
IN THE APPELLATE COURT OF ILLINOIS
FIRST DISTRICT

ILLINOIS COLLEGE OF OPTOMETRY,)	Appeal from the Circuit
an Illinois not for profit)	Court of Cook County,
corporation,)	Law Division
)	
Plaintiff-Appellant,)	
Cross-Appellee,)	
)	
v.)	No. 96 L 12332
)	
GRANT THORNTON, LLP,)	
an Illinois limited liability)	
partnership,)	
)	
Defendant-Appellee,)	Hon. Richard E. Neville,
Cross-Appellant.)	Judge, Presiding

**BRIEF OF DEFENDANT-APPELLEE,
CROSS-APPELLANT
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ORAL ARGUMENT REQUESTED

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INTRODUCTION

The Illinois College of Optometry (“ICO”) retained the accounting firm of Grant Thornton (“Grant”) to audit financial statements prepared by ICO. It is undisputed that Grant’s audits correctly determined that ICO’s financial statements fairly presented ICO’s financial position, including ICO’s expenditures; in other words, the transactions at issue here were all accurately (and openly) reflected in ICO’s books and records. ICO’s claims here are not based on the contention that there were any inaccuracies in its financial statements. Rather, ICO’s case is based on the premise that Grant should be liable to ICO for failing to tell it something that was accurately stated in the financial statements that ICO prepared and Grant reported upon — that is, how much money ICO was paying its own President, Boyd Banwell.

ICO makes these claims even though it is undisputed that the payments to its President were fully reflected in ICO’s own books and records and were known by the Chairman of ICO’s Board of Trustees, ICO’s Chief Financial Officer, and ICO’s Director of Accounting. Nonetheless, ICO contends that it cannot be deemed to have known the facts that were openly set forth in its own records and were known by its principal executive and financial officials. This argument flies in the face of decades of settled law concerning imputation of knowledge to a corporation. ICO’s position is unsupported by any authority in Illinois (or anywhere else), and, if accepted, would eviscerate the long-established rule that a corporation is deemed to know what its agents know or what is reflected in the company’s own books.

Here, the uncontested facts that the payments ICO made to its own President were (1) accurately set forth in the corporation’s records, and (2) known by ICO’s Chairman, Chief Financial Officer, and Director of Accounting, necessarily mean that ICO was deemed to know, as a matter of law, about the payments ICO was making to President Banwell — the precise information it claims Grant did not disclose

to it — years before it finally filed suit. As a result, ICO’s claims are barred either by the two-year statute of limitations or the five-year statute of repose for claims against accountants. Indeed, it is ICO that had an affirmative contractual obligation to disclose these payments to Grant, and to insure that ICO’s management was not engaged in any irregularities. In fact, ICO agreed in its contracts with Grant to indemnify Grant for any harm caused by misrepresentations made to Grant by college officials.

Despite all of this, ICO contends that Grant somehow should have known that the payments to Banwell had not been authorized by the full Board of Trustees and that the written authorizations issued by the Chairman of the Board were ultra vires acts. But no facts are alleged, or could be alleged, in support of this *ipse dixit*. Grant had no obligation whatever, under the parties’ contracts or professional accounting standards, to inform the ICO Board of its own President’s compensation. In fact, ICO elected *not* to hire Grant for a *separate* engagement to uncover defalcations or fraud by ICO officials. Moreover, Grant warned ICO about its high executive pay and recommended specifically that ICO look into the President’s compensation — advice that ICO elected not to follow.

ISSUES PRESENTED

1. Whether the trial court correctly held that ICO’s claims are time-barred, because
 - a. ICO is deemed to know the contents of its own books and records, and the allegedly unauthorized payments made to its President were accurately reflected in ICO’s books and records, and in the financial statements that ICO prepared, more than two years before it filed suit,
 - b. ICO’s Chairman of the Board not only knew about, but expressly authorized in writing, allegedly unauthorized payments to its President more than two years before filing suit and there are no allegations in the amended complaint that the Chairman’s interests were adverse to those of ICO,

c. ICO's Chief Financial Officer and its Director of Accounting actually knew of the majority of the allegedly unauthorized payments to its President more than two years before filing suit, and

d. Grant repeatedly told ICO, more than two years before suit was brought, that ICO's Presidential Evaluation Committee should review the President's compensation because it might be excessive.

2. Whether the trial court correctly held that claims arising out of the 1991 audit, which was performed more than five years before suit was filed, are barred by the five-year statute of repose for claims against accountants.

3. Whether the trial court correctly concluded that plaintiff did not adequately allege causation or damages.

4. Whether the amended complaint otherwise fails to state a cause of action against Grant for either breach of contract or negligence.

JURISDICTION

The trial court entered an order on December 5, 1997 that (a) dismissed without prejudice claims based on the fiscal year 1995 audit; (b) dismissed the remaining claims with prejudice pursuant to 735 ILCS 5/2-619(a)(5); and (c) granted Grant's motion to dismiss under 735 ILCS 5/2-615 with respect to the allegations of causation and damages, but otherwise denied the motion. App. A2.^{1/} This order disposed of all pending claims in the trial court. Plaintiff filed a timely notice of appeal on December 30, 1997. C 796. Grant filed a timely notice of cross-appeal on January 8, 1998. C 801. This Court has jurisdiction pursuant to S. Ct. Rule 303(a).

^{1/} Record materials contained in the Separate Appendix ("App.") filed by plaintiff or in the appendix attached to this brief ("Grant App.") are cited by appendix page number. Other parts of the record are designated as "C" followed by the page number.

STATEMENT OF FACTS

The statement of facts that follows is based on the allegations contained in ICO's amended complaint, the documents attached to (or referred to in) the amended complaint, and ICO's answers to Grant's first set of interrogatories. "Statements provided in answers to interrogatories are properly considered * * * on a section 2-619 motion to dismiss," *Kirby v. Jarrett*, 190 Ill. App. 3d 8, 15, 545 N.E.2d 965, 969 (1st Dist. 1989) (Freeman, J.), as are "affidavits, * * * documents and deposition transcripts," *id.* at 12, 545 N.E.2d at 968. See also, *e.g.*, *Dancor Int'l, Ltd. v. Friedman, Goldberg & Mintz*, 288 Ill. App. 3d 666, 674-75, 681 N.E.2d 617, 622-23 (1st Dist. 1997) (affirming the dismissal of accounting malpractice claims as untimely; the Court relied on the factual allegations of a federal complaint that was previously filed by the plaintiff and attached to the defendant's section 2-619 motion to dismiss); *Perkaus v. Chicago Catholic High School Athletic League*, 140 Ill. App. 3d 127, 134-35, 488 N.E.2d 623, 627-28 (1st Dist. 1986) (it is "entirely appropriate" for a section 2-619 motion to attach and rely on documents referred to in the plaintiff's complaint).

A. Procedural Background. ICO filed this suit on October 23, 1996. C 2. Grant moved to dismiss pursuant to 735 ILCS 5/2-615 and 5/2-619, and the trial court granted that motion in part. C 77, 234. The court granted the motion under section 2-619 and ruled that plaintiff's claims were time-barred to the extent that Joseph Ebbesen, the Chairman of ICO's Board of Trustees, was aware of the things that ICO claimed Grant should have disclosed to ICO. C 234. The court gave ICO another opportunity to plead a cause of action that was not barred by the statute of limitations. *Id.*

Accordingly, ICO filed an amended complaint that purports to plead claims for breach of contract and negligence. App. A16 (¶ 52). Both counts of the amended complaint are based on the underlying

theory that Grant, ICO’s independent auditor, allegedly failed to inform ICO of the specific amounts of money that ICO was paying its President, Boyd Banwell.

B. The Engagement Agreements. Grant was ICO’s auditor from 1977 to 1995. App. A16 (¶ 52). For each year, Grant and ICO signed a written Engagement Agreement setting forth the tasks that Grant was to perform and the payment that Grant was to receive from ICO. *E.g.*, App. A34-A38. This case concerns Grant’s audits of ICO’s financial statements for fiscal years 1991 through 1995.

The only relevant undertaking set forth in the Engagement Agreements was that Grant would audit the financial statements prepared by ICO: the Agreements provided that Grant would “audit the balance sheet of [ICO] * * * and the related statements of changes in fund balances and current fund revenues, expenditures and other changes for the year then ended.” App. A34, A43, A52, A60, A69. The financial statements were prepared by ICO and were “the responsibility of the College’s management.” C 367. “[B]ased on [its] audits,” Grant’s “responsibility [was] to express an opinion on these financial statements” — namely, whether the statements fairly presented ICO’s financial position. *Id.*

Each Engagement Agreement stated explicitly that “*an audit is not a special examination designed to detect defalcations or fraud*, nor a guarantee of the accuracy of the financial statements and is subject to the inherent risk that errors, irregularities, or illegal acts, if they exist, might not be detected.” App. A35, A44, A53, A61, A70 (emphasis added). The Agreements went on to explain that if ICO wanted Grant to perform such a “special examination,” it could retain Grant to do so in a “*separate engagement*” that would “direct special auditing procedures” for the purpose of uncovering “errors,

irregularities, or illegal acts.” App. A35, A44, A53, A61, A70 (emphasis added). ICO does not (and could not) allege that it entered into any such separate engagement with Grant from 1991 to 1995.^{2/}

In each of the Engagement Agreements executed by ICO and Grant, ICO agreed that (a) Grant’s audit would require management’s cooperation, (b) ICO would provide information and written representations upon which Grant would rely in performing its work, and (c) ICO was responsible for the “integrity” of ICO personnel and maintaining an appropriate internal control structure to “safeguard” ICO’s assets. App. A34-A35, A43-A44, A52-A53, A60-A61, A69-A70. The Engagement Agreements all state as follows:

“[T]he financial statements are the responsibility of the management and Board of Trustees of the College who are primarily responsible for the data and information set forth therein, as well as for the evaluation of the capability and integrity of the College’s personnel and the maintenance of an appropriate internal control structure, which includes adequate accounting records and procedures to safeguard the College’s assets. Accordingly, our completion of the audit will require management’s cooperation.”

App. A34, A43, A52, A60-A61, A69 (emphasis added). Furthermore, ICO agreed to indemnify Grant from all damages that it might sustain if any representation made by ICO or its management was not true: “as required by generally accepted auditing standards, our procedures will include obtaining written representation from management concerning such matters *which we will rely upon* and the College will indemnify and hold us harmless from any liability, damages and legal or other costs we might sustain in the event such representations are knowingly untrue.” *Id.* (emphasis added). In addition, the last two Engagement Agreements, dated May 11, 1994 and June 12, 1995, explained that the “written

^{2/} Grant was not retained for such an engagement until 1996, when it was hired by ICO’s lawyers to assist in investigating the payments to Banwell; that investigation determined that Banwell had been paid large amounts of money that ICO now claims were not authorized. App. A8 (¶ 25).

representation[s] from management * * * will confirm, among other things, * * * *the absence of irregularities involving management or those employees who have significant roles in the control structure.*” App. A61, A69-A70 (emphasis added).

C. ICO’s Claims. The amended complaint identifies six types of payments made to ICO’s President Banwell: (1) salary, (2) non-accountable expenses, (3) bonuses, (4) public relations, (5) American Express charges, and (6) petty cash disbursements. ICO admits that the first category — salary payments — was authorized by the full Board of Trustees, and thus Banwell’s salary is not part of ICO’s claim. App. A5 (¶ 10). The pertinent facts concerning the five remaining forms of payments are as follows.

