STATE LEGISLATIVE RESPONSES TO THE CALL FOR REFORM OF ACCOUNTANTS' LIABILITY TO NONCLIENTS FOR NEGLIGENCE

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I. INTRODUCTION

Since the mid-1970s, the accounting profession has confronted a litigation crisis. The accounting profession faced an estimated thirty billion dollars in liability claims at the end of 1991.[1] In 1993 the Big Six accounting firms' expenditures for settling and defending lawsuits were $1.1 billion, or 11.9 percent of domestic auditing and accounting revenues.[2] As a result, insurers have reduced the availability and increased the cost of professional liability insurance.[3] Rising numbers of CPAs, especially partners, have departed the profession.[4] Also in 1993, the Big Six accounting firms warned of the possibility of more bankrupt accounting firms unless legal reforms were made.[5] Hence, one response of the accounting profession to the

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'Arthur Anderson & Co., Coopers & Lybrand, Deloitte & Touche, Ernst & Young, KPMG Peat Marwick & Price Waterhouse, *The Liability Crisis in the United States: Impact on the Accounting Profession,* Statement of Position (Aug. 1992)(on file with author).

[2]Dan Dalton, John Hill, & Robert Ramsay, *The Big Chill,* J. ACCT., Nov. 1994, at 53; J. Granelli, *Jumping Ship,* L. A. TIMES, Oct. 22, 1995, at Dl, col. 1.

[3]Deductibles of up to $20 million are common while maximum coverage for a Big Six firm has declined to $100 million. A. Cowan, *Settlements Alarming Auditors and Lawyers,* N. Y. TIMES, Apr. 1, 1992, at D8, col. 1. *See also* R. R. Lochner, Jr., *Accountants' Legal Liability: A Crisis that Must Be Addressed,* ACCOUNTING HORIZONS, June 1993, at 92, 94. Many small CPA firms carry no insurance at all. *Id.* at 94.

[4]lncreasing numbers of experienced CPAs departing the ranks of the profession "is of concern to both CPAs and society, because a sound public accounting profession is essential to a healthy free enterprise system. In particular, there is concern that an exodus of experienced personnel from public accounting will harm audit quality." Dalton et al., *supra note 2,* at 53. A decrease in audit quality, or reliability of accounting information, has serious implications for the use of accounting data by the capital markets. The Securities and Exchange Commission (SEC) has stressed the critical nature of reliability, or audit quality:

> The importance of accurate and complete issuer disclosure to the integrity of the securities markets cannot be overemphasized. To the extent that investors cannot rely upon the accuracy and completeness of issuer statements, they will be less likely to invest, thereby reducing the liquidity of the securities markets to the detriment of investors and issuers alike.

In re Carnation Co., Exchange Act Release No. 22,214, 33 SEC Docket 1025, 1030 (1985).

[5]In November 1990, Laventhol and Horwath, the then seventh largest accounting firm in America, filed for Chapter 11 bankruptcy due to $2 billion in damage requests from pending lawsuits. The Big 6 firms did not consider themselves immune from the possibility of bankruptcy. Steven Marino & Renee Marino, *An Empirical Study of Recent Securities Class Action Settlements Involving Accountants, Attorneys or Underwriters,* 22 SEC. REG. L. J. 115, 149 n. 32 (1994) (citing an unpublished paper submitted to the SEC by the Big Six accounting firms).

litigation epidemic has been to launch a campaign aimed at legislative reform.

In 1986, a model accountants' privity statute was proposed by the American Institute of Certified Public Accountants ("AICPA").[6] In 1988, the AICPA established the Accountants' Legal Liability Subcommittee to study the federal and state laws affecting the liability of accountants.[7] Although lawsuits against accountants remain a problem, recent legislation indicates that the profession's efforts are producing results. In late 1995, Congress passed the Private Securities Litigation Reform Act of 1995.[8] This legislation includes numerous amendments to the federal securities laws that either restrict the scope of accountants' liability or reduce the damages paid by accountants.[9] While some notable lawsuits have been filed against accountants under

6.The model statute is entitled "A Statute for a Privity Requirement in Suits for Negligent Performance of Accounting Services." The model law reads as follows:

I. Applicability of Chapter-Suits for Negligent Performance of Accounting Services

a. This chapter applies to all causes of action of the type specified herein filed on or after the effective date.

b. This chapter governs any action based on negligence brought against any accountant or firm of accountants registered, licensed or practicing in this state by any person or entity claiming to have been injured as a result of financial statements or other information examined, compiled, reviewed, certified, audited or otherwise reported or opined on by the defendant accountant.

II. Requirement of Privity

No action covered by this chapter may be brought in any court in this state unless:

(a) The plaintiff (1) is the issuer (or successor of the issuer) of the financial statement or other information examined, compiled, reviewed, certified, audited or otherwise reported or opined on by the defendant accountant and (2) engaged the defendant accountant to examine, compile, review, certify, audit or otherwise report or render an opinion on such financial statements; or

(b) The defendant accountant: (1) was aware at the time the engagement was undertaken that the financial statements were to be made available for use in connection with a specified transaction by the plaintiff who was specifically identified to the defendant accountant; (2) was aware that the plaintiff intended to rely upon such financial statements in connection with such specified transaction; and (3) had direct contact and communication with the plaintiff and expressed by words or conduct the defendant accountant's understanding of the plaintiffs reliance on such financial statements or other information.

Michael Polelle, *Accountants' Privity Shield: An Illinois Mistake*? 38 DE Paul L. REV. 685, 695 (1989).

[7]Dan L. Goldwasser, *Is the Storm Ending?* CPA J., Oct. 1995, at 16; Gary M. Bolinger et al., *Legislating Liability Reform*, J. ACCT., July 1993, at 52.

8.Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995).

9.Some of the most important provisions of the Private Securities Litigation Reform Act for accountants include the limitation of joint and several liability. The imposition of joint and several liability can require one defendant to pay one hundred percent of the damages regardless of the degree of fault. Defendants, such as accountants, who do not intentionally violate the securities laws are responsible only for their share of the judgment. Two exceptions exist: (1) for those plaintiffs who demonstrate they are entitled to damages greater than 10 percent of their net worth (which may not exceed $200,000); and (2) when a defendant is insolvent each of the remaining defendants must pay up to 50 percent of their own liability as damages. 15 U.S.C. § 78 u-4, 109 Stat. 758 (1995). Another important provision of the act is its limitation on the damages an accountant can be held liable for under Section 10(b) of the Securities Exchange Act of 1934.

the federal securities laws, the vast majority of claims and large verdicts against accountants have been in state courts in which state tort rules are applied.[10]

