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Professional Negligence Liability of Public Accountants

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PROFESSIONAL NEGLIGENCE LIABILITY OF PUBLIC ACCOUNTANTS

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I. LIABILITY TO CLIENTS

At least since 1905, in this country, accountants have been recognized as "a skilled professional class . . . subject generally to the same rules of liability for negligence in the practice of their profession as are members of other skilled professions."[1] The question, then, is not whether the usual concepts of professional negligence apply to accountants,[2] but how. What situations have produced malpractice litigation? What are the specific practices or omissions which have resulted in liability? And what are the limits of liability?

Like other professionals, the accountant usually gets into the position where he must exercise his professional skill as the result of a contract. The contract says what he undertakes to do, but the law says he must do it with reasonable care, by professional standards. If he fails, he may be liable either for breach of his contract or, in tort, for breach of the general duty to exercise due care, arising out of the contract relationship.[3]

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1. Smith v. London Assur. Corp., 109 App. Div. 882, 96 N.Y. Supp. 820 (1905).
2. Gammel v. Ernst & Ernst, 245 Minn. 249, 253, 72 N.W.2d 364, 367, (1955): "Ordinarily, the standards of reasonable care which apply to the conduct of auditors or public accountants are the same as those applied to lawyers, doctors, architects, engineers, and other professional men engaged in furnishing skilled services for compensation." See Annot., 54 A.L.R.2d 324 (1957); LEVY, ACCOUNTANTS' LEGAL RESPONSIBILITY (1954); RICH, LEGAL RESPONSIBILITIES AND RIGHTS OF PUBLIC ACCOUNTANTS (1935).
3. Respecting the general proposition of liability either in tort or contract for negligent performance of a contract undertaking, see 2 HARPER & JAMES, TORTS 1049-50 (1956), and PROSSER, TORTS 478-83 (2d ed. 1955). For the proposition that alternative remedies in tort or contract are available as applied to actions against accountants, see Annot., 54 A.L.R.2d 324, 330 (1957); RESTATEMENT, TORTS § 552, comment *f* (1938); 35 YALE L.J. 76, 80 & n.12 (1925). Most of the reported decisions holding accountants liable, either in tort or contract, are cited in the notes below.

The fact that alternative remedies may be available does not mean that it is of no consequence which alternative is pursued. It may be critical with respect to the statute of limitations. American Indem. Co. v. Ernst & Ernst, 106 S.W.2d 763 (Tex. Civ. App. 1937) (action clearly stated in tort barred by tort statute of limitations). Though, apart from purely procedural problems, there is no reason why the plaintiff's pleading should not be construed to give him the advantage of the longer statute of limitations in a case where it makes a difference. See L.B. Labs., Inc. v. Mitchell, 39 Cal. 2d 56, 244 P.2d 385 (1952) (action not barred by two-year tort statute, notwithstanding allegations of negligence). Some courts have thought that it made a difference as to remoteness of damages whether the action was in tort or contract. See discussion *infra* at pp. 800-01. The theory of the action may also be of some significance with respect to application of the defense of contributory negligence. See discussion *infra* at pp. 809-12.

There are cases which are concerned over what the accountant has contracted to do, because lack of due care cannot be charged for failure to do something which the accountant has never undertaken to do. So there are questions whether the accountant has undertaken to do a "complete audit" or a "detailed audit," or whether he has contracted to do some less exacting job.[4] These are really questions of contract interpretation, and not "negligence" as related to the general standard of due care in tort. Today the accountant typically contracts to make an audit in keeping with generally accepted auditing standards,[5] which means that if it comes to litigation, either in tort or contract, the standards of the profession must be determined in each case as a question of fact, just as in most other cases involving professional malpractice. The accountant may limit his liability by expressly stating in his contract that he does not undertake to do some specific task usually associated with an audit or by stating his undertaking in clearly restrictive terms.[6] Accountants have been advised to do so when they are undertaking something more limited than the usual job.[7] But no accountant likes to acknowledge openly in a contract that he is undertaking a sub-standard job or deprecate his services by emphasizing what he is not going to do.[8] So, in the usual case, the contract merely sets the stage. It creates the relationship out of which arises the duty to exercise reasonable care or render skillfull performance by professional standards. The determination of professional standards and the question of violation—that is, negligence or breach—will be handled much as any other negligence problem in tort law.

A. *Sources of Litigation*

Most of the litigation between accountant and client has arisen out of two situations. Either the accountant is being sued to recover for losses suffered by reason of the client's reliance upon erroneous information respecting the financial condition of the audited business, or the accountant is being sued to recover losses suffered on account of the accountant's failure to discover defalcations of the client's employees.[9]

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4. See Maryland Cas. Co. v. Cook, 35 F. Supp. 160 (E.D. Mich. 1940); O'Neill v. Atlas Auto. Fin. Corp., 139 Pa. Super. 346, 11 A.2d 782 (1940); International Labs. Ltd. v. Dewar, 41 Man. 329, 336-37, 351-53, 363-66, 369-70 (1933); Fox & Son v. Morrish, Grant & Co., 35 T.L.R. 126 (K.B. 1918).
5. See LEVY, ACCOUNTANTS' LEGAL RESPONSIBILITY 12 (1954), and see point "1" of the "Standards of Reporting" set forth at page 803 *infra*.
6. See O'Neill v. Atlas Auto. Fin. Corp., 139 Pa. Super. 346, 11 A.2d 782 (1940); International Labs. Ltd. v. Dewar, 41 Man. 329, 336-37, 351-53, 363-66, 369-70 (1933).
7. See LEVY, ACCOUNTANTS' LEGAL RESPONSIBILITY 15 (1954).
8. *Id.* at 14-15.
9. See Annot., 54 A.L.R.2d 324, 327 (1957).

(1) *Erroneous report of financial condition:* In the typical case of the first type, the audited corporation claims it has paid out dividends which it could not afford in reliance upon a misleading report as to its profits or assets.[10] Often it is the receiver or referee in bankruptcy seeking to recover the dividends which actually rendered the business bankrupt or, in any event, should not have been paid if the true financial condition of the corporation had been known at the time.[11] There is a slight variation on the same type of situation when the accountant is engaged by an investor to ascertain the financial condition of a business in which investment is being considered, and the investor claims loss suffered in consequence of an unprofitable investment made in reliance upon the report which had led him to believe that he was getting something better.[12]

In either situation, the accountant's failure goes right to the core of the purpose for which he is employed. It is not surprising, therefore, that these cases produce no difficult problems, apart from the critical question of whether the accountant's performance was negligent in the particular case. Unlike the defalcation cases discussed below, there appears to be no special concern over remoteness of damage, nor is there difficulty over whether the scope of liability extends to cover this type of injury.[13]

(2) *Failure to discover defalcations:* The greatest number of reported cases arise out of the alleged failure of the accountant to discover fraud or embezzlement by his client's employees.[14] The damage

10. See *In re* London & Gen. Bank, 2 Ch. 673 (C.A. 1895), and cases cited note 11 *infra*.

11. Flagg v. Seng, 16 Cal. App. 2d 545, 60 P.2d 1004 (1936); *In re* Kingston Cotton Mill Co., 2 Ch. 279 (C.A. 1896); Leeds Estate, Bldg. & Inv. Co. v. Shepherd, 36 Ch. D. 787 (1887).

