, 1998 to Douglas Barrington and Anthony Power was that he and Michael Cooper had agreed that the Put was not necessary, but they had a "side letter" until Michael Cooper secured Ned Goodman's agreement. Once he had that agreement, Michael Cooper told Myron Gottlieb to tear up the side agreement. Bruce Richmond told Garfield Emerson it took a couple of months for Dundee to sort things out so that the "side letter" could be dispensed with.

222. The inconsistencies between Myron Gottlieb's explanation on April 3, 1998 and Ned Goodman's letter of April 4, 1998 were one of the subjects about which Brian Bellmore cross-examined Douglas Barrington.

Q. And did you see an inconsistency between what Mr. Goodman was saying in his letter and what you had told by Mr. Gottlieb the night before?

A. There is no inconsistency in my view in terms of cancellation of the Put. The second paragraph I always regarded as a rather gratuitous explanation from Mr. Goodman.

Q. It was consistent with what you had been told by Mr. Gottlieb the night before?

A. If you accept the reference in Tony's note to Cooper saying he had to check with his CEO, which is very odd language because Mr. Cooper was the CEO of the corporation in terms of how he referred to it, but assuming that what Myron was trying to communicate is he had to check with Ned, then Ned saying Mr. Cooper didn't know about it, doesn't make sense.

Q. That's absolutely nonsense, that's what it makes. It's nonsense, isn't it?

A. The explanation is nonsense. The question is whether or not the Put is cancelled.

*Transcript, Barrington, P. 4789, Qs. 14738 - 14740*

223. Brian Bellmore returned to this topic later in his cross-examination of Douglas Barrington.

- Q. The fact that that second paragraph is completely inconsistent with the story you were given by Gottlieb did not require any clarification, either through Goodman, Gottlieb or any other party?
- A. In terms of the question with respect to whether or not there was a Put with respect to the financial statement it did not require any follow-up. In terms of what we were to do in respect to our ongoing relationship it was a factor to take into account.

*Transcript, Barrington, P. 4794, Q.14755*

224. The auditors knew, or should have known, that Myron Gottlieb was the chair of the audit committee of Dundee Bancorp, the parent company of Dundee. The inconsistencies between Ned Goodman's letter and Myron Gottlieb's explanation should have been carefully examined. The professional scepticism of the auditor could only be satisfied with reasonable assurance, i.e. high but not absolute assurance according to CICA Handbook s. 5090.06. The auditors were not entitled to assume the second paragraph of the letter was a "gratuitous explanation" and they were not entitled to accept "nonsense". The failure of the auditors to try to resolve the inconsistencies puzzled the panel.

225. Rodney Seyffert's letter of April 5, 1998 was accepted as satisfying the third of the conditions, however, it made no reference to the Put Side Agreement of August 15, 1997 which gave rise to the suspicion that the Put still existed. His letter does make reference to his correspondence of August 26, 27, and 28, 1997 and confirms the opinion he gave then. His letter of August 27, 1997 included the following statement:

Without any compensation therefore, the put which was included in the letter agreement for the benefit of Dundee Realty was removed from the Master Agreement at the request of Livent Inc. to conform to Livent's intended accounting treatment of the transaction;

*Exhibit 94*

226. On August 27, 1997 Rodney Seyffert had opined that the Put had been removed from the Master Agreement. But the Put, which had been section 3.03 of the Master Agreement, had become the Put Side Agreement of August 15, 1997. Rodney Seyffert's letter of April 5, 1998 does not refer to the Put Side Agreement. The fact that Dundee had the Put Side Agreement and was relying on it was significant. It was the existence of the Put Side Agreement that prompted Deloitte to over-ride the duty of confidentiality it owed to another client, Dundee, and to convene the meeting at Deloitte on April 3, 1998; as well as the subsequent meetings and conversations of April 3 and 4, 1998 with Livent and Dundee representatives.

227. The only expert called by the members to testify after Peter Chant, Anthony Power, and Douglas Barrington had testified was Keith Vance. He had

read the transcripts, but was not present during their testimony. Keith Vance opined that with respect to April 3, 1998 and thereafter, Deloitte had shown they were acting with the appropriate degree of scepticism when they involved senior members of the firm and saw no inconsistencies in the information received. The specific issue of whether or not Rodney Seyffert's letter dealt with the Put Side Agreement was raised by Brian Bellmore in cross-examination as follows:

- Q. I just want to - - and I am belabouring this point, but I think it may be significant in assessing your evidence.  
Do you, as an expert auditor looking at Mr. Seaford's [sic] letter and looking at Mr. Barrington's requirement that Seaford [sic] confirmed in writing that the Put Agreement of August 15<sup>th</sup> had been in effect cancelled by Goodman's letter - - does it say that?
- A. It does not specifically say that, no.  
*Transcript, Vance, P. 5356, Q. 16392*

228. The panel concluded that an auditor acting with appropriate professional scepticism, and knowing that the Put Side Agreement contradicted the opinion which Rodney Seyffert gave in August 1997, would not be satisfied with Rodney Seyffert's letter of April 5, 1998. In the circumstances the panel concluded that in accepting the letter the auditors showed a remarkable lack of scepticism.

229. The chair of the Audit Committee was advised about the discovery of the Put Side Agreement. However, the Report to the Audit Committee dated April 9, 1998, makes no reference to the Put Side Agreement. The minutes of the Audit Committee meeting of April 9, 1998 do not refer to the Put Side Agreement or record any discussion of it by the Audit Committee, the latter being one of the conditions Douglas Barrington stipulated on April 4, 1998.

230. The auditors did not have sufficient appropriate audit evidence to conclude that the Put was not in place as of December 31, 1997 and, therefore, should not have released an unqualified audit opinion on the 1997 financial statements.

