THE TORTIOUS LIABILITY OF AUDITORS FOR THE NEGLIGENT PREPARATION AND PRESENTATION OF A BALANCE SHEET

Dimond Manufacturing Co. Ltd. v. Hamilton [1968] N.Z.L.R. 705

INTRODUCTION

Prior to the decision in *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.* [1964] A.C. 465 an auditor clearly owed a duty of care towards his client company whose accounts he prepared or audited, because he was professionally engaged by the company and his contract with it obliged him to carry out his audit carefully; but it was doubtful whether he also owed a duty of care to any third persons to whom his accounts were later shown unless his relationship with those third persons was fiduciary.[1]

The *Hedley Byrne* principle opened up possible liability to such third persons and since that decision, courts of various common law jurisdictions have been obliged, within the context of civil disputes raising the issue, to attempt to determine the necessary ingredients of the "special relationship" which must exist before liability can be established.[2] As a result there has naturally been speculation, particularly in professional spheres such as accountancy, as to the scope of the principle.

Dimond Manufacturing Company Limited and Others v. *Hamilton and Others* [1968] N.Z.L.R. 705[3] was concerned in part with this issue.

THE FACTS

The members of the plaintiff company wished to purchase business premises and their representative, H, entered into negotiations on 30 June 1964 with M, the secretary of Hamilton & McNeill Limited (in this paper referred to as "the company"), one of whose shareholders was the leasehold owner of the property that the plaintiffs were interested in purchasing. H understood M to be the company's "secretary-manager"; he did not know, however, that M was also a principal in the firm of accountants who audited the accounts of the company and that in practice, although he could not be the nominal auditor,[4] M himself usually made the audit.

At their first appointment, M made it clear to H that the purchasers would have to buy all the shares in the company as a prerequisite to their

1. *Nocton* v. *Ashburton* [1914] A.C. 932.
2. Cf. *Smith* v. *Auckland Hospital Board* [1964] N.Z.L.R. 241. *Evatt* v. *M.L.C. Assurance Co. Ltd.* [1967] 2 N.S.W.R. 465.
3. Only a portion of the judgment is recorded in the reports.
4. Companies Act 1955, s. 165 (1) (a).

obtaining the leasehold premises, because the company still had unsatisfied contractual obligations. When H inquired how much the shares would cost, M replied that it was up to him to formulate an offer. Without H's asking, M then showed him a copy of the company's balance sheet and profit and loss account for the year ending 31 January 1964 which had been prepared in March 1964.

The balance sheet bore an unqualified audit certificate given by M's firm and addressed specifically to "THE MEMBERS OF HAMILTON & McNEILL LIMITED". M deposed that although he himself had carried out the audit, he had not signed the audit certificate: his firm as a whole took responsibility for its correctness. In spite of the fact that these particular annual accounts had been asked for urgently by virtue of the imminent likelihood of the company's being wound up and the leasehold property put up for sale, there was no suggestion at the time when they were prepared and audited that the *shares* were to be sold.

H had the balance sheet before him for about ten minutes only. He deposed that he copied down its contents and the list of assets and liabilities and, having accountancy experience himself, he thought that as these documents were drawn up by public accountants on their letterhead and audited by them, they would be "reasonably accurate". He made it clear to M that his offer for the shares would have to be based on the figures shown in the balance sheet. The subsequent agreement for sale and purchase of the shares recorded that the purchase was made in reliance on the accounts and included a covenant by the vendor shareholders to indemnify the purchasers against any assets overstated or liabilities not disclosed in the accounts.

The dispute arose after settlement on 1 August 1964, when the new secretary prepared a balance sheet and profit and loss account as at 31 July 1964 and found, on checking the current assets and liabilities against those shown in the previous balance sheet, that certain assets had been overstated and that certain liabilities had been understated.

THE CAUSES OF ACTION AND JUDGMENT

The first cause of action was based on the vendors' covenant to indemnify the purchasers in respect of assets overstated or liabilities not disclosed in the accounts. Although the court held that there were some errors in the accounts, this cause of action failed for reasons not relevant to the present discussion.