12. Gammel v. Ernst & Ernst, 245 Minn. 249, 72 N.W.2d 364 (1955); Mead v. Ball, Baker & Co., 106 L.T.R. (N.S.) 197, 28 T.L.R. 81 (C.A. 1911).

13. One might expect to find some difficult questions of proof of causation—that is, that it actually was reliance upon the erroneous information which induced payment of the dividend or making the investment. But in most of the cases the problem has not arisen. In the cases involving payments of dividends, either the law or the corporate charter prohibited payment of a dividend except out of profit or surplus, and in each case a correct audit would have showed that there was no profit or surplus out of which to pay the dividend. See notes 10 and 11 *supra*. In the first investment case cited in note 12 *supra*, the purchase price was fixed according to information supplied by the audit, and so the question was too clear for argument. However, in the second case involving investment (note 12 *supra*), it was held that there had not been satisfactory proof that the prejudicial investment had in fact been induced by the erroneous financial information—in that case an inflation of inventory figures by only three per cent.

14. Maryland Cas. Co. v. Cook, 35 F. Supp. 160 (E.D. Mich. 1940); Dantzler Lumber & Export Co. v. Columbia Cas. Co., 115 Fla. 541, 156 So. 116 (1934); City of East Grand Forks v. Steele, 121 Minn. 296, 141 N.W. 181 (1913); National Sur. Corp. v. Lybrand, 256 App. Div. 226, 9 N.Y.S.2d 554 (1939); Craig v. Anyon, 212 App. Div. 55, 208 N.Y. Supp. 259, *aff'd without opinion*, 242 N.Y. 569, 152 N.E. 431 (1925); Smith v. London Assur. Corp., 109 App. Div. 882, 96 N.Y. Supp. 820 (1905); O'Neill v. Atlas Auto. Fin. Corp., 139 Pa. Super. 346, 11 A.2d 782 (1940); American Indem. Co. v. Ernst & Ernst,

and causation theory is that if the accountant had performed his undertaking properly, defalcations continuing after the audit would have been prevented, or there would have been a better chance of recovery from the dishonest employee or the bonding or insurance company. Causal connection and damage, if proved, are plain enough. The real problem has been whether the scope of liability extends this far.

This has given the courts some difficulty, though it now appears to be well settled that if negligence can be shown, the accountant can be held liable in such a case, either in tort for negligence or for breach of contract.[15] Some of the earlier decisions balked at extending the accountant's liability this far. Limitation of liability was accomplished by insisting that the action must be for breach of contract, thereby invoking what the courts thought to be a more restricted rule as to remoteness of damage.[16] Whether liability is limited in terms of what should have been foreseen at the time of making the contract[17] or in terms of foreseeable risks and natural and probable consequences in tort, these cases should be covered.[18] The use of and reliance upon audits as a means of some protection against defalcations are sufficiently established in commercial custom and practice, that it is unrealistic to say that loss resulting from failure to discover defalcations which could have been detected in the exercise of ordinary profes-

106 S.W.2d 763 (Tex. Civ. App. 1937); International Labs. Ltd. v. Dewar, 41 Man. 329 (1933); Fox & Son v. Morrish, Grant & Co., 35 T.L.R. 126 (K.B. 1918); and see Annot. 54 A.L.R.2d 324, 327 (1957).

15. Maryland Cas. Co. v. Cook, 35 F. Supp. 160 (E.D. Mich. 1940) (recovery allowed); Dantzler Lumber & Export Co. v. Columbia Cas. Co., 115 Fla. 541, 156 So. 116 (1934) (held to state a cause either in tort or contract); National Sur. Corp. v. Lybrand, 256 App. Div. 226, 9 N.Y.S.2d 554 (1939) (held to make a case for jury); Smith v. London Assur. Corp., 109 App. Div. 882, 96 N.Y. Supp. 820 (1905) (held to state a cause of action); Fox & Son v. Morrish, Grant & Co., 35 T.L.R. 126 (K.B. 1918) (recovery allowed). *But see* O'Neill v. Atlas Auto. Fin. Corp., 139 Pa. Super. 346, 11 A.2d 782 (1940) (no recovery because of limited undertaking); American Indem. Co. v. Ernst & Ernst, 106 S.W.2d 763 (Tex. Civ. App. 1937) (barred by statute of limitations); International Labs. Ltd. v. Dewar, 41 Man. 329 (1933) (no recovery because of limited undertaking); Annot., 54 A.L.R.2d 324, 327 (1957). Apparently contra to the main proposition: City of East Grand Forks v. Steele, 121 Minn. 296, 141 N.W. 181 (1913) (damages too remote); Craig v. Anyon, 212 App. Div. 55, 208 N.Y. Supp. 259, *aff'd without opinion*, 242 N.Y. 569, 152 N.E. 431 (1925) (damages too remote and contributory negligence).

16. City of East Grand Forks v. Steele, 121 Minn. 296, 141 N.W. 181 (1913); Craig v. Anyon, 212 App. Div. 55, 208 N.Y. Supp. 259, *aff'd without opinion*, 242 N.Y. 569, 152 N.E. 431 (1925). The assumption that there is a stricter rule as to remoteness of damages in contract cannot be easily accepted. See STALLYBRASS, SALMOND'S LAW OF TORTS 155-56 (10th ed. 1945): "[T]he rule as to remoteness of damage is the same whether the damages are claimed in actions of contract or tort. . . ." Corbin states that the rules in contract and tort may not be identical, but he concludes that it should not make any difference in a case which is both a breach of contract and a tort, because in such a case the plaintiff should be given the advantage of the more liberal rule. 5 CORBIN, CONTRACTS § 1019 & n.59 (1951).

17. See 5 CORBIN, CONTRACTS § 1019 (1951).

18. See note 15 *supra*.

sional skill is not one of the risks assumed by an auditor.[19] That is not to say that the accountant undertakes to guarantee against defalcations any business which he audits. That is a matter for internal control and insurance.[20] But the courts now agree that the accountant should indemnify his client for losses due to defalcation which would have been prevented if the accounting job had been done with reasonable care.[21] The real question is the standard of professional care required of the auditor, in the light of the risk of losses due to defalcations. In other words, it is not a matter of limiting liability categorically, but rather a problem of prescribing what is reasonable care with reference to the risk.

Many of these cases have been brought by a bonding company or insurance company, suing by way of subrogation to the right of the accountant's client. It has been consistently held that the surety who has covered the losses has the same rights against the accountant as the client had and is subject to the same defenses.[22] But an interesting situation arises when the employer is insured against losses due to defalcation and the accountant has professional liability insurance. Which insurance company should ultimately bear the loss? If it were left to the courts, the accountant's insurer would probably have to pay the client's insurer if the accountant was negligent. But this would not necessarily be a good result, for the same insurance companies may be writing both kinds of insurance, and the effect would be to drive up the premiums for professional liability insurance. This in turn might tend to discourage accountants from taking out liability insurance, which would not be a good thing from the underwriters' long range interests. Here is an interesting illustration of a problem where the presence of insurance has led to an accommodation of interests not necessarily coinciding with the rules of law which would otherwise govern the rights of the insured parties. For the American Institute of Accountants has worked out an agreement with a substantial number of the companies issuing fidelity bonds, that there will be no attempt to recover against the accountant unless his failure to discover the defalcation was due to affirmatively dishonest acts or gross negligence.[23] That is not the law between ac-

19. See National Sur. Corp. v. Lybrand, 256 App. Div. 226, 235-36, 9 N.Y.S.2d 554, 563 (1939): "Accountants, as we know, are commonly employed for the very purpose of detecting defalcations which the employer's negligence has made possible."

