LIABILITIES OF AUDITORS

A chartered accountant is a member of a valued profession. When he is appointed under a statute or under an agreement to carry out some professional work, it is to be presumed that he shall carry them out completely and with the care and diligence expected of him.

The nature of liabilities of professional accountants can be discussed under the following categories:

- civil liability for negligence or misfeasance;
- criminal liability;
- liability arising from professional misconduct; and
- liability for unaudited statements.

These liabilities are discussed in summarized form in the following table:

Nature of Liability	Remarks
1. Civil liability for negligence or misfeasance.	(a) **Negligence** – it is the breach of duty to take care. (b) When liable – if some cause and effect relationship between his negligence in the performance of audit and loss to the client is established. [In Liverpool and Wigan Supply Association case]. (c) Liabilities towards third parties – if the following essentials are present then he would be liable towards third parties: • the untrue statement; • the auditor knew it to be false or he was recklessly and consciously ignorant of the truthfulness; • the statement was made with an intention that the aggrieved person should act on it; and • the aggrieved has actually acted on it and suffered loss. (d) **Misfeasance** – it is the improper performance of a lawful act, or doing a lawful act in an unlawful manner; (e) Section 543 of the Companies Act empowers the Court to assess damages against the defaulting directors and other officers (including the auditor) in the following cases: • misapplication, retention or liable for money or property of the company; • breach of trust in relation to the company. (f) However, relief u/s 633 is available if the following is proved that: • he acted honestly; • he acted reasonably; and • having regard to the circumstances of the case, he ought fairly to be excused.

2. Criminal liability	(a) **Under the Companies Act:** • u/s 2 (30), he is deemed to be the officer of the company for certain purposes. Thus, on proven acts or omissions he can be penalised; • u/s 63, he can be fined or imprisoned or can be punished with both, for misstatement in the prospectus unless he proves that the statement was immaterial, he has reasonable grounds to believe and did believe upto the time of issue of the prospectus that the statement was true; • u/s 233, he is punishable with prescribed fine for non compliance of the Sections 227 and 229; • u/s 240, he is punishable with fine or imprisonment or both for not assisting the investigating officer appointed by the Central Government; • u/s 539, punishment of imprisonment or fine or both for falsification of books; • u/s 628, he shall be punishable with imprisonment and fine for deliberate act of commission or omission in the balance sheet, report, certificate, return etc. (b) **Under Indian Penal Code (IPC):** • u/s 197, issuing or signing false certificate; • u/s 477A, for falsification of books, papers, valuable security or account belonging to the employer. (c) **Under Income Tax Act:** • u/s 277A, prosecution for falsification of books of accounts or documents to enable any other person to evade tax, penalty or interest imposable under this Act, imprisonment from 3 months to 3 years; • u/s 278, abetment to make a false statement or declaration, imprisonment from 3 years to 7 years and fine; • u/s 288, he cannot represent an assessee if convicted of an offence connected with any income tax proceeding or if penalty has been imposed on him [except u/s 271(1) (a)/ (b)]. The period of disqualification shall be determined by CCIT or CIT; • under Rule 12A, punishable with rigorous imprisonment and fine, for giving false information in the Return prepared by him in his representative capacity or where false report or statement is furnished on the basis of his examination of client's records.

3. Liability for professional misconduct	This has been dealt in detail in the chapter on Code of Ethics.
4. Liability for unaudited statements	If audit is not statutorily required (e.g. in case of proprietorship firm), there will be no legal provisions as to his appointment, remuneration, rights, duties etc. These are the matters of agreement between the auditor and the client.

Questions:

1. State your views on the following: Certain weakness in the internal control procedure in the payment of wages in a large construction company auditor were noticed by the statutory auditor, who in turn brought the same to the knowledge of the Managing Director of the Company. In the subsequent year, huge defalcation came to the notice of the management. The origin of the same was traced to the earlier year. The management wants to sue the auditor for negligence and also plans to file a complaint to the Institute. **[C.A. (Final), May 2000]**

(**Hint:** Define the negligence and discuss the defences available to the auditor in light of case law Kingston Cotton Mills Limited, in which it was held that the auditor is a watch dog and not a blood hound, i.e., it is the duty of the auditor to probe into the depth only on case of suspicion. Also, state the management's responsibility as to the accounting system and the internal controls alongwith the working papers maintained by the auditor. Also refer discussion under Clause 7 of Part One of Second Schedule in the Chapter on Code of Ethics)

(Taken from the book on Professional Approach to Advanced Auditing published by Bharat Law House Private Limited)