The second cause of action alleged negligence against M, as an officer of the company, in showing the balance sheet to the plaintiff's agent, H, with the knowledge that they would place reliance upon its accuracy.

This was briefly dismissed by Tompkins J., because no grounds were submitted at the hearing "upon which a secretary, as an officer of the company, could have any duty to the purchasers of shares for negligence in the keeping of the books and in the preparation of the balance sheet". There appears to be a discrepancy between the way in which the cause of action was pleaded and the way in which it was discussed in the judgment. The cause of action was based not on any duty which might have arisen in the preparation of the accounts but on the duty which might later arise when they were shown to the purchasers' agent. This latter duty was not mentioned in the judgment.

The third cause of action was against M and the other partners of the firm of accountants as auditors, for the negligent preparation of the company's balance sheet and accounts when he and/or they ought reasonably to have foreseen that the documents would be likely to be shown to the plaintiffs and for M's negligently showing H the balance sheet and accounts knowing that the plaintiffs would rely upon their accuracy.

The issue dealt with in the judgment was whether the *Hedley Byrne* principle and then at 708 distinguishes both that case and *Candler* v. of care in preparing and auditing the accounts, to any potential purchaser of the company's shares who might at any future time be shown these documents and place reliance upon them.

The learned judge at pages 706-707 discusses the *Hedley Byrne* principle and then at 708 distinguishes both that case and *Candler* v. *Crane Christmas & Co.* [1951] 2 K.B. 164 from the *Dimond Manufacturing* case on their facts: in the first, the respondent bankers *knew* that the inquiry was made on behalf of advertising agents before they answered it; in the second, the accountants *knew* when preparing the accounts that they were to be shown to a specified potential investor in the company; but in *Dimond Manufacturing* the accountants did not know in fact that the accounts which they were auditing were later to be submitted to and relied upon by a purchaser of the company's shares. His Honour treats this lack of full prior knowledge of the purpose for which the information was later to be used as deciding the issue in favour of the defendants. His Honour says at 709 that if " . . . auditors who certify an annual balance sheet are by that fact alone under a liability to third parties for negligence in the preparation or certifying of such accounts . . . there would be a startling new and general liability upon all auditors to third parties of whose existence they were quite unaware at the time of making the report; and furthermore when the accounts were put to a use not within their knowledge when the accounts were prepared". A little later he says that to hold "that auditors certifying a balance sheet in this way enter into a relationship with persons who subsequently rely upon the balance sheet and thereby act to their detriment . . . or that there is implied thereby a voluntary undertaking to assume responsibility if the accounts were prepared negligently . . . would be to disregard the limits . . . which were placed upon such a non-contractual or non-fiduciary liability by the House of Lords in the *Hedley Byrne* case".

COMMENTS ARISING OUT OF THE JUDGMENT

1. Imputed Knowledge and the Question of Proximity:

The basis of his Honour's reasoning is that the auditors did not know in fact of the purpose to which these accounts were to be put three months later. In his conclusion, however, he says at 709 "I do not think that here, the auditors knew or *ought to have known*[5] that the accounts would be relied upon by the plaintiffs", thereby suggesting that liability in negligence could arise even though at the time they certify the accounts, the auditors have no actual knowledge that the plaintiffs are going to rely upon their work. The judgment does not give any indication of the circumstances in which such knowledge will be imputed to an auditor, nor does it set out the reasons which led his Honour to the conclusion that this knowledge was not to be imputed in this particular case.

The degree of proximity which is required before the auditors preparing or auditing the balance sheet enter into a "special relationship" with a third person is the subject of some conjecture. Both Denning L.J. (as he was then) and Lord Devlin, for example, have left open a possible duty of care owed to someone other than the very person to whom (say) an accountant knew his reports were to be referred: "I have confined the duty to cases where the accountant prepares his accounts and makes his report for the guidance of the very person in the transaction in question . . . I can well understand that it would be going too far to make an accountant liable to any person in the land who chooses to rely on the accounts in matters of business for that would expose him to liability 'in an indeterminate amount for an indeterminate time to an indeterminate class'.[6] Whether he would be liable if he prepared his accounts for the guidance of a specified class of persons in a specified class of transaction, I do not say. I should have thought he might be."[7]

