

The Duties of Accountants

The December issue of the Financial Circular, the organ of "The Institute of Municipal Treasurers and Accountants" of England, contains excerpts from a report of a legal action that has a very important bearing on the duties of accountants acting as auditors. While the case in question referred only to the auditing of the books of a private firm, the principle involved applies equally to the outside auditing of municipal accounts. This was evidently in mind of the Editor of the Financial Circular, though in publishing the report he makes no comments. The case is briefly as follows:—

The Duties of Accountants.

Fox and Son v. Morrish, Grant and Co.
(Before Mr. Justice A. T. Lawrence.)

In this action, which has occupied the Court, for six days, the plaintiffs claimed damages for negligence, or for breach of duty by the defendants towards them.

The plaintiffs were linen manufacturers at Leeds and warehousemen in London, and the defendants were accountants. The businesses at Leeds and in London were carried on as distinct businesses. The Leeds business had a banking account at Lloyds Bank (Leeds), and the London business had a banking account at the London County and Westminster Bank (formerly the London and County Bank). The financial affairs of both businesses were managed in London. The plaintiffs, in their statement of claim, alleged that they employed the defendants as accountants to prepare for their information and guidance annual balance-sheets for each of the businesses. It was an arrangement verbaddly made in the first instance about 1897 by Mr. Charles Fox, and the defendants since then had prepared the balance-sheets and had copied them into the plaintiffs' private ledgers. From 1911 to 1916 half-yearly balance-sheets were prepared by the defendants and presented to the plaintiffs, which purported to show the true position of the Leeds and London businesses.

Each of the balance sheets was alleged to be incorrect, and misleading as to the financial position of the business, and, the plaintiff said, was prepared unskillfully and negligently, inasmuch as each contained a specific statement as to the amount of "cash at bank and in hand," or (in the case of the Leeds business for December 30th, 1912) "overdraft at bank," or (in the case of the London business) "cash at London County and Westminster Bank," which was incorrect. The defendants were unskilled and negligent, it was alleged, in that it was their duty, before presenting balance-sheets containing the said statements to the plaintiffs, and copying them into the ledgers, to verify from the bank pass book of the particular business, or from a certificate given by the manager, or other official of the bank, that the said statement was as to each an accurate presentment of the state of the account, but the defendants in each case neglected to take either of the said steps, or if they did so, they negligently overlooked that the statements were each of them inaccurate.

Further negligence alleged was the non-discovery by the defendants that cheques for large amounts which appeared in the plaintiffs' books as paid to the Lloyds Bank to the credit of the Leeds business had in fact never been so paid, and did not appear to the credit of the Leeds business in the pass book of the Lloyds Bank account, or that cheques for smaller amounts were credited, and further that certain of the said cheques drawn on the London County and Westminster Bank were not debited in that account, and that there were entries in each year, and in both pass books, which did not agree with the plaintiffs' books of the account.

The discrepancy between the amounts stated as being "cash at bank in hand" or "overdraft" in the balance-sheets for the Leeds business were in fact represented by sums misappropriated during the period covered by the balance-sheets by a clerk in the plaintiffs' employment in London named Cranston. The amount of the discrepancy increased during the years 1911 to 1916, and at January 4th, 1917, the date of the last balance-sheet, amounted to £5,177 18s. 9d., and during 1916 Cranston further misappropriated £577 10s. 7d. from the London business. In consequence of the negligence above charged it was

said that the fraud was not discovered as it would otherwise have been.

The Defence.

By their defence the defendants denied that the terms of their employment were correctly or fully set out by the plaintiffs. They said that the terms of the employment were that the defendants should check the postings and additions in the plaintiffs' books, should make out a trading and profit and loss account, and prepare balance-sheets therefrom, and close the private ledger in accordance therewith. Save as aforesaid, it was no part of the defendants' employment to vouch or audit the plaintiffs' accounts. They admitted that they did not verify the entries in the plaintiffs' books from the bank pass books. They said pass books were not submitted to them for examination, and they denied that it was any part of their duty to procure the production of such pass books, or to obtain a certificate from the bank manager or any other official.

Judgment.

Mr. Justice A. T. Lawrence, in giving judgment, said that the liability of the defendants turned on what they were employed to do. It had been urged by the defence that Mr. Grant was not employed to audit the accounts, and was therefore not responsible for the documents which he prepared. It was true that he was not employed as auditor fully and generally, but he was employed under a specific engagement, as the result of an interview between the plaintiffs and the defendants under which he was to check the books, and it was understood that it was not to be a full audit. There was no requirement on the part of the plaintiffs that the defendants should verify everything. The question was whether Mr. Grant was wanting in due care and skill in the performance of his duty, in not having in any way checked the amounts appearing in the cash book as "cash in hand" and "at the bank." He made out his balance-sheets without taking any steps to ascertain whether those figures were correct. It turned out that Cranston, a dishonest clerk of the plaintiffs, ingeniously seeing that the bank pass book was not investigated, took advantage of that and played upon it.

The eminent accountants who had been called as witnesses on both sides, endeavoured to give evidence as favourable as possible to the defendants. They had tried to mitigate the severity of the standard laid down by Mr. Matthews; but they did not achieve complete success. They had to admit that in the preparation of balance-sheets the cash at the bank and in hand must be stated, and in stating it one must either look at the pass book or get a certificate from the bankers; or if that was not done the client must be told that had no been done. That was the real gravamen of the case as far as the defendants were concerned. Mr. Grant did not tell the plaintiffs that he was not doing this. He frankly admitted that he never had, as he was not bound to do so under the retainer. As to that, he was wrong. He agreed that the object of having a balance-sheet drawn up was that Mr. Fox might know what his business position was; and it was impossible for him to know how matters stood without knowing what was the result in cash. All business was conducted for the purpose of producing cash. There was not a single word in the retainer, or anything which passed between the parties, which relieved Mr. Grant from seeing that the cash was accurately stated in the balance-sheet. If the pass book had been looked at it would have been found that what was stated to be at the bank was not at the bank; and if the bank pass book had been examined it would have been found that the figures in the books had been inserted by Cranston.

There was a clear default of duty on the part of Mr. Grant; though it was natural and easy for him to slip into it at the time. But there was nothing in the arrangement made which discharged him from the duty of seeing that when he made a statement on his balance-sheet there was a foundation for it. It was a positive statement which was intended to be acted upon.

But some of the witnesses said that there was such a thing as checking books which did not imply any responsibility at all. An accountant might be called in, it was

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