

50 State Survey: Accountants' Liability to Third Parties

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Please note that statutes and case law vary from state to state and from time to time. This survey does not encompass all possible exceptions to statutes and it does not discuss all possible case law variations. In addition, choice of law rules may impact the result in certain cases.

ACCOUNTANTS' LIABILITY TO THIRD PARTIES

Public accountants owe their clients a legal and contractual duty of due care. Accountants may also owe a duty of due care to third parties who rely on their work. The courts have adopted different standards for determining when such a duty exists. Below is a description of each standard, followed by appendices identifying the standard applied by each state.¹

1. *Privity*:

- a.* Traditionally an accountant could not be held liable in contract or tort (e.g. negligence) to a third party with whom accountant was not in privity of contract.
- b.* Accountant's duty of care only extends to parties in contractual privity with accountant.

2. *Near Privity*:

- a.* Modifies the privity doctrine to include others whose relationship with the accountant approaches privity.
- b.* Requirements:
 - (1) Accountant knew the financial statements were to be used for a particular purpose;
 - (2) Accountant intended that a *known* third party rely; and
 - (3) Accountant's actions were connected to the third party, demonstrating accountants' knowledge of that party's reliance.²
- c.* Demanding standard because a casual connection is insufficient to link accountant to third party as required.³

¹ Accountants may also be liable to third parties for fraud, regardless of the standards described herein, if there is fraudulent intent and detrimental reliance. See e.g., *Joel v. Weber*, 569 N.Y.S.2d 955 (N.Y. App. Div. 1991); *Aetna Cas. & Sur. Co. v. Leahey Const. Co.*, 219 F.3d 519 (Ohio Ct. App. 2000); *Dougherty v. Zimble*, 922 F. Supp. 110 (N.D. Ill. 1996); *Curiale v. Peat, Marwick, Mitchell & Co.*, 630 N.Y.S.2d 996 (N.Y. App. Div. 1995); *Howard v. Dun & Bradstreet, Inc.*, 220 S.E.2d 702 (Ga. Ct. App. 1975); *Stephens Indus., Inc. v. Haskins & Sells*, 438 F.2d 357 (Colo. Ct. App. 1971).

² *Credit Alliance Corp. v. Arthur Andersen & Co.*, 438 N.E.2d 110 (N.Y. 1985).

³ *William Iselin & Co. v. Mann Judd Landau*, 522 N.E.2d 21 (N.Y. 1988)

(1) Most parties not in actual privity of contract with the accountant will not meet the standard because it requires proof that:

(a) Accountant's words or actions were directed towards the third party; or

(b) Something in the client's employment itself established a nexus approaching privity with the third party.⁴

(2) In most cases the accountant will not have communicated directly with the third party and thus the employment will, at best, be only incidentally for the purpose of inducing the third party to extend credit to, invest in, or transact business with the client.⁵

d. Third party must establish that it is an *intended* beneficiary of the accountant's employment by the client. This can be established by evidence that the primary purpose of the accountant's engagement was:

(1) To prepare financial statements, reports, or opinions for the use of the third party; or

(2) To be available on an ongoing basis to answer third party's questions regarding the client's financial statements or condition or regarding the accountant's opinion.⁶

e. A complaint alleging the following states a cause of action under this standard:

(1) Accountant was aware the financial statements would be used in connection with a particular transaction;

(2) Accountant was a key advisor to the client regarding the transaction; and

(3) Accountant has repeated direct communications with the third party regarding the client's financial position.⁷

3. *Restatement* § 552:⁸

a. Currently represents the majority view.

b. Provides that "one who supplied information during the course of his business, profession, employment, or in any transaction in which he has a pecuniary interest

⁴ *Westpac Banking Corp. v. Deschamps*, 484 N.E.2d 1351 (N.Y. 1985)

⁵ Dan L. Goldwasser and M. Thomas Arnold, *Accountants' Liability*, (Prac. Law Inst. 2001).

⁶ *Sec. Pacific Bus. Credit, Inc. v. Peat Marwick Main & Co.*, 597 N.E.2d 1080 (N.Y. 1992).

⁷ *Dept. of Econ Dev. v. Arthur Andersen & Co.*, 924 F. Supp. 449 (S.D.N.Y. 1996).

