Types of Claims Brought Against Accountants

Audit claims *are brought as breach of contract, negligence, negligent misrepresentation, fraud or breach of fiduciary actions by both clients and non-clients.* These claims typically yield significant awards and result from a CPA's failure to:*

1. Discover employee's embezzlement

2. Disclose fraud discovered during an audit

3. Disclose weakness in client's internal control

4. Detect & disclose material misstatements in client's financial statements

5. Detect & disclose to client discovery of creative accounts receivable and inventory practices of a company the client retained the CPA to audit

*Typical non-clients that bring claims for audit failures include:

- Creditors,
- Lenders
- Purchasers,
- Investors
- Stockholders, and
- Bondholders

Generally non-clients bring claims against CPAs when the CPA's client company becomes insolvent, because of detrimental reliance on the CPA's audit opinion in deciding to extend credit or loan money. The lawsuit is a means to recoup losses. Because these non-clients lack privity of contract, in order to maintain a claim against the CPA, the CPA must owe a duty to the non-client pursuant to state law.

Bookkeeping claims are brought by clients and the awards are not as significant as audit failure awards. They typically arise from:

1. Failure to set client expectations

2. Failure of accountant to perform the work timely

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Tax claims are the most frequent type of claims brought against accountants and CPAs, and they are brought by clients for an accountant/CPA's:

1. Untimely tax preparation and filing (missed deadlines)
2. Improper calculation of tax liability
3. Improper tax shelter advice
4. Incorrect tax planning advice
5. General erroneous tax advice
6. Misinterpretation of tax law* or technical standards
7. Misconstruing client's facts
8. Improper preparation of tax returns

*Not all misinterpretations constitute malpractice. Tax practitioners may be exonerated if their advice is incorrect as a result of a mere error in judgment concerning a doubtful or unsettled area of tax law. The law does not require tax practitioners to guarantee a particular outcome.

Reviews & Compilation claims typically arise from:

1. Failure to set client expectations
2. Failure of accountant to perform the work timely

Note: In a review or compilation the client may not understand that an accountant does not verify the accuracy of information contained in a financial statement. A well-drafted engagement letter eliminates this problem.

Consulting claims can result in significant awards for damages. They typically arise from an accountant's:

1. Failure to meet client's expectations
2. Failure to provide consulting advice timely
3. Failure to adequately evaluate client's financial or information technology systems
4. Failure to render adequate Projections and Forecasts services

5. Failure to render adequate Valuations services

Preparation & Review of Investment Program claims may arise when accountants prepare and review investment programs.

When consulting and advising clients in investment tax shelters to minimize tax liability, accountants have found themselves exposed to claims when the IRS does not accept the recommended investment vehicle. Consequently, the IRS may assess significant penalties against the client. The client then seeks to recoup these penalties from the accountant.