### **Myron Gottlieb's Acknowledged Misrepresentation - the "Side Letter"**

231. On April 3, 1998 the members received from Bob Savaria, a Deloitte partner involved in the audit of Dundee, the Put Side Agreement. This document was not included in Livent's index of Closing Documents but was included in Dundee's Index of Closing Documents. The Put Side Agreement was being relied upon by Dundee in April 1998.

232. On the evening of April 3, 1998 Myron Gottlieb acknowledged to Anthony Power and Douglas Barrington that there was a "side letter". He explained "... it was only temporary, a bridging situation". He further explained "...on August 15<sup>th</sup>, Dundee said it wanted a side agreement until something sorted out ... Couple of months later, Dundee said things were sorted out..." (emphasis added).

233. In August 1997 Myron Gottlieb told Peter Chant, Douglas Barrington and the Audit Committee that the Put had been intentionally deleted from the Master Agreement. He had Livent's legal counsel, Rodney Seyffert, confirm in writing that the Put had been removed from the agreement. Clearly at and before the Audit Committee meetings of August 26, and August 29, 1997, Myron Gottlieb lied to Deloitte and the Audit Committee.

234. As a result of this misrepresentation, it was obvious (or should have been obvious) to Anthony Power and Douglas Barrington that the third quarter financial statements announced to the public, the OSC and the SEC in 1997, were materially misstated and that the Prospectus Offering for US \$125,000,000 filed with the SEC, with which Deloitte had associated itself, may also have been misstated. It seems these matters were not addressed. Rather, Deloitte's focus appeared to be in determining whether the Put Side Agreement was in existence at December 31, 1997 for purposes of the year end financial statements. In spite of Peter Chant's warnings, there seemed to be little or no attention paid to the impact of Myron Gottlieb's misrepresentations to these public announcements and filings or, in fact, other significant representations made by Livent management to Deloitte.

235. Thus Myron Gottlieb misled the auditors, the Audit Committee and the public in August and early September 1997 about a material transaction. The auditors failed to consider the broader implications of the admitted deception, including the representations made by management throughout the audit.

#### **The Stipulated Audit Procedures Were Not Satisfactorily Completed**

236. Douglas Barrington's speaking notes of Saturday, April 4, 1998, listed four specific conditions which Livent was required to satisfy in order that Deloitte could accept Myron Gottlieb's explanation and complete the audit. These conditions were, in effect, the audit plan to deal with the suspicions about the Put. None of these four audit procedures were completed.

#### **The Exercise of Professional Judgment**

237. The panel heard considerable evidence about the exercise of professional judgment and what it entailed. One fundamentally important exercise of professional judgment at issue in this hearing related to the reasonable suspicions about the Put and the procedures, analysis and conclusions reached by the auditors to dispel those suspicions. The proper exercise of professional judgment requires the auditor to reach a correct conclusion. It is not enough for the auditor to have an appropriate process, to identify the issues and to correctly set out what should be done.

238. In the paragraphs above, the panel has set out its reasons as to why the audit evidence obtained ought not to have been accepted as sufficient appropriate audit evidence to dispel the suspicions.

239. The auditors knew that the representations of management were particularly crucial with respect to the unique revenue generating transactions

and the estimate of the recoverability of preproduction costs. Others shared their view – Wilton had cautioned Deloitte as to the possibility of side agreements.

240. Myron Gottlieb had been told in July and early August 1997, that if the Dundee arrangement included a Put, the revenue could not be recognized. Livent's Press Release of August 13, 1997 included revenue from the Dundee arrangement in the interim financial statements as at June 30, 1997. Douglas Barrington, unlike Peter Chant, characterized this as an error in judgment on Myron Gottlieb's part. The fact that Myron Gottlieb had not disclosed the Put Side Agreement of August 15, 1997 would cause a sceptical auditor to re-examine his assessment of Myron Gottlieb's conduct in August 1997, and the representations he made.

241. The need to take the unusual step of requesting a special meeting with the Audit Committee in August 1997, because Myron Gottlieb continued to insist that the revenue be recognized in the second quarter, should have made the auditors more suspicious of his explanation in April 1998. They should have recognized that he would go to considerable lengths to ensure that the financial statements presented the arrangement in the manner he desired.

242. In his evidence Douglas Barrington said that an accountant's own experience and background should be brought to bear when exercising professional judgment. He added, "and when people have relevant knowledge and relevant experience they tend to reach the right decisions more often and faster." (Transcript, P. 4624, Q. 14259)

243. While the discovery of the Put on April 3, 1998 was the occasion for an emergency meeting of all the partners with relevant knowledge and several other senior partners including the partner in charge of risk management and internal and external legal counsel, the same partners and advisors did not reconvene to review the evidence and consider its adequacy. Given the seriousness of the issues, sceptical auditors owed it to themselves, the shareholders and the public to collectively analyze the evidence as a whole and they did not.

244. Peter Chant had dealt directly with Myron Gottlieb and Michael Cooper in August 1997. He had been Deloitte's chief spokesperson in August 1997, and also at the Audit Committee meetings of August 26 and August 29, 1997. Of the members charged, he had the most experience dealing directly with Livent's senior management. He was a senior partner of Deloitte. He was excluded from the decision making process on and after April 3, 1998.

245. Myron Gottlieb's admission regarding the existence of a "side letter" was made after the meeting of the Deloitte partners at which Peter Chant expressed his conclusion that Myron Gottlieb had lied. This would have caused an auditor acting with appropriate scepticism to recognize that Peter Chant may have had a point. It may have been that Myron Gottlieb would have subsequently been able to satisfy a sceptical auditor that his misrepresentation did not result in a misstatement for the third quarter of 1997. Nonetheless, a sceptical auditor should have, at the very least, challenged Myron Gottlieb in this regard.