1. Non-accountable Expenses. Pursuant to a 1987 employment agreement, which ICO admits was approved by its Board, ICO provided Banwell with an annual expense allotment of \$125,000 for which he would “not be required to account” to ICO. App. A10 (¶ 29). The 1987 agreement was admittedly approved by the Board, and thus Banwell was entitled to receive at least \$125,000 in non-accountable expenses every year. *Id.* In subsequent years, Ebbesen, the Chairman of the Board, approved increases of this amount in letters sent to Banwell, allegedly without the authorization or knowledge of the Board of Trustees. App. A10-A12 (¶¶ 30-35). The letters generally explained that the increases were needed due to the “increased activity and cost of doing business for the College.” C 534-37.

One such increase occurred on July 1, 1991, when Banwell and ICO entered into a new employment agreement, replacing Banwell’s 1987 contract. C 509, 529. The 1991 contract included a provision increasing the amount of Banwell’s non-accountable expenses to \$322,000. App. A10-A11 (¶ 31). Ebbesen signed this employment agreement on behalf of ICO. *Id.* ICO alleges here that only one paragraph of the 1991 agreement, the one dealing with non-accountable expenses, was not authorized by

the Board. *Id.* ICO admits that the Board authorized the \$200,000 salary that Banwell received pursuant to this agreement. App. A9 (¶ 28).

Starting in 1992, the amount of non-accountable expenses was no longer fixed by contract. ICO and Banwell signed a contract, dated June 11, 1992, providing instead that “[f]or the expenses of the office of the President of the College, the College shall provide an expense account in its Budget on a yearly basis.” C 565.

ICO’s Director of Accounting, Richard Schepler, was aware that Ebbesen had increased the amount of non-accountable expenses to which Banwell was entitled. A June 23, 1992 letter from the Director of Institutional Services asked Ebbesen to sign — and return to Schepler — a letter increasing the amount of Banwell’s non-accountable expenses to \$346,000 annually. C 665-66.

As indicated above, the amended complaint alleges that there was a writing, signed by Chairman Ebbesen, approving every increase in President Banwell’s non-accountable expenses. The amended complaint also alleges that Chairman Ebbesen was not authorized to increase Banwell’s non-accountable expenses, but ICO does not plead any facts to support these conclusory allegations. App. A5 (¶ 10), A10-A12 (¶¶ 30-35). Similarly, ICO also contends that Grant should have discovered that the written authorizations increasing Banwell’s non-accountable expenses, signed by ICO’s Chairman of the Board or fully reflected in a written contract between Banwell and ICO, were not authorized by ICO, but it does not allege any facts indicating how Grant should have known this purported fact. App. A19 (¶ 62); C 183.

2. *Bonuses.* ICO admits that it authorized all of the bonus payments to Banwell. App. A12-A13 (¶¶ 38, 41-42, 44). ICO alleges, however, that the authorized bonuses were “intended to have been

for a gross amount” but that Ebbesen “increased” the bonus amounts in signed letters authorizing a net bonus rather than the gross amount authorized by ICO. *Id.* (¶¶ 39, 42, 45). The amended complaint alleges no facts to support the conclusion that Ebbesen did not have the authority to sign letters providing Banwell with a net bonus. The amended complaint also does not allege any facts indicating how Grant should have known that the bonuses for net amounts authorized in writing by ICO’s Chairman of the Board were not authorized by ICO or why Grant should have known that ICO “intended” to give only gross bonuses when the documents given to Grant contained the representation that the bonuses were to be net bonuses.

3. *Public Relations Payments.* According to the amended complaint, “Ebbesen signed letters purporting to authorize [public relations] payments [to Banwell] without authorization or knowledge of the Board of Trustees.” App. A14 (¶ 47). ICO has admitted, however, that its Chief Financial Officer, Charles Smith, and its Director of Accounting, Richard Schepler, knew of the public relations payments to Banwell. Grant App. A11-A12. The amended complaint does not allege any facts supporting the conclusion that Ebbesen acted without authority in approving these payments, nor does it specify how Grant should have known about this alleged lack of authority.

4 & 5. *Petty Cash Disbursements and American Express Charges.* ICO has admitted that Banwell was entitled to obtain petty cash reimbursements, and to pay American Express bills with ICO’s funds, to cover business expenses. Grant App. A14, A16-A17. ICO, however, had “no written policy” for petty cash reimbursement or payment of American Express charges. Grant App. A16. For petty cash payments, the practice, as described by ICO, was for Banwell to submit supporting documents to the “business office,” where they were typically “reviewed” by Director of Accounting Schepler or someone

on the accounting staff. *Id.* ICO has explained that “[t]he review was for the purpose of determining the proper account to charge, and not to determine whether Dr. Banwell was entitled to be reimbursed.” *Id.* With respect to American Express bills, the practice was for Banwell to submit the bills to Schepler, along with a note indicating “what the charge was for”; Schepler “would then cause a College check to be issued to American Express.” Grant App. A17.

ICO alleges, upon information and belief, that Banwell “directed” petty cash payments to himself and “caused ICO to pay” amounts he charged on his American Express card for personal expenses. App. A14-A15 (¶¶ 48-50). The complaint does not allege any facts indicating how Grant should have known that some of these payments may have been for personal items, not business expenses. ICO has acknowledged that it may turn out that all of the petty cash payments and American Express charges were entirely proper. Grant App. A13. At least as of January 1997, ICO was continuing to investigate whether any of those payments were improper. Grant App. A14-A15.

* * *

According to ICO’s allegations, all five categories of payments to Banwell discussed above were reflected in ICO’s books and records. According to ICO, it provided Grant “with information which disclosed the amounts which Banwell received as salary, expense allowance, bonuses and ‘public relations’ payments.” App. A19 (¶ 61). In addition, the amended complaint alleges that “Grant [] had access to all of ICO’s books and records which disclosed the amounts paid to Banwell from Petty Cash and paid to American Express for Banwell’s credit card charges, as well as access to all of the documentation submitted for such payments.” App. A20 (¶ 64).

D. Grant’s Advisory Memoranda. Grant “prepared and issued to the Board of Trustees” Memoranda of Advisory Comments regarding “each of [Grant’s] audits of ICO’s Financial Statements for fiscal years 1991 through 1995.” App. A17-A19 (¶¶ 55-59); C 340-41, 344-46, 349-51, 354-57, 360-64 (the advisory memoranda).

In these advisory memoranda, all sent to the Board of Trustees (C 339, 343, 348, 353, 359), Grant told ICO to investigate whether it was paying excessive compensation to its officers — in particular, the college President. In the advisory memorandum for fiscal year 1992, which is dated August 28, 1992, Grant warned ICO about the consequences of the college paying “excessive compensation” to, and the “personal expenses” of, ICO’s “officers.” App. A18 (¶ 57). Grant cautioned in its 1992 memorandum that there was a “serious issue relat[ing] to the private inurement provisions” in the federal tax laws; those provisions are designed to insure that tax-exempt organizations are not being used for the “private interests of related parties.”^{3/} C 344. Grant noted in particular that the college had a “Presidential Evaluation Committee to assist in maintaining policies regarding compensation and compensation reviews,” and Grant “recommend[ed] that the Committee consider using comparable salaries paid within the industry to help support the reasonableness of salaries paid” in order to “document the adequacy of the compensation to all officers.” *Id.* Grant recommended that ICO do this in order to “ensur[e] that all funds are spent for the benefit of the College” and that ICO “maintain[] proper documentation and records with respect to

^{3/} Grant told ICO that violating the private inurement provisions “could cause an entity to lose its tax-exempt status on a retroactive basis,” and that “[c]onsidering the serious penalty for violating the private inurement provisions, the College needs to be aware of the types of actions that have been held to be inurement violations. Inurement has been found where *excessive compensation was paid to officers, directors or other parties.*” C 344 (emphasis added).

payments to and from officers, directors and other parties.” *Id.*

Grant repeated its warnings to ICO in subsequent years. Grant’s memorandum for fiscal year 1993, issued on August 27, 1993, noted the IRS’s “increased scrutiny” of private inurement questions; stated Grant’s “understand[ing]” that the College, as part of its annual “evaluat[ion]” of the President, had “obtained published comparable industry information”; “recognize[d] the positive steps” taken by the college to date; and “recommend[ed]” that the college “specifically document the relationship between the comparable industry information and the detailed responsibilities of the President.” App. A18 (¶ 58); C 349. These warnings were reiterated for fiscal year 1994. In a memorandum to ICO dated August 26, 1994, Grant recommended that ICO’s Presidential Evaluation Committee, as part of its annual review of the President’s performance and in addressing possible private inurement issues, “*specifically document the relationship between the comparable industry information and the detailed responsibilities and compensation of the President.*” App. A18-19 (¶ 59); C 356 (emphasis added).

E. The Trial Court’s Decision. The trial court ruled that ICO’s claims based on the 1991 audit were barred by both the five-year statute of repose for claims against accountants, 735 ILCS 5/13-214.2(b), and the two-year statute of limitations, 735 ILCS 5/13-214.2(a). App. A1. In addition, the court held that claims arising out of the 1992-1994 audits were barred by the two-year limitations period. *Id.* Finally, the court denied in part Grant’s motion to dismiss under 735 ILCS 5/2-615, but did rule, as to all of the claims, that the amended complaint did not allege causation or damages with sufficient specificity. App. A2. The court then granted ICO’s motion to voluntarily dismiss without prejudice its claims based on the 1995 audit. App. A2. ICO and Grant each appealed to this Court.

STANDARD OF REVIEW

ICO correctly notes that this Court's review of the trial court's decision is de novo. ICO Br. 11 (citing *Mackereth v. G.D. Searle & Co.*, 285 Ill. App. 3d 1070, 1074, 674 N.E.2d 936, 939 (1st Dist. 1996)). ICO is incorrect, however, in suggesting that the trial court should not have considered ICO's interrogatory answers or other evidentiary materials in ruling on Grant's section 2-619 motion. See ICO Br. 11 (arguing that section 2-619 requires that "the grounds for dismissal must appear on the face of the complaint"). As noted at p. 4, *supra*, it is settled law that interrogatory answers and admissible evidence submitted by the parties are properly considered in ruling on limitations issues in a section 2-619 motion. And although "well-pleaded facts and reasonable inferences are accepted as true" for purposes of a section 2-619 motion, "[c]onclusions of law" in a complaint "are not accepted as true." *Hermitage Corp. v. Contractors Adjustment Co.*, 166 Ill. 2d 72, 85, 651 N.E.2d 1132, 1139 (1995).

