Potential Liability of Accountants to Third Parties for Negligence

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of equitable relief seems, quite clearly, both theoretically and practically untenable. Very simply put, a money judgment for damages which produces, and can produce, no money because of the defendant's insolvency, is an "adequate" remedy only in the most technical and unrealistic understanding of that term. If equity truly looks to substance rather than form, and if its function is to provide a remedy where justice demands that the plaintiff be accorded a remedy, then equity must recognize the insolvency of the defendant as a sufficient ground, in and of itself, for the exercise of equitable jurisdiction. Such exercise, of course, must be consistent with the totality of equitable jurisprudence so that, if recognized, such jurisdiction would still be subject to equity's traditional power of discretionary abstention when the decree would result in undue hardship to third persons such as creditors. It is submitted, further, that the UCC's narrow recognition of insolvency as a basis for specific performance increases, rather than decreases, the need for the general recognition of such a remedy precisely because of the limited applicability of the Code provision. The requirement that the seller become insolvent within ten days from his receipt of the buyer's first payment of the purchase price in order that the buyer might avail himself of his specific performance remedy has its basis in the concern for the possible fraudulent effect of a longer period of retention on seller's other creditors. But, again, it is submitted that if there are no other creditors or if their claims are such that they will not be prejudiced by the relief granted, insolvency of the defendant should be an independent ground for plaintiff's obtaining specific performance and should be so apart from any arbitrary time limit for the onset of defendant's insolvency. The state of the law in this area is such that the courts should at least re-examine the validity of their present positions, instead of merely setting forth the negative position in summary fashion and assuming its validity. It seems probable that, were this re-examination undertaken, the courts would reject the traditional technical basis for excluding insolvency as a basis for equitable jurisdiction and allow relief on that basis in all cases where such relief could be granted in a manner consistent with other applicable equitable considerations.

POTENTIAL LIABILITY OF ACCOUNTANTS TO THIRD PARTIES FOR NEGLIGENCE

A public accountant has a duty to his client to perform the accounting services bargained for with the skill to be expected of a reasonable, prudent man with his knowledge and training.
A breach of this duty renders the accountant liable to his client for tort and contract damages. However, the prevailing rule has been that the accountant is not liable for negligent misstatement of the financial condition of his client to third parties who relied thereon. But, recently, there has been an influx of suits seeking to overturn this rule of no liability for negligence outside privity of contract. The purpose of this note is to examine the various theories upon which accountants have been held liable to third parties for misstatement, in order to determine whether it would be feasible to expand the grounds for liability.

**Liability for Negligence**

It has long been clear that privity of contract is not a requirement for a cause of action if the action is based upon the defendant's intentional deception of a plaintiff. It follows, therefore, that if an accountant intentionally certifies a false balance sheet, knowing that it will be used to induce other parties to lend money or extend credit, he is liable for his fraud to parties whom he should reasonably have expected to rely upon his misrepresentations.

However, the law governing liability to third parties in the general area of negligence has followed a different course. The early rule was that there would be no liability for negligence except to parties in privity. This strict limitation was gradually weakened by cases such as *Heaven v. Pender*. In that case, defendant, a dock owner, put up a staging outside a ship in his dock under a contract with the shipowner. Plaintiff was a worker employed


2 At this point, it is important to mention that the Securities Act of 1933, as amended in 1934, provided for liability of the accountant to investors who lose money in the acquisition of securities which were described by a registration statement containing false data prepared by such accountant. An accountant would not be liable under the statute if his statement had been neither negligent nor fraudulent; the burden of proving this lack of fault is on the defendant-accountant. The provision presently appears in 15 U.S.C. §77ww (1964). However, the application of the statute does not extend to protect those who merely grant credit to the party described in the financial statement. See Meek, *Liability of the Accountant to Parties Other Than His Employer for Negligent Misrepresentation*, 1942 Wis. L. Rev. 371, 383-88. A more complete discussion of the federal statute is beyond the scope of this note. However, it should be mentioned that, at the time of the writing of this note, there is a definite movement to extend federal statutory coverage. See The Wall Street Journal, Nov. 15, 1966, p. 1, col. 6.