246. The audit field work started two weeks later than expected which placed Deloitte under pressure to meet the deadlines to file Livent's financial statements. Despite client and time pressure, Deloitte still needed to exercise their professional judgment appropriately.

247. The audit plan to deal with the suspicions about the Put was not followed. The audit evidence was not critically and sceptically analyzed.

### **The CFO Did Not Sign the Representation Letter**

248. The representation letter which Deloitte had drafted with the identified risks in mind, including the risk that there could be side agreements, was signed on May 1, 1998. The unqualified audit opinion was released on April 17, 1998. Deloitte's claim that they acted with increased professional scepticism is contradicted by this departure from normal practice.

249. The failure to exercise professional scepticism with respect to the representation letter was manifested in another respect. Maria Messina, a former Deloitte partner, the Vice-President of Finance and the CFO of Livent had not signed the representation letter which Deloitte had prepared. The Panel accepted what Anthony Power said at the end of his first day of evidence.

Q. And did the failure of the CFO and the internal legal counsel to sign this representation letter produce any concern or degree of scepticism with respect to the contents and reliability of the contents of the representation letter?

A. Sorry, I'm not hearing you very well.

Q. Did the fact that Ms. Messina, the CFO, and the internal legal officer of the company did not sign the representation letter cause you concern or scepticism with respect to the representations that were being made to you in that letter?

A. I had -- I was unaware that the chief CFO and the chief in-house had not signed. I assumed -- my assumption is that they had signed.

Q. Had you seen that, what would have been your reaction?

A. I would have gone back and insisted that at least the CFO would make representation and I wouldn't sign the statements until I received that representation.

Q. You would not sign the statements and released the audit without that representation --

A. That's right.

Q. -- by the CFO?

A. That's right.

Q. Why is that?

A. Because they're vital to the process. The chief financial officer is so involved in the financials and the financial affairs of the company and so it is my policy to -- it would be my experience that I would want to see the chief financial officer's signature on the letter of representation.

*Transcript Power, P. 3536, Qs. 10958 - 10963*

250. The failure to ensure that the representation letter was signed before the unqualified audit opinion was released, and signed by the CFO and the internal legal counsel, reflects a lack of due care.

### THE PUT AND ITS SIGNIFICANCE

251. The investigators, in their report, concluded that the members had sufficient appropriate audit evidence to dispel their suspicions about the Put. Allan Wiener confirmed this opinion in his reply evidence. If the only evidence the panel had heard was the *vive voce* evidence of Allan Wiener, the panel might have come to the same conclusion. The parties have agreed, however, that all of the evidence was before the panel for consideration. As is set out above, on the basis of all of the evidence the panel considered, the members did not have sufficient appropriate audit evidence to dispel their suspicions of the continued existence of the Put.

252. It was clear from the time counsel for Peter Chant opened his case that what the *CICA Handbook* refers to as a fundamental auditing postulate – the assumption of management's good faith and the ability to rely on the representations of management – was at issue. It was only then that the Professional Conduct Committee learned that in a Deloitte meeting on April 3, 1998, Peter Chant had expressed his opinion that Myron Gottlieb had repeatedly lied to the auditors and that Deloitte should dissociate itself from the Livent audit.

253. The members, and, in particular, Peter Chant's counsel assert that the investigators would have known of Peter Chant's dissenting conclusion except for their limited approach to the investigation. They assert that the investigators should have asked more open ended questions. The panel agrees with this observation.

254. The Professional Conduct Committee submits that Peter Chant was not candid with the investigators about his dissenting opinion. In this regard, the following transcriptions of questions asked and the answers given by Peter Chant to the investigators are relevant:

Q. Was consideration given by D&T to resign the 1997 audit at any stage?

(if yes) What is your recollection of any discussion on this issue?

Answer as recorded by Allan Wiener :

Yes – at some stage.

Whether or not Livent was capable of being audited in context of the Put discovery.

Answer as recorded by Stephen Held:

Yes I was aware. The issue had to do with whether the client was capable of being audited.

In the context of the discovery of the PUT.

Q. In view of all of the difficulties encountered during the 1997 audit, why in your opinion, did D&T remain as auditors of Livent?

Answer recorded by Allan Wiener:

Collective decision of the firm that sufficient appropriate audit evidence can be obtained.

Answer recorded by Stephen Held:

Collective decision of the firm that sufficient appropriate audit evidence could be obtained.

*Exhibit 67, Tab E*

255. The panel is not prepared to find that Peter Chant's answers were false or misleading. However, the investigators' failure to ask the appropriate follow up questions is not the only reason the Professional Conduct Committee did not know about Peter Chant's dissenting opinion.

256. After the members appeared before the Professional Conduct Committee, counsel to the committee wrote to the counsel who appeared with the members. The letter, dated November 6, 2003, reads as follows:

Further to your attendance with Mr. Ken Fredeen and with the members Tony Power, Claudio Russo, Doug Barrington and Peter Chant, I can advise that the professional conduct committee is continuing to review this matter. We anticipate that the committee will be meeting again very shortly to complete their discussion of the investigation materials.

In the meantime the committee has asked me to clarify through you one or two areas of confusion.

The professional conduct committee was unclear as to the precise role played by Mr. Peter Chant and Mr. Doug Barrington. The committee understands that Mr. Chant and Mr. Barrington were the advisory partners but they are not clear as to what responsibility the advisory partners have in making the decisions on the file. Could you articulate for the professional conduct committee the responsibilities of Mr. Chant and Mr. Barrington for decisions pertaining to revenue recognition and

sale of density rights, as well the decision to accept the \$27.5 million adjustment to pre-production costs for 1997. Finally the committee would like to know who in particular had the responsibility for authorizing the release of financial statements.