None of the material offered by Grant is contrary to the well-pleaded allegations in ICO's amended complaint, and ICO does not dispute the facts they establish. Most significantly, ICO does not deny that its agents knew about the payments to Banwell; rather, ICO only disputes the purely legal issue of whether that knowledge should be attributed to it. In short, there are no factual disputes with respect to Grant's motion to dismiss ICO's claims as time-barred, and thus Grant's motion was properly brought under section 2-619.^{4/}

^{4/} The case relied upon by ICO (at 11), *Rowan v. Novotny*, 157 Ill. App. 3d 691, 510 N.E.2d 1111 (1st Dist. 1987), is not to the contrary. That was a libel case where the Court held that the limitations issue could not be resolved on a section 2-619 motion because there was a question of fact there as to when the plaintiff knew or should have known about the libelous conduct. *Id.* at 694, 510 N.E.2d at 1113. See also *Lofthouse v. Suburban Trust & Savings Bank*, 185 Ill. App. 3d 889, 891-93, 542 N.E.2d 36, 38-39 (1st Dist. 1989) (affirming the grant of defendant's section 2-619 motion on limitations grounds and explaining that *Rowan* involved a disputed question of fact); *Dancor*, 288 Ill. App. 3d at 672-77, 681 N.E.2d at 621-25 (affirming dismissal, (continued...))

ARGUMENT

I. ICO’S CLAIMS ARE TIME-BARRED.

The statute of limitations governing claims asserted against accountants bars claims that are “based upon tort, contract or otherwise” and are filed more than two years “from the time the person bringing an action knew or should reasonably have known of [the challenged] act or omission.” 735 ILCS 5/13-214.2(a). In addition, there is an absolute five-year statute of repose; no claims may be asserted against an accountant more than five years after the “act or omission alleged * * * to have been the cause of the injury.” 735 ILCS 5/13-214.2(b). ICO’s original complaint was filed on October 23, 1996; therefore, ICO cannot recover for any acts or omissions it knew or should have known about before October 23, 1994 under the two-year rule, and all allegations regarding acts or omissions taking place before October 23, 1991 are barred under the five-year statute of repose.

A. The Two-Year Limitations Period Bars The Claims Based Upon All Of The Engagement Letters Or Audit Reports.

The “act or omission” at issue in this case is Grant’s alleged failure to tell ICO how much money Banwell was receiving from ICO. ICO knew or should have known about this “act or omission” as soon as ICO is charged with knowledge of how much it was “really paying” Banwell. See *City Nat’l Bank v. Checkers, Simon & Rosner*, 32 F.3d 277, 284 (7th Cir. 1994) (the Illinois statute of limitations for claims against accountants is triggered when the plaintiff is on notice of the need to investigate possible claims). See also *Knox College v. Celotex Corp.*, 88 Ill. 2d 407, 416, 430 N.E.2d 976, 980 (1981) (limitations

⁴(...continued)

under section 2-619, of an accounting malpractice claim on limitations grounds).

period begins running when the plaintiff has sufficient information to be put on inquiry to determine “whether a legal duty to him had been breached”). The time at which ICO is charged with that knowledge is determined by standard principles concerning imputation to a corporation of the knowledge of its officers, directors, and agents.

“Corporations are artificial legal entities, and the only knowledge which a corporation can be said to have is the knowledge which is imputed to it under principles of agency law.” *Campen v. Executive House Hotel, Inc.*, 105 Ill. App. 3d 576, 585-86, 434 N.E.2d 511, 517 (1st Dist. 1982). The general rule is that “knowledge which a corporate agent receives while acting within the scope of his or her agency is imputed to the corporation if the knowledge concerns a matter within the scope of the agent’s authority.” *Id.* at 586, 434 N.E.2d at 517. Indeed, “it is well established that business knowledge acquired by an agent in the natural scope of his employment is imputed to the principal.” *St. Paul Mercury Ins. Co. v. Statistical Tabulating Corp.*, 155 Ill. App. 3d 545, 550, 508 N.E.2d 433, 436 (1st Dist. 1987) (holding that information in a letter sent to a salesman is imputed to his employer as a matter of law). Thus, “[i]f the president, vice-president or director of a corporation has knowledge or notice of a fact, knowledge or notice of that fact is generally imputed to the corporation. * * * Notice to the director of a corporation is notice to the corporation.” *In re Pubs, Inc.*, 618 F.2d 432, 438 (7th Cir. 1980) (applying Illinois law and citing Illinois cases). See also *A.T. Kearney, Inc. v. INCA Int’l, Inc.*, 132 Ill. App. 3d 655, 662, 477 N.E.2d 1326, 1333 (1st Dist. 1985) (“If an officer of a corporation has knowledge or notice of a fact, that knowledge or notice is generally imputed to the corporation”) (applying this rule where one corporate officer knew of another’s breach of fiduciary duty).

There are five reasons why ICO knew or should have known as a matter of law, before October 23, 1994, about all of the payments it made to Banwell. First, all of the payments at issue here were reflected in ICO's own books and records. Not only are corporate directors deemed to know the content of their organization's own records, but the payments here were obviously within the knowledge of ICO's Accounting Department, which wrote the checks to Banwell. Second, Chairman of the Board Ebbesen knew about or signed written authorizations for all of the non-accountable expenses, bonuses, and public relations payments, and this knowledge is also attributed to ICO. Third, even if ICO could somehow establish that Ebbesen was an adverse agent and avoid imputation on that basis, Grant would be entitled to rely on Ebbesen's representations under the doctrine of apparent authority and ICO is therefore estopped from denying his authority. Fourth, ICO's Chief Financial Officer and its Director of Accounting both knew about many of the payments to Banwell — in particular, the public relations, petty cash and American Express payments. The Director of Accounting also knew about the increases in non-accountable expenses that Ebbesen had authorized. The knowledge of the Chief Financial Officer and the Director of Accounting is imputed to ICO and was sufficient to put ICO on inquiry notice. Fifth, Grant repeatedly advised ICO to investigate whether it was paying excessive compensation to its officers — specifically, its President — before October 23, 1994.

Any one of these five reasons is sufficient to affirm the dismissal of ICO's complaint. But considered as a whole, the case in favor of imputing to ICO knowledge of its payments to its own President is overwhelming. ICO contends, in effect, that a corporation may ignore facts that are contained in its own records and that are known to the corporation's Chairman, President, Chief Financial Officer, and Director

of Accounting. No Illinois case has ever so held. Indeed, ICO's position is contrary to, and would require overturning, Illinois precedents that have been on the books since at least the turn of the century.

1. ICO is deemed to know the contents of its own books and records.

ICO does not contest that the information it claims Grant should have provided was contained (and stated accurately) in ICO's own books and records. Indeed, ICO claims that it provided Grant "with information which disclosed the amounts which Banwell received as salary, expense allowance, bonuses and 'public relations' payments," as well as "records which disclosed the amounts paid to Banwell from Petty Cash and paid to American Express for Banwell's credit card charges." App. A19-A20 (¶¶ 61, 64). But if all of this information was contained in ICO's records, then ICO, the members of its Board of Trustees, and its officers are deemed to have known it.

ICO and its Board members are deemed to know the content of ICO's own books and records because of the "general rule that knowledge of the contents of the corporate files and records *will be presumed* in its directors." *Harris Trust & Sav. Bank v. Joanna-Western Mills Co.*, 53 Ill. App. 3d 542, 550, 368 N.E.2d 629, 635 (1st Dist. 1977) (emphasis added). See also, *e.g.*, *In re Illinois Valley Acceptance Corp.*, 531 F. Supp. 737, 740 (C.D. Ill. 1982) ("Generally, knowledge of corporate records and documents is imputed to all directors"). As suggested by the phrase "*will be presumed*," the presumption is conclusive. This has long been established in Illinois law. For example, the Supreme Court held in *Mamerow v. National Lead Co.*, 206 Ill. 626, 69 N.E. 504 (1903), that

"the directors of a corporation are in law *conclusively presumed to know* its condition, its business, its receipts and *expenditures*, and all the general facts which go to make up that condition and business, as shown by the entries on its regular books."

Id. at 638, 69 N.E. at 508 (emphasis added). Similarly, in *Roth v. Ahrensfeld*, 373 Ill. 550, 555, 27 N.E.2d 445, 447 (1940), the Supreme Court held that a corporation was “conclusively bound] with notice of [a] transaction” that was “openly recorded and fully disclosed in its journal, ledger books, and in its annual reports.” Indeed, directors of a corporation have an affirmative “duty * * * to have knowledge of [the corporation’s] affairs,” including its “financial condition.” *Mamerow*, 206 Ill. at 633, 638, 69 N.E. at 506, 508.^{5/}

ICO attempts to sidestep the general rule by arguing that it does not apply when the rule is being used to “estop [a] party without knowledge.” ICO Br. 18 (quoting *Perlman v. First Nat’l Bank*, 15 Ill. App. 3d 784, 305 N.E.2d 236 (1st Dist. 1973), *appeal dismissed*, 60 Ill. 2d 529, 331 N.E.2d 65 (1975)). ICO has waived this argument, having never made it below. *Brown v. Lober*, 75 Ill. 2d 547, 556, 389 N.E.2d 1188, 1193 (1979) (“It is well settled that questions not raised in the trial court will not be considered by this court on appeal”); *Nugent v. Miller*, 119 Ill. App. 3d 382, 387, 456 N.E.2d 640, 643 (2d Dist. 1983) (“A point not raised in the trial court cannot be urged on appeal”); see C 404-05. For the same reason, ICO has waived its related argument that the normal imputation rules do not apply when the party asserting estoppel is not “ignorant of the truth,” but “itself has knowledge of facts belying the [other party’s] knowledge.” ICO Br. 19.

Even if these arguments had not been waived, they are without merit. To begin with, ICO’s principal authority on this point, *Perlman*, has nothing to do with imputing to a corporation knowledge of

^{5/} Even if the Supreme Court in *Mamerow* and *Roth* had adopted the rule that the presumption is rebuttable rather than conclusive, that would not have helped ICO because it did not offer any evidence to rebut a presumption of corporate knowledge. All that ICO offered in the trial court was an affidavit from Chief Financial Officer Smith stating he “*did not know* if the full Board knew of the extent of the payments.” App. A80 (emphasis added). An affidavit confessing to a lack of knowledge obviously cannot rebut a presumption created by law.

facts contained in the corporation's own files. *Perlman* is an estoppel case in which a bank was arguing that its *customers* knew how the bank calculated interest and should be estopped from challenging the bank's computation method. What is more, the rule that a corporation is presumed to know what is in the corporation's own records is not grounded on principles of estoppel. Rather, corporate directors are "conclusively presumed to know * * * all the general facts" that are "shown by the entries on its regular books" because

"it is their duty to know these things in the exercise of their official functions. This doctrine is said to be one founded in public policy, essential to the safety of third persons in their dealings with corporations, and to the protection of stockholders interested in the welfare and safe management of corporations."

Mamerow, 206 Ill. at 638, 69 N.E. at 508.

Moreover, ICO's argument is based on the proposition that it is a party "without knowledge." ICO Br. 18. But the whole point of the imputation doctrine is that it provides conclusively that a corporation *has* knowledge of what is contained within the corporation's records. The premise of ICO's argument against imputation — that it lacked knowledge — is definitively refuted by the imputation rule itself. A legal rule cannot be defeated by an argument that assumes as a starting point something that is rejected as a matter of law by the rule itself.

ICO also argues that the general imputation rule "only works in favor of dealings with third parties and not in favor of fellow directors or officers." ICO Br. 19 (quoting *Illinois Valley Acceptance*, 531 F. Supp. at 740). See also *Harris Trust*, 53 Ill. App. 3d at 550, 368 N.E.2d at 635 (the "general rule" that knowledge of corporate files is imputed to the corporation's directors "is only indulged in favor of third parties, and not for fellow directors or officers"). But *Grant* is a third party. Even if *Banwell* or *Ebbesen* may not be able to use the presumption, *Grant* is entitled under Illinois law to rely on the imputation principle.