4 See Note, supra note 1, at 321.


6 11 Q.B.D. 503 (C.A. 1883).
by a ship painter who had contracted with the shipowner to paint the outside of the ship. Plaintiff climbed on the staging to paint the ship, and was injured when it collapsed. The defendant was held liable despite lack of privity, the court resting its holding on an analogy to a situation where a plaintiff is invited onto the defendant’s premises for their mutual economic benefit. The privity doctrine was first abrogated in the United States in cases where the negligence was such as would be likely to put human life in imminent danger. Thus, in *Thonis v. Winchester*, the court held a defendant-vendor liable for negligence in mislabeling poison sold to plaintiff’s wife. The privity rule was further weakened by Judge Cardozo in *MacPherson v. Buick Motor Co.*, wherein it was held that if the item causing injury was something which, while not inherently dangerous, “is reasonably certain to place life and limb in danger when negligently made,” the manufacturer would be liable to the ultimate buyer of his product.

In England, the courts were not willing to disregard the privity requirement where the defendant’s negligent misstatement would cause mere economic injury to third parties. In *LeLievre v. Gould*, the plaintiff, a mortgagee, agreed with the mortgagor to advance money to the builder of a house. The payments were to be made as the building progressed, which progress was to be determined and reported by the defendant, an architect and surveyor hired and paid by the mortgagor. It appeared that the defendant was aware of the arrangement, and knew that the plaintiff would rely on his reports in advancing money. The defendant negligently reported progress so that, when the plaintiff advanced money to the builder in reliance upon the report, the expected security was deficient. The project was unsuccessful and the plaintiff sued the architect for damages. The court held for the defendant, stating that he owed no duty of care to the plaintiff since there was no privity. The court implied that the defendant would have been liable to the plaintiff only for fraud. *Heaven* was distinguished on the ground that there is an inherent difference between negligence that can possibly result in bodily harm and negligence that can result only in possible economic injury from reliance upon a negligent statement.

Prior to 1922, this distinction was apparently recognized by the American courts. However, in *Glanzer v. Shepard*, Judge Cardozo, writing for the Court, seemed to indicate that New York,

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7 6 N.Y. 396 (1852).
8 217 N.Y. 382, 111 N.E. 1050 (1916).
9 1 Q.B. 491 (C.A. 1893).
11 233 N.Y. 236, 135 N.E. 275 (1920).
in certain circumstances, would hold a party liable for his negligent misrepresentations, even in the absence of privity of contract. In that case, the defendant, a public weigher, supplied the plaintiffs, purchasers of beans, with a certificate stating the determined weight of a shipment of beans. The defendant supplied the certificate at the request of the seller of the beans, with whom he had contracted. After paying the seller in reliance upon the weight certified by the defendant, the plaintiffs discovered that the beans had been weighed incorrectly. The Court granted judgment for the plaintiffs, concluding that when the defendant undertook the task of weighing, he assumed a duty to weigh carefully toward all those whose conduct would foreseeably be governed thereby.

Those who construed Glanzer as implying that the New York courts would, when the case arose, hold a public accounting firm liable to third parties for its negligent audit, were proved wrong by the decision of the Court of Appeals in Ultramares Corp. v. Touche. In that case, the defendants, a firm of public accountants, were hired by a company to certify its balance sheet. The company made a practice of borrowing extensively and exhibiting its balance sheet to creditors as a basis for the loans. The defendants knew of this practice. After they prepared and certified the balance sheet, the defendants supplied the company with thirty-two copies, as requested, although they did not know to whom these copies would be distributed. The defendants annexed to the balance sheet their certificate of audit which stated that the balance sheet was in accordance with the accounts and that it represented, in their opinion, the "true and correct view" of the financial condition of the company. Relying upon the certificate, the plaintiff extended credit to the company. Actually, the company had falsified its books and was insolvent. The investigation by the defendants as to the accuracy of the books was highly inadequate. The plaintiff sued for damages it had incurred through its reliance upon the certified balance sheet, proceeding on alternate theories of negligence and fraud.

The Court held that the defendants were not liable to the plaintiff for their negligence since there was no privity of contract. It stated, however, that the defendants would be liable, even without privity, if the plaintiffs could prove fraud.

