

To Our Readers



most interesting and disturbing feature in the practice of audit and accountancy has been looming over the horizon. While this is as yet confined to the developed countries and that too among the relatively large corporates, nevertheless, the issue will be coming into focus the more foreign investments as well as corporate investments come to India and as more Indian companies go global. The issue arises from the extent of professional liability in the case of company failures. Till now, professional accountants had to worry, especially after the Enron and other scandals, only about fishy accounting practices of their clients. The new trend is for non-clients to hold the auditors and the accountants of a failed company also responsible. More and more non-clients are coming forward to bring third party suits against accountants and auditors saying that they relied upon the reports of the accountants' and auditors' judgements in deciding whether to put money in, lease property or engage in a long-term financial relationship of any client with the company. Such third parties normally say that they believe that the accountant/auditor owes him or her a duty of care. To quote, the 'Accountancy' (December, 2003), 'the most highly publicized example of third party action is the case of Bannerman where a Scottish Judge ruled that the bank manager, in this case from the Royal Bank of Scotland, could rely on the opinion of an accountant. This is despite the fact that no relationship existed between the bank and the accountant.'

Obviously, the global view of accountant's/auditor's liability is becoming much greater. It is in this context that the application of Accounting Standards, especially those which rely on judgements of the auditor about management's ability to deal with the future in any form must be looked at very carefully. It is in the application of a Standard like Going Concern, for instance where a third party could come and very well say that they relied upon the auditor's judgements about Going Concern and therefore, the auditor has failed in his duty to provide them with sufficient warning about the extent of risk. The response in U.K. has been to add a disclaimer from the part of the auditors, but as the 'Accountancy' says whether this disclaimer will work will depend upon lot of factors. This is a gray area as of now but will get defined through case laws, if in India also such suits are brought by the creditors of a failed company.

In effect, it raises a moot point for those involved in intellectual theorizing and also a point for those who go over board in describing the responsibilities of corporates as well as auditors to stakeholders. If non-clients can bring liability suits then, the auditor/accountant is clearly entitled to ask, who is my client?

The British Journal suggests that the auditor can advise a limitation clause in his engagement letter which limits the extent of duty to the client, limits the remedies available in breach and so forth. But the major issue remains as a conflict of points of view on duties of the auditor towards the whole gamut of stakeholders vs. his own very practical difficulties in terms of acceptance of personal liability. The fact that his application of judgement in most instances is crucial, makes the auditor a prime target for those who believe that accountants and auditors have deep pockets.

As we said at the beginning, fortunately, such cases have not yet cropped up in India but that is not to say that they will not crop up tomorrow or the day after. It is in this context that liability insurance for auditors has now to be looked at in a different way but more importantly, the whole concept of application of Accounting Standards relying on larger degrees of judgemental matters needs to be examined in detail.

March, 2004

*Editor
The Institute of Chartered Accountants of India*