Finally, ICO seems to argue for a special exception to the general rule of imputation of knowledge to a corporation when accountants are involved. ICO asserts that if the general rule applies, there would be “no purpose” in having accountants provide advisory comments or inform clients of “irregularities” or problems with the corporation’s “internal controls.” ICO Br. 20. But no court has ever adopted such an exception for cases involving accountants. The imputation doctrine applies in all corporate matters involving third parties; it is not a principle that may be discarded for a particular type of litigation.

Beyond that, Grant’s audits were *not* intended to discover “irregularities” (although if Grant had actual knowledge of any, it would have been obliged to inform ICO). As we have already explained at some length, Grant explicitly told ICO that “an audit is not a special examination designed to detect defalcations or fraud,” App. A35, A44, A53, A61, A70; that ICO had to represent to Grant that there were no “irregularities involving management or those employees who have significant roles in the control structure,” App. A61, A69-A70; and that ICO could hire Grant for a “separate engagement” to uncover “irregularities, or illegal acts,” App. A35, A44, A53, A61, A70 — which ICO never did.

What is more, ICO’s argument is based on a fundamental misunderstanding of the purpose of an accountant’s audit of a company’s financial statements. Financial statements are prepared by the company, not the accountant; the company “has direct control over and assumes primary responsibility for their contents.” *Bily v. Arthur Young & Co.*, 834 P.2d 745, 749, 762 (Cal. 1992). The accountant’s role is to examine the company’s records to determine if there is information that will have a material impact on the accuracy of the financial statements that is not already reflected in the statements; it is not to make ad hoc disclosures about the company’s internal controls, a subject that need not even be disclosed in the audit report. See *Monroe v. Hughes*, 31 F.3d 772, 775 (9th Cir. 1994) (“Neither applicable professional

standards, nor any legal authority of which we are aware * * * treat deficiencies in internal controls of a company as material to the audit report itself”). Unlike the typical corporate defalcation case, in which company personnel manipulate the books to conceal their theft of money, there was *no* missing information here — *all* of ICO’s payments to Banwell were completely and accurately reflected in ICO’s books. And when the financial statements are accurate, the accountant’s responsibility is to tell the corporation that its financial statements fairly reflect its financial condition. *Bily*, 834 P.2d at 749. That is what Grant did. There is no obligation, however, to inform the corporation of specific line item expenditures that are accurately recounted in the financial statements that the corporation itself has prepared.

Contrary to ICO’s suggestion (at 20), it is not the “purpose” of an audit to tell the corporation what it does not already know. Even if that were the purpose of an audit, there is still a reason why accountants discuss with a corporation items that the corporation is already deemed to know: accountants often make recommendations to clients in an effort to head off possible future problems — here, for example, Grant advised ICO repeatedly (but as it turned out, in vain) to examine the compensation being paid to ICO’s President, which Grant warned might be considered excessive even though such matters have no direct impact on the financial statements. See SAS No. 60 (April 1988). (SAS is the Statement on Auditing Standards published by the American Institute of Certified Public Accountants. See *Bily*, 834 P.2d at 750.)

ICO cannot avoid the clear effect of the presumption established by the Illinois Supreme Court in *Mamerow* and *Roth*: corporate directors are deemed to know the contents of their corporation’s own books and records. And once ICO’s directors are deemed to know something, they know it as a matter of law. They are not allowed to “forget” that information and then seek to hold Grant liable for not telling them something they are already deemed to know as a matter of law.

In the end, ICO is seeking to hold Grant liable for the failures of ICO's officers and directors to live up to their affirmative "duty" to be knowledgeable about ICO's affairs. See *Mamerow*, 206 Ill. at 638, 69 N.E. at 508. But their failures are not Grant's responsibility. ICO should not try to blame Grant for the head-in-the-sand approach of the officers and directors that ICO selected.

2. The knowledge of the Chairman of the Board about Banwell's compensation is attributed to ICO.

The facts about Banwell's compensation that were known by ICO's Chairman of the Board, Joseph Ebbesen, are also imputed to ICO under the general rule that the knowledge of corporate directors is imputed to the corporation. See p. 15, *supra*. ICO contends that this general rule does not apply because of the adverse agent exception. Under this exception, "knowledge will not be imputed where the agent has a motive or interest in concealing the facts from the principal." *McKey & Poague, Inc. v. Stackler*, 63 Ill. App. 3d 142, 152, 379 N.E.2d 1198, 1205 (1st Dist. 1978). In other words, "the common law treats the principal as ignorant of facts known to an agent acting adversely to the principal, and for his own benefit." *Ash v. Georgia-Pacific Corp.*, 957 F.2d 432, 436 (7th Cir. 1992) (emphasis added). See also *Cowan v. Curran*, 216 Ill. 598, 617, 75 N.E. 322, 329 (1905) (adverse agent exception applies "where the agent acts *for himself, in his own interest* and adversely to that of the principal") (emphasis added). However, to come within this exception to the normal rule of imputation, the agent must be acting "*secretly*" and "*entirely for his own or another's purposes.*" RESTATEMENT (SECOND) OF AGENCY § 282(1) (1958) (emphasis added). Thus, "knowledge is imputed in a case of 'joint' interests even though the agent's primary interest is inimical to that of the principal." 3 *Fletcher*

Cyclopedia Corporations § 822, at 126 (rev. 1986). See *Hartmann v. Prudential Ins. Co. of Am.*, 9 F.3d 1207, 1210 (7th Cir. 1993) (a principal is bound by the agent’s acts “even if the agent has a dual motive” and performs acts that the principal “would not have authorized and may even have forbidden”; it is only “when an agent acts *entirely* on his own behalf * * * [that] the principal is not bound”) (emphasis added).

The amended complaint does not contain any allegations that satisfy the adverse agent exception. ICO does allege that Banwell, without the knowledge or authority of the Board of Trustees, appointed Ebbesen as a legislative consultant starting in 1987 and increased Ebbesen’s salary for those services several times thereafter. App. A6 (¶¶ 15-18). Significantly, however, the amended complaint does not allege that Banwell appointed Ebbesen in exchange for Ebbesen’s authorization of payments to Banwell, that Ebbesen did not actually perform the consulting services for which he was paid, or that the college did not benefit from those services.^{6/} Nor does the amended complaint allege that Ebbesen acted “secretly.” In short, there are no allegations indicating that Ebbesen’s interests were *adverse* to the college’s. Not only are there no allegations that Ebbesen’s interests were adverse, but the amended complaint contains only conclusory allegations that Ebbesen somehow knew that, as Chairman of the Board, he was acting without the Board’s approval in executing contracts and signing letters authorizing bonus payments to Banwell and increasing Banwell’s non-accountable expenses. App. A10-A13 (¶¶ 30-35, 39-46). And even those

^{6/} Plaintiff argues that Ebbesen agreed to be retained as a consultant despite “the Board’s reminder not to do so.” ICO Br. 14. But the Board did not indicate that Ebbesen should not be a consultant until the second half of 1995. App. A6 (¶ 16). The Board never suggested that there was anything wrong with Ebbesen’s consulting work between 1987 and 1995; on the contrary, the fact that the Board did *not* ask Ebbesen to return any of the money he was paid for consulting services from 1987 to June 1995, see App. A6-A7 (¶¶ 15-21), indicates that the Board believed that there was nothing wrong with those payments.

conclusory allegations do not show that Ebbesen was without authority, let alone that his interests were adverse to ICO's. All of these conclusory allegations therefore must be disregarded. See *Majumdar v. Lurie*, 274 Ill. App. 3d 267, 268, 653 N.E.2d 915, 917 (1st Dist. 1995) ("we do not accept as true any conclusions of law or fact contained within the complaint which are unsupported by allegations of specific facts upon which those conclusions rest"). See also *Connick v. Suzuki Motor Co.*, 174 Ill. 2d 482, 498, 675 N.E.2d 584, 592 (1996) (conclusory allegations are insufficient to establish agency "because they contain no facts to support a finding that the [alleged agents] had actual or apparent authority to act on [the alleged principal's] behalf").

Indeed, evidence submitted by ICO in the trial court indicates that the Chairman of its Board has always had the authority to enter into binding agreements on behalf of the college by signing letters that were sent to the President. See C 641 (1987 letter from Board Chairman W. Judd Chapman to Banwell, informing Banwell of his salary increase and bonus); C 643 (same, for 1988); C 647 (same, for 1989); C 649 (same, for 1990); C 623 (1982 contract, signed by Chairman Kushuer); C 626 (1983 contract, signed by Chairman Henry); C 632 (same, for 1985); C 628 (1985 interest-free loan agreement, signed by Chairman Henry); C 639 (1987 contract, signed by Chairman Chapman).

The allegations in the amended complaint do not come close to satisfying the stringent standards required to establish that Ebbesen was an adverse agent. In cases applying the adverse agent exception, the courts have required far more than the claim that the agent was being paid for services rendered by the very entity trying to avoid the imputation of knowledge. For example, in *Ash*, the adverse agent exception was satisfied because the agent (the CEO) was diverting payments from the principal to his own shell corporation. 957 F.2d at 436. Similarly, in *Metropolitan Sanitary Dist. v. Anthony Pontarelli & Sons*,

Inc., 7 Ill. App. 3d 829, 839-41, 288 N.E.2d 905, 912-13 (1st Dist. 1972), the Court found an adverse interest where the agent was conspiring with a third party to defraud the principal entirely for the benefit of the agent and the third party. In *McKey*, the Court found that two agents were motivated to conceal the facts from their principal because they were real estate brokers who were violating laws prohibiting racial discrimination. 63 Ill. App. 3d at 152, 379 N.E.2d at 1205. And in *Kearney*, this Court held that a corporate officer's knowledge *was imputed* to the corporation even though the officer actively participated a scheme to (1) induce an innocent third party to make a substantial down payment on a future project to be done by the corporation, and (2) use the money to repay a \$100,000 personal debt the officer owed instead of for the job the corporation had agreed to undertake. 132 Ill. App. 3d at 662, 477 N.E.2d at 1333.

In this case, there are no allegations in either of ICO's complaints that Ebbesen's interests were adverse to those of the college. Nor is there any allegation that the compensation paid to Ebbesen for his services was in any way linked to his issuance of the written authorizations for the payments to Banwell. Without even an *allegation* that there was a *quid pro quo* between Ebbesen and Banwell, it cannot be said that Ebbesen acted "for his own benefit" when he authorized the payments to Banwell. See *FDIC v. Shrader & York*, 991 F.2d 216, 225 (5th Cir. 1993) (holding that even if there was misappropriation of funds with regard to one transaction, this did not affect other transactions because the agent's "possible adverse interest in one transaction does not spill over into other transactions for purposes of the imputation rule").