⁸ *Restatement of Torts* 2d, § 552 (1977).

has a duty of reasonable care and competence to parties who rely upon the information in circumstances in which the maker was *manifestly aware of the use to which the information was to be put and intended that it be so used.*⁹

- c. Accountant's liability extends to a *foreseeable person or limited class of persons for whom the information was intended*, either directly or indirectly, even if the identity of the person is unknown.¹⁰
- d. Reliance must be *actually foreseen*.¹¹
 - (1) For example, accountant supplies information to a third party or limited class of third parties; or
 - (2) Accountant knows the recipient of the information intends to supply it to the third party or limited class of third parties.¹²
- e. Courts look to the purpose for which the accountant's financial statement was made to determine whether the third party's reliance is justifiable.
 - (1) Accountant must have made the statement to induce the third party to rely upon it.¹³
 - (2) Accountant is not liable absent actual knowledge of the use of the statement.¹⁴
 - (3) Liability to third party is more likely if accountant supplied information directly to the third party.¹⁵
 - (4) Third party must rely on the actual statement and not a secondhand report of the same.¹⁶
- f. Accountant may limit liability by disclaimer alerting parties not in privity that they rely at their peril.

⁹ *Id.*

¹⁰ *Id.*

¹¹ Goldwasser and Arnold, *supra* note 5.

¹² *Id.*

¹³ *Id.* If this cannot be shown there will be no liability in the absence of privity, willfulness, physical harm or property damage

¹⁴ *Nycal Corp. v. KPMG Peat Marwick LLP*, 688 N.E. 2d 1368 (Mass. 1998); But cf. *Arthur Andersen LLP v. Superior Court*, 79 Cal. Rptr. 2d 879 (Cal. App. 1998) (accountants, in the business of auditing insurance companies, charged with knowledge of law pertaining to insurance company audits and, thus, that financial statements would be furnished to Insurance Commissioner).

¹⁵ *First Fla. Bank, N.A. v. Max Mitchell & Co.*, 558 So. 2d. 9 (Fla. 1990).

¹⁶ *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 367 S.E.2d 609 (N.C. 1988).

- g.** Accountant has a duty to those whose reliance is actually foreseen, even if the specific identity of the person(s) is not known.

4. **Foreseeability:**

- a.** Accountant is liable to all third parties whose reliance upon accountant's negligently prepared financial statement is reasonably foreseeable.¹⁷
- b.** Unlike the Restatement standard, the third party need not be a person or one of a class of persons whose reliance was actually foreseen by the accountant.
- c.** Creates broad potential liability and thus several courts have established limits. For example: Accountant not liable for a foreseeable injury if there is a strong public policy reason for denying recovery.¹⁸

5. **Statute:**

- a.** Several states have enacted statutes limiting the civil liability of accountants resulting from the negligent preparation of financial reports or statements.¹⁹
- b.** For example, legislation in Illinois, Arkansas, Michigan, and Utah provides that an accountant will not be held liable in negligence to persons not in privity if the accountant sends a letter to the client identifying only those persons he or she intends to rely on the services; the accountant will only be liable to the identified persons and to those in privity.²⁰

¹⁷ *H. Rosenblum, Inc. v. Adler*, 461 A.2d 138 (N.J. 1983).

¹⁸ *Citizens Nat'l Bank v. Timm, Schmidt & Co.*, 335 N.W.2d 361 (Wis. 1983); See also, *Rosenblum*, supra note 17 at 153 (institutional investor who does not obtain audited statements directly from company may not recover from its accountant); *Touche Ross & Co. v. Commercial Union Ins. Co.*, 514 So. 2d 315, 322-23 (Miss. 1987) (accountant "remains free to limit the dissemination of his or her opinion through a separate agreement with the audited entity.").

¹⁹ See Appendices I and II.

²⁰ See Appendix I for citations of statutes.

APPENDIX I

MATRIX OF STANDARDS APPLIED BY EACH STATE

(Alphabetically by State)

