

## Chapter 4—Overview of Auditor's Legal Liability

The tort of negligence consists of the following:

1. the duty of the professional to use such skill, prudence, and diligence as other members of his profession commonly possess and exercise
2. a breach of that duty
3. a proximate or legal causal connection between the negligent behavior and the injury
4. actual loss or damage

**Fraud contains these elements:**

**1—a misrepresentation of a material fact**

**2—an intent to deceive**

**3—the innocent party has justifiably relied on the misrepresentation and**

**4—damages**

**The elements of proof for a claim of breach of fiduciary duty are:**

**1—the fiduciary relationship**

**2—causation**

**3—damage**

**The test for determining the creation of the relationship is the extent to which the allegedly subservient party reposes faith and confidence in the other party.**

**1—community standard—the plaintiff must show that the accountant's conduct fell below the care and skill usually employed by persons performing similar tax services in the local community. Tax practitioners do not insure the correctness of their work and they are not necessarily liable when it proves faulty.**

**2—tax specialists standard—the duty to apply a higher specialist standard of care may be invoked by either of these situations:**

**a. the general practitioner undertakes an engagement calling for skills of the specialist or**

**b. the practitioner advertises or holds out as one capable of performing special services**

**3-- fiduciary standard—requires those assuming an advisory function to adhere to the highest standards of candor and good faith**

**4—contract standard—a particular standard of care as provided by a contract between the parties.**

**--a tax preparation error causes over payment of taxes**

**--a tax preparation error causes underpayment of taxes**

**--an erroneous tax election causes a loss of future tax benefits**

**--negligent tax advice causes the client to owe more tax than is expected**

**--there is negligent failure to timely prepare a required return**

## **Liability to Third Parties—Common Law**

### **Elements of negligent misrepresentation:**

- 1. the defendant negligently asserts a false statement to a plaintiff to whom a duty is owed;**
- 2. the defendant intends that his statement will be acted upon by the plaintiff;**
- 3. the defendant has knowledge that the plaintiff will probably rely on the statement;**
- 4. the plaintiff justifiably relies on the statement;**
- 5. damage; and**
- 6. causation.**

## **The Restatement Approach**

**Under the Restatement standard, an accountant who audits or prepares financial information for a client:**

**--owes a duty not only to the client but to any other person or one of a group of persons whom the accountant or client intends the information to benefit: (1) if that person justifiably relies on the information in a transaction or one substantially similar to it that the accountant or his client intends the information to influence; and (2) if that person suffers a pecuniary loss as a result of his reliance**

- 1. no misstatements or omissions existed;**
- 2. any misstatements or omissions did not pertain to material facts; or**
- 3. the misstatements or omissions were not causally related to the purchaser's loss.**

**A buyer or seller filing a section 18 claim must demonstrate:**

- 1. the existence of a material false or misleading statement;**
- 2. that he or she acted in good faith and relied on the statement;**
- 3. that he or she had no knowledge of the inaccuracy of the statement;  
and**
- 4. damage.**

**A buyer or seller filing a claim under section 10 (b) must prove the following elements:**

- 1. the existence of a material false or misleading statement;**
- 2. that he or she relied on such statement;**
- 3. that the material false or misleading statement caused damage;**
- 4. intent to deceive or scienter on the part of the auditor; and**
- 5. damage.**