The committee may have other questions but your assistance with these for now would be appreciated.

I look forward to hearing from you.

*Exhibit 25, Tab 56*

257. The members' response to the Professional Conduct Committee was a letter sent by their counsel dated November 28, 2003. This letter (the letter of November 28, 2003) reads as follows:

You have requested clarification of certain of the information discussed before the Professional Conduct Committee ("PCC") on October 27, 2003. That information specifically relates to the role assumed by certain Deloitte & Touche LLP ("Deloitte") partners during the 1997 audit ("Audit") of the annual financial statements of Livent Inc. ("Livent").

As set out in the audit plan provided to Livent's Audit Committee, Deloitte client service team for the Audit was led by Tony Power as Lead Client Services Partner. The advisory partner on the Audit was Doug Barrington, the technical advisory partner was Peter Chant and the audit engagement partner was Claudio Russo.

Tony Power had responsibility for the final approval of Deloitte issuance of its opinion on Livent's annual financial statements on completion of Deloitte quality assurance review process.

Doug Barrington's role as advisory partner was to be available to be consulted with on difficult issues relating to the overall Livent engagement, including the Audit. Peter Chant acted both as a further advisor on issues specifically relating to generally accepted accounting principles and as a resource on past issues, given his prior experience on earlier Livent engagements. To the extent Messrs. Barrington and Chant were involved with issues on the Audit, it was at the request of Tony Power.

We understand from our discussions that the PCC is requesting specific clarification as to the decision making process relating to Deloitte acceptance of the recognition in Livent's 1997 annual financial statements of revenue on the AT&T and Ford naming rights transactions, the revenue recognition on the Dundee Realty Corporation transaction and the decision to accept a significant write-down by Livent of its pre-production costs.

Mr. Power was the ultimate decision maker in respect of each of these decisions. In making those decisions Mr. Power consulted with Mr. Barrington and Mr. Russo. In addition, Mr. Chant was consulted in respect of each of these decisions, except the decision to accept the write-down of pre-production costs. In each case, notwithstanding Mr. Power's ultimate responsibility, the decisions reached by the client services team were very much a matter of consensus. Mr. Power

would not have made the decisions he made without the concurrence of the other partners. (emphasis added).

*Exhibit 25, Tab 57*

258. The last paragraph of this letter, referring to decisions which were “very much a matter of consensus”, and which “would not have been made without the concurrence of the other partners”, is false and misleading. It may be that the decisions referred to in the last paragraph of the letter were not intended to include the decision to release the audit opinion but only to refer to the decisions with respect to revenue recognition, including the Dundee arrangement. Even if this was the intention, the letter is false and misleading.

259. Moreover the members knew that the letter was false and misleading and that Peter Chant would tell the truth at the hearing. On April 29, 2005, Peter Chant wrote to Alan MacGibbon, the Managing Partner and Chief Executive of Deloitte & Touche LLP. The subject matter of the letter was the charges brought against himself and his three partners. The following extracts from the letter are particularly relevant:

As you know, I informed the firm after the charges were laid by the Institute in the Livent matter, through Bruce Richmond and Colin Taylor, its Chief Executive at the time, as well as yourself, since your assumption of that office, that my testimony on the Livent matter would reflect differences of opinion that arose between myself and various partners of the firm in the conduct of that audit prior to the issuance of the audit opinion on the 1997 fiscal year statements of Livent.

The response to that letter, a copy of which is attached, was sent to the PCC by Fraser Milner, (I understand on instructions from others within the firm) without my prior knowledge or concurrence. I learned of that letter only after I was charged. That letter inaccurately characterizes my involvement as being part of a consensus on all accounting decisions, with the possible exception of a decision on writing down preproduction costs. That characterization did not correctly represent my position on the matters specifically mentioned. Furthermore, the letter also stated that while Tony Power had ultimate authority for the release of the audit opinion, he would not have done so without the concurrence of Claudio Russo, Doug Barrington and myself. That statement was untrue, as I have clearly dissented to the firm’s client continuance decision subsequent to the discovery of the put, and any subsequent decision to release an audit opinion.

I have previously communicated in writing to Ken Fredeen my request that the firm correct the misstatements in the Fraser Milner letter to the PCC. No such correction has been made. I have also told my fellow partners with whom I am charged that I will testify truthfully at the hearing about the GAAP positions with

which I concurred and on which I did not concur, and my position on client retention and the release of the 1997 Livent audit opinion. In several meetings with the partners, and with you, Alan, I have made my position clear. I have not to this point, however, disclosed any of these matters to the PCC or the Discipline Committee.

I must under oath disclose to the committee the truth, the whole truth, and nothing but the truth with respect to the relevant events.

*Exhibit 141*

260. The fact that the information set out in the letter of November 28, 2003 was not true was not made known to the Professional Conduct Committee until Peter Chant's counsel opened his defence on August 27, 2005. The members left the Professional Conduct Committee with this false and incomplete information for more than one and one half years. The letter of November 28, 2003 was before the panel of the Discipline Committee in January 2005.

261. As his letter of April 29, 2005 makes clear, Peter Chant did not concur with the proposed recognition of revenue relating to the Dundee arrangement. In fact, he was not prepared to accept management representations at all. Nor, did he agree with the ultimate decision to release the audit opinion.