ICO essentially concedes that the allegations in its amended complaint cannot satisfy the adverse agent exception; it argues that the necessary link between the payments to Banwell and those to Ebbesen

is pled in *other* lawsuits. ICO Br. 10, 14-15. But having had two chances to include these allegations in *this* case — particularly after the trial court granted the first motion to dismiss specifically because of Ebbesen’s knowledge — ICO cannot now rely upon pleadings filed by *different* attorneys in *different* cases against *different* parties; the allegations required to sustain the claims against Grant had to be made in *this* case, not in some other litigation. ICO’s decision not to make such factual allegations here is fatal to ICO’s argument. Indeed, the absence of any allegations here about a purported conspiracy between Banwell and Ebbesen is all the more striking given ICO’s willingness to make such allegations in other lawsuits. The difference, particularly in light of the repleading that ICO did here, can only be attributed to a deliberate strategic choice by ICO in this litigation — and “strategic choices made in litigation carry with them strategic losses.” *Korwek v. Hunt*, 646 F. Supp. 953, 966 (S.D.N.Y. 1986), *aff’d*, 827 F.2d 874 (2d Cir. 1987).^{2/}

Finally, even considering the other complaints, the adverse interest exception does not apply here because ICO had a contractual obligation to disclose to Grant accurate and honest information about the compensation it paid Banwell. The adverse interest exception does not apply where “the failure of the agent to act upon or to reveal the information results in a violation of a contractual or relational duty of the principal to a person harmed thereby.” RESTATEMENT (SECOND) OF AGENCY § 282(2)(a) (1958). See

^{2/} Even if this Court were to consider the allegations made in other cases, it would do ICO no good. To establish the adverse interest exception, “the agent must have totally abandoned the principal’s interest and be acting for his own purposes or those of another. In other words, the interests of the agent must be completely adverse to those of his principal.” *Martin Marietta Corp. v. Gould, Inc.*, 70 F.3d 768, 773 (4th Cir. 1995) (citing 3 *Fletcher Cyclopedia Corporations*). The other pleadings do not establish that Ebbesen “totally abandoned” ICO’s interests and was acting “completely” for the benefit of himself or Banwell. Indeed, according to one of those pleadings, Ebbesen claims that in signing the bonus memos he did not notice the term “net” bonus. C 427. Lack of attention in signing a document does not constitute total abandonment of the principal’s interest, and it cannot excuse giving a third party, Grant, false information.

also *Greene v. Cuykendall*, 40 N.Y.S.2d 801, 814-15 (Sup. Ct. 1943) (applying this rule and holding the principal liable for acts of the agent “in spite of the adverse and personal interest” of the agent); *National Credit Union Administration v. Ticor Title Ins. Co.*, 873 F. Supp. 718, 727 (D. Mass. 1995) (applying this rule and imputing the agents’ knowledge “despite their adverse interest”).

That is the situation here. ICO owed a contractual and relational duty to disclose truthful information to Grant under professional standards and the law. *E.g.*, AICPA Professional Standards AU §§ 110.02 (1991), 333A.05 (1992). This responsibility is also embodied in the Engagement Agreements between ICO and Grant:

- ! ICO explicitly assumed the obligation to provide Grant with exactly the type of information that, if ICO’s allegations are taken as true, was withheld from Grant, see pp. 6-7, *supra*;
- ! ICO represented that there were no “*irregularities involving management or those employees who have significant roles in the control structure*,” App. A61, A69-A70 (emphasis added); and
- ! Grant expressly warned ICO that “an audit is *not a special examination designed to detect defalcations or fraud*, nor a guarantee of the accuracy of the financial statements and is subject to the inherent risk that errors, irregularities, or illegal acts, if they exist, might not be detected,” *id.* (emphasis added).

If the written authorizations were fraudulent, as ICO claims, then Ebbesen’s failure to reveal this fact to Grant resulted in a violation of ICO’s duties to Grant, and ICO, as a result, is bound by Ebbesen’s knowledge.

3. The knowledge and actions of Ebbesen are also attributed to ICO under the doctrine of apparent authority.

There is another reason why Ebbesen’s knowledge is imputed to ICO and why ICO is charged with knowledge of, and bound by, the written authorization letters that Ebbesen signed with respect to Banwell’s bonuses and non-accountable expenses: Ebbesen had apparent authority to sign those letters.

It is settled law that “[t]he principal may be bound by the agent’s knowledge either because the agent is apparently doing something which he is authorized to do or because the act is the type of thing which he is employed to do and the other party thereto reasonably believes that the agent is acting within the employment.” RESTATEMENT (SECOND) OF AGENCY § 282 comment f (1958).

Apparent authority “arises when a principal creates, by its words or conduct, the reasonable impression in a third party that the agent has the authority to perform a certain act on its behalf.” *Crawford Sav. & Loan Ass’n v. Dvorak*, 40 Ill. App. 3d 288, 292, 352 N.E.2d 261, 264 (1st Dist. 1976). “The principal, having placed the agent in a situation where he may be presumed to have authority to act, is estopped as against a third person from denying the agent’s apparent authority.” *Id.* at 292-93, 352 N.E.2d at 264. Moreover, “it is true that an agent’s knowledge is imputed to his principal even if the agent is trying to defraud his principal, provided that the third party is not in cahoots with the agent.” *Hartmann*, 9 F.3d at 1212. (There are no allegations here that Grant and Ebbesen were “in cahoots.”) See also RESTATEMENT (SECOND) OF AGENCY § 282(2)(b) (1958) (“The principal is affected by the knowledge of an agent who acts adversely to the principal * * * if the agent enters into negotiations within the scope of his powers and the person with whom he deals reasonably believes him to be authorized to conduct the transaction”).

Illinois courts have applied these principles to hold that corporations are bound by the acts of corporate officers or other corporate agents with apparent authority to act on the corporation’s behalf:

“when, in the usual course of the business of a corporation, an officer or other agent is held out by the corporation or has been permitted to act for it or manage its affairs in such a way as to justify third persons who deal with him in inferring or assuming that he is doing an act or making a contract within the scope of his authority, the corporation is bound

thereby, even though such officer or agent has not the actual authority from the corporation to do such an act or make such a contract.”

American Union Financial Corp. v. University Nat'l Bank, 44 Ill. App. 3d 566, 568-69, 358 N.E.2d 646, 648 (3d Dist. 1976). Accord *Diversification Consultants, Inc. v. Candy-Gram, Inc.*, 130 Ill. App. 2d 1029, 1032, 264 N.E.2d 788, 791 (1st Dist. 1970). Persons who deal with a corporate officer or agent are “justified in assuming that he has authority to perform the act in question,” *American Union*, 44 Ill. App. 3d at 569, 358 N.E.2d at 648, because persons outside the corporation

“ought not to be required to search for the precise authority of the [agent] to fulfill each ordinary and usual function of his office; if the president is unworthy of trust in the execution of the ordinary business affairs of the corporation, then it seems more equitable that the corporation, rather than persons dealing with it, should suffer.”

Krantz v. Oak Park Trust & Sav. Bank, 16 Ill. App. 2d 331, 334, 147 N.E.2d 881, 882 (1st Dist. 1958).

By making Ebbesen the Chairman of its Board and placing him in a position where he could make written authorizations regarding Banwell's compensation, ICO created the impression that Ebbesen was authorized to authorize payments to Banwell. If ICO's Chairman of the Board was not authorized to authorize payments to its President, who would be? Some individual had to sign the written authorizations — who better than the Chairman? In fact, the Chairmen who preceded Ebbesen routinely signed letters to President Banwell telling Banwell of his annual bonuses and salary hikes. C 641, 643, 647, 649. And prior Chairmen, like Ebbesen in 1991, also signed ICO's employment contracts with Banwell, on behalf of the college. C 533, 623, 626, 628, 632, 639. Grant had no reason as a matter of law to doubt that Chairman Ebbesen did not have similar authority. See *Krantz*, 16 Ill. App. 2d at 334, 147 N.E.2d at 882 (president of corporation is presumed to have authority to execute agreements on behalf of the company);

McCormick v. Unity Co., 142 Ill. App. 159, 171-72 (1st Dist. 1908) (where directors allowed two directors “to control and conduct the affairs of the company, without protest or objection, the law presumes that all of [the directors] knew of and acquiesced in what was done, and treats such acquiescence as equivalent to formal authority”), *aff’d*, 239 Ill. 306, 87 N.E. 924 (1909); *Village of Prairie du Rocher v. Schoening-Koenigsmark Milling Co.*, 248 Ill. 57, 62, 93 N.E. 425, 427-28 (1910) (contracts signed by corporate vice president are “presumed to have been done by the authority of the corporation”). It may be, as Chief Financial Officer Smith stated in his affidavit, that the *full* Board would not necessarily have actual knowledge of the *precise* amount being paid to the President (App. A80) — although ICO’s Presidential Evaluation Committee would — but that does not mean that the Chairman of the Board would not have the apparent authority to sign documents setting forth the President’s compensation.

ICO has failed to plead any facts indicating how Grant should have known that Ebbesen exceeded his authority when he authorized the payments to Banwell or when he executed the 1991 and 1992 employment agreements with Banwell. Similarly, ICO has failed to plead any facts indicating that Ebbesen did not, at least, have apparent authority to authorize payments to Banwell. This omission is particularly important here because Ebbesen appeared to be exercising the same authority possessed by his predecessors as Chairman of the Board — they regularly signed letters to Banwell announcing his bonuses and also executed Banwell’s employment contracts on behalf of the college. See *Krantz*, 16 Ill. App. 2d at 335, 147 N.E.2d at 883 (“unless knowledge or notice of such lack of authority” by the president of a corporation “were communicated to the [third party], it would be entitled to rely upon the presumed authority of the chief executive officer”). Accord *Kaplan v. First Trust & Sav. Bank*, 48 Ill. App. 2d 374, 377-78, 199 N.E.2d 243, 245 (1st Dist. 1964).

ICO's claims rest at bottom on an ill-defined "obligation" by accountants to verify that the employer has in fact authorized the salaries being received by each and every employee, for there is no logical reason to insist on this sort of verification only for the company President — theoretically, any employee could be receiving more than he or she is entitled to. In fact, under the plaintiff's rationale, an accountant would also be obliged to make sure that people who signed any contracts on behalf of a corporation actually had the authority to do so. But no professional accounting standard requires this level of detail, and no court has ever imposed this type of sweeping obligation on accountants. And for good reason. Audits would be "unreasonably costly and impractical" if auditors "need[ed] to question the genuineness of all records and documents obtained from the client" and "require[d] conclusive rather than persuasive evidence to corroborate all management representations." SAS No. 53, ¶ 17 (April 1988). Judicially-created duties of this sort would serve to "raise the costs of all audits," as accountants would not only be required to do more work, but would "increase[] fees to cover anticipated liabilities" that might result from the broader duties that have been imposed on them. *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990). The end result? "[F]irms would purchase less accounting service"; "the price would go up as the amount of oversight went down." *Id.* See also *Bily*, 834 P.2d at 766.

For all of these reasons, Grant was entitled to rely upon, and ICO cannot deny, Ebbesen's apparent authority to act on behalf of the college. Accordingly, ICO is "bound by [Ebbesen's] knowledge," RESTATEMENT (SECOND) OF AGENCY § 282 comment f, and that means that the statute of limitations began running more than two years before ICO finally filed suit on October 23, 1996.

4. ICO's Chief Financial Officer and Director of Accounting knew about the majority of the allegedly improper payments to Banwell.