Judge Cardozo, writing for the majority in Ultramares, felt compelled to distinguish that case from the decision in Glanzer v. Shepard. In Glanzer, the "end and aim" of the transaction was to benefit the plaintiff, while in Ultramares the service was primarily for the information of the company, and only incidentally for the use of third parties. Therefore, principles similar to those regarding

\[1255\text{N.Y. 170, 174 N.E. 441 (1931).}\]
third-party beneficiary contracts were not applicable. The validity of this distinction between the two cases has been challenged by numerous authorities. It would seem that, under contract theory, a distinction such as the one posited by Judge Cardozo would be valid. A court could find that the plaintiff in Glanzer was, indeed, a third-party beneficiary of the contract between the vendor and the defendant public weigher. Such a conclusion would be untenable in an Ultramares situation. However, such a distinction on grounds of contract theory cannot account for the difference in the two holdings, since the Court in Glanzer based its decision upon principles of tort, stating: "We do not need to state the duty in terms of contract or of privity."

Under pure tort theory, it appears that the result in Ultramares should not have been opposite to that in Glanzer for the sole reason that the party likely to be injured by the negligence was not specifically known. The possibility of harm to the plaintiffs in both cases seems to fall within the foreseeability or "risk reasonably to be perceived" rule of tort liability for negligence.

Apparently, the primary reason for the Court's refusal to extend liability of accountants for negligence to third parties was the public policy of not wishing to injure the accounting profession by imposing such a vast potential liability upon it. As Judge Cardozo stated: "if liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class." However, it has been suggested that a better justification for Ultramares is that practical reasons require that liability for causing mere pecuniary loss should be more limited than liability for causing physical harm. Nevertheless, at the time Ultramares was decided, there was ample precedent in New York for disregarding the tort theory for the public policy reason of avoiding the exposure of a class of people to practically unlimited liability. Whatever the distinction between Glanzer and

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13 Id. at 182-83, 174 N.E. at 445-46.
14 See, e.g., Note, supra note 1, at 326; Meek, supra note 2, at 382; Seavey, supra note 10, at 48-49.
15 See Note, supra note 1, at 326; Seavey, supra note 10, at 48.
16 See Note, supra note 1, at 326; Seavey, supra note 10, at 48.
17 See Note, supra note 12, at 179, 174 N.E. at 444.
18 See Note, supra note 10, at 49.
19 See Ryan v. New York Cent. R.R., 35 N.Y. 210 (1866). There a defendant who negligently caused a fire was held liable only for damages resulting from the direct sparks of its fire, and not for damages that occurred when the fire began to spread. The reason given by the Ryan Court for the refusal to extend greater liability was lack of proximate cause, but this logic seems fallacious. Apparently, the actual basis for the decision was the public policy matter, i.e., the Court feared that it would be extremely risky for one to live in a community if he might be liable in damages for
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Ultramares, most courts accepted the doctrine that an accountant is not liable to third parties for his negligent misstatement.\textsuperscript{20} It seems that the principal reason Ultramares has been generally followed is that the courts have considered it socially undesirable to extend potential liability to such an incalculable degree.\textsuperscript{21}

However, in \textit{State Street Trust Co. v. Ernst},\textsuperscript{22} the New York Court of Appeals rendered a decision which many thought relaxed the standard of liability announced in Ultramares. In that case, the defendants, public accountants, knew that a balance sheet prepared by them was unreliable in certain areas into which there had not been an adequate investigation. The defendants furnished their client with ten copies of the balance sheet which had been certified by them and which contained no such notation of any limitation or explanation. Subsequently, the defendants sent a new balance sheet, identical to the first, but containing a reference to a cover letter explaining the extent of their investigation. The plaintiff extended credit in reliance upon the balance sheet originally furnished and thereafter suffered a loss when the company became insolvent. The Court upheld the jury’s verdict for the plaintiff, concluding that the negligence of the defendants in certifying and issuing a balance sheet without qualification, which they knew should not be relied upon without explanation, was sufficient to allow an inference of fraud by the jury. Judge Lehman, dissenting, stated that Ultramares established the rule that even gross negligence is not sufficient for liability unless the accountants’ investigation was “so flimsy as to lead to the conclusion that there was no genuine belief back of it.”\textsuperscript{23} He concluded that the evidence was not sufficient to justify an inference of fraud.