STATE	STANDARD APPLIED	AUTHORITY
Alabama	Restatement § 522	<i>Boykin v. Arthur Andersen & Co.</i> , 639 So. 2d 504 Ala. 1994).
Alaska	Restatement § 522	<i>Selden v. Burnett</i> , 754 P. 2d 256 (Alaska 1988).
Arizona	Restatement § 552	<i>Standard Chartered PLC v. Price Waterhouse</i> , 945 P.2d 317 (Ariz. Ct. App. 1996).
Arkansas	Statute similar to near privity (accountant can limit liability by letter)	<i>Swink v. Ernst & Young</i> , 988 S.W.2d 660 (Ark 1995); Ark. Stat. Ann. §§16-114-302,17-12-701.
California	Restatement § 552	<i>Bily v. Arthur Young & Co.</i> , 834 P.2d 745 (Cal. 1992).
Colorado	Privity	<i>Stephens Indus., Inc. v. Haskins & Sells</i> , 438 F.2d 357 (Colo. Ct. App. 1971).
Connecticut	Near Privity	<i>Twin Mfg. Co. v. Blum, Shapiro & Co.</i> , 602 A. 2d 1079 (Conn. Super. Ct. 1991).
Delaware	None specified to date	
District of Columbia	None specified to date	
Florida	Restatement § 552	<i>First Fla. Bank, N.A. v. Max Mitchell & Co.</i> , 558 So. 2d 9 (Fla. 1990). <i>NationsBank, N. A. v. KPMG Peat Marwick LLP</i> , 813 So. 2d 964 (Fla.App. 2002)
Georgia	Restatement § 552	<i>Badische Corp. v. Caylor</i> , 356 S.E.2d 198 (Ga. 1987).
Hawaii	Restatement § 552	<i>Kohala Agric. V. Deloitte & Touche</i> , 949 P.2d 141 (Haw. Ct. App. 1997).

Idaho	Near Privity	<i>Idaho Bank & Trust Co. v. First Bancorp</i> , 772 P.2d 720 (Idaho 1989).
Illinois	Statute (accountant can limit liability by letter)	Ill. Comp. Stat. Ann. Chap. 225, § 450/30.1.
Indiana	Near Privity	<i>Toro Co. v. Krouse, Kern & Co.</i> , 827 F.2d 155 (7th Cir. 1987).
Iowa	Restatement § 552	<i>Eldred v. McGladrey, Hendrickson & Pullen</i> , 468 N.W.2d 217 (Iowa 1991).
Kansas	Statute (similar to near privity)	Kan. Stat. Ann § 1-402.
Kentucky	Restatement §552	<i>Ingram Indus., Inc. v. Nowicki</i> , 527 F. Supp. 683 (E.D. Ky. 1981).
Louisiana	Restatement § 552	<i>First Nat'l Bank of Commerce v. Monco Agency Inc.</i> , 911 F.2d 1053 (5th Cir.1990).
Maine	Restatement § 552	<i>Bowers v. Allied Inv. Corp.</i> , 822 F. Supp. 835 (D. Me. 1993).
Massachusetts	Restatement § 552	<i>Nycal Corp. v. KPMG Peat Marwick LLP</i> , 688 N.E. 2d 1368 (Mass. 1998).
Maryland	Near Privity	<i>PPM America, Inc. v. Marriott Corp.</i> , 820 F. Supp. 970 (D. Md. 1993). <i>Walpert, Smullian & Blumenthal, P.A. v. Katz</i> , 762 A.2d 582 (Md. 2000)
Michigan	Statute (accountant can limit liability by letter) Restatement § 552	M.C.L.A. § 600.2962. <i>Law Offices of Lawrence J. Stockler, P.C. v. Rose</i> , 436 N.W. 2d 70 (Mich. App. 1989).
Minnesota	Restatement § 552	<i>NorAm Inv. Servs., Inc., v. Stirtz, Bernards, Boyden, Surdel & Larter</i> , 611 N.W.2d 372 (Minn. App. 2000).
Mississippi	Foreseeability	<i>MidAmerican Bank & Trust Co. v. Harrison</i> , 851 S.W.2d 563 (Mo. Ct. App. 1993) <i>Touche Ross &</i>

		<i>Co. v. Commercial Union Ins. Co.</i> , 514 So. 2d 315 (Miss. 1987).
Missouri	Restatement § 552	<i>Mark Twain Plaza Bank v. Lowell H. Listrom & Co.</i> , 714 S.W. 2d 859 (Mo. App. 1986). <i>MidAmerican Bank & Trust Co. v. Harrison</i> , 851 S.W.2d 563 (Mo. Ct. App. 1993)
Montana	Near Privity	<i>Thayer v. Hicks</i> , 793 P.2d 784 (Mont. 1990).
Nebraska	Restatement §552 Privity	<i>St. Paul Fire & Marine Ins. Co. v. Touche Ross & Co.</i> , 507 N.W.2d 275 (Neb. 1993). <i>Citizens Nat. Bank of Wisner v. Kennedy and Coe</i> , 441 N.W.2d 180 (Neb. 1989).
Nevada	Privity	<i>Eikelberger v. Rogers</i> , 549 P.2d 748 (Nev. 1976).
New Hampshire	Restatement § 552	<i>Spherex, Inc. v. Alexander Grant & Co.</i> , 451 A.2d 1308 (N.H. 1982). <i>Demetracopoulos v. Wilson</i> , 640 A.2d 279 (N.H. 1994)
New Jersey	Statute similar to near privity Foreseeability	N.J. Stat. Ann. § 2A: 53A-25. <i>H. Rosenblum, Inc. v. Adler</i> , 461 A.2d 138 (N.J. 1983).
New Mexico	None specified to date	
New York	Near Privity	<i>Parrott v. Coopers & Lybrand</i> , 741 N.E.2d 506 (N.Y. 2000).
North Carolina	Restatement § 552	<i>Raritan River Steel Co. v. Cherry, Bekaert & Holland</i> , 367 S.E. 2d 609 (N.C. 1988). <i>Marcus Bros. Textiles, Inc. v. Price Waterhouse, LLP</i> , 513 S.E.2d 320 (N.C. 1999)
North Dakota	None specified to date	
Ohio	Restatement § 552	<i>Haddon View Inv. Co. v. Coopers & Lybrand</i> , 436 N.E.2d 212 (Ohio 1982). <i>Fed. Mgt. Co. v. Coopers & Lybrand</i> , 738 N.E.2d