As might be expected, most of ICO's payments to Banwell were known by ICO's Chief Financial Officer, Charles Smith, and ICO's Director of Accounting, Richard Schepler. ICO has admitted that Smith and Schepler knew about the public relations, petty cash, and American Express payments. In ICO's answers to Grant's interrogatories, ICO conceded that Smith and Schepler knew about the public relations payments to Banwell. Grant App. A11-A12. Smith and Schepler also knew that Banwell was directing petty cash funds to himself; in fact, the petty cash receipt forms and supporting documents submitted by Banwell were reviewed by the business office, "usually" by Schepler. Grant App. A14, A16. ICO also admitted that "all * * * officers" of the college, including Banwell, "were authorized to direct petty cash payments to themselves." Grant App. A14. As for the American Express payments, Schepler required Banwell to approve the invoices, and Schepler would then issue checks to American Express. Grant App. A17. Schepler thus plainly knew about the American Express payments. And ICO itself submitted evidence indicating that Schepler also knew that Ebbesen had authorized increases in the amount of non-accountable expense payments to which Banwell was entitled. C 665-66 (June 1992 letter to be sent to Schepler showing increase in non-accountable expenses to \$346,000).^{8/}

ICO does not (and could not) dispute any of this. Nor does ICO dispute that Smith and Schepler knew about the payments to Banwell before October 23, 1994 and that the knowledge of Smith and Schepler is imputable to ICO. Instead, ICO contends, first, that Smith and Schepler "did not have enough

^{8/} There is every reason to think that the Director of Accounting was also aware of the letters from Ebbesen stating the net bonuses that Banwell was to receive. The Accounting Office had to cut the checks to pay Banwell the bonuses.

information to know that the payments were improper,” and second, that Smith was told by Banwell not to communicate directly to the Board. ICO Br. 16-17. Neither is sufficient to avoid imputation to Smith and Schepler’s employer.^{9/}

There are three problems with the argument that Smith and Schepler lacked sufficient information to know that the payments to Banwell were unauthorized. First, plaintiff has waived this argument because it was never made in the trial court. See C 404; *Brown*, 75 Ill. 2d at 556, 389 N.E.2d at 1193; *Nugent*, 119 Ill. App. 3d at 387, 456 N.E.2d at 643. Second, knowledge of the payments’ allegedly unauthorized nature is irrelevant; what is important is that Smith and Schepler’s knowledge of the *amounts* of the payments is imputed to ICO — *that* is what Grant allegedly should have told ICO, and *that* is what the college already knew, through its Chief Financial Officer and its Director of Accounting. See *Bryant v. Livigni*, 250 Ill. App. 3d 303, 310, 619 N.E.2d 550, 556 (5th Dist. 1993) (knowledge of facts is imputed to a corporation even if the information is not given to someone in the corporation who can appreciate the significance of the information). Third, if anyone should know whether particular payments are authorized, it is the Chief Financial Officer and the Director of Accounting; after all, they were the ones ultimately in charge of the Accounting Office, which sent out the checks to Banwell.

There is no merit either to the argument that Smith’s knowledge should not be imputed to ICO because Banwell, who had the power to fire Smith, told him not to communicate directly with the Board, due to college “policy” that all communications with the Board “must flow through the President.” App. A79. Even assuming that the Board chose to completely isolate itself from ICO’s other officers and rely exclusively on Banwell, that does not mean the Board can now disavow responsibility for the knowledge

^{9/} ICO suggests that Banwell also told Schepler not to communicate directly with the Board, ICO Br. 17, but there was no such evidence; the only evidence was that Smith alone had been told by Banwell not to contact the Board. See App. A79-A80.

or actions of its other officers; a corporation cannot structure its business to evade settled principles concerning imputation of its agents' knowledge. ICO's Chief Financial Officer knew about the payments; therefore, ICO knew about them as a matter of law. "Whether reported to higher authorities or not, the information still constitutes 'corporate knowledge.'" *Bryant*, 250 Ill. App. 3d at 310, 619 N.E.2d at 556. See also *Roth*, 373 Ill. at 555-56, 27 N.E.2d at 447-48 (knowledge imputed to corporation even though directors took no action on learning of the facts at issue). Tellingly, ICO does not cite a single case in which a court has adopted the theory that knowledge is not imputed to a corporation when one of its high-ranking officers is told not to communicate with other corporate officials.

Any fear by Smith that Banwell might fire him if he told the Board about the payments to ICO is also insufficient to evade the general rule of agency imputation. The imputation doctrine is based upon "[t]he presumption that the agent communicates the knowledge which he has to the principal." *Pontarelli*, 7 Ill. App. 3d at 840, 288 N.E.2d at 912 (quoting *Cowan*, 216 Ill. at 617, 75 N.E. at 329). That presumption is rebutted when the agent is not acting on behalf of the corporation, but rather is *adverse* to the corporation; this occurs "where it is *certainly expected* that the agent will not perform this duty, as where the agent, though nominally acting as such, is in reality acting in his own or another's interest, and adversely to that of his principal." *Id.* (emphasis added) (quoting *Cowan*, 216 Ill. at 617, 75 N.E. at 329).

Smith was not an adverse agent, and no court to date has held that knowledge of the Chief Financial Officer of a company is not attributed to the company because of an alleged fear of being fired. Indeed, adoption of a "fear of firing" exception would create a potentially-huge loophole in the doctrine of imputed knowledge. It would be poor public policy for this Court to hold that it is "certainly expected,"

id., that a Chief Financial Officer would not perform his duties to the company whenever he thought his job might be at stake. To the contrary, if the Chief Financial Officer had important information regarding payments to ICO's President, he is under an obligation to pass on that information to the necessary individuals within the corporation in order to satisfy his own fiduciary duties. See *Mile-O-Mo Fishing Club, Inc. v. Noble*, 62 Ill. App. 2d 50, 56-57, 210 N.E.2d 12, 15 (5th Dist. 1965) (officers of not-for-profit corporations owe fiduciary duties to corporation); *Shlensky v. South Parkway Bldg. Corp.*, 19 Ill. 2d 268, 278, 166 N.E.2d 793, 799 (1960) ("officers of a corporation[] occupy a fiduciary relation toward it"). Even a mere agent "owes a duty of loyalty and *full disclosure* to [a] principal," and "*must* make known to his principal *all* material facts which are within the agent's knowledge that may *in any way* affect the transaction and subject matter of his agency." *Kearney*, 132 Ill. App. 3d at 661, 477 N.E.2d at 1332 (emphasis added). And "[t]he principle pertaining to disclosure by the agent to the principal of relevant information applies equally to the officers and directors of a corporation." *Illinois Valley Acceptance*, 531 F. Supp. at 741. "[A]n officer is under a *duty to 'disclose* to [the principal corporation] any facts coming to his knowledge in the course of his agency which may affect its interests; a failure to do so is a breach of duty.'" *Id.* (emphasis added).

Thus, regardless of what Banwell may have told Smith, Smith had a fiduciary obligation to inform ICO of any facts that may affect ICO's interests, and it was "certainly to be expected" that Smith would inform ICO about the payments to Banwell. Accordingly, the normal imputation rules apply. Since Smith knew about the payments, ICO knew about the payments.^{10/} Furthermore, the fact that ICO has *retained*

^{10/} The fact that Banwell was Smith's superior and therefore had power over Smith in no way abrogates Smith's independent duties to ICO. In a case where employees knew that the store manager had battered his son, that knowledge was imputed to the corporation even though the employees were of "equal or lesser rank" than the store manager. *Bryant*, 250 Ill. App. 3d at 309, (continued...)

Smith as its Chief Financial Officer despite his admitted breach of a fiduciary duty to disclose to the ICO Board what Smith knew about the payments to Banwell indicates that ICO has ratified Smith's conduct. This is another reason to impute Smith's knowledge to ICO. *Athanas v. City of Lake Forest*, 276 Ill. App. 3d 48, 56, 657 N.E.2d 1031, 1037 (2d Dist. 1995) ("Ratification * * * occurs when the principal, with knowledge of the material facts of the unauthorized action, takes a position inconsistent with nonaffirmation of the action").

In short, ICO is deemed to know, through Schepler and Smith, about ICO's public relations, petty cash, and American Express payments to Banwell, as well as the increases in non-accountable expenses. Knowledge of these payments, which allegedly caused injury to ICO, was sufficient to begin the limitations period, even assuming that Schepler and Smith were in the dark with respect to the only remaining allegedly improper item, the bonus payments that Banwell received. See *Dancor*, 288 Ill. App. 3d at 677, 681 N.E.2d at 625 ("The mere fact that the extent of injury is not immediately known or ascertainable does not postpone the triggering of the statute of limitations") (citing *Golla v. General Motors Corp.*, 167 Ill. 2d 353, 657 N.E.2d 894 (1995)). And once there is a duty to inquire, as here, the plaintiff is deemed to know all of the facts that its investigation would have uncovered. *Dancor*, 288 Ill. App. 3d at 674, 681 N.E.2d at 623 (the statute of limitations begins to run when a party has "sufficient knowledge to cause it to inquire

¹⁰(...continued)

619 N.E.2d at 555-56. "There is no rule which requires this knowledge held by coworkers to be disregarded unless the coworker possessing the knowledge 'outranks' the employee in question. To the contrary, whether the agent obtaining the knowledge is in a subordinate or a superior position in the corporation, that knowledge is still chargeable to the corporation if the information concerns a matter within the scope of the agent's authority." *Id.* at 309, 619 N.E.2d at 556.

further of a possible actionable wrong”); *Winkelman v. Blyth & Co.*, 518 F.2d 530, 531 (9th Cir. 1975) (holding that once plaintiffs were on notice of defendants’ false representations, they were also on notice of other frauds committed by defendants). There can be no doubt that a prompt investigation by ICO would have disclosed the same facts about the payments to Banwell that were disclosed when ICO finally got around to examining its President’s compensation in 1996.

5. Before October 23, 1994, Grant repeatedly told ICO to investigate whether it was paying excessive compensation to its officers.

In addition to the fact that ICO, for several reasons, was deemed to know as a matter of law how much money it was paying its own President, the claims against Grant are time barred because Grant repeatedly warned ICO, more than two years before ICO filed suit, that ICO should investigate whether it was paying excessive compensation to President Banwell. For three years running, from August 1992 to August 1994, Grant told ICO that

- ! There was a “serious issue” concerning possible “excessive compensation” being paid to ICO’s officers, including in particular the President. App. A17-A18 (¶ 57).
- ! “[C]omparable salaries paid within the industry,” which ICO’s Presidential Evaluation Committee had obtained, should be used by ICO to ascertain the “reasonableness” of the President’s compensation. C 344.
- ! The Presidential Evaluation Committee, as part of its annual review of the President’s performance and compensation, should “*specifically document* the relationship between the comparable industry information and the detailed responsibilities and *compensation of the President.*” App. A19 (¶ 59) (emphasis added).

ICO contends that Grant’s memoranda did nothing more than (a) “call[] the Board’s attention to the private inurement provisions” and “the types of actions that had been held to violate those provisions,” and (b) “applaud[]” and “recognize[] the positive steps taken by the College in connection with the

inurement provisions.” ICO Br. 22. That is not at all a fair reading of Grant’s memoranda. Starting in 1992, Grant cautioned ICO repeatedly about possible private inurement problems and advised ICO specifically that it should compare its President’s compensation with comparable salaries paid elsewhere in the industry to determine whether that compensation was reasonable in light of the “serious” tax consequences that would ensue if it was not. On their face, Grant’s advisory memoranda definitively refute the contention that ICO “did not know there was anything to investigate.” ICO Br. 22.