While it is possible that the jury erred on the question of fact as to whether fraud could be inferred from the defendants’ acts, the language of the Court in its affirmance of the jury’s verdict did not manifest any intent to overturn the Ultramares doctrine. The holding in State Street has, however, been misinterpreted on occasion to mean that gross negligence in itself is a sufficient reason to impose liability.\textsuperscript{24}

\textsuperscript{21} See Meek, supra note 2, at 389.
\textsuperscript{22} 278 N.Y. 104, 15 N.E.2d 416 (1938).
\textsuperscript{23} Id. at 126, 15 N.E.2d at 425.
\textsuperscript{24} See Duro Sportswear, Inc. v. Cogen, 73 Misc. 534, 131 N.Y.S.2d 20 (Sup. Ct. 1954).
Several jurisdictions have adopted the theory that there is a conclusive presumption that when a man represents a fact to be true to his own knowledge, he warrants the truth and becomes the insurer of its accuracy. This position has tended to confuse the areas of fraud and mere negligence. Since a certificate of audit usually states that the balance sheet, to the knowledge or opinion of the accountants, is a true representation of the financial condition of the company, such a theory naturally operates to impair the acknowledged Ultramares doctrine that an accountant would not be liable for negligence, unless there was privity. It has been suggested by some authorities that the Court in Ultramares itself had adopted this strange theory. Upon analysis, however, this conclusion seems fallacious. True, the Court in Ultramares did state:

The defendants certified as a fact, true to their own knowledge, that the balance sheet was in accordance with the books of account. If their statement was false, they are not to be exonerated because they believed it to be true.

This language should not be interpreted to mean that when the defendants certified the balance sheet as true to their own knowledge they warranted its truth. It simply means that if the defendants said it was true to their own knowledge, and they had no knowledge on the subject, i.e., whether the balance sheet accurately reflected the actual condition of the business, there would be no sincere belief, and, therefore, the statement would amount to fraud.

Another and perhaps more confusing theory adopted by some of the cases holds that a misrepresentation constitutes fraud if the defendant would have known its falsity had he acted in a reasonable manner. "In those jurisdictions which adhere to this extension, negligence actually constitutes the basis of liability though under the name of fraud."

In any event, the intermingling of negligence and fraud has led to much uncertainty as to the state of the law regarding the standard of liability of accountants. Actually, there is a clear difference between fraud and negligence. A person is not guilty of fraud if he actually believed what he said to be true. The fact that he formulated this belief through grossly negligent activity does not ipso facto negate all possibility that he did have an

25 Meek, supra note 2, at 376. This theory has been applied only when the facts represented were capable of actual knowledge rather than just opinion.
26 Meek, supra note 2, at 337.
27 Supra note 12, at 189, 174 N.E. at 448.
28 Meek, supra note 2, at 375.
29 See Seavey, supra note 10, at 51-52.
honest belief in its truth. On the other hand, the fact that the defendant professed an honest belief after hasty and negligent investigation may lead a jury to conclude that he did not, in fact, have such honest belief—these circumstances may properly give rise to the "inference of fraud." If the jury, therefore, reasonably decides that the defendant, though grossly negligent, was merely stating what he actually believed was the truth, the Ultramares doctrine compels a decision for the defendant. However, even if such an instruction were submitted to the jury, the question of whether the defendant actually did have an "honest belief" is extremely hard to answer with any degree of certainty. This predicament, added to the possible utilization of one of the theories described above—liability for gross negligence per se; statement as "true to one's own knowledge" acting as a warranty; the reasonable man standard in finding fraud—makes the question of liability in a given case very unpredictable.30

In England, the courts have followed the rationale of Ultramares insofar as accountants' liability to third parties for their negligent audits is concerned. In Candler v. Crane Christmas & Co.,31 the plaintiff invested money in a company on the basis of a balance sheet prepared and certified by the defendant accounting firm. The financial statement had been prepared with the knowledge that it was to be utilized to induce the plaintiff to invest. The defendant had been negligent in his audit, and the plaintiff lost his investment when the company was liquidated. There was no evidence of fraud. The court held for the accounting firm, reasoning that in the absence of a contractual or fiduciary relationship, the defendants owed no duty of care to the plaintiff in preparing and certifying the statement. Lord Justice Denning, in dissent, would have held the defendants liable, but expressly confined this opinion to cases "where the accountant prepares his accounts and makes his reports for the guidance of the very person in the very transaction in question." 32