Accountants continue to confront the threat of litigation, based on state tort theories, whenever non-clients incur financial or economic losses.[11] Negligent misrepresentation is one of the most significant state tort theories.[12] Many courts, law review commentators, and attorneys confuse the separate torts of negligence and negligent misrepresentation. *Bily* v. *Arthur Young and Co.,* 834 P.2d 745, 768 (Cal.
1992) . The key difference is that the plaintiff must justifiably rely on the information supplied by the accountant's work product to recover damages for negligent misrepresentation. *Id.* at 772. This article will use both terms to refer to negligent misrepresentation because most court decisions and law review articles do so. For more discussion on the distinction made between negligence and negligent misrepresentation by the *Bily* court, see Thomas G. Mackey, Accountants' Liability After *Bily* v. *Arthur Young & Co.:* A More Equitable Proposal for Third Party Recovery, 45 HASTINGS L. J. 147, 160-162 (1993). Under this theory, nonclient plaintiffs argue that their reliance on accounting information served as the principal

Traditionally, a plaintiffs damages are the difference between the purchase price of the security and either
(1) the price at which the security was sold or (2) the price of the security when the market has adjusted to public discovery of an alleged misrepresentation. *Affiliated Ute Citizens* v. *U.S.,* 406 U.S. 128, 154-155 (1972); *Nelson v. Serwold,* 687 F.2d 278, 280-281 (9th Cir. 1982). The computation of damages in this manner has the potential to overestimate substantially the plaintiffs actual damages. Baruch Lev & M. deVilliers, *Stock Price Crashes and 10b-5: A Legal, Economic and Policy Analysis,* 47 STAN. L. REV. 7, 10
(1994) . One amendment to the Securities Exchange Act of 1934 provides that civil damages cannot exceed the difference between the security purchase or sale price and the mean trading price of the security during the 90-day period starting on the date of disclosure of the misstatement or omission. 15 U.S.C. § 78u-4, 109 Stat. 748 (1995). Finally, the act requires that any plaintiff bringing a § 10(b) suit must prove that the accountant's material misstatement or omission actually caused the loss. 15 U.S.C. § 78u-5, 109 Stat. 757
(1995) . For a discussion of provisions of the Private Securities Litigation Reform Act of 1995 applicable to accountants see Ronald R. King & Rachel Schwartz, *The Private Securities Litigation Reform Act of 1995: A Discussion of Three Provisions,* 11 ACCOUNTING HORIZONS, Mar. 1997, at 92; Joel Seligman, *The Private Securities Reform Act of 1995,* 38 ARIZ. L. Rev. 717 (1996); Harvey L. Pitt et al„ *Promises Made, Promises Kept: The Practical Implications of the Private Securities Litigation Reform Act of 1995,* 33 SAN DIEGO L. Rev. 845 (1996); Carl W. Schneider & Jay Dubow, *Forward-Looking Information-Navigating the Safe Harbor,* 51 Bus. LAW. 1071 (1996); Robert B. Thompson, *"Simplicity and Certainty" in the Measure of Recovery Under Rule 10b-5,* 51 BUS. Law. 1177 (1996).

[10]Legal Liability Task Force, National Association of State Boards of Accountancy, *Current Legal Liability Issues of Concern to State Boards of Accountancy* (1994) (on file with author); Arthur Andersen et al„ *supra* note 1. Accounting/auditing related settlements and judgements arising from cases with state law claims but no federal securities claims increased by a factor of twelve between 1990 and 1992. Marino & Marino, *supra* note 5, at 153.

11.Bonita A. Daley & John M. Gibson, *The Delineation of Accountants' Legal Liability to Third Parties: Bily and Beyond,* 68 St. JOHN'S L. Rev. 609, 610 (1994).

[12]*Id.* The reasons are: (1) it is not as difficult to prove as fraud. In the latter, the plaintiff must prove intent to deceive or in some cases, recklessness, on the part of the accountant; (2) state securities laws apply only to purchasers and/or sellers of securities; and (3) nonclients cannot sue for breach of contract. Many courts, law review comentators, and attorneys confuse the separate torts of negligence and negligent misrepresentation. *See* Bily v. Arthur Young & Co., 834 P.2d 745, 768 (Cal. 1992). The key difference is that the plaintiff must justifiably rely on the information supplied by the accountant's work product to recover damages for negligent misrepresentation because most court decisions and law review articles do so. For more discussion on the distinction made between negligence and negligent misrepresentation by the *Bily* court, see Thomas G. Mackey, *Accountants' Liability After Bily v. Arthur Young & Co.: A More Equitable Proposal for Third Party Recovery,* 45 HASTINGS L.J. 147, 160-162 (1993).

basis for their investments or loans.[13] Hence, the issue for state tort reform legislation is the extent to which someone other than the client is owed a professional duty and can sue or has the standing to sue an accountant over a negligent audit.[14]

The purposes of this article are threefold. The first is to assess the current status of accountant privity law reform. The second purpose is to examine judicial decisions made under various state privity statutes in light of the different legal standards used by the states in deciding which third parties have standing to sue accountants for negligence. The third purpose is to enhance and update the knowledge of attorneys, regulators, accountants[15] and educators about accountants' legal responsibilities to nonclients for negligence. A precise statement of legal standards, especially statutory ones, enhances one's ability, ex ante, to gauge an accountant's liability exposure.[16]

II. Overview of the Various Legal Standards to Determine Accountant Liability to Nonclients for Negligent Misrepresentation

Prior to enactment of any accountant privity statute, four main approaches or legal standards evolved to decide which nonclients are owed a duty by accountants for negligent misrepresentation. These four rules are: (1) privity (a direct connection or a contractual relationship between two parties); (2) near privity; (3) the known users or *Restatement* approach; and (4) the reasonable foreseeability rule. These four rules are not discrete points but lie on a continuum. These various approaches can lead to a different outcome, that is, whether or not the non-client has a right to sue, under the same set of facts.[17] An outline of the four main approaches is a starting point for an analysis of accountant privity statutes.

[13]Daley & Gibson, *supra* note 11, at 610. Negligent misrepresentation evolved from the tort of fraud. The necessary elements are: (1) the defendant (or accountant) negligently asserts a false statement to a plaintiff (or nonclient) to whom a duty of care is owed; (2) the defendant (or accountant) intends that his statement will be acted upon by the plaintiff; (3) the defendant has knowledge that the plaintiff (or third-party user) will probably rely on the statement, which, if erroneous, will cause loss or injury; (4) the plaintiff justifiably relies on the statement; (5) the plaintiff suffers actual damage; and (6) the damage was proximately caused by the defendant's conduct. Martens Chevrolet, Inc,, v. Seney, 439 A. 2d 534, 539 (Md. App. 1982).

[14]Legal Liability Task Force, *supra* note 10; Daley & Gibson, *supra* note 11, at 610. State law which deals with this issue is usually referred to as privity legislation.

[15]The terms accountant and auditor will be used interchangeably. However, it should be noted that it is auditing services which give rise to the greatest liability exposure.

[16]John Siciliano, *Negligent Accounting and the Limits of Instrumental Tort Reform*, 86 MICH. L. REV. 1929, 1955 (1988).