> Wherever there is a relationship equivalent to contract there is a duty of care . . . I regard this proposition as an application of the general conception of proximity. Cases may arise in the future in which a new and wider proposition, quite independent of any notion of contract will be needed. There may, for example, be cases in which a statement is not supplied for the use of any particular person . . . It will then be necessary to return to the general conception of proximity. . . .[8]

Lord Pearce has suggested that considerations of policy will determine where the line is drawn in doubtful cases falling somewhere between situations such as those in *Candler* or *Hedley Byrne* on the one hand and that in *Ultramares Corporation* v. *Touche*[9] on the other hand: "How

5. Emphasis added.
6. *Ultramares Corporation* v. *Touche* (1931) 255 N.Y. 170 at 179; 174 N.E. 441 at 450 per Cardozo C.J.
7. *Candler* v. *Crane Christmas & Co.* (supra) at pp. 183-184 per Denning L.J.
8. *Hedley Byrne* v. *Heller* (supra) at pp. 530-531 per Lord Devlin.
9. Supra n. 6. In this case the defendant accountants had been asked to prepare an audit knowing that in the ordinary course of business the certified balance sheet would be exhibited freely as the basis of financial dealing. Thirty-two copies were supplied to the client company and subsequently a new investor relying on a copy suffered grave financial losses. His claim against the auditors failed, since liability in negligence "is bounded by contract and is enforced between the parties by whom the contract is made". p. 177 and p. 448 per Cardozo C.J.

wide the sphere of the duty of care in negligence is to be laid depends ultimately on the court's assessment of the demand of society for protection from the carelessness of others."[10]

The differing views on these considerations of policy and on the public accountant's role in modern society may be illustrated by contrasting a passage from the judgment of Cardozo C.J. in the *Ultramares* case with an extract from a recent article by Professor E. J. Bradley. Cardozo C.J. was concerned at the possible liability of accountants "in an indeterminate amount for an indeterminate time to an indeterminate class". He made the observation at page 448:

> Public accountants are public only in the sense that their services are offered to anyone who chooses to employ them. This is far from saying that those who do not employ them are in the same position as those who do.

On the other hand, Professor Bradley, after pointing to the availability of insurance (*inter alia*), says:

> The legal duties of the auditor ought to be co-extensive with his professional pretensions. He aspires to more than being a rubber stamp for management, so his legal duties ought to go beyond that status. The staunchest protection against legal liability . . . is the exercise of a high degree of independent professionalism.[11]

It is the resolution of these considerations of policy which will determine the extent and degree of particularity of the information which accountants and auditors must have before they can be liable to third parties. Must the third party be specifically identified to the accountant or is it sufficient that the third party belongs to a class which the accountant ought reasonably to foresee will (or might) use the accounts? Is it essential that the accountant know of the very transaction in respect of which the accounts are to be used or is some less specific information sufficient? The answers to questions such as these involve an evaluation of competing interests in society and the test of reasonable foreseeability will be circumscribed, or even superseded, by the dictates of policy. Thus, in the *Ultramares* case, policy, as conceived by Cardozo C.J., precluded liability even though it was reasonably foreseeable (and, indeed, almost certain) that creditors and investors (of some kind or other) would rely upon the accounts in their financial dealings with the company.

Before going on to consider the special limitations which the policy may apply to the test of foreseeability, it may be worthwhile to consider the finding in *Dimond Manufacturing* at page 709 that the accountant in that case ought not to have known "that the accounts would be relied upon by purchasers of the shares of the company". His Honour rightly points out at page 708 "there was no proposal or intention at the time

10. *Hedley Byrne* v. *Heller* (supra) at p. 536 per Lord Pearce.
11. (1966) J.B.L. 190 at 196.