20. See LEVY, ACCOUNTANT'S LEGAL RESPONSIBILITY 12-16 (1954).

21. See note 15 *supra*.

22. See Maryland Cas. Co. v. Cook, 35 F. Supp. 160 (E.D. Mich. 1940); Dantzler Lumber & Export Co. v. Columbia Cas. Co., 115 Fla. 541, 156 So. 116 (1934); National Sur. Corp. v. Lybrand, 256 App. Div. 226, 9 N.Y.S.2d 554 (1939); American Indem. Co. v. Ernst & Ernst, 106 S.W.2d 763 (Tex. Civ. App. 1937).

23. See Carey, *Defalcation in Relation to Audit, Internal Control, and*

countant and client, but it is probably a more satisfactory way of adjusting the problem where insurance enters the picture.

(3) *Tax related situations:* Apart from cases arising from incorrect reports of financial conditions and failure to discover defalcations, the only reported cases between accountant and client involve tax related situations. In one case an accountant was held liable for his negligent failure to file an income tax return on time.[24] In another he was held liable for loss due to negligence in setting the base price in a stock transaction so as to make it appear that there had been a gain where in fact there had not. This caused the client, on the accountant's advice, to sell other stocks at a loss to offset the supposed gain. The problem of measuring damages in such a case was intriguing, but pretty much sui generis.[25]

B. *Professional Standards and Particular Acts or Omissions as Negligence*

It is necessary to start with the generalization that the accountant's duty is to exercise reasonable care in the circumstances. But that does not advance the inquiry very far, when the question is whether a particular act or omission is reasonable or unreasonable. Unless we concede that the negligence formula serves no purpose but to call forth the *ad hoc* reaction of a jury, we need to seek out some more specific standards to incorporate into the negligence formula for the guidance of the jury. On the other hand, any attempt at classifying every particular accounting procedure as acceptable or unacceptable or to prescribe a fixed accounting procedure for every situation will be quite fruitless.

It should help, in this connection, to distinguish between accounting procedures and accounting standards.[26] It is the standards we are looking for. Once we find the guide lines to the proper objectives of the audit, it may well be that there is a range of alternative procedures available to accomplish the desired end. It may be that accounting procedures which are adequate in one setting will not be in another. And it may even be necessary for the accountant to devise new procedures and operations to come up to proper standards in a peculiar circumstance.

Having this in mind, we can venture a statement of the accountant's duty in terms a little more specific than the starting generalization,

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Fidelity Bonds, 83 J. ACCOUNTANCY 353 (1947), and LEVY, ACCOUNTANT'S LEGAL RESPONSIBILITY 27-28 (1954).

24. L.B. Labs., Inc. v. Mitchell, 39 Cal. 2d 56, 244 P.2d 385 (1952).

25. Rassieur v. Charles, 354 Mo. 117, 188 S.W. 2d 817 (1945).

26. See COMMITTEE ON AUDITING PROCEDURE, AMERICAN INSTITUTE OF ACCOUNTANTS, GENERALLY ACCEPTED AUDITING STANDARDS—THEIR SIGNIFICANCE AND SCOPE 11-12 (1954); and SALMONSON, AUDITING STANDARDS, THE LAW AND THIRD PARTIES 10-11 (Ph.D. dissertation, Univ. of Mich., 1956).

but still broad enough to be meaningful in evaluating expected variances in accounting procedures. The accountant must exercise the care and competence reasonably expected of persons in his profession,

(1) to ascertain the facts on which his report is made;
(2) in drawing inferences from facts not stated in the report; and
(3) in communicating the information so that it may be understood.[27]

This statement of the accountant's duty in terms of legal concepts of negligence is consistent with the slightly more specific statement of professional standards formulated by the American Institute of Accountants:

General Standards

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

2. In all matters relating to the assignment an independence in mental attitude is to be maintained by the auditor or auditors.

3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of Field Work

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.

2. There is to be proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

Standards of Reporting

1. The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.

2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.

3. Informative disclosures in the financial statements are regarded as reasonably adequate unless otherwise stated in the report.

4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an over-all opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.[28]

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27. This is essentially a paraphrase of comment *e*, RESTATEMENT, TORTS § 552 (1938).

28. COMMITTEE ON AUDITING PROCEDURE, AMERICAN INSTITUTE OF ACCOUNTANTS, GENERALLY ACCEPTED AUDITING STANDARDS—THEIR SIGNIFICANCE AND SCOPE 13-14 (1954).

With these standards in mind, it should be possible to evaluate how the negligence formula has worked in individual cases.

(1) *Negligence in ascertaining the facts—negligent investigation:* In one of the earliest pronouncements on the subject it was recognized that "It was . . . the duty of the auditor not to confine himself merely to the task of verifying the arithmetical accuracy of the balance-sheet, but to inquire into its substantial accuracy. . . ."[29] The accountant does not discharge his duty by examining the books of the company

> without inquiry and without taking any trouble to see that the books themselves shew the company's true position. He must take reasonable care to ascertain that they do so. Unless he does this, his audit will be worse than an idle farce. . . . An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly shew the true position of the company's affairs . . . .[30]

Significantly most of the reported cases have involved some alleged failure to ascertain facts which should have been ascertained in the exercise of reasonable care—a breakdown in the investigative process.[31]

In the famous *Ultramares* case,[32] an entry of $706,843.07 had been added to accounts receivable after total accounts receivable had been posted. A cursory check of this single item would have revealed that the interpolated item was not supported by any journal entry, but the accountant did not investigate. The matter was more complicated in *National Sur. Co. v. Lybrand.*[33] The embezzlements consisted of a series of abstractions from petty cash. Shortages were concealed by delaying and substituting bank deposits from day to day, and, when outside audits were made, by "kiting" checks from one bank to another on the audit date, so that the sums covered thereby appeared in two banks at the same time. Suspicion should have been aroused by late deposits or bank transfers and by the fact that the "kiting" checks were taken from the check book out of sequence. The accountants never requested or examined duplicate deposit slips, and they never noticed the difference between the items on the deposit slips and the entries on the deposit books. If they had followed the usual procedure of checking the deposits with all banks as of the same day, the whole scheme would have been exposed.[34] In *Maryland Cas. Co. v. Cook,*[35]

29. Leeds Estate, Bldg. & Inv. Co. v. Shepherd, 36 Ch. D. 787, 802 (1887).
30. *In re* London & Gen. Bank, 2 Ch. 673, 682-83 (C.A. 1895).
31. See Annot., 54 A.L.R.2d 324, 327; Note, *Accountants' Liability,* 13 St. John's L. Rev. 310, 314 (1939); and cases cited below.
32. Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931); Annot., 74 A.L.R. 1153 (1931).
33. 256 App. Div. 226, 9 N.Y.S.2d 554 (1939).
34. *Ibid.* See also Note, *Accountants' Liability,* 13 St. John's L. Rev. 310, 315 (1939): "This case is particularly interesting not only because the procedure as to the verification of cash is generally recognized by accountants, but

there had been some rather crude alterations in the tax rolls in the city treasurer's office. If the accountant had checked these tax rolls against the lists in the assessor's office he would have found the discrepancy caused by the defalcations of the treasurer.