[17]One prime example of such a situation occurred in Performance Motorcars v. Peat Marwick, 643 A. 2d 39 (N.J. Super. 1994). Performance Motorcars, Inc., a New York business, sued Peat Marwick in a New Jersey court, alleging that it suffered losses after one of its customers. Coated Sales, Inc., went bankrupt. *Id.* at 40. Performance claimed it had relied on audited financial statements negligently prepared by Peat Marwick. *Id.* Performance conceded that if New York law applied, it would not be able to sue Peat Marwick. *Id.* Ultimately, an appeals court held that New Jersey law applied giving Performance a legal right to sue under New Jersey law applicable at the time of the suit. In 1995, the New Jersey legislature passed a statute which changed state law to a stricter standard than the one applied in *Performance Motorcars* for determining the scope of an accountant's duty to nonclients. N.J. STAT. Ann. § 2A : 53A-25 (West 1996).

A. Privity Rule

The requirement of strict privity to establish an accountant's duty to nonclients is the most restrictive standard on the liability continuum. Strict privity was first established as a state standard in *Landell* v. *Lybrand.*[18] Today, strict privity is the law in only Pennsylvania and Virginia.[19]

B. Near Privity Standard

The near privity standard was first applied to determine the scope of an accountant's duty to nonclients for negligence in *Ultramares Corporation v. Touche}*[0] In that case, Touche, Niven & Company, CPAs, were engaged to audit the balance sheet of Fred Stern & Company, a rubber importer, for fiscal year end 1923.[21] Touche gave the Stern firm thirty-two copies of the certified balance sheet in March 1924, knowing that it would be shown to various creditors and stockholders.[22] Ultramares, a factoring business, made numerous loans to Stern in reliance on the audited balance sheet.[23] In January 1925, Stern went bankrupt.[24] The New York Court of Appeals denied Ultramares' negligence claim.[25] However, the court of appeals fashioned an exception to strict privity that has become known as the primary benefit rule, that is, the plaintiff must be an intended third-party beneficiary.[26] The court reasoned that although Touche knew the balance sheet would be shown to various unidentified creditors and stockholders, Touche had not been hired by Stern with the knowledge that Ultramares was an intended third-party beneficiary of Touche's work.[27] Overly rigorous interpretations of *Ultramares* over the years have resulted in the case symbolizing a privity requirement for recovery under negligent misrepresentation.[28]

Over fifty years later, the New York Court of Appeals affirmed its adherence

18.107 A. 783 (Pa. 1919). In Pennsylvania, strict privity continues to be the prevailing rule of law. Guy v. Liederbach, 459 A. 2d. 744 (Pa. 1983).

[19]In Virginia, strict privity became the applicable legal standard in 1993. Ward v. Ernst & Young, 435 S.E. 2d 628 (Va. 1993).

[20]174 N.E. 441 (N.Y. 1931).

21.ld. at 442.

[22]Id.

[23].ld. at 443.

[24.I]d.

[25]*Id.* at 446-447. The decision in Glanzer v. Shepard, 135 N.E. 275 (N.Y. 1922), influenced the outcome reached in *Ultramares.* In *Glanzer,* the Court of Appeals held that a public weigher, hired by a seller of beans, was liable to a third party who purchased beans from the bean vendor. The third party was overcharged for the beans because the public weigher negligently overstated the weight of the beans. The public weigher had been hired by the seller to provide a weight certificate directly to the bean purchaser. In distinguishing *Glanzer* from *Ultramares,* Judge Cardozo noted that the service rendered by the public weigher was primarily for the information of a third person while in *Ultramares* the auditor's service was primarily for the benefit of the Stem Company (the auditor's client) and only collaterally for the use of third parties.

[26]*Ultramares,* 174 N. E. at 445-446.

[27.] Id at 446.

[28]R. J. Gormley, *The Foreseen, the Foreseeable and Beyond—Accountants' Liability to Nonclients,* 14 SETON HALL L. Rev. 528, 531-532 (1984); Daley & Gibson, *supra* note 11, at 620.

to a near privity rule in *Credit Alliance* v. *Arthur Andersen & Company.*[29] The court characterized its holding as a clarification and extension of *Ultramares* and *Glanzer.*[30] The clarification consists of a three-prong test that a nonclient must meet to fall within the ambit of an auditor's duty for purposes of negligent misrepresentation. The three elements are: (1) the accountant must have known that the financial reports were to be used for a particular purpose or purposes; (2) in the furtherance of which a known party or parties was intended to rely; and (3) there must have been some conduct on the part of the accountants linking them to that party or parties, which indicates the accountant's understanding of that party's or parties' reliance.[31] Affirmative conduct on the part of the accountants linking them to the relying party, in the eyes of the New York court, is an extension of *Ultramares* and *Glanzer*. Linking conduct, however, is left undefined in the decision.

A companion case to *Credit Alliance*, however, sheds some light on the linking requirement. In *European American Bank* v. *Strauhs & Kay*[32] the linking conduct test was met by direct communication, both orally and in writing, and a series of personal meetings between the plaintiffs and the accountants.[33] New York upheld the *Credit Alliance* rule in 1992.[3] By court decision, Connecticut, Idaho, Montana, and Nebraska now follow the *Credit Alliance* near-privity rule or a minor variation thereof.[35]

C. THE RESTATEMENT APPROACH

In 1968, a federal district court in Rhode Island first expanded accountant liability for negligence to specifically foreseen or known users.[36] Specifically, the district court held that an accountant should be liable in negligent misrepresentation for financial misinformation relied upon by actually foreseen and limited classes of persons.[37] The district court actually applied section 552 of the Restatement (Second) of Torts, a compendium of law drafted by the American Law Institute.[38] Under the

[29]483 N. E. 2d 110 (N.Y. 1985). Credit Alliance Corporation provided equipment financing to L. B. Smith, Inc., for many years. *Id.* at 111. In 1978, Credit Alliance advised Smith that any future extensions of credit would require audited financial statements. *Id.* Smith provided Credit Alliance with its consolidated financial statements, including an unqualified opinion from Arthur Andersen, for fiscal years 1976 through 1979. *Id.* In 1980, L. B. Smith, Inc., filed for bankruptcy. *Id.* at 112.

30.Id. at 118.

31.Id.

[32]483 N.E. 2d 110 (N. Y. 1985).

[33]W. at 120.

34.Security Pacific v. Peat Marwick Main, 597 N. E. 2d 110 (N. Y. 1985).

35.See Twin Mfg. Co. v. Blum, Shapiro & Co., 602 A. 2d. 1079 (Conn. Super. 1991); Idaho Bank & Trust v. First Bancorp., 772 P. 2d 720 (Idaho 1989); Thayer v. Hicks, 793 P. 2d 784 (Mont. 1990); Citizens Nat. Bank v. Kennedy & Coe, 441 N. W. 2d 189 (Neb. 1989).

[36]Rusch Factors, Inc. v. Levin, 284 F. Supp. 85 (D. R.I. 1968).

[37]*Id.* at 93.