[the accounts] were prepared to endeavour to sell the shares of the company". Nevertheless, it is still arguable that the accountant ought reasonably to have foreseen that the shares might be sold and that, if they were, then it would be almost inevitable that the purchaser would rely upon the accounts in assessing the value of the shares. In *The Wagon Mound (No. 2),*[12] the Privy Council treated as reasonably foreseeable a risk which though remote, could not be brushed aside as far-fetched or fantastic. In the writer's view, no matter how obscure a company may be, nor how contented its shareholders, its accountant would rarely be justified in dismissing as far-fetched or fantastic, the possibility of a sale of the shares. Further, in *Dimond Manufacturing,* the possibility of sale of the shares was increased by the fact that one of the shareholders had asked the accountant to prepare the accounts as soon as possible because the company had been operating at a loss and she was contemplating putting it into liquidation and selling the property from which it conducted its business. A sale of shares is, of course, a different transaction from a winding-up and sale of assets, but the significance of the proposed winding-up is that it showed the accountant that one of the shareholders wished to end her connection with the business and to sell the business premises. It cannot be regarded as fantastic that the shareholder should, in the event, achieve this wish through a sale of shares rather than a winding-up. Indeed, when a prospective purchaser of the assets was found, it was the accountant himself who suggested that a sale of shares was the most appropriate form of transaction whereby the shareholder might attain her wish. Accordingly, the writer submits with respect, that the judge may not have been correct in assuming that it was not foreseeable that the accounts would be relied upon by a member of a certain class, namely potential purchasers of shares in the company.

Not only may it be argued that it is reasonably foreseeable that the annual accounts of any company may be used by a prospective purchaser of shares in the company, but it may also be contended that it is one of the two primary purposes of such accounts to provide members of the company and investors (including creditors) "with as much information as is practically possible to enable investment decisions to be made". This contention put forward by the Professor of Accounting at the University of Auckland[13] can be supported by reference to a textbook recently published by the Canadian Institute of Chartered Accountants.[14] A similar view was taken by Denning L.J. in *Candler's* case when he said at page 184 that the accountant expresses his opinion on the accuracy of the accounts "not so much for the satisfaction of his own client, but more for the guidance of shareholders, investors, revenue authorities, and others who may have to rely on the accounts in serious matters of business".

Notwithstanding the comments in the preceding two paragraphs, it

12. *Overseas Tankship (U.K.) Ltd.* v. *The Miller S.S. Co. Pty. Ltd.* [1967] 1 A.C. 617 at 643.
13. *The Accountants Journal* July 1967, Vol. 45 No. 11, 443 at 447.
14. R. W. V. Dickerson, *Accountants and the Law of Negligence* (1965) at 92.

must be conceded that the case for the plaintiff in *Dimond Manufacturing* was not as strong as the case for the plaintiff in *Ultramares*. In *Dimond Manufacturing* there was only a possibility that the accounts would be relied upon by a purchaser of shares while in the American case it was almost certain that some lender or other would advance money in reliance on the accounts. Yet the plaintiff failed in *Ultramares* even though the accountants had supplied 32 extra copies of the balance sheets to the company because they knew that the company's business was such that it would be continually entering into financial dealings with investors, lenders and other persons who would be shown and who would rely upon the balance sheets. The claim was rejected not because the accountants could not foresee the use of the balance sheet by lenders as a class, but because neither the plaintiff nor the transaction in which it was to rely upon the balance sheet had been identified with sufficient particularity at the time when the balance sheets were certified and because there was no contract between the accountants and the lender.

It is, perhaps, unfortunate that Tompkins J. did not find it necessary to review the decision in *Ultramares* or to define precisely the circumstances in which accountants could be liable to third parties in respect of an inaccurate set of accounts. As it is we are left with the conflicting formulations suggested by the text-writers. For example:

(a) *Salmond on Torts* (14 Ed. 1965) 283 would require that the accounts be prepared in response to an *inquiry* for the guidance of the very person in the very transaction in question.

(b) Street, *The Law of Torts* (3rd Ed. 1963) at page 206 would impose liability only where there was *actual knowledge* of the person by whom and the transaction in which the accounts were to be used.

(c) *Winfield on Tort* (8 Ed. 1967) 244 would require that the accountant be able to *foresee* that the accounts would be relied upon by the plaintiff in the particular transaction in question or in a transaction substantially identical therewith.