These cases involved circumstances that should have aroused suspicion and thus moved the auditor to verify more carefully. But even lacking such circumstances, the accountant is under some obligation to do more than verify the balance of debits and credits.[36] Especially is this true of the cash account. A steady string of cases makes it clear than an accountant can be held negligent for failing to verify the amount of cash on deposit at the bank or failing to set up some sort of spot check or sampling technique to ascertain if there are supporting vouchers to show that payments were properly authorized and to test the genuineness of cancelled checks.[37] Without this, the hazards of defalcations going undetected are unreasonably great.

The reported decisions are not so clear when it comes to verification of inventory. There are holdings that it was not negligent for the accountant to accept the report of a responsible employee of the company without independent verification.[38] But these are old cases, and it appears that contemporary professional standards would require the accountant to verify inventory by a reliable, independent check or sampling process, or plainly state that he has not done so.[39]

Not all of the cases concerning the adequacy of the investigative process involve embezzlement. Allegedly inadequate investigations have given rise to claims resulting from prejudicial reliance upon inflated reports of assets or understatement of liabilities.[40]

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because the defendant accountants had either written or edited text books defining the duties of a reasonable, cautious audit with respect to cash, and they had, literally, neglected to take their own advice."

35. 35 F. Supp. 160 (E.D. Mich. 1940). *Cf.* Fidelity & Deposit Co. v. Atherton, 47 N.M. 443, 144 P.2d 157 (1943).

36. See Annot., 54 A.L.R.2d 324, 327 (1957); Note, *Accountant's Liability,* 13 ST. JOHN'S L. REV. 310, 314 (1939); and cases cited below.

37. Dantzler Lumber & Export Co. v. Columbia Cas. Co., 115 Fla. 541, 156 So. 116 (1934); National Sur. Corp. v. Lybrand, 256 App. Div. 226, 9 N.Y.S.2d 554 (1939); Smith v. London Assur. Corp., 109 App. Div. 882, 96 N.Y. Supp. 820 (1905); Fox & Son v. Morrish, Grant & Co., 35 T.L.R. 126 (K.B. 1918). See Note, *Accountants' Liability,* 13 ST. JOHN'S L. REV. 310, 314 (1939): "This much is settled: The duty of an accountant with respect to cash is not limited to the mathematical accurancy of the figures; he is required, in addition, to test their soundness."

38. Mead v. Ball, Baker & Co., 106 L.T.R. (n.s.) 197, 28 T.L.R. 81 (C.A. 1911); *In re* Kingston Cotton Mill Co., 2 Ch. 279 (C.A. 1896).

39. See LEVY, ACCOUNTANTS' LEGAL RESPONSIBILITY 18 (1954); and Note, *Accountants' Liability,* 13 ST. JOHN'S L. REV. 310, 317-19 (1939).

40. C.I.T. Financial Corp. v. Glover, 224 F.2d 44 (2d Cir. 1955) (alleged failure to discover overvaluation of receivables, but found not negligent because of peculiar necessity to rely upon judgment of client's officer); Duro Sportswear, Inc. v. Cogen, 131 N.Y.S.2d 20, *aff'd without opinion,* 285 App. Div. 864, 137 N.Y.S.2d 829 (1954) (alleged understatement of liabilities due to failure to check for unposted obligations, found to be negligent); Candler v. Crane, Christmas & Co., [1951] 2 K.B. 164 (failure to check and discover

Where there was a finding of negligence in these cases it was not inconsistent with the professional standard that accountants should obtain sufficient competent evidential matter through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion. Many of the same cases might also involve violation of the professional requirement of a reasonably adequate study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted. In fact, the latter may be a better way of describing the negligence in most of the cases, because the facts will show that where the accountant failed to detect defalcations, the internal control was usually inadequate.[41] And here was the accountant's initial shortcoming, in not concluding that the internal control was too flimsy to permit reliance without more extensive testing procedures.

(2) *Negligence in drawing inferences—errors in judgment:* The issue may seem rather clear-cut when we speak of a failure to ascertain the facts. But what of the case where the accountant has gathered all the facts that ordinary professional competence demands, but has drawn a mistaken inference from these facts[42]—in other words, has committed an error in judgment? The fact that it is merely an error in judgment will not necessarily exonerate him. For an accountant holds himself out not only as one having specialized mechanical skills in dealing with figures, but also as one having expert knowledge and judgment in matters coming within his professional competence. He should be expected to exercise better judgment than a layman might upon the same available facts.[43] The issue, then, is twofold. Is this matter within his special competence?[44] And has he exercised the quality of judgment reasonably expected of one in the profession?[45] As to the latter, it is not conclusive that he may be shown wrong after the fact, or that other professionally acceptable alternatives were

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fictitious capital asset, found negligent but not grounds for liability to third party); Beardsley v. Ernst, 47 Ohio App. 241, 191 N.E. 808 (1934) (failure to verify earnings of foreign constituents; no recovery as to third party, where report disclosed accountant's reliance upon unverified source); *cf.* Leeds Estate, Bldg. & Inv. Co. v. Shepherd, 36 Ch. D. 787 (1887).

41. See National Sur. Corp. v. Lybrand, 256 App. Div. 226, 9 N.Y.S.2d 554 (1939); Dantzler Lumber & Export Co. v. Columbia Cas. Co., 115 Fla. 541, 156 So. 116 (1934); Maryland Cas. Co. v. Cook, 35 F. Supp. 160 (E.D. Mich. 1940); Fox & Son v. Morrish, Grant & Co., 35 T.L.R. 126 (K.B. 1918).

42. See RESTATEMENT, TORTS § 552, comment *e* (1938): "[T]he supplier of the information . . . . must exercise the competence reasonably expected of one in his business or professional position in drawing inferences from facts not stated in the information."

43. *Ibid.* See Gammel v. Ernst & Ernst, 245 Minn. 249, 72 N.W.2d 364 (1955); Annot., 54 A.L.R.2d 324, 329 (1957).

44. See C.I.T. Financial Corp. v. Glover, 224 F.2d 44 (2d Cir. 1955); O'Connor v. Ludlam, 92 F.2d 50 (2d Cir. 1937).

45. See notes 43 and 44 *supra.*

available. The accountant does not guarantee correct judgment or even the best of professional judgment—just reasonable competence.[46]

It is to the credit of the accounting profession that there are relatively few cases charging the accountant with incompetent judgment.[47] The cases in the foregoing section indicate that on a few occasions a very few accountants have been careless about ascertaining facts, but apparently most of the practitioners in the profession possess the training and competence necessary to exercise sound judgment once they have the facts.