38.RESTATEMENT (SECOND) OF TORTS § 552 (1977). Restatements are a product of attorneys working under the aegis of the American Law Institute. Restatements are not binding authority on courts but represent a synthesis of common law rules. The text of §552 reads as follows:

> §552. Information Negligently Supplied for the Guidance of Others
>
> (1) One who, in the course of his business, profession or employment, or in any other

standard, an accountant who audits or prepares financial information for a client: (1) owes a duty not only to the client but to any other person or one of a group of persons whom the accountant or client intends the information to benefit; (2) that person justifiably relies on the information in a transaction or one substantially similar to it that the accountant or his client intends the information to influence; and (3) that person suffers a pecuniary loss as a result of his reliance.[39] No liability exists, however, to parties whom the auditor had no reason to believe the information would be made available, or when the client's transaction, as represented to the auditor, changes so as to increase materially the audit risk.[40] Historically, courts have had some difficulty in applying the Restatement rule because no bright line exists to distinguish one type of user from another in any given situation.[41] Despite such difficulty, certain general principles have evolved from application of the Restatement standard in numerous cases.

The accountant need not know the exact identity of the nonclient to be held liable under the Restatement standard [42] A duty is owed to those persons, or the limited class of persons, who the professional is actually aware will rely upon the information.[43] It is the notice of the intended use or reliance, not the size of the group of potential users, which is important.[44] In fact, the Restatement rule does not extend accountant liability to third parties if no accountant-client communications exist concerning the intended use of the report.[45] The accountant must supply the information or know that his client intends to supply the information to a person or a

> transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2).. . [T]he liability stated in Subsection (1) is limited to loss suffered
>
> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

39.Id. See also Daley & Gibson, *supra* note 11, at 632.

40.RESTATEMENT (SECOND) OF TORTS §552(2) cmts. i, j; Daley & Gibson, *supra* note 11, at 627. *Audit risk* is the risk that the auditor will unknowingly fail to appropriately modify his opinion on financial statements that are materially misstated. W. C. BOYNTON & W. G. KELL, MODERN AUDITING 231 (6th ed. 1996).

[41]Richard S. Panttaja, *Accountants' Duty to Third Parties: A Search for a Fair Doctrine of Liability,* 23 STETSON L. REV. 927, 941 (1994); Bethlehem Steel Corp. v. Ernst & Whinney, 822 S.W. 2d 592, 595 (Tenn. 1991); Raritan River Steel v. Cherry, 367 S.E. 2d 609, 617 (N.C. 1988).

[42]Amwest Sur. Ins. Co. v. Ernst & Young, 677 So. 2d 409, 411 (Fla. Dist. Ct. App. 1996); RESTATEMENT (SECOND) OF TORTS §552 cmt. h (1977).

[43]Badische Corp. v. Caylor, 356 S.E.2d 198, 200 (Ga. 1987).

44.Amwest Sur. Ins. Co., 677 So. 2d 409,411 (Fla. Dist. Ct. App. 1996). By receiving notice of the third parties to whom potential liability may be incurred, the auditor can decide whether to accept the engagement, adjust the audit plan to meet the needs of third parties, and negotiate audit fees that are commensurate with the scope of liability. Daly & Gibson, *supra* note 11, at 633.

[45]Badische Corp. v. Caylor, 356 S.E.2d 198, 199-200 (Ga. 1987); RESTATEMENT (SECOND) OF TORTS §552(2)(a) & (b); Brian K. Kirby & Thomas L. Davies, *Accountant Liability: New Exposure for An Old Profession,* 36 San DIEGO L. REV. 581, 584 (1991).

limited group of persons.[46] The major difference between the primary benefit rule of *Ultramares* and the Restatement or known users' rule is that the latter does not require the identity of specific parties be known to the auditor, only that they be members of a limited group known to the auditor.[47] The Restatement standard enlarges the class of persons to whom the accountant owes a duty to intended *identifiable* beneficiaries and to any unidentified members of the *intended* class of beneficiaries.[48] Eighteen states currently follow the Restatement standard or a variation thereof.[49]

D. THE REASONABLE FORESEEABILITY RULE

Auditor liability to nonclients expanded again in 1983 with the decision in *Rosenblum* v. *Adler*,[50] In its decision, the New Jersey Supreme Court cited a series of product liability cases that demonstrate that negligent misrepresentations may be the basis for liability irrespective of privity/[1] The court viewed damages for physical injury as analogous to damages for economic loss, raising the query, "[I]f recovery for defective products may include economic loss, why should such loss not be compensable if caused by negligent misrepresentation?"[52] The court concluded that an auditor has a duty to all those whom the auditor should reasonably foresee as receiving and relying on the audited statements.'' However, the duty extends only to those users whose decision is influenced by audited statements obtained from the audited entity for a proper business purpose.'[4] The court's holding indicates that "the auditor owes a

46.Raritan River Steel v. Cherry, 367 S.E.2d 609, 614 (N.C. 1988) According to this case, the Restatement requires only that the auditor *know* at the time he audits or prepares his report that his client intends to supply information to another person or limited group of persons. Whether the auditor acquires this knowledge from his client or elsewhere is irrelevant. *Id.* at 618.

47.T. Gossman, *The Fallacy of Expanding Accountants' Liability,* 1988 COLUM. BUS. L. REV. 213, 218.

48.Ryan v. Kanne, 170 N.W.2d 395, 403 (Iowa 1969). Intent to influence a class of beneficiaries is a threshold issue. A plaintiff may rely on an accountant's misrepresentation but no liability exists without intent to influence. Bily v. Arthur Young & Co., 834 P.2d 745,771 (Cal. 1992).

49.*See* Boykin v. Arthur Anderson & Co., 639 So. 2d 504 (Ala. 1994); Seiden v. Burnett, 754 P.2d 256 (Alaska 1988); Standard Chtd. v. Price Waterhouse, 1996 Ariz. App. LEXIS 243 (Ariz. Ct. App. 1997); Bily v. Arthur Young & Co., 834 P. 2d 745 (Cal. 1992); Cent Bank v. Mehaffy, Rider, Windholz et al., 892 P.2d 230 (Colo. 1995); First Fla. Bank v. Max Mitchell & Co., 558 So. 2d 9 (Ha. 1990); Badische Corp v. Caylor, 356 S.E.2d 198 (Ga. 1987); Kohala Agriculture et al. v. Deloitte & Touche, 949 P.2d 141 (Haw. App. 1997); DeRyan v. Kanne, 170 N.W.2d 395 (Iowa. 1969); Nycal Corp. v. KPMG Peat Marwick, 688 N.E.2d 1368 (Mass. 1998); Bonhiver v. Graff, 248 N.W.2d 291 (Minn. 1976); MidAmerican Bank & Trust Co. v. Harrison, 851 S.W.2d 563 (Mo. App. 1993); Spherex, Inc. v. Alexander Grant & Co., 451 A.2d 1308 (N.H. 1982); Raritan River Steel v. Cherry, etc., 367 S.E.2d 609 (N.C. 1988); Haddon View Inv. Co. v. Coopers & Lybrand, 436 N.E.2d 212 (Oh. 1982); ML-Lee Acquisition Fund, L.P. v. Deloitte & Touche, 463 S.E.2d 618 (S.C. App. 1995); Bethlehem Steel Corp. v. Ernst & Whinney, 822 S.W.2d 592 (Tenn. 1991); Blue Bell v. Peat. Marwick, Mitchell & Co., 715 S.W.2d 408 (Tex. App.-Dallas 1986); Haberman v. Public Power Supply System, 744 P.2d 1032 (Wash. 1987); First Nat. Bank of Bluefield v. Crawford, 386 S.E.2d 310 (W.Va. 1989).