		842 (Ohio Ct. App. 2000)
Oklahoma	Foreseeability	<i>Stroud v. Arthur Andersen</i> , 37 P.3d 783 (Okla. 2001).
Oregon	Restatement §552	<i>U.S. Nat'l Bank of Oregon v. Fought</i> , 630 P. 2d 337 (Or. 1981).
Pennsylvania	Privity	<i>Pell v. Weinstein</i> , 759 F. Supp. 1107 (M.D. Pa. 1991).
Rhode Island	Restatement § 552	<i>Forcier v. Cardello</i> , 173 B.R. 973 (D. R.I. 1994).
South Carolina	Restatement § 552	<i>ML-Lee Acquisition Fund, L.P. v. Deloitte & Touche</i> , 489 S.E. 2d 470 (S.C. 1997).
South Dakota	None specified to date	
Tennessee	Restatement § 552	<i>Bethlehem Steel Corp. v. Ernst & Whinney</i> , 822 S.W.2d 592 (Tenn. 1991).
Texas	Restatement § 552	<i>Scottish Heritable Trust v. Peat Marwick Main & Co.</i> , 81 F.3d 606 (5th Cir.1996).
Utah	Statute (accountant can limit liability by letter) Restatement §552	Utah Code Ann. § 58-26-12. <i>Milliner v. Elmer Fox & Co.</i> , 529 P.2d 806 (Utah 1974).
Vermont	Restatement § 552	<i>Nordica USA, Inc. v. Deloitte & Touche</i> , 839 F. Supp. 1082 (D. Vt. 1993).
Virginia	Privity	<i>Ward v. Ernst & Young</i> , 435 S.E.2d 628 (Va. 1993).
Washington	Restatement §552	<i>ESCA Corp. v. KPMG Peat Marwick</i> , 959 P.2d 651 (Wash. 1998).
West Virginia	Restatement § 552	<i>Costa v. Neimon</i> , 366 N.W.2d 896 (Wis. Ct. App.

		1985) <i>First Nat'l Bank v. Crawford</i> , 386 S.E.2d 310 (W. Va. 1989).
Wisconsin	Foreseeability	<i>Citizens Nat'l Bank v. Timm, Schmidt & Co.</i> , 335 N.W.2d 361 (Wis. 1983). <i>Costa v. Neimon</i> , 366 N.W.2d 896 (Wis. Ct. App. 1985)
Wyoming	Statute similar to near privity	Wyo. Stat. § 33-3-201.

APPENDIX II

MATRIX OF STATES APPLYING EACH STANDARD (Organized by Standard)

PRIVITY

Colorado
Nevada
Pennsylvania
Virginia

NEAR PRIVACY

Connecticut
Idaho
Indiana
Maryland
Montana
New York

RESTATEMENT §522

Alabama
Alaska
Arizona
California
Florida
Georgia
Hawaii
Iowa
Kentucky
Louisiana
Massachusetts
Maine
Michigan*
Minnesota

Missouri
Nebraska
New Hampshire
North Carolina
Ohio
Oregon
Rhode Island
South Carolina
Tennessee
Texas
Utah*
Vermont
Washington
West Virginia

FORESEEABILITY

Mississippi
New Jersey*
Oklahoma
Wisconsin

STATUTE

Arkansas
Illinois
Kansas
Michigan
New Jersey
Utah
Wyoming

NO STANDARD SPECIFIED TO DATE

Delaware
District of Columbia
New Mexico
North Dakota
South Dakota

* State governed also by statute.

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