262. The members assert that the Put was not in issue - not part of the case they had to meet. The panel disagrees.

263. Without the full knowledge of the Put Side Agreement, the procedures followed and audit evidence obtained to dispel the suspicions about the Put, and Peter Chant's dissenting opinion, neither the Professional Conduct Committee nor the investigator had all of the relevant evidence necessary to determine whether or not the suspicions with respect to the Put had been properly dispelled. The members cannot be allowed to benefit from withholding relevant information from the Professional Conduct Committee.

264. The members knew that the sufficiency and appropriateness of the evidence accepted to dispel their suspicions about the Put, and the implications which followed, were issues they would have to face, and did face, at this hearing. They were not prejudiced by any failure of the Professional Conduct Committee to identify this issue as part of the case they had to meet.

### **LIVENT'S REVENUE RECOGNITION AND GAAP**

265. It was the position of the Professional Conduct Committee that it was contrary to GAAP to recognize revenue from the naming rights agreements before the theatres were built and open to the public.

266. In addition, the Professional Conduct Committee took the position that the requirement of *CICA Handbook* s. 3400.07, "all significant acts had been completed" precluded the concept of reasonable assurance that the acts would be completed.

267. It was the position of the members that the revenue from the naming rights contracts could be recognized when the right to name the building had been sold, provided that there was reasonable assurance that the theatre would be built and open to the public. The members submitted that *CICA Handbook* s. 3400.07 did not preclude the concept of reasonable assurance. The panel agreed with the members and the experts for the members.

268. The panel concluded that, while there were other alternative (and perhaps, more appropriate) income recognition approaches, the auditors were not required to accept only the most preferable alternative, so long as the alternative approaches complied with GAAP.

### **DELOITTE AUDIT PROCEDURES AND GAAS**

269. It was the position of the Professional Conduct Committee that as a result of the misstatements and misrepresentations encountered during the audit, Deloitte should have altered their planned audit procedures.

270. It was the position of the members that they had obtained sufficient appropriate audit evidence and that the planned auditing procedures did not need to be revisited.

### **THE RELEVANT PERIOD**

271. The members, particularly Douglas Barrington, assert that conduct which took place outside of the dates specified in the charge[s] is not relevant. The panel concluded that the phrase "in or about" which precedes the words "January 1, 1998 to March 27, 1998" in both charges does mean that the conduct of the members in the time between March 27, 1998 and April 17, 1998, (the date Livent was authorized to use the unqualified audit opinion) is relevant.

### **ARE THE PARTICULARS PROVEN?**

#### **Did the Auditors Meet the Standards of the Profession?**

##### **Charge 1, particular i)**

272. With respect to the recognition of revenue from the sale of the naming rights of the Pantages Theatre complex to AT&T, the panel concluded that as the suspicions about the Put had not been dispelled, it was not appropriate to recognize all the revenue from the AT&T naming rights agreement.

273. The auditors should have come to the same conclusion in April 1998 as Deloitte and Martin Calpin did on the re-audit in the autumn of 1998. The auditors were not entitled to conclude that there was reasonable assurance that “all significant acts” under the arrangement to build the Pantages Theatre complex would be completed because the suspicions about the likely existence of the Put had not been dispelled. Therefore, it was not appropriate to recognize all of the revenue from the AT&T agreement to name the Pantages Theatre complex.

274. It is not a defence for a member to establish that the number of dollars specified in a particular of Charge 1 is incorrect. If the revenue which was recognized differs materially from the revenue which ought to have been recognized, then the particular is proven. Charges of professional misconduct are not to be treated as counts in a criminal indictment.

275. After the re-audit, the financial statements for the year 1996 recognized half of the revenue from the AT&T agreement. The panel concluded this was a reasonable apportionment of the potential revenue had the Pantages Complex been completed. This sum, \$4.6 million was clearly material.

276. The particular was proven. The auditors did not meet the standards of the profession.

**Charge 1, particular ii)**

277. The funds required to complete the construction of the Oriental Theater in Chicago were held in escrow and the construction was proceeding on or ahead of schedule. The panel, therefore, concluded that there was reasonable assurance that the Oriental Theater would be completed and opened to the public and, it was acceptable to recognize the revenue in 1997.

278. The panel recognized that if the position of the Professional Conduct Committee was correct, and the revenue from the Oriental Theater should not have been recognized until 1998 when it opened, then the revenue from the Lyric Theater in New York should have been recognized in 1997, not as it was in 1996. In this sense, even if the Professional Conduct Committee’s position had been accepted, the issue relating to appropriate revenue recognition from the sale of the Ford naming rights related to 1996, not 1997.

279. The particular was not proven. The auditors did meet the standards of the profession.

**Charge 1, particular iii)**

280. With respect to the revenue from the Dundee arrangement it was Deloitte’s position throughout the relevant time, July 1997 to April 1998 (and at this hearing), that if there was a Put, the revenue from the arrangement should not be recognized.

281. As long as the Put was in effect, it could not be said that effective ownership of the rights had been transferred. Anthony Power confirmed this when asked by Brian Bellmore about the revenue recognition criteria for the Dundee transaction.

Q. Looking at item 3 under revenue recognition criteria for the sale of density rights, you note, "Livent has transferred effective ownership of rights and purchaser has no right to Put the property back to Livent."

A. Yes.

Q. That was a significant criteria then?

A. It was indeed.

*Transcript, Power, P.3648, Qs. 11393 - 11394*

282. The revenue of \$5.6 million should not have been recognized. It is clearly material.

283. The particular was proven. The auditors did not meet the standards of the profession.

**Charge 1, particular iv)**

284. In their summary memorandum dated March 26, 1998, Anthony Power and Claudio Russo concluded there should be no loss recognized on the First Treasury transaction because Livent had retained sufficient recourse such that a sale had not taken place. Peter Chant had previously opined to Claudio Russo that Livent retained the foreign exchange risk on this transaction.