Quite apart from the unresolved differences between these three formulations, it may well be that all of them are unduly conservative. They appear to require the accounts to be provided for use by a particular person in a particular transaction. However, as already mentioned in this note, Denning L.J. has specifically reserved possible liability to a "specified class of persons in a specified class of transaction",[15] and Lord Devlin has left open the question of liability in cases where the accounts were "not supplied for the use of any particular person".[16] When the courts do come to rule on these questions, one hopes they will give them some weight to such considerations of policy as:

(a) the independent professional status claimed for themselves by public accountants and auditors and readily accorded to them by the general public, including the commercial community;

15. *Candler* v. *Crane Christmas & Co.* (supra) at 184.
16. *Hedley Byrne* v. *Heller* (supra) at 531.

(b) the widespread and well-recognised practice among potential creditors and investors of relying upon accounts prepared or audited by *public* accountants engaged by the company rather than by the investors or creditors themselves.. Accounts prepared by a member of the company's staff and not subjected to independent professional audit would not be accepted so unquestioningly;

(c) the view that it is one of the primary functions of company accounts to provide investors and creditors as well as shareholders with as much information as is practicably possible to enable investment decisions to be made;

(d) the ability of accountants to protect themselves by endorsing on the accounts a disclaimer of liability to third parties;

(e) the ability of accountants to insure themselves against such liability and to distribute the cost of the premiums by increasing their charges.

2. A Second Duty of Care:

Although Tompkins J. recognises that M was the person who prepared the accounts and that in giving them to H to peruse, M was *then* well aware that the plaintiffs would place reliance on them in formulating an offer for the company's shares, his Honour was content to dismiss these facts as irrelevant to the question whether there was a duty of care when the accounts were certified. With respect, it is submitted that although his Honour's view was correct in so far as it related to the duty alleged to arise when the accounts were prepared and certified, it overlooks the fact that the statement of claim contains an alternative allegation of negligence against M and his partners in that "M showed the balance sheet and accounts to H acting as the agent for the plaintiffs and knew that they would be relied upon". This latter allegation prompts the following questions:

(i) *Can a duty of care arise when an accountant allows his certified accounts to be shown to persons not contemplated at the time when he or his firm certified them?*

In *Hedley Byrne* no two Lords conceived of the principle they were all concerned to enunciate, in exactly the same way. Lord Hodson, however, at page 514 did approve the formulation of principle made by Lord Morris of Borth-y-Gest:

> . . . if in a sphere in which a person is so placed that others could reasonably rely on his judgment or skill, or on his ability to make careful inquiry, such person takes it upon himself to give such further information or advice, or *allows his information or advice to be passed on to another person* who, as he knows or should know will place reliance upon it, then a duty of care will arise.[17]

17. (Supra) at 503. Emphasis added.

An accountant or auditor is within the denotation of "such person" and prima facie if he allows his audited balance sheet to be passed on to someone whom he knows or ought to know will place reliance upon it, this would be sufficient to create a duty of care.

The circumstances in which the balance sheet was shown by M to H have already been set out in some detail. They clearly disclose that although M proffered it to H, he did not do so in response to any express inquiry from H as to the company's financial position. Admittedly it is a moot question whether or not an inquiry is a prerequisite of a duty of care. Given Lord Morris's test, however, it is suggested that, in the circumstances of this case where accounts were offered when an inquiry or request for them would have been almost inevitable, it makes no difference that no such inquiry was actually made. It ought to be enough that M showed the accounts to H, knowing that he and his colleagues would rely upon their contents.

The consequence of subsequently showing the accounts to a person not contemplated at the time when they were prepared is not retrospectively to impose a duty to exercise care in the preparation of the accounts. It would be logically impossible to say that the subsequent act of showing the accounts creates a duty to exercise care in doing something which has already been done. By showing the accounts to a third party, the accountant undertakes a new duty which is quite separate and distinct from any earlier duty which he may have owed when actually preparing or certifying the accounts.