50.461 A.2d 138 (N. J. 1983). The holding in this case ceased to be law in March 1995 upon the enactment of an accountant liability statute. N. J. STAT. Ann. §2A-53A-25 (West 19%).

51.Rosenblum, 461 A.2dat 145-146.

52.*Id.* at 147. Jodi B. Scherl, *Evolution of Auditor Liability to Noncontractual Third Parties: Balancing the Equities and Weighing the Consequences,* 44 AM. U. L. REV. 256, 272 (1994).

53. Rosenblum, 46\ A.2d at 153.

54. Id.

duty of care to all who obtain a firm's financial statement directly from the audited entity, but owes no such duty of care to those who obtain it from an annual report in a library or from a government file."[55] At the time, *Rosenblum* radically altered accountants' negligence liability by extending the accountants' duty of care to reasonably foreseeable third parties under certain circumstances.[56] Today, however, only Mississippi and Wisconsin follow the reasonable foreseeability standard.[57]

III. STATE ACCOUNTANT PRIVITY STATUTES

The trend toward a narrower scope of liability due to legislative reform started when Illinois passed an accountant liability statute in 1986. Since that year, Arkansas, Illinois, Kansas, Michigan, New Jersey, Utah, and Wyoming have enacted statutes which address accountants' liability to nonclients for negligence.[58] These new accountant liability statutes can be classified collectively in the near-privity category because such statutes have a narrower scope of duty than Restatement section 552, but a wider scope of duty than the *Credit Alliance* test or the *Ultramares* rule. The statutes do, however, exhibit some variation.

A. Arkansas, Illinois, and Utah

The Arkansas, Illinois, and Utah statutes are considered together because they possess virtually identical language.[59] Despite the common wording, the statute has been interpreted differently creating uncertainty for accountants, lawyers, and

[55]Denzl Causey, *Accountants' Liability In An Indeterminate Amount for An Indeterminate Class: An Analysis of Touche Ross & Co. v. Commercial Union Ins. Co.*, 57 Miss. L. J. 379, 380 (1987).

[56]Willis Hagen III, *Accountants' Common Law Liability to Third Parties*, 1988 COLUM. Bus. L. REV. 181, 189. The holding in *Rosenblum* became ineffective in March 1995 upon passage of an accountant liability statute by the New Jersey legislature. *See* text accompanying notes 112-118 *infra.*

[57]*See* Touche Ross v. Commercial Union Insurance Co., 514 So. 2d 315 (Miss. 1987); Citizens State Bank v. Timm, Schmidt & Co., 335 N.W.2d 361 (Wis. 1983).

[58]*See* Ark. CODE ANN. § 16-114-302 (Michie 1991); 225 III. COMP. STAT. 450/30.1 (West 1996); KAN. STAT. ANN. §1-402 (West 1993); MICH. COMP. LAWS §600.2962 (1996); N.J. STAT. ANN. §2A:53A- 25 (West 1995); UTAH CODE ANN. §58-26-12 (1994); WYO. STAT. ANN. § 33-3-201 (Michie 1996). The operative language for each state statute discussed can be seen *infra* at Table 1.

[59]The Arkansas statute reads as follows:

> No person . . . shall be liable to persons not in privity of contract... for civil damages resulting from acts, omissions, decisions, or other conduct in connection with professional services, except for:
> (2) Other acts, omissions, decisions, or conduct, if the person, partnership or corporation was aware that a primary intent of the client was for the professional services to benefit or influence the person bringing the action. .. . For purposes of this subdivision, if the person, partnership, or corporation:
> (A) Identifies in writing to the client those persons who are intended to rely on the services, and
> (B) Sends a copy of the writing or similar statement to those persons identified in the writing or statement, then the person . . . may be held liable only to the persons intended to rely in addition to those persons in privity of contract.. ..

ARK. CODE ANN. §16-114-302 (Michie 1991).

regulators. In fact, distinct constructions have been placed on the statute by federal and state courts in Illinois.[60]

Robin v. *Falbo*,[61] a federal district court case, was first to construe the Illinois accountant liability statute. In that case, Berry, McEnerney, & Cukierski, the defendant accounting firm, allegedly persuaded the plaintiffs, Dr. Erwin Robin, Mary Robin, and Dr. H. Jae Ihm, to invest in the Meadows Limited Partnership through material false and misleading statements and omissions.[62] The district court acknowledged that the operative language of the statute[63] may be reasonably interpreted in more than one way.[64] First, the language may be construed as making liability to a nonclient "conditioned upon" the auditor identifying in writing those who may rely on the auditor's work product. No liability attaches without such a writing from the accountant.[65] Second, the words in the statute may be read as giving auditors an exemption from liability to third parties when the auditor prepares a writing setting forth those nonclients who may rely and sends a copy of that writing to those persons.[66]

The district court noted that the first interpretation is odd but the legislative history of the law indicates that this was the intended meaning of the statute.[67] The first interpretation makes it effectively impossible for a nonclient to sue an accountant for negligent misrepresentation.[68] The accountant, rather than the client, must identify third parties who may rely on the accountant's work product and notify the client and third parties in order to be liable for negligent misrepresentation to third parties.

In 1993, the Northern District of Illinois again applied the same interpretation to the Illinois accountant liability statute.[69] No Illinois state court had construed the accountant liability statute before or at the time of the *Endo* ruling. In *Dougherty* v.

60.Several federal district court decisions addressed the Illinois accountant liability statute before any state appellate court rendered a statutory interpretation. Under the *Erie* doctrine, these federal court decisions interpreted the statute based on statutory rules of construction, legislative history, and the plain meaning of the operative language.

[61]NO. 91-C-2894, 1992 U.S. Dist. LEXIS 11075, at *1 (N. D. 111. July 23, 1992).

[62]*ld.* at *l-*2.

63.The Illinois statute reads in relevant part:

> No person, partnership or corporation...shall be liable to persons not in privity of contract with such person, partnership, or corporation.. .except for (2) such other acts, omissions, decisions or conduct, if such person, partnership or corporation was aware that a primary intent of the client was for the professional services to benefit or influence the particular person bringing the action; provided, however, for purposes of this subparagraph (2), if such person, partnership, or corporation (i) identifies in writing to the client those persons who are intended to rely on the services, and (ii) sends a copy of such writing...to those persons identified in the writing...then such person, partnership, or corporation.. .may be held liable only to such persons intended to so rely...

225 III. COMP. STAT. 450/30 (West 1996).

[64]*Robin,* 1992 U.S. Dist. LEXIS 11075, at *23. Specifically, the court questioned whether or not the second part of subsection 2 (defined as the part beginning, "provided, however") was a condition to the application of the exception set forth in the first part of subsection 2, or whether instead the second part of subsection 2 was merely an exemption to the exception set forth in the first part of subsection 2 *Id* at *23- *24.