(3) *Negligence in making the report—negligent communication:* We are here concerned with cases where the accountant presumably made an adequate investigation, and did not draw any careless inferences, but failed to report his findings and conclusions properly.[48]

46. See Gammel v. Ernst & Ernst, 245 Minn. 249, 253, 72 N.W.2d 364, 367 (1955): "The imposition of such standards does not leave them [auditors or public accountants] without adequate protection since their liability . . . arises only as the result of methods or practices . . . which indicate lack of reasonable care, fraud, or bad faith and since they are entitled to a wide discretion in the selection of such methods and in determining which of several practices or principles is most sound or best suited for the work undertaken by them."

47. Curiously, the three relevant cases involved liability to third parties, where it was necessary to proceed on a theory of fraud or gross negligence as giving rise to an inference of fraud. See discussion at pp. 812-21 *infra*. In O'Connor v. Ludlam, 92 F.2d 50 (2d Cir. 1937), the accountant had reported certain notes as being "secured." The error was not one of failure to investigate. He had inspected the pertinent documents and had reached the conclusion that the notes were secured. The court instructed the jury that this was a matter on which an honest mistake could be made and that this was not a matter as to which the accountant held himself out as possessing any special competence. The accountant was exonerated.

In C.I.T. Financial Corp. v. Glover, 224 F.2d 44 (2d Cir. 1955), the accountant was charged with bad faith or incompetent judgment for failure to disclose overvaluation of receivables or failure to set up a larger reserve to cover them. The jury found that valuation of the loans was peculiarly dependent upon valuation of collateral, that the accountant claimed no special competence for this, and, as shown by his report, relied upon one of the client's officers who had special ability. The accountant was exonerated.

But in State St. Trust Co. v. Ernst, 278 N.Y. 104, 15 N.E.2d 416 (1938), it was charged that the accountants had reported a large block of questionable receivables at face value, notwithstanding their investigation had disclosed an extremely unsatisfactory state of collections. The court held that the evidence supporting this charge was sufficient that the jury would be justified in finding gross negligence in failing to reveal the unsatisfactory state of the accounts or set up a large reserve to cover them. If the accountants did have the information which the court said should have warned them, then their error was not in failing to investigate. (How far can an accountant be expected to go in ascertaining the "collectibility" of receivables, anyway?) It was an error in judgment. The question for the jury, if ordinary negligence were the test of liability, would have been whether the judgment exercised fell below the competence reasonably expected of a trained professional accountant. But with fraud as the theory of liability, it is highly questionable that evidence of nothing more than bad judgment should have been enough to make a case for the jury.

48. See RESTATEMENT, TORTS § 552, comment *e* (1938): "He must exercise reasonable care and competence in communicating the information so that it may be understood by the recipient, since the proper performance of the other two duties would be of no value if the information accurately obtained was so communicated as to be misleading."

Failures seem to be of two sorts. Either the accountant completely omits some pertinent fact known to him in making out his report, or he says something about it but fails to do it in words or terms that give an adequate understanding to a person of ordinary understanding in the circumstances. Thus in a Kansas case,[49] the accountant failed to state in his report that the cash account was made up in part of personal checks of the employee who had custody of the cash. Here was information which the client should have had. The accountant was negligent for not reporting it.[50] Errors of the other type—partial or misleading disclosures—are probably more common. In one of the earliest reported cases[51] the accountant had learned that the principle asset of the client banking company—loans—was in an unsatisfactory state and inadequately secured. He reported this to the directors, but in his balance sheet prepared for shareholders he showed the asset at full value, with only the qualification that it was "subject to realisation." The court correctly refused to let the accountant escape liability on the basis of these weasel words. By any reasonable standard the words failed to convey pertinent information respecting the unsatisfactory state of the accounts. The court said that the accountant's duty of reasonable care was not discharged by merely putting readers on inquiry.[52]

The question of negligence in communication is closely related to the question of negligent investigation, in cases where the accountant has relied upon unverified, secondary sources for information disclosed in the report. The courts have exonerated the accountant where there was reasonable reliance upon information supplied by others and the accountant made the basis for his information known in his report.[53] However, if the accountant should fail to disclose the source of his information in such a case, thus leaving room for the infer-

49. Board of County Comm'rs v. Baker, 152 Kan. 164, 102 P.2d 1006 (1940).

50. *Ibid. Cf.* O'Connor v. Ludlam, 92 F.2d 50 (2d Cir. 1937) (balance sheet failed to disclose certain contingent liabilities known to auditor but excluded as a matter of discretion; *held,* not sufficient evidence of fraud for third party liability, though some intimation it might be negligence.)

51. *In re* London & Gen. Bank, 2 Ch. 673 (C.A. 1895).

52. *Cf.* O'Connor v. Ludlam, 92 F.2d 50 (2d Cir. 1937) (trust funds included in cash account without explanation but with an offsetting entry in the liability column; *held,* not sufficient evidence of fraud for third party liability, though strong intimation it would be negligent according to good accounting practices).

53. C.I.T. Financial Corp. v. Glover, 224 F.2d 44 (2d Cir. 1955) (express disclaimer of responsibility for valuation of receivables, where accountant had to rely upon peculiar knowledge of client's officer); Beardsley v. Ernst, 47 Ohio App. 241, 191 N.E. 808 (1934) (certificate construed to disclaim that accountant had examined books of foreign subsidiary and to give notice that balance sheet was based merely upon information received respecting same); *cf. In re* Kingston Cotton Mill Co., 2 Ch. 279 (C.A. 1986) (auditor relied upon manager's statement for inventory; *held,* not negligent).

ence that the information was independently verified, this might be basis for a finding of negligence.[54]

It will be recalled that the suggested professional standards set forth above (1) require the accountant to have competent evidential matter to support his findings, and provide that (2) the report shall state whether the financial statements are presented in accordance with generally accepted accounting principles, (3) informative disclosures in the report are to be regarded as reasonably adequate unless stated otherwise, (4) the report shall either contain an opinion respecting the financial statements as a whole or give the reasons why such an opinion cannot be expressed, and (5) the report shall contain a clear-cut explanation of the character of the auditor's examination and the degree of responsibility which he assumes. These standards are certainly as demanding as anything that has been imposed upon accountants in the decided cases relative to due care in making the report.

C. *Special Defenses*

Apart from the obvious defenses of no negligence, no damage, or no causal relation, there are several additional defenses which involve special problems.

Probably the most interesting of these is the question of contributory negligence. The few times it has arisen it has been in cases involving defalcations by the client's employee.[55] The client claims loss resulting from the accountant's negligence in failing to detect the embezzlement, and the accountant asserts contributory negligence in the loose way in which the client carried on his business, thereby allowing the defalcations to occur.

Paradoxically enough, the first court to apply the defense of contributory negligence in such a case, conceived the action as being for breach of contract. The New York Court of Appeals in *Craig v. Anyon*[56] accepted the jury's finding of negligence against the accountant, but nevertheless limited the plaintiff to recovery of compensation paid to the accountants, holding that plaintiff could not recover for the losses due to failure to discover the defalcations.

The result was based upon the court's questionable conception of

54. See Note, *Accountants' Liability,* 13 St. John's L. Rev. 310, 327 (1939): "Balance sheets and like financial statements should show clearly on their face items that are not verified. The words 'we hereby certify' should be eliminated where exceptions buried in the footnotes have the effect of nullifying the certification. The term 'according to information supplied by officers and directors' should be entirely eliminated from the statements issued to the investing public."