(ii) *What would be the nature of the duty?*

A recent note on the *Dimond Manufacturing* case[18] suggests that the M should have been liable for showing the accounts to the purchasers' agent "not because the accounts were carelessly made up, but because he is now showing an unreflective balance sheet knowing the purpose of it, and knowing that the plaintiffs would rely upon it". This formulation seems to regard the duty which the auditor undertakes as equivalent to a contractual warranty that the accounts accurately show the company's financial position and does not appear to allow the accountant the defence that any mistake was not caused by any failure to exercise reasonable care on his part. However, as *Winfield on Tort* has pointed out:

> It is sometimes overlooked that the duty arising from a special relationship is at its highest a duty of reasonable care. It is not a duty to take every possible care: still less is it a duty to be right.[19]

The possibility that the showing of the accounts to the third party could retrospectively create a duty of care in their preparation and auditing has already been rejected in the present article. This means that the duty of care must entail the doing of something or the refraining from doing something at some time *after* the auditor has decided to let

18. Case and Comment: (1968) N.Z.L.J. 366 at 367.
19. *Winfield on Tort* (8 ed. 1967) 244.

the third party see the accounts. Because the auditor is merely showing accounts previously prepared, it becomes very difficult to formulate the duty of care which he undertakes. To say the auditor is under a duty to take reasonable care to see that the accounts are accurate seems to imply that he is under a duty to check them before handing them to the third party. In many cases the only reliable check which he could make might involve doing practically the whole audit over again. In *Hedley Byrne* two of the Law Lords[20] said that a banker who was asked gratuitously to give an opinion on a customer's credit-worthiness was not obliged "to expend time and trouble in searching records, studying documents, weighing and comparing the favourable and unfavourable features and producing a well balanced and well-worded report". Similarly, where a prospective purchaser of shares wishes to examine the company's accounts he neither asks for nor expects the accountant to check his previous work and it would be unreasonable for him to expect such a check to be made gratuitously. If the purchaser wants the accounts to be checked, he should make a specific request (and undertake to pay the accountant for his time and trouble) or preferably engage his own accountant to make the check. In practice, of course, the purchaser is content to rely upon the assumption that the accountant will have exercised proper skill and care at the time when he did the original audit. In these circumstances it appears somewhat misleading to talk of the accountant's duty as being to take reasonable care to see that the accounts are fair and accurate.

An alternative to describing the accountant's obligation as a duty of care may possibly be to describe this obligation as a "duty of honesty". Thus, the references of three of the Law Lords in *Hedley Byrne* to a duty of honesty[21] have led Honoré to postulate this as an intermediate duty,[22] lying between the duty to abstain from deceit (as so narrowly regarded in *Derry* v. *Peek* (1889) 14 App. Cas. 337) and the ordinary duty of care. *Winfield on Tort* (8 Ed.) 245 observes that it is quite unnecessary to create this duty of honesty just in order to fix a lower level of obligation since, if it would be unreasonable in the circumstances to expect a banker to spend time and trouble in searching records, then even the ordinary duty of care (the duty to take reasonable care) would not require him to do so. Thus, there is no need to formulate a new duty (of honesty) in order to absolve him from liability for not searching. In the sense in which Honoré uses the duty of honesty, it is really co-extensive with the duty of care.

In the writer's opinion, whatever difficulty there may be in defining the precise terms of the duty undertaken by the accountant in *Dimond Manufacturing*, there is no difficulty in setting out the reasons why he ought to have been liable if it were held that any errors in the accounts arose from his failure to exercise this skill and prudence which a reasonably competent and careful accountant or auditor would have exercised

20. Lord Morris of Borth-y-Gest at 503 and Lord Hodson at 512.
21. Lord Reid at 489, Lord Morris of Borth-y-Gest at 503-4 and Lord Hodson at 512-3.
22. (1965) 8 J.S.P.T.L. (N.S.) 284 at 290-1.

in the preparation and auditing of the accounts. He would be liable because, with the knowledge that the plaintiffs intended to rely upon the accounts for the purposes of calculating the amount of their intended offer to buy the shares in the company, he has shown to them accounts which he ought to know assign to the assets and liabilities values which are greater or less than their true values, calculated in accordance with good accounting practice. The accountant must be taken to know of these discrepancies because, as the man who prepared and audited the accounts, he knows the methods which were actually used to assess the values of the assets and liabilities (as shown in the accounts) and, as a public accountant, he ought to know that these methods were not in accordance with good accounting practice and therefore were not accurate or reliable.