285. However, Anthony Power and Claudio Russo, in the Report to the Audit Committee dated April 9, 1998 changed the conclusion they had documented less than two weeks previously and concurred with Livent's treatment of the First Treasury transaction as a sale. This conclusion was again expressed in the June 5, 1998 audit summary memorandum.

286. The Professional Conduct Committee submitted that there was no support in the working papers for this change. In addition the Professional Conduct Committee submitted that the purpose and effect of treating the First Treasury transaction as a sale was to avoid reporting a material \$3.7 million dollar liability (the result if the transaction had been treated as a financing arrangement); and, to further ensure that the treatment did not conflict with the accounting treatment of the naming rights transactions.

287. Counsel for Anthony Power and Claudio Russo submitted that the change in conclusion reflected a more accurate understanding of the terms of the agreement between Livent and First Treasury and, specifically, the limits of First Treasury's recourse to Livent. The experts called by the members to testify noted that the issue was one of professional judgment and indicated that while there were factors that could lead a reasonable auditor in either direction,

Deloitte's assessment of the extent of the recourse provide by Livent to First Treasury was reasonable.

288. The panel agreed with the opinion of the investigator and Peter Chant that the First Treasury transactions should not have been treated as a sale of receivables given Livent's retention of the foreign exchange risk.

289. The panel concluded the transaction should have been treated as a transfer. As a result, the liabilities would have been increased by \$3.7 million which is material.

290. The particular was proven. The auditors did not meet the standards of the profession.

**Charge 2, particular i)**

291. The panel dismissed this particular during submissions when the Professional Conduct Committee requested that it be dismissed after hearing all of the evidence.

**Charge 2, particular ii)**

292. The thrust of this particular, as counsel for the members Anthony Power and Claudio Russo acknowledged at paragraphs 184 and 190 of their written submissions, is that the members had failed to ascertain the reliability of management budgets and, accordingly, failed to obtain sufficient appropriate audit evidence to properly assess the recoverability of preproduction costs.

293. There is no dispute that the comparison of the 1997 production budgets (prepared by management in 1996) to actual results in 1997 was not performed for all of 1997. The comparison was performed for the first three quarters but not the last quarter.

294. The investigator did not agree that Claudio Russo's analysis of the impact of a 10% change in show revenue to the recoverability of preproduction costs constituted a sensitivity analysis as envisaged by the CICA Handbook s. 5305 – Audit of Accounting Estimates. The panel agrees. However, the panel does not find that the failure to conduct a sensitivity analysis, in and of itself, constitutes a failure to meet the required professional standards.

295. While the panel did not agree with Allan Wiener's reasoning, it did agree with his conclusion. The auditors had insufficient audit evidence to assess the recoverability of preproduction costs.

296. In his testimony, Garfield Emerson advised that the valuation of pre-production costs was an area of key concern to the Audit Committee, and that he and Martin Goldfarb, another member of the Audit Committee, had indicated their concerns in this area to Deloitte.

297. Preproduction costs were specifically identified as subject to management estimation and representations. The events, beginning with the discovery of the

Put and culminating with the request for an additional \$27.5 million write-down of preproduction costs in early April 1998 should have raised suspicions about the reliability of management's estimates and the presumption of management's good faith.

298. The preproduction costs were accumulations of disbursements and journal entries. The panel concluded that Deloitte did not have sufficient appropriate audit evidence upon which to conclude that controls over purchases, payables and disbursements operated effectively throughout 1997.

299. The purpose of the tests of controls was explained in the analysis of Top-Down Controls working paper:

Purpose:

To determine whether internal controls at Livent are effective and in place throughout the audit period thereby allowing us to rely on the controls and reduce the scope of detailed audit testing. This will be performed on an account and potential error basis.

*Exhibit 82, Tab 11*

300. The exceptions which were discovered during control testing and the events of April 1998 were not anticipated when the audit was planned in November 1997. The information discovered was significantly different than the information on which the audit plan was based and should have been cause for reconsideration of the audit plan in accordance with CICA Handbook s. 5130.29.

301. Allan Wiener set out his understanding in the investigators report (Exhibit 44) CICA Handbook s. 5130.29. He read this section in his oral testimony. It reads:

During the audit, information may come to the auditor's attention, as a result of performing auditing procedures or from other sources, that differs significantly from the information on which the audit plan is based. Such information may cause the auditor to modify the nature, extent and timing of procedures. For example, the number of misstatements encountered may alter the auditor's judgment about levels of inherent and control risk, or other information obtained about the financial statements may alter his or her preliminary judgment about materiality. In such cases the auditor will need to re-evaluate the nature, extent and timing of planned auditing procedures based on his or her revised assessments of materiality, inherent risk and control risk.

302. Claudio Russo and Anthony Power did not revisit the planned auditing procedures. The panel agreed with Allan Wiener and concluded that they should have.

303. The panel believes that Claudio Russo and Anthony Power did not exercise due professional care to ensure that the Management Representation letter was signed before the audit opinion was released. It was not signed by the CFO even though the letter contained specific references to the validity and valuation of preproduction costs.

304. Further, by failing to document the concerns about the Put in early April 1998 in the audit file, the Quality Assurance Review (QAR) partner was not provided with all of the information needed to complete the Quality Assurance Review in accordance with Deloitte policy.

305. With respect to the QAR review, the QAR checklist was signed by Claudio Russo who testified that a QAR partner, Hugh Bradford, had reviewed the file but was not available to sign off. There was no evidence in the file from Hugh Bradford or at this hearing that he completed the review.