55. See Annot., 54 A.L.R.2d 324, 343 (1957).

56. 212 App. Div. 55, 208, N.Y. Supp. 259, *aff'd without opinion,* 242 N.Y. 569, 152 N.E. 431 (1925).

contract rules respecting remoteness of damage.[57] And yet it held that plaintiff could not have a recovery, beyond the contract price, among other reasons, because the plaintiff had been contributorily negligent in trusting too much to the dishonest employee and not checking up on him more closely.

The case has never been overruled, but its significance is very doubtful, first because of its curious confusion of tort and contract principles, and second because of the qualifying distinction suggested in a later New York case, *National Sur. Corp. v. Lybrand.*[58] This was likewise an action to recover losses resulting from the accountants' failure to discover defalcations. The clerk who had been embezzling funds had unfettered control over their disposition, and so the trial court held that plaintiff was barred, applying the principle of *Craig v. Anyon.* The Appellate Division reversed, holding that the question of contributory negligence should have gone to the jury, limited, however by this significant language:

> We are . . . not prepared to admit that accountants are immune from the consequences of their negligence because those who employ them have conducted their own business negligently. . . . Accountants, as we know, are commonly employed for the very purpose of detecting defalcations which the employer's negligence has made possible. Accordingly, we see no reason to hold that the accountant is not liable to his employer in such cases. *Negligence of the employer is a defense only when it has contributed to the accountant's failure to perform his contract and to report the truth. . . .* That was the principle applied in *Craig v. Anyon* . . . where the embezzler had been negligently represented to the accountants as a person to be trusted.[59]

Some have argued that contributory negligence never should have been applied in professional malpractice cases. If the action was for breach of contract, recovery could not be defeated on the basis of contributory fault in relying upon performance. Just because remedy is sought in the alternative form of tort, it should not be forgotten that the essence of the wrong is breach of contract. The treatment of these cases in tort, it is argued, probably springs from their resemblance to the ancient action on the case for misfeasance in applying a common calling in the handling of another's goods or property, or from a kind of mechanical jurisprudence that equated the contract undertaking to perform with ordinary skill to the duty of ordinary care in negligence cases. But the consequences of violating the duty, which is imposed only by reason of the contract, should be the same whether the action is in contract or tort, which means there is no place for contributory negligence.[60]

57. See discussion at note 16 *supra.*
58. 256 App. Div. 226, 9 N.Y.S.2d 554 (1939).
59. *Id.* at 235-36, 9 N.Y.S.2d at 563. (Emphasis added.)
60. See Rouse, *Legal Liability of the Public Accountant,* 23 KY. L.J. 1, 41-42

These are persuasive arguments, but it seems to me that they go too far in trying to establish the contract as the basis of duty. It is true that the contract usually brings the parties into the relationship which causes the law to impose a duty. But in the final analysis the duty in tort does not arise from the agreement of the parties, but rather from the thing that the defendant has undertaken to do with relation to the plaintiff's interests. Thus if the defendant refused to perform the agreement and never started the audit, there could be no action in tort though there would be in contract. Yet the duty to take care in tort would be fully effective if the undertaking, once commenced, had been wholly gratuitous, there being no contract for lack of consideration.[61]

The existence of the contract does not change the elements of the tort cause of action. So to be consistent, I suppose the possibility of contributory negligence must be accepted, if the action is in tort. But contributory negligence is a failure to use reasonable care in looking after one's own interests in the circumstances. And here one of the circumstances is that the plaintiff has engaged defendant to help protect his interests. There can be nothing unreasonable about plaintiff's conducting his affairs on the assumption that defendant is doing his job properly. It should not be possible to base contributory negligence on a failure to take affirmative protective measures in reliance upon defendant's faithful performance.[62] The New York Appellate Division probably had the right idea. That is, contributory negligence must be accepted as a theoretical defense, but it applies only if the plaintiff's conduct goes beyond passive reliance and actually affects defendant's ability to do his job with reasonable care.

Two other defenses deserve special mention. It has already been pointed out that many of these actions against accountants are brought by a surety, suing by way of subrogation after having covered the client's losses.[63] The surety is subject to any defenses that the accountant would have against his client. Furthermore, since the action by way of subrogation is in equity, the claim of the surety may be subject to additional equitable defenses. At least this was the ruling in one case.[64] The employee who was primarily responsible for the defalcations had made substantial payments to the surety on account of the surety's payments to the client for the loss, and the employee had given his note for the balance, secured by a mortgage on property

(1934); and Comment, *The Legal Responsibility of Public Accountants,* 35 YALE L.J. 76 (1925).

61. See RESTATEMENT, TORTS § 552, comment *c* (1938).

62. See Comment, *The Legal Responsibility of Public Accountants,* 35 YALE L.J. 76, 80-81 (1925).

63. See note 22 *supra.*

64. Fidelity & Deposit Co. v. Atherton, 47 N.M. 443, 144 P.2d 157 (1943).

valued in excess of the amount due the surety company. The surety had made no attempt to collect on this note, though it was long past due. The court held that the negligence of the surety in failing to collect on the note was sufficient equitable ground for defeating the surety's claim against the accountants, whose negligence was alleged to have caused the loss.

In very limited circumstances, it is possible that the accountant might claim tort immunity as an arbitrator. While such is not true of the ordinary audit, there are circumstances where the accountant does undertake an audit primarily to arbitrate differences between parties who have agreed to abide by his findings. Several English cases have held that judicial immunity to tort extends to arbitrators.[65] But the only reported decision in this country considering the matter as applied to an accountant has taken a very narrow view of the defense, though it did not altogether reject the possibility of its applying in a proper case.[66]

II. LIABILITY TO THIRD PARTIES

In the wake of the *Ultramares* decision,[67] a great deal has been written about an accountant's liability to persons other than his employer for damages resulting from reliance upon erroneous information in the accountant's report.[68] There is no need, therefore, to treat the subject exhaustively here.

We must remember that there was a time when negligence was not accepted as a distinct theory of tort liability. Negligence was just another way of violating other duties, whether it be the duty in trespass to avoid inflicting harm directly by force and violence, or the duty in trespass on the case covering indirect injuries, or duty assumed by contract in assumpsit.[69] Thus it is not surprising that in

65. Pappa v. Rose, L.R. 7 C.P. 32 (1871); Tharsis Sulphur & Copper Co. v. Loftus, L.R. 8 C.P. 1 (1872); Boynton v. Richardson [1924] Weekly N. 262; Finnegan v. Allen [1943] 1 K.B. 425.

66. Gammel v. Ernst & Ernst, 245 Minn. 249, 72 N.W.2d 364 (1955).

67. Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931); Annot., 74 A.L.R. 1153 (1931).

