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Civil LITIGATION

Avoiding accounting malpractice

I was recently consulted by the former client of a certified public accountant. The client, who I'll call "Ms. Smith," hired the accountant to manage all financial aspects of her business. This included providing payroll services and preparing and filing tax returns related to payroll tax and sales and use tax. After several years, the IRS and New York State Department of Taxation conducted audits of Ms. Smith's business. She learned that the accountant had filed inaccurate tax returns and failed to file some quarterly tax returns. This resulted in her business owing a large sum for back taxes along with penalties and interest. Ms. Smith was having difficulty paying down the tax owed in arrears and wanted to know what, if any, legal recourse she had against the accountant.

License to practice

Many professions in New York require a license to practice, including attorneys, engineers, financial advisors, stockbrokers, auditors, bankers and accountants. Article 130 of the New York State Education Law (NYSED) "provides for the regulation of the admission to and the practice of certain professions." NYSED § 6500. The provision outlines the procedure for applying to become and being admitted as a licensed professional. Article 149 of the NYSED, entitled "Public Accountancy," provides that only a "person licensed to practice under this article shall practice public accountancy" or use the title or designation "certified public accountant," "CPA," or "public accountant." NYSED § 7402.



By **DAVID H. FITCH**
Daily Record
Columnist

Ms. Smith was completely unaware that her accountant was filing inaccurate and incomplete returns on behalf of her business. She groused that she specifically sought out the accountant as he held himself out on his website as being qualified to provide such specialized, professional services. The accountant's failure to meet these obligations resulted in unpaid taxes as well as significant interest and penalties. What were her options to hold the accountant liable for his mistakes?

Professional malpractice

Licensed professionals are subject to civil claims of malpractice if they owe an affirmative duty of care to the client, breach that duty by negligent activity, and the client suffers financial loss which is proximately caused by the negligence. Here, the accountant, once hired by Ms. Smith, owed a duty to exercise due care while performing accounting and payroll services for the business. The accountant breached this duty by providing improper and/or flawed accounting services. Furthermore, the services provided were deficient, inadequate, professionally negligent, and overall not competent.

In other words, the accountant deviated from the standard of care to be exercised by accountants engaged to provide tax advice and to prepare and file accurate tax returns. Finally, the direct and proximate result of the accountant's breach of duty resulted in Ms. Smith's business incurring additional tax liability, interest, and penalties. It also forced her to hire another accountant to prepare amended tax returns, which can be included in her claim for damages. She can also include as damages legal fees required to pursue civil action against the accountant.

The fact that Ms. Smith settled her business' tax audits by agreeing to satisfy the unpaid past tax, along with interest and penalties, does not preclude her from pursuing a malpractice lawsuit against the accountant. She relied on the accountant to represent her business with the reasonable skill, care and diligence that members of the accounting and payroll profession commonly possess and exercise in similar situations. The accountant represented to Ms. Smith that he had a high level of experience in providing accounting and payroll services and was competent to perform these services for her business in compliance with professional accounting standards.

Another cause of action available to Ms. Smith is negligent misrepresentation. To bring such a claim, "a plaintiff is required to allege that the speaker is bound to the other party 'by some relation or duty or care.'" *JP Morgan Chase Bank v. Winnick*, 350 F. Supp. 2d 393, 400 (SDNY 2006)

(quoting *Dallas Aerospace, Inc. v. CIS Air Corp.*, 352 F.3d 775, 788 (2d Cir. 2003)). “In ordinary commercial contexts...it is imposed only on those persons who possess unique or specialized expertise, or who are in a special position of confidence and trust with the injured party such that reliance on the negligent misrepresentation is justified.” *Id.* The plaintiff must show: “(1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information.” *Abu Dhabi Commercial Bank v. Morgan Stanley & Co. Inc.*, 910 F. Supp. 2d 543, 546 (S.D.N.Y. 2012) (quoting *Mandarin Trading,*

16 N.Y.3d 173, 180 (2011)); see also *Dallas Aerospace* at 788. Note that a claim for negligent misrepresentation does not require proof of intentional or malicious conduct.

Ms. Smith can assert that the accountant, once hired, had a duty to provide her with accurate information and services, failed to do so, and she justifiably relied on his advice and work product.

Consideration for practitioners

Accountants, like all licensed professionals in New York, must be acutely aware of the duties and responsibilities that come with providing specialized services. Obtaining adequate malpractice insurance coverage should be every accountant’s first step. It is also import-

ant for accountants, like all professional practitioners, to research potential clients and become familiar with the scope of their business. If you know the professional needs of a prospective client, you can craft a contract or retainer agreement that accurately memorializes the services that you will (and won’t) be providing. Finally, accountants should have a current understanding of the ethics guiding the profession in order to avoid potential conflicts or impropriety.

David H. Fitch is a partner in Underberg & Kessler’s Litigation, Municipal and Health Care practice groups. He concentrates his practice in civil and commercial litigation.