The Candler case differed on the facts from Ultramares, since, in the former case, the defendants knew that the plaintiff was the specific party for whom the balance sheet was being prepared. Based upon this disparity, it seems that even Lord Justice Denning's dissent is consistent with Ultramares, since he reasoned upon principles analogous to Glanzer. Therefore, it would seem that the majority was willing to limit the liability of accountants for negligence to an even greater extent than the Court in Ultramares. In Hedley Byrne & Co. v. Heller & Partners,33 the House of Lords was faced with a controversy involving the liability of

30 See Hawkins, supra note 20, at 817-18.
31 (1951) 1 All E.R. 426 (C.A.).
32 Id. at 435.
33 (1963) 2 All E.R. 575 (H.L.).
bankers in giving references concerning the credit-worthiness of their customers. Plaintiffs were a firm of advertising agents. They had taken substantial advertising orders from a company on credit terms, and, therefore, wanted to ascertain the company's reliability. Plaintiffs caused inquiries to be made by their own bank of the defendants, who were bankers of the company in question, and satisfactory references were given. Although the case was decided in favor of the defendants, primarily because defendants had expressly disclaimed liability when they gave their opinion, the court commented unfavorably on Candler.

The decision in Hedley, in regard to its effect upon the liability of accountants in England, has been interpreted to mean that actions for professional negligence may be successful if financial loss is suffered by third parties through their reliance upon the professional skill and judgment of persons with whom there was no contractual or fiduciary relationship. Hedley changed the Candler doctrine to the extent that accountants can be held liable when third parties rely upon their negligently prepared financial statements if “the accountants knew or ought to have known that the reports, accounts or financial statements in question were being prepared for the specific purpose or transaction which gave rise to the loss and that they would be shown to and relied on by third parties in that particular connection.” Apparently, the House of Lords in Hedley adopted the views stated by Lord Justice Denning in his dissent in Candler. However, it is not certain whether courts will view Hedley as imposing liability upon accountants in a situation such as the one presented in Ultramares, where the defendants knew their balance sheet probably would be relied on by third parties but did not know exactly by whom or in what specific transaction. In any event, it is clear that the Hedley decision indicated a change from the prior English rule, indicating a willingness to impose upon accountants a greater liability to third parties.

The Recent Dilemma

Recently, there has been a new wave of litigation against accounting firms in the United States. In March, 1966, it was estimated that eighty law suits, involving more than twenty-million dollars, were pending against public accountants throughout the country. All these suits were filed by investors and

34 Accountants' Liability To Third Parties—The Hedley Byrne Decision, J. ACCOUNTANCY, Oct. 1965, pp. 66, 67. This statement was prepared for the public by the Council of The Institute of Chartered Accountants in England and Wales.
35 Id. at 67.
36 Heinemann, supra note 3. As of November 1966, 100 suits were reported. The Wall Street Journal, Nov. 15, 1966, p. 1, col. 6.
creditors who alleged pecuniary loss due to the defendant accounting firms' failure to discover or report vital data concerning the companies whose books they were auditing. 37

Several possible explanations for this influx of suits have been advanced: (1) the hope of banks and other financial institutions to make accounting firms a source of salvage when credit losses occur; 38 (2) the general growth of the American economy and the related increase in loss potential in the event of a business failure; 39 and (3) the publicity accompanying the six-million dollar lawsuit against Peat, Marwick, Mitchell & Co., the nation's largest public accounting firm, brought by the two largest banks in the United States, the Bank of America and the Chase Manhattan Bank. 40

Regardless of the reasons for the suits, and although most accountants expect them to fail, they have generated much concern in the accounting community. While there is no reason under classic negligence theory to allow accountants to escape liability to third persons or classes of persons whom they could reasonably have expected to rely upon their financial reports, the public policy issue once again arises. It is feared that the future of accounting firms, particularly small ones, might be jeopardized by exposure to such potentially astronomical liability. It has been correctly stated that “accounting firms are at a peculiar disadvantage in that the numbers of people who might rely on an auditor's opinion, and the amounts involved, are virtually unlimited. This is not generally true of other professions.” 41 It also seems safe to say that the possible liability of an accounting firm for its negligence, if a duty of care to third parties were imposed by law, would be much greater than the potential liability of a tortfeasor causing physical harm. Obviously, it is not socially desirable to have reputable accounting firms ruined financially because of one negligent audit.