68. MacMillan, *Sources and Extent of Liability of a Public Accountant*, 15 CHI.-KENT L. REV. 1 (1936); Meek, *Liability of the Accountant to Parties Other Than His Client for Negligent Misrepresentation*, 1942 WIS. L. REV. 371; Rouse, *Legal Liability of the Public Accountant*, 23 KY. L.J. 3 (1934); Seavey, *Candler v. Crane, Christmas & Co.—Negligent Misrepresentation by Accountants*, 67 L.Q. REV. 466 (1951); and the following notes and comments: 31 COLUM. L. REV. 858 (1931); 16 CORNELL L.Q. 419 (1931); 33 ILL. L. REV. 349 (1938); 26 ILL. L. REV. 49 (1931); 36 IOWA L. REV. 319 (1951); 29 MICH. L. REV. 648 (1931); 3 N.Y.U. INTRA. L. REV. 11 (1947); 16 N.Y.U.L.Q. 436 (1939); 6 RUTGERS L. REV. 478 (1952); 13 ST. JOHN'S L. REV. 310 (1939); 6 U. CHI. L. REV. 127 (1938). See also the following three notes which were published before the *Ultramares* case but treat the same question of third party liability: 28 COLUM. L. REV. 216 (1928); 21 MICH. L. REV. 200 (1922); 29 YALE L.J. 234 (1919). There is also rather extensive treatment in professional accounting journals. A good bibliography is collected in SALMONSON, AUDITING STANDARDS, THE LAW AND THIRD PARTIES 318-22 (Ph.D. dissertation, Univ. of Mich., 1956).

69. See PROSSER, TORTS 170 (1st ed. 1941).

cases involving commercial interests, where the relationship of the parties grew out of contract, the courts had difficulty in seeing any duty owed to parties not in privity to the contract.[70]

The idea of a general duty to avoid unreasonable risks to foreseeable interests of others, had begun, in the latter part of the nineteenth century, to develop promisingly as applied to physical injury to interests of personality and property, as evidenced by Brett's famous dictum in *Heaven v. Pender*.[71] But the extension of the same idea into the field of intangible commercial interests was at the same time resisted, as shown in the case of *LeLievre & Dennes v. Gould*.[72] There it was held that an architect-surveyor who carelessly gave erroneous progress certificates to the owner of a building under construction, could not be held liable for negligence to the plaintiff who had lost money through loans made to the owner in reliance upon the certificate.

At almost the same time, the House of Lords in *Derry v. Peek*[73] had made it clear that the traditional action for deceit could not be extended to cover merely negligent misrepresentations. Thus the prospects for liability beyond privity of contract for negligent misrepresentation seemed rather well foreclosed.

But the courts of this country were more enterprising. A few of them rejected *Derry v. Peek* outright and were willing to entertain an action for a merely negligent misrepresentation.[74] And a substantial number got around the scienter problem by finding a fictitious intent to deceive in the representation as to the state of the informer's knowledge in making a statement of fact which he did not know to be true.[75]

70. The classic illustration is Winterbottom v. Wright, 10 M. & W. 109, 152 Eng. Rep. 402 (Ex. 1842). See dissenting opinion of Denning, L.J., in Candler v. Crane, Christmas & Co., [1951] 2 K.B. 164, 174 for an interesting discussion of the historical development of the negligence concept as related to the particular problem of negligent misrepresentation. See also, Jenks, *Negligence and Deceit in the Law of Torts*, 26 L.Q. REV. 159 (1910); Labott, *Negligence in Relation to Privity of Contract*, 16 L.Q. REV. 168 (1900); Winfield, *History of Negligence in the Law of Torts*, 42 L.Q. REV. 184 (1926.

71. 11 Q.B.D. 503 (C.A. 1883).

72. [1893] 1 Q.B. 491 (C.A.).

73. 14 App. Cas. 337 (1889).

74. Cunningham v. C.R. Pease House Furnishing Co., 74 N.H. 435, 69 Atl. 120 (1908). This was a case involving physical harm to the person, but New Hampshire did not limit its departure from *Derry v. Peek* to such cases. See Weston v. Brown, 82 N.H. 157, 131 Atl. 141 (1925). It should be noted that this was conceived as an action for negligence. That is, misrepresentation was just another way of causing harm through negligence. See, PROSSER, TORTS 702, 733 (1st ed. 1941). Actually this idea as applied to cases involving physical injury to the person had much earlier beginnings. See Thomas v. Winchester, 2 Selden 397 (N.Y. 1852), *infra* note 76; see Bohlen, *Misrepresentation as Deceit, Negligence, or Warranty*, 42 HARV. L. REV. 733 (1929).

75. See PROSSER, TORTS 734-35, 741-42 (1st ed. 1941); Meek, *Liability of the Accountant to Parties Other Than His Employer for Negligent Misrepresentation*, 1942 WIS. L. REV. 371, 376-80; Note, 28 COLUM. L. REV. 216, 218-19 (1928).

Over in the negligence area, the limitations of privity in cases involving commercial transactions finally gave way to the more general duty of reasonable care as to foreseeable risks, first in cases involving physical harm to person or property,[76] and then finally in a case involving purely commercial interests. This was the case of *Glanzer v. Shepard.*[77] A public weigher was engaged by the seller of beans to certify the weight to the buyer. The buyer sued the weigher for loss due to negligent overstatement of the weight. Judge Cardozo, speaking for the New York Court of Appeals, rejected defendant's argument that there was no duty beyond privity of contract. The law imposed a duty not limited to contract, arising out of the proximity of defendant's undertaking to plaintiff's known interests. "Constantly the bounds of duty are enlarged by knowledge of prospective use."[78]

At this stage one might have thought that an accountant who carelessly made his audit, under circumstances where he should have foreseen that it would be relied upon by a third party, would be held liable for his negligence, notwithstanding one earlier decision

76. The process by which the limitation of privity was eroded is ably documented in the case which is thought of as the landmark in this area. MacPherson v. Buick Motor Co., 217 N.Y. 382, 111 N.E. 1050 (1916). As to physical harm due to negligent misrepresentation, see Thomas v. Winchester, 2 Selden 397 (N.Y. 1852); and Cunningham v. C.R. Pease House Furnishing Co., note 74 *supra.*

77. 233 N.Y. 236, 135 N.E. 275 (1922), *affirming* 194 App. Div. 693, 186 N.Y. Supp. 88 (1921). That is not to say that *Glanzer v. Shepard* was the first case extending negligence liability beyond privity of contract in situations involving injury to commercial interests as distinguished from physical injury to person or property, but rather to say that for purposes of this study it was the most significant case up to that time. There had been other extensions of liability beyond strict privity of contract, but they were thought of more as qualifications and refinements of the privity rule. Abstractors who were employed by vendors had been held liable to vendees who relied upon an abstract negligently made, but there were more cases holding the other way. The cases where recovery was allowed invariably involved a tight nexus between the abstractor and the plaintiff—that is, the abstractor knew that the abstract was being ordered for the use of a vendee in connection with a contemplated sale. And recovery was usually rationalized within orthodox privity limitations by resort to theories of agency or third party beneficiary rather than based upon a general duty of care. See Note 31 Colum. L. Rev. 858, 861-62 & nn. 15, 16, 17, 20 (1931); Note, 28 Colum. L. Rev. 216, 219-20 & n.16 (1928); Note, *Accountants' Liability,* 13 St. John's L. Rev. 310, 312-13 n.13 (1939); Annot., 34 A.L.R. 67, 68-69, 71 (1925); Restatement, Torts, Explanatory Notes § 628 at 107-08 (Tent. Draft No. 13, 1936); 1 Harper & James, Torts 546 n.5 (1956). There was also a class of cases in which public officers or quasi-public inspectors who were responsible for certifying certain findings had been held liable for negligence to persons other than the immediate recipient of the certificate who had acted in reliance upon it. But here there were also cases going the other way, and where recovery was allowed it was thought of as resulting from a peculiar duty owed to the public at large arising from the nature of the office and not as a general duty of reasonable care beyond privity of contract. Most of the cases are collected in the Annot., 34 A.L.R. 67, 76-77, 79-80 (1925). See also Note, *Accountants' Liability,* 13 St. John's L. Rev. 310, 312-13 n.13 (1939); Meek, *Liability of the Accountant to Parties Other Than His Employer for Negligent Misrepresentation,* 1942 Wis. L. Rev. 371, 382-83; and 1 Harper & James, Torts 546 n.5 (1956).