65.ld. at *24.

66.Id.

[67]*Id*.

68.Dougherty v. Zimbler, 922 F. Supp. 110, 116 (N. D. III. 1996).

69.Endo v. Albertine, 812 F. Supp. 1479 (N. D. 111. 1993).

Zimbler[70] the Illinois accountant liability statute was given the same meaning as in the *Endo* and *Robin* decisions noted previously. However, the *Dougherty* court itself noted that no Illinois state court had yet published a decision interpreting the writing requirements of the statute.[71]

The statutory interpretation adopted in three separate decisions by an Illinois federal district court was followed by the Arkansas Supreme Court in *Swink* v. *Ernst & Young.*[12] In that case, James Swink, Jr., individually sued Ernst & Young based on a 1985 audit and tax services contract between Ernst & Young and Swink & Company, Inc.[73] James Swink, Jr., was not named as a party to the contract but he argued that he suffered losses as a result of an inaccurate audit for fiscal year 1988.[74] The state supreme court found that Swink, Jr. was neither a third-party beneficiary to the contract nor in privity with Ernst & Young.[75] The accountant taking the affirmative steps of written identification and notification were held to be a condition for liability to a third party for negligent misrepresentation.[76] Under the Arkansas interpretation, which is the same as the one followed by the Illinois federal district court, a nonclient must be in privity with the accountant to recover for negligent misrepresentation unless the nonclient has a writing from the accountant. The Arkansas approach is stricter than the most recent ruling by an Illinois state appellate court.

In *Chestnut* v. *Pestine Brinati et al.*,[77] the Illinois first district appellate court found that the statutory language[78] merely provides accountants with an exception to a general rule of liability where the accountant prepares and sends a writing to specific persons intended to rely on the accountant's services.[79] Plaintiff Chestnut Corporation invested $1,300,000 in Alphatype Corporation in reliance on Alphatype's 1987 and 1988 audited financial statements.[80] Alphatype lost large sums of money and filed for bankruptcy.[81] Chestnut Corporation sued Pestine Brinati. for negligent misrepresentation claiming that: (1) inventory was overstated; (2) accounts receivable was overstated; and (3) no accrual was made for vacation pay.[82] Defendant accountants argued for the statutory interpretation adopted by the federal district court in Illinois in *Robin*[w] and the Arkansas Supreme Court in *Swink v. Ernst & Young.*[*4] The first district appellate court disagreed by holding that the statutory language "if such person [accountant] . . . was aware that a primary intent of the client was for the

[70] *Dougherty,* 922 F. Supp. at 117.

[71] Id.

[72] 908 S.W.2d 660 (Ark. 1995).

[73] W. at 661.

74. Id.

[75] *Id.* at 663.

[76] *ld.* at 662-663.

[77] 667 N.E.2d 543 (111. App. 1996).

[78] *See supra* note 63.

[79] *Chesnut,* 667 N.E.2d at 546-47. The general rule of liability is that an accountant owes a duty to a nonclient if the accountant was aware that a primary intent of the client was for the professional services to benefit or influence the particular third party. *Id.* at 546. [m] *ld.* at 545.

80. ld.

[81] *Id.*

82. Id.

83. Robin, 1993 U.S. Dist. LEXIS 11075, at *24.

[84] *Swink,* 908 S.W.2d at 546.

professional services to benefit or influence the . . . person bringing the action" creates a general rule of accountant liability.[85] The court, however, did not address the question of the effect of a writing on the accountant's liability.[86] Under the *Chestnut* (Illinois) reading of the statute, a nonclient may state a cause of action under the statute without a writing.[87] If no writing from the accountant exists then the nonclient must prove the intent of the client and the accountant's knowledge of that intent.[88] The Illinois interpretation is still a near-privity standard but is not as narrow as the Arkansas standard.

In 1990 Utah enacted an accountant liability statute identical to the Arkansas and Illinois statutes.[89] No reported court cases have been decided by any Utah state court, but the federal district court in Vermont applied the Utah statute in *Nordica USA, Inc., v. Deloitte & Touched* In 1990, the Nordica Group and Fischer Gesellschaft ("Fischer") started talks on the possible sale of Fischer's wholly-owned subsidiary, Kastle AG.[91] Kastle USA was owned by Kastle AG.[92] Nordica alleged that copies of Kastle USA's audited financial statements were provided as part of the acquisition talks.[93] In September 1991, Nordica and Kastle AG entered into a stock purchase agreement pursuant to which Nordica bought all of the outstanding shares of Kastle USA.[94] In February 1992, Nordica USA, a subsidiary of Nordica Group, and Kastle USA merged.[95] Nordica filed suit against Deloitte & Touche ("D&T") claiming losses from overpayment for the stock of Kastle USA as a result of reliance on financial statements audited by D & T.[96]

The district court first decided that Nordica USA had standing to sue under Utah law and then applied Utah's accountant liability statute. As a nonclient, Nordica's claim had to fit within subsection two of the statute.[97] The main point of

[85] *Chestnut,* 667 N.E.2d at 546-547. In other words, the *Chestnut* court rejected a reading of the statutory provision that makes written notice to a third party a condition of liability for negligent misrepresentation. Christine M. Guerci, Annotation, *Liability of Independent Accountant to Investors or Shareholders,* 48 A. L. R. 5th 389, 418 (1997).

86. Chesnut, 667 N.E.2d. at 547.

[87] W. at 547.

88. Id.

89. UTAH CODE ANN. §58-26-12 (1994).

90. 839 F. Supp. 1982 (D. Vt. 1993).

[91] 1d at 1084.

92. *Id.*

[93] *Id.*

[94] *Id.* at 1085.

[95] *Id.*

[96] *Id.*

[97] Subsection two of Utah's accountant liability statute requires a nonclient to fit within the following exception to the privity rule:

> (2) Other acts, omissions, decisions, or conduct, if the person knew that a primary intent of the client was for the professional services to benefit or influence the particular person bringing the action; except, however, for the purposes of this subsection, if the person:
> (a) identified in writing to the client those persons who are intended to rely on the services; and
> (b) sent a copy of the writing or similar statement to the persons identified in the writing then he or any of his employees, partners, members, officers... may be liable only to the persons intended to rely...

contention centered on *when* the defendant accountant knew that a primary intent of the client was for the services rendered to benefit or influence a particular third party.[98] The statute is silent on when the accountant must possess the requisite knowledge of the client's intent. The district court decided that a defendant accountant must know of the client's intent to benefit or influence a third party "at the time the audit was performed."[99] Otherwise, accountants' liability to third parties under the statute would be virtually unlimited.[100] The court reasoned that a client could contract for audit services and forward the documents to third parties years later creating the specter of indeterminate liability for auditors.[101]

B. Kansas

In 1987, Kansas enacted a statute which does not require affirmative conduct by the accountant to restrict his liability.[102] Four conditions must occur for a nonclient to have a legal right to sue: (1) the accountant knew the third party intended to rely on the services;[103] (2) the accountant knew the services rendered the client would be made available to the third party;[104] (3) the nonclient must be identified in writing to the accountant;[105] and (4) the third party's reliance must be in connection with specific transactions identified in writing.[106] Any writing which identifies the relying plaintiff and specific transaction(s) need not originate with the accountant,[107] as required under the Arkansas and Utah statutes.[108] Unlike Arkansas, Illinois, and Utah,[109] the Kansas statute clearly indicates that the accountant must have known of the third party's reliance during the engagement or assented to such reliance with the client after the engagement.[1] Moreover, the Kansas statute explicitly mentions that liability extends only to "specified transactions described in writing" while the Arkansas, Illinois, and Utah statutes set forth no such requirement.[111] In sum, the Kansas statute appears to be somewhat more restrictive than the Illinois statute, as presently construed, but not as narrow as the Arkansas statute, as currently applied.