To be sure, the memoranda did not state the amount of Banwell’s compensation, but there was no reason for Grant to think that it needed to do so. After all, as the advisory memoranda indicate, Grant was informed that ICO’s Presidential Evaluation Committee, the designee of the Board, reviewed the President’s compensation and performance every year. One would expect that a committee with these particular responsibilities would already know what the President’s compensation was.^{11/}

Grant sent all of the advisory memoranda discussed above to the Board more than two years before ICO filed suit on October 23, 1996. The red flags that the Board was given concerning excessive compensation to the President were more than enough to put ICO on notice that it should investigate that compensation and determine how much it was paying its executives, including Banwell. See *Dancor*, 288

^{11/} Chief Financial Officer Smith’s affidavit states that he was told by unidentified Grant personnel that “it was not unusual for the *full* board of Trustees not to know of the President’s compensation.” App. A80 (emphasis added). This statement is not admissible, but even if it were, it is probative of nothing — Grant was told that it was the full Board’s designee, the Presidential Evaluation Committee, which was responsible for all aspects of the President’s compensation, not the “full” Board. And in any event, regardless of the actual knowledge of the “full board,” ICO was deemed to know as a matter of law about its President’s compensation for all of the reasons discussed already.

Ill. App. 3d at 674, 681 N.E.2d at 623 (limitations period under 735 ILCS 5/13-214.2 began to run when plaintiff “had sufficient knowledge to cause it to inquire further of a possible actionable wrong”); *City Nat’l Bank*, 32 F.3d at 284 (statute of limitations begins to run when plaintiff is on notice of a need to investigate). What is more, the amended complaint establishes that, had ICO commenced an investigation, it would have learned about all of the matters surrounding the payments to Banwell because, as discussed above, all of the payments to Banwell were reflected in ICO’s books and records. App. A19-A20 (¶¶ 61, 64).

In short, if ICO had reviewed its own files when Grant warned ICO about the importance of monitoring its executive compensation, ICO would have learned about (a) the alleged overpayments to Banwell, and (b) its alleged claim against Grant for Grant’s failure to provide this information. Because Grant’s warnings about executive compensation started the limitations period, all of ICO’s claims are barred by the statute of limitations.

B. Claims Arising Out Of The 1991 Audit Are Barred By The Five-Year Repose Period.

The five-year statute of repose for claims against accountants provides that claims are barred if asserted more than five years after the “act or omission alleged * * * to have been the cause of the injury.” 735 ILCS 5/13-214.2(b). ICO filed its original complaint on October 23, 1996. C 2. Because of the five-year repose period, ICO cannot bring claims for any “act or omission” of Grant that occurred before October 23, 1991.

This means that any claim arising out of the 1991 audit is barred by the statute. As ICO concedes (ICO Br. 23), the 1991 audit was completed on August 30, 1991, more than five years before ICO filed its initial complaint. See also C 339 (1991 advisory memorandum, dated August 30, 1991); C 367 (August 30, 1991 opinion on ICO’s 1991 financial statements).

ICO's only response is to assert in its brief that a Grant agent discussed the 1991 audit with ICO on October 24, 1991. ICO Br. 23. But there is no such allegation in the amended complaint, and no such evidence in the record. As a result, this allegation is not properly before the Court and should be disregarded. *Vala v. Pacific Ins. Co.*, 695 N.E.2d 581, 582-83 (Ill. App. 4th Dist. 1998) (in reviewing entry of an order granting a section 2-619 motion, "the appellate court will examine the complaint and all evidentiary material before the trial court at the time of entry of the order"). In any event, at the time of the alleged meeting, the audit report had already been issued by Grant and received by ICO. The statute of repose bars any claims based upon that audit, and the statute cannot be extended by arguing that the audit's conclusions were discussed at a later meeting with ICO. If that were the rule, a client could extend indefinitely what was supposed to be an absolute repose period simply by calling the accountant and asking questions about the audit. This is not a reasonable reading of the statute and could not have been what the General Assembly intended. Such a construction of the statute would "create[] uncertainty and doubt, where the legislature intended to promote predictability and finality." *Golla*, 167 Ill. 2d at 370, 657 N.E.2d at 902.

II. THE TRIAL COURT CORRECTLY CONCLUDED THAT ICO DID NOT ADEQUATELY ALLEGE CAUSATION OR DAMAGES.

As an independent ground for dismissal, the trial court held that the amended complaint "d[id] not plead causation and damages with sufficient specificity" and thus had to be dismissed pursuant to 735 ILCS 5/2-615. App. A2. The trial court's conclusion is correct.

The causation and damages allegations in the amended complaint read in their entirety as follows:

"75. But for Grant Thornton's negligence and breach of its duty of professional care, ICO would not have made excessive payments to Banwell and would not have incurred additional damages.

“76. Grant Thornton’s negligence and breach of its duty of professional care was the proximate cause of injury to ICO. ICO’s damages were a natural and foreseeable consequence of Grant Thornton’s negligence.”

App. A33. This is entirely too conclusory to pass muster. See *Huls v. Clifton, Gunderson & Co.*, 179

Ill. App. 3d 904, 909-10, 535 N.E.2d 72, 76-77 (4th Dist. 1989) (affirming dismissal of plaintiffs’

complaint because it failed to plead proximate cause and damages where plaintiffs did not specifically state what they would have done if the defendant accounting firm had informed them of its lack of independence);

Majumdar, 274 Ill. App. 3d at 268, 653 N.E.2d at 917 (“we do not accept as true any conclusions of

law or fact” in the complaint that “are unsupported by allegations of specific facts upon which those

conclusions rest”). Since ICO does not specifically state what it would have done differently if Grant had

not violated its duty of professional care, it did not adequately plead proximate cause and damages.

ICO attempts to rescue its claims by pointing to ¶ 74 of the amended complaint. See ICO Br. 23-24. But ¶ 74 alleges only the manner in which ICO believes Grant breached the duties that it owed ICO; ¶ 74 says nothing about how, if at all, Grant’s alleged breaches caused any harm to ICO. The adequacy of the allegations concerning causation and damages must be determined by looking at ¶¶ 75 and 76, the only paragraphs in the amended complaint that mention either of these essential elements. And because the allegations in those paragraphs are woefully insufficient, the trial court correctly granted this part of Grant’s motion to dismiss under section 2-615.

CROSS-APPEAL

Although the trial court properly granted Grant's section 2-615 motion with respect to causation and damages, it should have also granted the section 2-615 motion with respect to several other fatal deficiencies in the amended complaint. There are several reasons why Grant is entitled to judgment in its favor under section 2-615.

III. THE TRIAL COURT SHOULD HAVE GRANTED IN ITS ENTIRETY GRANT'S MOTION TO DISMISS UNDER SECTION 2-615.

A. As A Matter Of Law, Grant Did Not Cause ICO's Alleged Damages.

As ICO admitted in the trial court, both of its claims are based upon Grant's alleged failure to inform it of the payments to Banwell. C 209. Therefore, ICO must demonstrate that in fact Grant's failure to disclose this information caused ICO's damages. *Stojkovich v. Monadnock Bldg.*, 281 Ill. App. 3d 733, 738, 666 N.E.2d 704, 708 (1st Dist. 1996). But as we have already shown, ICO is deemed as a matter of law to have known about the payments to Banwell. Since ICO is deemed to know what Grant allegedly failed to disclose, Grant's conduct cannot, as a matter of law, have caused ICO's alleged damages. As a result, the amended complaint should have been dismissed pursuant to section 2-615 for failure to state a cause of action.

Moreover, in the auditing context, to establish causation, the plaintiff must also allege reliance because "[i]f nobody relied upon the audit, then the audit could not have been a 'substantial factor in bringing about the injury.'" *FDIC v. Ernst & Young*, 967 F.2d 166, 170 (5th Cir. 1992). In fact, ICO conceded below that it was obligated to plead reliance. C 412. See also, *e.g.*, *Smolen v. Deloitte, Haskins & Sells*, 921 F.2d 959, 964 (9th Cir. 1990) ("Appellants must present some evidence establishing the element of causation, in the sense of actual and justifiable reliance upon misrepresentations or omissions of material fact, to avoid summary judgment" on their claims against an accounting firm); *Drabkin v.*

Alexander Grant & Co., 905 F.2d 453, 454-57 (D.C. Cir. 1990) (accounting firm entitled to judgment as a matter of law in absence of evidence of reliance on accountants' work). Here, the amended complaint was legally insufficient because it did not make the factual allegation of reliance. Even if the amended complaint had alleged reliance, it would still have to be dismissed, because if the knowledge of ICO's Chairman, Chief Financial Officer, and Director of Accounting is imputed to ICO, then ICO knew what it allegedly was not told. With such knowledge, ICO could not have relied upon anything Grant did or did not say. *Newton v. Aitken*, 260 Ill. App. 3d 717, 722, 633 N.E.2d 213, 218 (2d Dist. 1994) (where "plaintiff had access to the same records and documents to which defendant had access," she "either knew, or could have learned through ordinary prudence, all that defendants knew" and thus "had no right to rely on any representation of defendant").

The reliance requirement is another reason that any claims arising out of the 1995 audit are barred (in addition to the fact that the trial court dismissed those claims and ICO has not pursued them). Since the college already knew about the payments to Banwell through its own records and because of what its key executive and financial officials knew, it could not possibly have relied on Grant's failure in 1995 to inform it of those payments. Thus, the 1995 audit could not possibly have caused any harm to ICO.

B. ICO's Breach Of Contract Claim Is Fatally Defective.

The parties agreed in the trial court that the contracts here — the engagement letters attached to the amended complaint — are unambiguous. As a result, this Court may construe the terms of the contracts as a matter of law. *E.g., Saunders v. Michigan Ave. Nat'l Bank*, 278 Ill. App. 3d 307, 315-16, 662 N.E.2d 602, 609-10 (1st Dist. 1996) (interpreting terms of the contract and affirming

dismissal of breach of contract claim); *Tishman Midwest Management Corp. v. Wayne Jarvis, Ltd.*, 146 Ill. App. 3d 684, 689, 500 N.E.2d 431, 434 (1st Dist. 1986) (affirming dismissal of breach of contract claim; where “the contract is clear and unambiguous, then its interpretation is a question of law”). And as a matter of law, it is apparent that there are three independent reasons why ICO’s breach of contract claim must be dismissed.

1. ICO did not substantially comply with all material terms of the contracts.

“It is well settled that one seeking to recover on a contract must allege and prove that she has substantially complied with all of the material terms of that contract.” *Fryison v. McGee*, 106 Ill. App. 3d 537, 540, 436 N.E.2d 12, 15 (1st Dist. 1982). ICO baldly alleges that it “performed all of its obligations under the Engagement Agreements,” App. A22 (¶ 69), but other allegations in the amended complaint establish that this conclusory statement has no basis in well-pleaded fact and that, in actuality, ICO did not comply with its contractual obligations under the Engagement Agreements.

Specifically, ICO breached its contractual “responsibility” to ensure the “capability and integrity of the College’s personnel” and to maintain “an appropriate internal control structure, which include[d] * * * procedures to safeguard the College’s assets.” App. A34, A43, A52, A60-A61, A69. Given the allegations ICO makes about its directors and officers in this appeal, ICO also violated its promise that there would not be any “irregularities involving management or those employees who have significant roles in the control structure.” App. A61, A69-A70. ICO seeks to recover from Grant for allegedly improper payments made to the President that were based upon written authorizations issued by the Chairman and that were known to ICO’s Chief Financial Officer and its Director of Accounting, who did nothing in

response. ICO also has filed RICO claims against Banwell claiming that the Chairman's authorizations were fraudulent. If this is not an "irregularit[y] involving management," what is?