However, much of this danger to accounting firms could be alleviated through an adequate program of liability insurance for negligence. Such coverage, now standard practice among accounting firms, includes any award of damages, as well as a portion of the cost of defending in an action. 42 If liability for negligence were extended to third parties, premiums could be expected to increase. It has been maintained that the extent of this increase would render the cost of such insurance coverage prohibitive. 43

37 Heinemann, supra note 3.
38 Editorial, supra note 3.
39 Heinemann, supra note 3, at p. 9, col. 1.
40 Id. at p. 9, col. 2.
43 Editorial, supra note 41, at 34.
Just one year ago, fifteen insurance companies wrote such liability policies relatively freely. Now, influenced by the many suits, only six handle them as an “accommodation” for big accounts or “in a limited manner.” Several companies have raised their rates by a third in order to make the coverage profitable.\(^4\) It is conceivable that if some of the pending suits succeed, rates will go even higher.

However, even if insurance costs were to increase, coverage should not become absolutely prohibitive. Since, practically speaking, all public accounting firms would be required to pay the increased premiums, the extra expense could be partially allocated to the general business community in the form of an increase in the standard auditing fee. Also, the increased expense would seem deductible as a business expense for federal income tax purposes.\(^4\) These cost-absorbing devices, it is submitted, are sufficiently adequate to warrant a fresh judicial inquiry into the accountant’s “immunity.”

**The Accountant’s Due Care**

It is submitted that there are two areas in which auditors can act negligently as to third parties. The first area involves the audit of the financial statement itself. The auditor has a duty to investigate to see if the balance sheet reflects the actual financial condition of the company. The first step in this process is to compare the balance sheet to the books, to make sure that the two coincide. The next step is to examine the accounts themselves, to see that the entries are accurate. Certain accounts are verified only on a sampling or test basis, since it would be too tedious and unnecessary to do otherwise. Under this procedure, auditors are deemed negligent if they fail to make a sufficient number of checks or fail to investigate suspicious circumstances. Accountants would not be held liable under the new negligence test if they acted properly, but were duped by the company into certifying a false balance sheet. This answers the complaint of many accountants that often, even when the accountants have used reasonable care in their investigation, it is impossible to detect a well organized plan to deceive by an unscrupulous management.

The second area of possible negligence concerns the duty of the auditors to accurately report the findings of their investigation.


\(^4\) Insurance premiums are generally deductible if the insurance is connected with the taxpayer’s business. For example, malpractice insurance premiums paid by a physician are deductible expenses. 4A MERNER, *FEDERAL INCOME TAXATION* § 25.104 (1966 ed.). Rev. Rul. 60-365, 1960-2 *CUM. BUL.

49.
on the certified balance sheet, *i.e.*, not only must the investigation be adequate, but any doubts raised by the investigation must be reported with the financial statement. The misrepresentation usually does not involve the balance sheet itself, but the opinion attached to the balance sheet, *i.e.*, the auditor’s certificate. The certificate usually states that, in the opinion of the auditors, the statement accurately represents the financial condition of the company. Standard auditing procedure dictates that the accountant, when he associates his name with a financial statement, must: (1) express an unqualified opinion; (2) disclaim an opinion or express a qualified opinion when he has reason to believe that the statement is not entirely reliable either because he has not made an adequate investigation or because there were circumstances which aroused his suspicions; or (3) when unaudited financial statements are presented on his stationery without comment, disclose prominently on each page of the financial statement the fact that they were not audited.