UTAH CODE ANN. §58-26-12 (2) (1994). The Utah statute is virtually identical to the Arkansas and Illinois statutes.

98.*Nordica USA*, 839 F. Supp. at 1090.

99.*Id.*

100.*Id.* at 1090-91.

101.*Id.*

102.KAN. STAT. ANN. §1-402 (1993).

103.*Id.* at §1 -402(b)(2).

104.*Id.* at §1-402(b)(1).

105.*Id.*

106.*Id.* at §1-402(b)(2).

107.*Id.* at §1-402(b).

108.ARK. CODE ANN. §16-114-302(2) (Michie 1991); UTAH CODE ANN. § 58-26-12(2) (1994).

109.The accountant liability statutes in Arkansas, Illinois, and Utah are silent on whether or not the accountant's awareness or knowledge of the client's intent can occur after reliance on the financial statements by the nonclient. None of these three statutes defines precisely when the accountant *was aware* of the primary intent of the client.

110.SCAN. ST AT. ANN. § 1-402(b)(1) (1993).

111.*Id.* at § 1-402(b)(2).

C. New Jersey

In 1995 New Jersey passed a statute which limits accountant liability to nonclients."[2] Enactment of a statute is particularly significant in New Jersey's case. Between 1983 and 1995, New Jersey adhered to the reasonable foreseeability rule set forth in *Rosenblum.* Passage of an accountant liability statute moved New Jersey from one end of the liability continuum almost to the opposite end. The New Jersey statute[113] is a virtual codification of the three-prong test of *Credit Alliance."*[4] Despite the statute's restrictive scope, it does not require any of the three elements for an accountant's duty to nonclients to be in writing, except in the case of a bank.[115] When a bank is a claimant, the accountant must acknowledge in writing the bank's intended reliance and the client's knowledge of such reliance.[116]

The New Jersey statute is different than the Arkansas, Illinois, and Utah statutes. The laws of the latter three states do not mandate that the accountant be aware of a specific transaction in which the nonclient is benefitted or influenced as required under the New Jersey statute.[117] Also, the accountant's knowledge of the nonclient's intended reliance must be expressed to the plaintiff under New Jersey's statute,[118] the *linking conduct* requirement, but not under the statutes of Arkansas, Illinois, and Utah.

D. Wyoming

In 1995 Wyoming also enacted an accountant liability statute.[119] Three conditions must be present at the time the engagement was undertaken for a duty to nonclients to arise: (1) the accountant was aware that the services performed were to be made available in connection with a specific transaction; (2) the transaction was

112.N.J. STAT. Ann. § 2A:53A-25 (West 1996).

[113]The pertinent language of the New Jersey statute reads as follows:

> No accountant shall be liable for damages for negligence arising out of and in the course of rendering professional services unless . . . . the accountant:
>
> (2) (a) Knew at the time of the engagement by the client or agreed with the client after the time of the engagement, that the . . . service rendered to the client would be made available to the claimant, who was specifically identified to the accountant in connection with a specified transaction . . . ;
>
> (b) Knew that the claimant intended to rely upon the . . . service in connection with that specified transaction; and
>
> (c) directly expressed to the claimant, by words or conduct, the accountant's understanding of the claimant's intended reliance.

N.J. STAT. ANN. § 2A:53A-25 (West 19%).

[114]483 N.E.2d 110 (N.Y. 1985).

[115]The New Jersey statute applies to banks with the addition of the following provision: "In the case of a bank claimant, the accountant must acknowledge the bank's intended reliance on the .accounting service and the client's knowledge of that reliance in a written communication." N.J. STAT. Ann. § 2A:53A-25 (West 19%).

116.Id.

[117]ARK. CODE. ANN. § 16-114-302 (Michie 1991); 225 ILL. COMP. STAT. 450/30.1 (West 19%); UTAH CODE ANN. § 58-26-12 (1994).

118.N.J. STAT. ANN. § 2A:53A-25(2)(c) (West 1996).

119.Wyo. STAT. ANN. § 33-3-201 (Michie 19%).

specifically identified to the accountant; and (3) the accountant was aware that the suing party intended to rely on his services.[120] The Wyoming law bears some similarity to the Kansas statute[121] except for one significant difference. Wyoming requires the accountant to state in writing on any financial statement or other document those third parties who may rely, the document's purpose, and that the accountant's liability may be limited.[122] The accountant's liability to nonclients is not restricted unless the writing requirements are met.[123]

E. Michigan

In 1996, an accountant liability law took effect in Michigan.[124] The liability limitation provided by the statute appears to be aimed only at certified public accountants.[125] A CPA cannot be liable for negligence to a third party unless the accountant was informed in writing by the client at the time of the engagement that it was the client's primary intent for the accounting services to benefit or influence the nonclient.[126] The statute allows the client to identify in writing not only specific persons but a generic group or class of persons who the client intends to benefit or influence with the CPAs' services.[127] It is possible that the client could describe a class of users so large that a certified public accountant could face potential liability to a significant number of nonclients.

All seven state statutes reduce the probability of a miscommunication or misunderstanding between the accountant, client, and third party. The statutory requirements provide "more certainty because the third party knows before reading a financial statement whether he can recover from the auditor."[128] Uncertainty may be increased, however, when a state adopts an accountant liability statute that may be interpreted in more than one way, for example, Arkansas, Illinois, and Utah. In most instances, accountant liability statutes establish known and required conditions under which an accountant may be liable for negligence to a nonclient. Litigation risk for accountants is diminished by the near privity nature of each of the seven state statutes[129] since auditors generally do not need to be concerned about as many third-

[120] *Id.* at § 33-3-2l(c)(ii).

121.Kan. Stat. Ann. § 1-402 (1993).

[122] WY0. Stat. ANN. § 33-3-201(d) (Michie 1996).

123. Id

[124] Under Michigan's accountant liability law, a certified public accountant may be liable for a negligent act, omission, decision, or other conduct if the "certified public accountant was informed in writing by the client at the time of the engagement that a primary intent of the client was for the. . .accounting services to benefit or influence the person bringing the action for civil damages. . .The certified public accountant may be held liable only to each identified person, generic group or class description." MICH. COMP. LAWS § 600.2962(1996).