306. The particular was proven. The auditors did not meet the standards of the profession.

**Charge 2, particular iii)**

307. The \$27.5 million write-down was 13.75 times the amount of the materiality level determined by Deloitte for its audit. It was five times greater than the general provision for unrecoverable preproduction costs which was thought necessary in early 1998. While the experts, other than Allan Wiener, were not prepared to say that the write-down of \$27.5 million fell outside of the “zone of reasonableness”, they acknowledged it was approaching the outer limit of that zone. Management, although willing to accept this write-down, did not change its view that such a write-down was not appropriate even though the Audit Committee concluded a write-down was necessary.

308. While the panel accepts that Claudio Russo reviewed the issue of the recoverability of preproduction costs after the Audit Committee meeting of April 9, 1998, there is no evidence that in conducting this review, he reconsidered the reliability of management’s representations with respect to either preproduction costs or the results of control testing.

309. In the circumstances of early April, 1998, the members should have concluded that the request for the \$27.5 million write-down presented them with both the opportunity and the necessity to reassess management’s representations and reconsider the nature, extent and timing of audit procedures.

310. The particular was proven. The auditors did not meet the standards of the profession.

**Charge 2, particular iv)**

311. It is the position of the members that the accounts payable test in which five errors were found was only one of four substantive procedures undertaken in the accounts payable section of the audit and based on the totality of procedures carried out, sufficient audit evidence was obtained.

312. It is the position of The Professional Conduct Committee that the nature, extent and timing of planned audit procedures should have been re-evaluated and that either the sample errors should have been extrapolated and taken to the Summary of Unrecorded Differences (SUDS) or the sample size revisited.

313. The panel agrees with the Professional Conduct Committee. The panel believes that the working paper note which indicated that no errors were found because the client had corrected those errors during the audit was an incorrect determination. Unexplained sample errors should have been extrapolated to determine the potential quantum of errors in the entire population. This extrapolated error should have been reflected in SUDS and should have been combined with other likely misstatements.

314. The panel concluded that the implications of these errors on the assessment of audit testing should have been considered.

315. The particular was proven. The auditors failed to meet the standards of the profession.

**Charge 2, particular v)**

316. It is the position of the members that the assurances of Livent's accounting staff and the corroborating representations of Gordon Eckstein, who had worked with Garth Drabinsky and Myron Gottlieb for many years, were sufficient audit evidence to explain the capitalization of the three F&D Scene amounts, (three of the 60 items in the sample selected for the test of additions to fixed assets.) F & D Scene was a related party which should have further sensitized the auditors' scepticism. It should have been a relatively simple matter to request copies of these invoices from F & D Scene or examine evidence of payment. The CICA Handbook s. 5300.26 reads in part:

"A response from a person within the entity does not usually constitute sufficient appropriate audit evidence in itself but requires corroboration. Such corroboration may include making further enquires from other appropriate sources within the entity. Consistent response from different sources provide an increased degree of assurance, especially when they are independent of each other."

317. It is the position of the Professional Conduct Committee that further work should have been undertaken given the events of April 1998 and the concerns about management's good faith.

318. The panel agrees with the Professional Conduct Committee that the members failed to obtain sufficient audit evidence in the circumstances. The panel concluded that the implications of these exceptions on the assessment of audit testing should have been considered.

319. This particular was proven. The auditors did not meet the standards of the profession.

**Charge 2, particular vi)**

320. The panel found that the charge was not proven and agreed with the members and their experts that the method followed by Livent in computing the amortization for preproduction costs provided a reasonable and practical manner of giving effect to the accounting policy.

321. The particular was not proven.

**Charge 2, particular vii)**

322. The panel concluded on the evidence that the foreign subsidiaries were financially and operationally independent and, as a result, it was appropriate to treat them as self-sustaining entities. The evidence in this regard could not reasonably be questioned. Livent and Deloitte addressed this issue in 1995 at the prompting of the SEC.

323. The auditors should have specifically addressed this issue each year and there should have been a working paper to evidence this fact. The subsidiaries were more financially and operationally independent in 1997 than they were in 1995 and 1996. In the circumstances, however, this lack of documentation does not constitute a breach of professional standards.

324. The particular was not proven.

**Charge 2, particular viii)**

325. The panel concluded that First Treasury had recourse against Livent and that Livent retained the foreign exchange risk.

326. This particular was proven. The auditors did not meet the standards of the profession.

**DO THE BREACHES CONSTITUTE PROFESSIONAL MISCONDUCT?**

327. The departure or departures from the required standards of the profession must be significant in order to constitute professional misconduct. In determining whether a departure is significant, both the nature of the conduct itself – the departure from the required standards – and the impact of the departure[s] are considered.

328. The breaches proven by particulars i), iii), and iv) of Charge 1 and particulars ii), iii), iv), v), and viii) of Charge 2 are significant enough, in and of themselves, to constitute professional misconduct.

329. As these departures individually constitute professional misconduct, it follows that collectively, they constitute professional misconduct. Also, collectively, they reveal the essential nature of the misconduct, namely an improper exercise of professional judgment with respect to the reasonable suspicions about the Put and the failure to reconsider their planned auditing procedures. The auditors said that their scepticism was “sky high”. However, with respect to the impugned conduct, the evidence disclosed that the auditors failed to exercise the professional scepticism required in the circumstances.

## WHO WAS RESPONSIBLE?

330. This is not a case which raises complex issues about whether or not an advisory partner or national office partner should be held responsible when the audit team has breached a rule of professional conduct. The role played by an advisory partner can vary, as the submissions of Douglas Barrington made clear.

331. In this case the evidence with respect to who was responsible for the serious departures from the required standards of the profession is clear to the panel.