The use of qualified certificates is one of the existing and accepted standards of the accounting profession. If the accountant expressly disclaimed a particular part of the financial statement, he, of course, would not be liable for an inadequate investigation affecting that part, since the disclaimer should indicate to potential creditors of the company that they rely upon that portion of the financial statement at their own risk. The disclaimer, however, could not relieve the accountant from negligently failing to recognize and pursue suspicious circumstances when his audit program is otherwise adequate. A possible undesirable result of use of disclaimers as a hedge against liability could arise where accountants, intimidated by the new standard of liability, use disclaimers even though confident of the accuracy of their audit. Such a practice would hamper the effectiveness of auditors, and could prove to be a needlessly adverse reflection of the credit standing of their client. There is also the strong possibility that an accounting firm which refuses, for these reasons, to give an unqualified certification of its client’s financial statement will find itself without the client.

Still, disclaimers have a definite value if used in proper circumstances—in situations where the accountant is unable to adequately investigate a part of the financial statement. It is appropriate to note that the Council of the Institute of Chartered Accountants in England and Wales recommends the use of disclaimers

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47 See Roady & Anderson, Professional Negligence 264 (1960); American Institute of Accountants, Committee on Auditing Procedure, Generally Accepted Auditing Standards—Their Significance and Scope (1954).
48 See supra note 42.
to protect an accountant from liability to third parties. The method approved is either to specifically restrict the scope of the auditor's report or to express appropriate reservations in a note attached to the financial statements and referred to therein.\textsuperscript{49}

There is a fear on the part of many accountants that, even when they have acted with due care, suits against them which attempt but fail to establish negligence will nevertheless undermine the profession and the firm because of the bad publicity. This eventuality could be partially avoided by a pretrial review of the facts by a panel of impartial experts.\textsuperscript{50} It is submitted that were such an arrangement to be prescribed by the state legislatures or appellate courts (assuming that accountants will be held liable to third parties for negligence), it would serve an important role in several respects: (1) the fear of the accountant-defendants that a misdirected jury will find negligence where none existed, would be alleviated; (2) the adverse publicity suffered by protracted public litigation would be reduced; and (3) the amounts expended on legal fees during the defense of an extended litigation will be reduced.

As it exists today, there is some confusion as to the scope of the accountant's liability under the Ultramares doctrine, i.e., the differentiation between fraud, negligence, gross negligence, and inference of fraud.\textsuperscript{51} A clarification of this area would be brought about if the courts recognized that accountants may be validly held liable to third parties for negligence. Such action would set a simple legal theory to be followed, let accountants know exactly the extent of their liability, and permit them to procure insurance based on this definitive statement of their responsibility. The necessity of struggling through the intricacies of the intermingling of fraud with negligence would be obviated.

It has been seen that the primary reason accountants have not been held liable to third parties is the fear of possible economic ruin to accounting firms. However, the fact is often ignored that the creditor who has loaned money on the basis of a negligent audit and who has not been negligent himself may also be facing financial ruin if recovery is denied. The question then arises as to who should sustain the loss—the negligent accounting firm which could have foreseen the harm or the innocent creditor.

**Conclusion**

When English accountants were faced with liability to third parties for negligence by the Hedley decision, they, as are their American counterparts, were concerned. However, when they

\textsuperscript{49} \textit{Supra} note 34, at 67.
\textsuperscript{50} Editorial, \textit{supra} note 41, at 34.
\textsuperscript{51} \textit{Ibid.}
realized that liability would be imposed upon them only for negligence and only to a foreseeable group, they accepted the change in the law with good grace. In fact, the accounting institute in England stated in response to the *Hedley* decision:

Accountants have always recognized that they have a responsibility to third parties in these circumstances, even if it was hitherto considered to be unenforceable in law, and it is recognized best practice that . . . the extent to which the accountant accepts responsibility should be made clear beyond possibility of misunderstanding. . . .

Of course, the fact that English accounting authorities have accepted the overruling of the *Candler* decision, where the defendants knew exactly whom the relying parties would be, does not necessarily imply that they would also so willingly accept liability in an *Ultramares* situation. In any event, there is no reason why American accountants should not follow this lead and recognize that they should accept greater legal responsibility to third parties who reasonably rely on their certificates. American accountants have recognized a moral responsibility to such parties, and, for the reasons stated in this note, there should be a legal responsibility as well.

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52 *Supra* note 34, at 67.