125.Id.

[126] ID.

127. Id.

[128] E. R. Fencl, *Rebuilding the Citadel: State Legislative Responses to Accountant Non-Privity Suits*, 67 WASH. U. L. Q. 863, 887 (1989).

[129] It may be argued that under Michigan law, circumstances could arise (e.g., a client provides an accountant a writing that names a large class of users as those to be benefitted by the CPA's services) which could defeat the near-privity character of the statute. However, a CPA may decline a client engagement

party claimants in those states with an accountant liability statute.

IV. Conclusion

Four legal standards have evolved to determine which third-party users are owed a duty by accountants for purposes of negligent misrepresentation. These four legal approaches are known as the privity, near privity, the Restatement or foreseen users, and reasonable foreseeability rules. The expansion of accountant liability to nonclients from the 1960s through the mid-1980s led to legislative reform efforts on the part of the accounting profession during the last decade. During that time, seven states have enacted accountant liability statutes which collectively are near-privity in nature. The last state to adopt an accountant privity statute was Michigan in 1996. In Illinois and Arkansas, however, different interpretations have been placed on virtually identical language. An interpretation of one Illinois court implies that a larger class of nonclients have a legal right to sue accountants for negligence.

The enactment of the seven statutes may signal an overall trend toward a narrower scope of liability to nonclients for negligence. The ongoing legislative reform efforts of the accounting profession may result in more certainty, *ex ante*, for both accountants and users as more states move to a near-privity standard. A continuation of this trend may signal a change in state public policy decisions away from the transfer of risk from financial statement users to accountants.

because the client must inform the CPA at the time of the engagement who is to be influenced by the accounting services. MICH. COMP. Laws §600.2962 (1996).

TABLE 1

STATUTORY JURISDICTIONS		
State	**Statute Cite**	**Standard**
Arkansas	ARK. CODE ANN. §16- 114-302 (Michie 1991). Took effect in 1987. In Swink v. Ernst & Young, 908 S.W. 2d 660 (Ark. 1995), the Arkansas Supreme Court construed the statute to shield an accountant from liability to a nonclient unless the accountant has identified in writing those persons intended to rely on his services and sent a copy of that writing to those persons.	Statutory modification of the primary benefit rule with a provision that allows the auditor to limit those nonclients who may rely on the services rendered. The statute reads as follows: No person shall be liable to persons not in privity of contract...for civil damages resulting from acts, omissions, decisions, or other conduct in connection with professional services, except for: (2) Other acts, omissions, decisions, or conduct, if the person, partnership or corporation was aware that a primary intent of the client was for the professional services to benefit or influence the person bringing the action. ,.[I]f the person, partnership or corporation... (a) Identifies in writing to the client those persons who are intended to rely on the services, and (b) Sends a copy of the writing or similar statement to those persons identified in the writing or statement, then the person...may be held liable only to the persons intended to rely, in addition to those persons in privity of contract...

State	Statute Cite	Standard
Illinois	225 111. COMP. STAT. 450/30.1 (West 1996) formerly ILL. REV. STAT. 1991, Ch. I11, *[[5535.1. Took effect in 1986. Chestnut v. Pestine Brinati et al., 667 N. E. 2d 543 (111. App. 1996) held that a nonclient may state a cause of action under the statute without a writing. The statutory language merely provides accountants with an exemption from liability where the accountant prepares and sends a writing to specified persons intended to rely on the accountant's services. The court did not reach the question of the effect of a writing on the accountant's liability.	The statute's language is virtually identical to the wording of the Arkansas statute. The Illinois law has been interpreted differently than the Arkansas statute.

State	Statute Code	Standard
Kansas	KAN. ST AT. ANN. §1-402(1993). Took effect in 1987. Monarch Normandy v. Normandy Square, 817 F. Supp. 899 (D. Kan. 1993) applied the statute in dismissing a negligent misrepresentation count against a CPA firm.	Statutory primary benefit rule similar to *Ultramares.* The statute reads as follows: No person...shall be liable to any person or entity for civil damages resulting from acts, omissions, decisions or other conduct amounting to negligence in the rendition of professional accounting services *unless:* (a) the plaintiff directly engaged such person...or (b) (1) the defendant knew at the time of the engagement or the defendant and the client mutually agreed after the time of the engagement that the...accounting services rendered.. .would be made available to the plaintiff, who was identified in writing to the defendant; and (2) the defendant knew that the plaintiff intended to rely upon the...accounting services rendered the client in connection with specified transactions described in writing.
Michigan	MICH. COMP. LAWS §600.2962 (1996). Took effect in January 1996.	A certified public accountant may be liable for a negligent act, omission, decision or other conduct if the "certified public accountant was informed in writing by the client at the time of the engagement that a primary intent of the client was for the...accounting services to benefit or influence the person bringing the action for civil damages... The certified public accountant may be held liable only to each identified person, generic group or class description."

State	Statute Cite	Standard
New Jersey	N. J. STAT. ANN.§2A:53A-25 1996)	Strict near-privity rule similar to *Credit Alliance.* The statute reads as follows: No accountant shall be liable for damages for negligence arising out of and in the course of rendering professional services unless ...the accountant: (2) (a) knew at the time of the II engagement by the client or agreed with the client after the time of the engagement, that the ...service rendered to the client would be made available to the claimant, who was specifically identified to the accountant in connection with a specified transaction...; (b) knew that the claimant intended to rely upon the ...service in connection with that specified transaction; and (c) directly expressed to the claimant, by words or conduct that accountant's understanding of the claimant's intended reliance... (3) In the case of a bank claimant, the accountant must acknowledge the bank's intended reliance on the ...accounting service and the client's knowledge of that reliance in a written communication.

State	Statute Code	Standard
Utah	UTAH CODE Ann. §58- 26-12 (1994). Enacted in 1990. In Nordica USA, Inc., v. Deloitte & Touche, 839 F. Supp. 1082 (D. Utah 1993), the federal district court in Vermont applied the same interpretation to Utah's statutory wording as the Arkansas Supreme Court did to virtually identical language (in Arkansas' statute). The federal court also held that the accountant must be aware of the client's intent to benefit or influence a third party at the time audit work is performed.	Virtually identical to the Arkansas and] Illinois statutes in wording.

State	Statute Code	Standard
Wyoming	Wyo. Stat. Ann. §33- 3-201. (Michie 1996). Took effect in 1995.	A strict near-privity statute that requires a positive action by the accountant. The statute reads as follows: No action may be brought under this section unless: (ii) the defendant accountant firm: (a) was aware at the time the engagement was undertaken... that the financial statements or other information were to be made available for use in connection with a specified transaction... and the transaction was specifically identified to the defendant; and (b) was aware that the plaintiff intended to rely upon such financial statements or other information... To be entitled to the limitation on liability the accountant shall: (i) identify the purpose of the document and the persons or entities that are entitled to receive and rely upon the financial statement or other information...reported or opined on...in the document prepared by the accountant, and (ii) include thereon a statement in a prominent place that advises users of the document that the liability of the accountant to third parties... may be limited...