If it is necessary to express this liability as arising from a duty to do or refrain from doing something then it might be said that either:

(a) the accountant was under a duty to warn the purchasers that the values of the assets and liabilities had not been assessed in accordance with good accounting practice; or

(b) the accountant was under a duty not to show the purchasers' agent a set of accounts which he knew or ought to have known were not reliable for their purposes.

(iii) *In which capacity would M be liable?*

The second cause of action alleges that the secretary as secretary is liable for showing the audited accounts. The third cause of action alleges that the accountants also are liable for showing the accounts. Does the fact that M has shown the balance sheet in his capacity as secretary make any difference?

Arguably, a secretary and the accountant or auditor of a company would be under the same duty of care, i.e. not to pass on accounts which they know or ought to know are unreliable. The standard of care, however, may differ, depending upon the circumstances. On the one hand, the secretary would not usually be expected to know that the accounts had not been prepared and audited in accordance with good accounting practice; provided that the public accountants doing the audit are of good standing, he can assume that they have followed good accounting practice, and therefore a secretary who is a layman would not be liable, except in exceptional circumstances.[23] On the other hand, in a case such as *Dimond Manufacturing*, where the secretary does know of the methods used in the preparation of the accounts (e.g. because he prepared them himself) and where, because he is also a practising public accountant, he ought to know those methods were contrary to good practice, then he may be liable in his capacity as secretary. Thus, in *The Wagon Mound (No. 2)* Walsh J. suggested that if a person has

23. For example, if after the accounts were prepared or audited the accountants had been dismissed for incompetence or if in some way it had been established that the accounts were unreliable or not prepared in accordance with good practice.

particular knowledge, he may not be able to escape liability merely because an ordinary person of his type or class (e.g. the ordinary company secretary) might not have had that knowledge.[24]

Even if M were not liable in his capacity as secretary, he should have been liable as the accountant who prepared the accounts and/or as the auditor who audited them. It could be said that H consulted M as "secretary-manager" of the company and that it was in that capacity that M showed the accounts to H. Even assuming that it is realistic to regard M as acting in one capacity rather than another, the compelling conclusion is that in his capacity as accountant and auditor, M allowed the accounts to be shown to H and that, accordingly, a duty of care was imposed upon him in those capacities also. Provided that M was acting in the ordinary course of his firm's business, his partners would also be liable if M failed to fulfil his duty of care.[25]

3. The Problem of the Dual Functionary:

M's role in the Dimond Manufacturing Company represents the confusion of two spheres of activity. Arising out of the case, a layman has levelled the criticism that "there does seem to be a weakness in the New Zealand company law system, when a secretary of a company can also be a party to the auditing of the company's accounts. To many, it already seems strange that so many professional accountants in practice throughout New Zealand have so many outside interests—as T.A.B. Agents, operating finance companies, as company directors, etc. It is felt that these outside activities detract from the real business of accountancy and may tend to lower the standards of the profession".[26]

Under section 165 (1) (a) of the Companies Act 1955, M as secretary of the company was not eligible for appointment as auditor, but because the disqualification of any partner of an officer or servant of the company[27] applies only to public companies,[28] the company was able to appoint M's partner as its auditor. The wisdom of this dispensation in favour of private companies is open to question, but, in any case, it is submitted that an auditor does not fulfil his duties if, without making any independent check of his own, he merely certifies the accounts which have been prepared by a partner who is himself disqualified from acting as auditor.

CONCLUSION

For the reasons given, it is the writer's view that liability in negligence ought to have arisen in *Dimond Manufacturing* by virtue of breach of a duty of care in presenting the company's accounts.

An appeal from Tompkins J.'s decision has been made and one may speculate whether issues other than those dealt with in His Honour's judgment will be raised before, and considered by, the Court of Appeal.

E. A.

24. *Miller S.S. Co. Pty. Ltd.* v. *Overseas Tankship (U.K.) Ltd.* [1963] N.S.W.R. 737 at 746. See also Prosser: *The Law of Torts,* 3rd ed. 164.
25. Partnership Act 1908, s. 13.
26. *Evening Post* April 15, 1968, p. 26.
27. s. 165 (1) (b).
28. s. 354 (4).