332. Douglas Barrington and Bruce Richmond provided the leadership for the meeting of April 3, 1998 and the steps taken that day to begin to dispel or confirm the suspicions about the Put. Thereafter, Douglas Barrington took the lead role. He set out the audit plan to deal with suspicions about the Put which was to be followed before the suspicions could be dispelled. He failed to ensure that this plan was followed. He and Anthony Power accepted the evidence which the panel finds inadequate. As between the two, the panel concluded Douglas Barrington played the lead role. On this critically important issue, he was not acting as national office partner, or even as an advisory partner giving advice when requested. He was a major decision maker, if not the major decision maker with respect to the audit plan to deal with the suspicions about the Put. It is clear that Douglas Barrington, assisted by Anthony Power and Claudio Russo, failed to carry out the procedures and properly evaluate the evidence received.

333. Douglas Barrington attended the Audit Committee meetings of August 1997 and April 9, 1998. He had a thorough knowledge of the issues with respect to the Put in August 1997. The representations of senior management with respect to the Put had been made directly to him. He reviewed the summary memoranda (top memoranda) prepared by Anthony Power.

334. The panel concluded that, of the four partners charged under Charge 1, Douglas Barrington had the most authority within the firm. He had the authority to compel Peter Chant to assist Claudio Russo on April 8, 1998. He accepted Myron Gottlieb's explanation of the Put Side Agreement and the evidence provided on and after April 3, 1998. Douglas Barrington was responsible for accepting less than sufficient appropriate audit evidence to satisfy the requirements of the audit plan to deal with the suspicions about the Put.

335. Accordingly, Douglas Barrington is responsible for the misconduct which was proven with respect to particulars i) and iii) of Charge 1. With respect to particular iv) of Charge 1, while he reviewed the financial statements with respect to this particular, unlike particulars i) and iii), he was not a decision maker and is not responsible for particular iv).

336. Anthony Power, the Lead Client Service Partner, acknowledged that he was responsible for the audit. He accepted ultimate responsibility. While he had no knowledge of the letter of November 28, 2003 before it was sent, he did not disagree with its contents.

337. Claudio Russo, the Audit Engagement Partner, does not deny his responsibility. He was directly responsible for the audit work which gave rise to Charge 2. While he did not have the final word on the release of the audit opinion, nor was he one of the partners who made the decision with respect to dispelling the suspicions about the Put, he also agreed with those decisions. The panel concluded that if he had advised Anthony Power of the audit exceptions or dissented from the decisions being made, then Anthony Power would most likely have listened to him.

338. Claudio Russo did not adequately document the suspicions raised about the Put and the steps taken to confirm or dispel those suspicions. The audit plan to deal with the suspicions about the Put and the evidence subsequently gathered were not included in the working papers and, as a result, were not available for review as part of the quality assurance review process. Claudio Russo also signed off on the quality assurance review and did not obtain a written confirmation from the QAR partner for the file. Claudio Russo did not get the representation letter signed before the audit opinion was released, nor did he advise Anthony Power that the CFO had not signed the representation letter.

339. Peter Chant insisted at the meeting of April 3, 1998, that Myron Gottlieb had lied on more than one occasion, and as a result, Deloitte should dissociate itself from the audit. If it had been within Peter Chant's control, the audit opinion on the financial statements would not have been issued.

340. Peter Chant's only involvement on the audit after April 3, 1998, was to review the financial statements which Claudio Russo sent him. He did so at the direction of Douglas Barrington. He did not agree with the treatment of the First Treasury transaction, particular iv), but he did not have the authority to communicate his dissenting opinion to Livent.

### **CONCLUSION WITH RESPECT TO GUILT OR INNOCENCE ON THE CHARGES**

341. It follows from the above that with respect to Charge 1:

- a) Anthony Power and Claudio Russo are guilty of Charge 1 in that particulars i), iii) and iv) have been proven and that the departures from the required standards of the profession are so significant that they constitute professional misconduct;
- b) Douglas Barrington is found guilty of Charge 1 in that particulars i) and iii) have been proven and the departures from the required standards of the profession are so significant that they constitute professional misconduct;
- c) Peter Chant is not guilty of Charge 1.

342. It also follows from the above that with respect to Charge 2, Anthony Power and Claudio Russo are guilty of the Charge in that particulars ii), iii), iv), v) and viii) have been proven and, that these departures from the required standards of the profession are so significant that they constitute professional misconduct.

343. When the formal or written Decision and Order of the Discipline Committee is issued by the Secretary, the provision setting out the actual decision will read as follows:

1. After hearing and considering the evidence and submissions, and after deliberating, for the reasons set out by the panel in their Decision and Reasons for Decision dated February 11, 2007, with respect to Charge 1, the panel finds:

- a) Douglas Barrington, Anthony Power and Claudio Russo guilty of the Charge; and
- b) Peter Chant not guilty of the Charge.

2. After hearing and considering the evidence and submissions, and after deliberating, for the reasons set out by the panel in their Decision and Reasons for Decision dated February 11, 2007 with respect to Charge 2, the panel finds:

Anthony Power and Claudio Russo guilty of the Charge.

DATED AT TORONTO THIS 11<sup>th</sup> DAY OF FEBRUARY, 2007  
BY ORDER OF THE DISCIPLINE COMMITTEE

*Louise Hayes*

B.L. HAYES, CA – DEPUTY CHAIR  
DISCIPLINE COMMITTEE

MEMBERS OF THE PANEL:

J.A. CULLEMORE, FCA  
M.B. MARTENFELD, FCA  
H.G. TARADAY, CA  
B. RAMSAY (PUBLIC REPRESENTATIVE)