

Legal Liabilities Of Accountants

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With reference, to the basis for Liability, there are numerous legal theories under which an accountant might be liable. However, the main basis of liability is the duty to exercise ordinary skill and care. Breach of this duty may lead to an action on tort under negligence. Closely related are also suits stemming from agency relationship between accountants and clients. Because this relationship is contractual in nature, breaching such duty might trigger an action in breach of contract.

Moreover, many times the accountant involved in the action will be a partner in a public accountant firm. If so, the law of partnership will be involved, probably resulting in liability for all of the partners. If the accountant is an employee and not a partner, the firm may still be liable under the doctrine of respondent superior.

The liability of the accountant can be both civil and criminal and when an accountant violates a duty, he may be called before a judicial body, an administrative professional body, or both. Accountants, generally have a duty to perform their contractual obligations. If an accountant agrees to complete an engagement by certain time and fails, there will be liability for whatever damages result. For example, suppose an accounting firm agrees to complete an audit by February 15 because it has been informed of a deadline set by a prospective lender to the client. If the audit report is not finished until March and the lender has no more funds available at that time, the accountant would be liable for the client's resulting loss. The fact that the accounting firm had other deadlines would not be a defense.

Ordinarily, an accountant may not delegate responsibilities without the consent of the client. This is because the contract is a personal one, based on the skill, training, and personality of the accountant.

Even when there is no express agreement, the law imposes a duty of care on public accountants engaged to provide services to a client. The failure of an accountant to discover fraud by the client's employees or others is not in itself

proof of negligence by the accountant. The investigative techniques used by accountants will not always uncover the fraud of a skillful person. However, accountants cannot overlook questionable entries or omissions in the accounts and supporting records of the client. The individual circumstances will determine what action the accountant is required to take when he discovers irregularities.

Certainly, it is necessary to notify a person in the management if an accountant has a basis for suspicion of fraud. Notifying a person thought to be a participant in the fraud would never be appropriate.

The traditional defenses of contributory negligence and comparative negligence may apply in negligence action against an accountant. However, courts hesitate to allow the client's contributory negligence to excuse the accountant's negligence because of the accountant's superior skills.

The intentional misrepresentation of material facts or the intentional failure to disclose such information to a client may result in the accountant being found liable for fraud. Such behavior could be described as acting with the knowledge of an untruth or the reckless disregard for the truth. Suppose that an accountant represents that he completed an audit of the client when in reality he merely accepted the accuracy of the client's books without investigation. The accountant may be liable in fraud for any losses suffered by the client from the time when the audit should have discovered the embezzlement.

Generally, in a negligence or contract action, the client is limited to recovering compensatory damages. That is, the damage award is limited to the amount that will replace the actual loss caused by the accountant's wrong. If the accountant is found liable in fraud, however, the client may be able to recover punitive damages as well. Under a punitive damage award, the client will receive an amount in excess of his actual loss. This award is designed to punish the accountant for his fraudulent conduct.