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Accountants' Liability and Liability Insurance

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Recommended Citation

American Institute of Accountants. Committee on Accountants' Liability and Liability Insurance, "Accountants' Liability and Liability Insurance" (1953). *Guides, Handbooks and Manuals*. 888. https://egrove.olemiss.edu/aicpa_guides/888

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American Institute of Accountants

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THE NATIONAL ORGANIZATION OF CERTIFIED PUBLIC ACCOUNTANTS

270 MADISON AVENUE, NEW YORK 16, N. Y.

September 16, 1953

TO PUBLIC ACCOUNTING PRACTITIONERS AND FIRMS
REPRESENTED IN THE AMERICAN INSTITUTE
OF ACCOUNTANTS

Subject: *Accountants' Liability and Liability Insurance*

The risks which confront certified public accountants in the conduct of their practice are a source of continued concern to the Institute's Committee on Accountants' Liability and Liability Insurance. The common law does not subject the accountant to any greater degree of liability than the members of other professions. Yet, because his opinions and the reports which embody such opinions reach innumerable interested parties with whom he has no contractual relationship, he may be exposed to greater hazards than those engaged in most other professions. The liability of public accountants in the United States has not yet been clearly defined because of the comparatively small number of law suits against accounting firms that have been tried to a conclusion in the appellate courts. Although the accountant's responsibility for negligence has been defined and limited in a number of important cases involving claims by third parties, these cases have emphasized his exposure to the claims of such persons on grounds of fraud, misrepresentation, or deceit. Since the cases which have been decided may serve as legal precedents in future situations, the Committee recommends that every practicing

accountant familiarize himself with them by reading Chapter 6 in the *CPA Handbook* which is titled "Legal Responsibility and Civil Liability." A careful reading of this chapter, written by Saul Levy, will provide a clearer understanding of the accountant's possible civil liability, both to clients and to third parties.

The development and maintenance of high professional standards is one of the Institute's principal functions. Through the activities of the committees on accounting procedure and auditing procedure and the other technical committees, standards of auditing and of financial reporting have been developed which assure accountants adhering to them the highest degree of professional performance. These standards have been enunciated in the Statements on Auditing Procedure and the Accounting Research Bulletins, and in other official pronouncements of the Institute. A significant step forward in reporting practices occurred in 1949 when the Institute membership formally adopted Statement on Auditing Procedure No. 23, *Clarification of Accountant's Report When Opinion is Omitted*. This Statement, which has since been consolidated in the *Codification of Statements on Auditing Procedure*, has very important implications with regard to accountants' liability. There is enclosed with this letter a reprint of an article by Arthur M. Cannon titled "Significance of Auditing Statement 23 in Relation to Accountants' Liability." This article, which appeared in the November 1950 issue of *The Journal of Accountancy*, stresses the fact that the standards which have been developed by the accounting profession establish for the courts the nature and extent of an accountant's responsibility. Therefore, accountants who ignore these standards in the conduct of their practice are needlessly exposing themselves to increased hazards.

Professional practice of the highest caliber minimizes the possibility of liability claims against an accountant.

Unfortunately, however, the risk still exists that, despite careful attention to professional standards, he may find himself faced with a lawsuit which will entail extraordinary expense even if he wins the case. The importance of carrying liability insurance should be apparent to every public accountant.

The coverage afforded by most accountants' liability insurance policies now being written is similar. The insured is indemnified against direct pecuniary loss and expense arising from any claim made during the policy period by reason of legal liability for damages caused, or alleged to have been caused, through neglect, error, or omission in the performance of professional services. The insurer also agrees to defend the insured in any suit alleging such acts, even if the suit is groundless. Some policies cover legal liability for damages arising from dishonesty, misrepresentation, or fraud, except affirmative dishonesty or actual intent to deceive or defraud. In other policies this coverage requires the payment of an additional premium. The policy usually contains an exclusion section in which acts not insured by the company are enumerated. Such items vary, but they generally include loss and expense arising from claims for libel or slander by the insured and liability under the Securities Act of 1933. The coverage may usually be extended to give protection against Securities Act liability by the payment of an additional premium.

The companies writing most of the accountants' liability policies in the United States are American Surety Company of New York and Indemnity Insurance Company of North America (both of which have recently effected a 5% reduction in premiums), as well as Lloyd's of London which writes this type of insurance through various agencies in this country. J. H. Minet & Co. (Canada) Ltd. of Montreal has specialized in writing policies of this type on behalf of Lloyd's of London. The amount of coverage desired

varies appreciably because of the wide variation in types of accounting practice. The maximum amount provided by the two American companies is \$500,000. Lloyd's offers larger policies. Premiums do not vary greatly among the three underwriters and are based upon the amount of coverage and the number of partners and employees of the insured firm. In relation to the risks covered, the premiums are not excessive.

Your Committee urges that you be alert to the risks involved in the practice of accounting, that you constantly check your practice against the recommendations of the committees on auditing procedure and accounting procedure, and that you carry as much insurance as possible as a precaution against the extraordinary financial burden involved in defending your professional reputation when and if it is attacked.

Committee on Accountants' Liability
and Liability Insurance

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Enclosure