ICO did not substantially comply with its contractual promises regarding the integrity of its employees, maintenance of appropriate internal controls, and irregularities by management. Accordingly, ICO cannot assert a claim for breach of contract against Grant. See *Begier v. Price Waterhouse*, 1992 WL 236175, at *4 (E.D. Pa. Sept. 14, 1992) (where client breached representations in engagement letter, client "breached the agreement, and any performance failure by [the auditor] is excused"); *Cenco Inc. v. Seidman & Seidman*, 686 F.2d 449, 453 (7th Cir. 1982) (an auditor's "breach of contract is excused if the promisee's hindrance or failure to cooperate prevented the promisor from performing the contract"); *Bily*, 834 P.2d at 766 (referring to "the inherent dependence of the auditor on the client"). Grant cannot be blamed for (a) the allegedly unauthorized actions of ICO's own Chairman of the Board and President, and (b) the inaction of ICO's Chief Financial Officer and Director of Accounting, when the Engagement Agreements squarely put the obligation to prevent such conduct upon ICO and not upon Grant. ICO assumed the risk of officer defalcation or fraud, and this Court should not disturb the parties' risk allocation. See *McClure Engineering Assocs., Inc. v. Reuben H. Donnelley Corp.*, 95 Ill. 2d 68, 72, 447 N.E.2d 400, 403 (1983) (there is a "wide-spread policy of permitting competent parties to contractually allocate business risks as they see fit"). Because ICO's own pleading establishes that it breached material terms of the Engagement Agreements and that ICO's breach resulted in the harm that ICO alleges it has suffered, ICO has no claim for breach of contract against Grant.

2. Grant never agreed to review Banwell’s compensation, and therefore ICO cannot recover against Grant for its alleged failure to do something beyond the terms of the contract.

“When the terms of a contract are clear and unambiguous, they must be enforced as written and no court can rewrite a contract to provide a better bargain to suit one of the parties.” *Saunders*, 278 Ill. App. 3d at 316, 662 N.E.2d at 610 (affirming grant of motion to dismiss breach of contract claim). “It is axiomatic that a court * * * must enforce the terms as written.” *Kulins v. Malco, Microdot Co.*, 121 Ill. App. 3d 520, 527, 459 N.E.2d 1038, 1044 (1st Dist. 1984).

It is undisputed that Grant and ICO never agreed that Grant was to review Banwell’s compensation to determine if he was receiving too much money from ICO. On the contrary, Grant agreed simply to audit the financial statements that ICO had prepared, App. A34, A43, A52, A60, A69; Grant expressly warned ICO that “*an audit is not a special examination designed to detect defalcations or fraud * * ** and is subject to the inherent risk that errors, irregularities, or illegal acts, if they exist, might not be detected,” App. A35, A44, A53, A61, A70 (emphasis added); and Grant made it clear that if ICO wanted Grant to “detect defalcations or fraud,” ICO had to retain Grant to do so in a *separate* engagement, *id.* See also *Cenco*, 686 F.2d at 454 (“Auditors are not detectives hired to ferret out fraud”). ICO never asked Grant to perform any such separate engagement (until 1996, when Grant was retained to participate in an investigation of the payments to Banwell, see p. 6 n.2, *supra*). Thus, while ICO may now wish it had struck a different bargain with Grant, it is clear from the engagement letters that ICO *never* hired Grant to

determine whether Banwell was receiving excessive compensation. ICO cannot now assert claims based on the allegation that Grant failed to do something that Grant was not obligated to do.^{12/}

3. ICO did not contract for a specific result.

Illinois law permits a contract claim against an accountant if, and only if, the accountant and the client contracted “for a specific result.” *Holland v. Arthur Andersen & Co.*, 127 Ill. App. 3d 854, 869, 469 N.E.2d 419, 429 (1st Dist. 1984). (In *Holland*, the plaintiff had contracted for a specific result because the auditor had promised that “all irregularities coming to its attention would be reported” and it could “reasonably be inferred from [the plaintiff’s] allegations that [the auditor] became aware of irregularities.” *Id.* at 868-69, 469 N.E.2d at 428-29.) ICO, however, alleges in its breach of contract claim that Grant did not comply with “its implied agreement to perform in accord with due professional care.” App. A22 (¶ 70). But ICO has not identified any specific contractual duties assumed by Grant in

^{12/} In the trial court, ICO argued that, notwithstanding the plain import of the contracts, Grant had the obligation to review Banwell’s compensation because it was required to understand ICO’s internal control structure. C 409-10. This argument was rejected in *Midwest Imports, Ltd. v. Coval*, 71 F.3d 1311 (7th Cir. 1995). As *Midwest Imports* makes clear, an auditor is to look at internal controls *only* to the extent necessary to permit the auditor to express an opinion on a company’s financial statements. *Id.* at 1318. Because that is the only purpose of an internal control review in an audit, when the “financial statements fairly present[] the financial position of the company,” that means necessarily that the accountant complied with the professional standards governing the review of a company’s internal control structure. *Id.* (affirming summary judgment on this basis). That is the situation here. There is no allegation that the financial statements did not take into account the payments actually made as reflected in ICO’s books and records. Nothing more was required pursuant to internal control testing, and certainly nothing in an internal control analysis requires that compensation be reviewed. “[N]o professional auditing standard requires” anything “beyond a mere preliminary review of the control system.” *Id.* Further, as *Midwest Imports* holds, an auditor is not required to search for reportable conditions, but only to report those which were found. *Id.* ICO does not allege that Grant found anything that it did not report, and thus ICO’s assertions about internal controls have no legal significance.

addition to its general and preexisting duty to observe professional care in the performance of the audit.^{13/} As a result, ICO is not seeking to recover against Grant for “a specific result” for which it has “contracted,” and thus it has not stated a breach of contract claim. *Holland*, 127 Ill. App. 3d at 868-69, 469 N.E.2d at 428-29.

The fact that a breach of contract claim must be based on something specific to the contract that goes beyond the duties imposed in a negligence claim was recently confirmed by this Court’s decision in *Majumdar v. Lurie*. In that legal malpractice action, the Court held that the plaintiff could not plead both breach of contract and negligence when both claims were based on the same operative facts. 274 Ill. App. 3d at 273, 653 N.E.2d at 920. Thus, in order to state both a breach of contract claim and a negligence claim, ICO must be able to identify additional facts supporting its contract claim that do not apply to its negligence claim. That it cannot do, and, therefore, its breach of contract claim fails.

It is true that although Grant expressly warned ICO that its audits might not uncover “errors, irregularities, or illegal acts,” Grant also promised in the 1991-1993 engagement letters to bring any such items to ICO’s attention if Grant actually discovered them. App. A35, 44, 53. But there are no allegations in the amended complaint that Grant became aware of material errors, irregularities, or illegal acts, yet failed to call them to ICO’s attention. ICO never alleged, nor could it allege, that Grant had actual knowledge

^{13/} There is nothing unusual in permitting claims for breach of contract against auditors only when the client contracted for a specific result. See, e.g., *FDIC v. Regier Carr & Monroe*, 996 F.2d 222, 224 (10th Cir. 1993) (holding that there was no claim for breach of contract under Oklahoma law where the plaintiffs sought to recover for “nothing beyond [the accountant’s] normal duty of care”); *FDIC v. Schoenberger*, 781 F. Supp. 1155, 1157 (E.D. La. 1992) (for “allegations of [accountant] malpractice to rise to the level of a breach of contract claim, Louisiana law requires non-feasance of a specifically warranted result”).

of any such irregularities. Indeed, the thrust of ICO's theory in this case is that it seeks to recover against Grant for *failing* to learn about these irregularities. See also *Midwest*, 71 F.3d at 1318.

The fact that ICO did not hire Grant to discover "errors, irregularities, or illegal acts" is confirmed by the fact that Grant offered to enter into a "*separate* engagement" that would "direct special auditing procedures" for the purpose of uncovering "errors, irregularities, or illegal acts." App. A35, A44, A53, A61, A70 (emphasis added). ICO does not allege, as it could not, that it entered into any such separate engagement during the relevant time period. In other words, ICO chose *not* to hire Grant for the specific purpose of uncovering "errors, irregularities, or illegal acts." It would be nothing short of incredible if Grant could be held liable for failing to perform a task that ICO decided not to hire Grant to do. ICO's claim for breach of contract must be dismissed with prejudice.

C. ICO's Negligence Claim Is Also Deficient As A Matter Of Law Because Grant Was Not Obligated To Determine If Banwell Was Being Paid Too Much.

The negligence claim, too, is legally insufficient. The trial court should have dismissed it under section 2-615 for failure to state a claim.

In *Barnes v. Rakow*, 78 Ill. App. 3d 404, 407, 396 N.E.2d 1168, 1171 (1st Dist. 1979), this Court held that "in the case of a defendant charged with negligence because of his failure to perform an act allegedly required by contract, the question of whether the defendant actually had a duty to perform the act usually must be determined from the terms of the contract." See also *Majumdar*, 274 Ill. App. 3d at 270, 653 N.E.2d at 918 (in "actions for negligence arising out of the breach of a duty voluntarily assumed under the terms of a contract * * * the scope of the duty is * * * limited to the contractual undertaking"). This principle requires dismissal of the negligence claim here.

In *Barnes*, a negligence claim against surveyors asserted that they failed “to discover and inform plaintiff during the course of their work that the master survey prepared by other surveyors overstated the total acreage.” 78 Ill. App. 3d at 405, 396 N.E.2d at 1170. The trial court granted the surveyors’ motion for summary judgment because “each of their three contracts with plaintiff * * * did not impose on them the duty of verifying the accuracy of the [other] survey.” *Id.* at 406, 396 N.E.2d at 1171. In affirming, this Court held that “before a defendant can be liable for negligence, he must have breached a duty owed the plaintiff,” *id.* at 407, 396 N.E.2d at 1171, and since the defendants “had no duty under the express terms of any of their contracts” to review the previous survey, plaintiff’s negligence claim failed as a matter of law. *Id.* at 409, 396 N.E.2d at 1172-73.

ICO’s negligence claim here is based on the assertion that Grant failed to tell ICO how much it was paying Banwell. However, as we have already shown, Grant’s only obligation was to audit the financial statements of ICO; Grant expressly did not undertake in the contract any separate obligation to uncover misconduct by college personnel. Since, as explained above, there is no claim for breach of contract in the present case, there is also no claim for negligence under *Barnes*.

CONCLUSION

The judgment of the trial court should be affirmed with respect to (1) its dismissal with prejudice, pursuant to 735 ILCS 5/2-619(a)(5), of all claims arising out of the 1991-1994 audits; and (2) its granting of defendant’s motion to dismiss, pursuant to 735 ILCS 5/2-615, because of ICO’s insufficient allegations of causation and damages. In the event that this Court does not agree, the trial court’s denial of the remain-

der of Grant's motion to dismiss under 735 ILCS 5/2-615 should be reversed. In addition, the claims arising out of the 1995 audit should be dismissed with prejudice.

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