78. 233 N.Y. 236, 240, 135 N.E. 275, 276 (1922).

to the contrary in *Landell v. Lybrand*.[79] But any such notion was soon upset by Judge Cardozo's opinion for the New York Court of Appeals in the *Ultramares* case.[80] It was held that the accountants, whose report had been relied upon by a third-party investor, could not be held liable on the basis of negligence, even though the accountant had reason to know that his report might be used for some such purpose. To hold otherwise would threaten liability in an unlimited amount to an indefinite class of persons for a casual slip or blunder. It would extend the scope of duty to refrain from negligent misrepresentations as far as the duty to refrain from fraud. The accountant might, nevertheless, be held liable for fraud in representing that he had examined the books if, in fact, he had not, or for representing that in his opinion the balance sheet reflected the actual financial condition of the business, if he had no reasonable basis upon which to form such an opinion. Negligence might be evidence from which to draw an inference of fraud, but it was no substitute for fraud as the basis of liability.

Glanzer v. Shepard, imposing liability for negligent misrepresentation, was distinguished, not overruled. The distinction was said to be that in *Glanzer v. Shepard* the third party's reliance upon the certificate had been the very end and aim of the transaction. The service had been rendered "primarily for the information of a third person . . . and only incidentally for that of the formal promisee," whereas in *Ultramares* the service was primarily for the benefit of the client and only incidentally for the use of them to whom the client might show the report.[81] Many commentators have thought that the key to this distinction was that in *Glanzer v. Shepard* the defendant knew the party to whom his information was to be given and, in fact, communicated it directly to him.[82] And this has led to considerable criticism of the *Ultramares* decision,[83] because the distinction seemed narrow and artificial.

But the important thing is that the courts since *Ultramares* have not attempted to develop the distinction, whatever it was. Instead they have accepted a general proposition of no third-party liability

79. 264 Pa. 406, 107 Atl. 783 (1919). See Note, *Privity of Contract and Tort Liability*, 21 MICH. L. REV. 200 (1922).
80. Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931). See note 68 *supra*.
81. 255 N.Y. at 182-83, 174 N.E. at 446.
82. See Note, 13 ST. JOHN'S L. REV. 310, 325-26 (1939); Note, 36 IOWA L. REV. 319, 326 (1951); Note, 29 MICH. L. REV. 648 (1931). See 1 HARPER & JAMES, TORTS 547 (1956); PROSSER, TORTS 736-39 (1st ed. 1941).
83. See note 82 *supra*. See Meek, *Liability of the Accountant to Parties Other Than His Employer for Negligent Misrepresentation*, 1942 WIS. L. REV. 371, 388-91; Note, *Torts—Liability for Accountants' Misrepresentations*, 6 U. CHI. L. REV. 127 (1938); Note, *Limitations on the Action for Negligent Misrepresentation*, 31 COLUM. L. REV. 858, 867-71 (1931). *But cf.* Green, *The Judicial Process—Ultramares Corp. v. Touche*, 26 ILL. L. REV. 49 (1931).

for negligent misrepresentation[84] and have tried to work out the cases under fraud theories. In *Beardsley v. Ernst*[85] and *O'Connor v. Ludlam*,[86] the fraud formula set out in *Ultramares* was strictly applied, with the result that the accountants escaped liability to the third parties, even though the proof was such that there could have been a finding of negligence in a suit between accountant and client.[87] But in the next decision by the New York Court of Appeals, the approach seemed to shift.

The error charged against the accountants in *State St. Trust Co. v. Ernst*[88] was essentially their failure to call attention to the unsatisfactory state of collections on a large block of loans, the firm's principal asset. Certainly there were indications of the unsatisfactory state of the accounts, and it may have been bad judgment to report them as good receivables without some explanation or caveat. But the trial judge did not think this was enough to leave the case to the jury on a question of fraud. The Appellate Division unanimously agreed. But the Court of Appeals reversed by a split decision. Judge Finch, speaking for the majority, stated their reasons in these terms:

> We have held that in the absence of a contractual relationship or its equivalent, accountants cannot be held liable for ordinary negligence in preparing a certified balance sheet even though they are aware that the balance sheet will be used to obtain credit. Ultramares Corporation v. Touche, 255 N.Y. 170, 174 N.E. 441, 74 A.L.R. 1139. Accountants, however, may be liable to third parties, *even where there is lacking deliberate or active fraud. . . .* [H]eedlessness and reckless disregard of consequence *may take the place of deliberate intention.*[89]

This was a subtle shift from *Ultramares*. Indeed, by selective emphasis upon language from one decision or the other, it can be argued that there really is no difference. But it made a difference in result. The court in the *State Street Trust* case held that a finding of fraud could be based on what amounted to a matter of negligent judgment, at worst.[90] Judge Cardozo had been careful in *Ultramares* to point out that "liability cannot be predicated upon error however great in the exercise of judgment."[91] The difference was this: in *Ultramares* fraud was the basis of liability; gross negligence was not a substitute.

84. See Note, 36 IOWA L. REV. 319, 322 (1951).
85. 47 Ohio App. 241, 191 N.E. 808 (1934).
86. 92 F.2d 50 (2d Cir. 1937).
87. LEVY, ACCOUNTANTS' LEGAL RESPONSIBILITY 44 (1954).
88. 278 N.Y. 104, 15 N.E.2d 416 (1938).
89. *Id.* at 111-12, 15 N.E.2d at 418-19. (Emphasis added.)
90. See SALMONSON, AUDITING STANDARDS, THE LAW AND THIRD PARTIES 131-37 (Ph.D. dissertation, Univ. of Mich., 1956); Dohr, *Some Reservations on the State Street Trust Company Case,* 70 J. ACCOUNTANCY 218, 224 (1940); Note, 36 IOWA L. REV. 319, 328 (1951).
91. Quoted from dissenting opinion of Lehman, J., in State St. Trust Co. v. Ernst, 278 N.Y. 104, 128, 15 N.E.2d 416, 426 (1938).

It might be evidence of an intent to deceive or a reckless disregard for the truth if the basis for the statement was "so flimsy *as to lead to the conclusion* that there was no genuine belief back of it."[92] But in the *State Street Trust Co.* case, gross negligence became a substitute basis for liability.[93]

At least that is how the decision has been interpreted and applied since. In *Duro Sportswear, Inc. v. Cogen*,[94] the New York courts held the accountant liable to a third party who had relied upon the report, notwithstanding an express finding that there was no fraud. Liability was based upon a finding of gross negligence.[95] In *C.I.T. Financial Corp. v. Glover*,[96] the accountants were exonerated upon a finding that there was nothing misleading about their report. But it appears that the instructions to the jury presented the case upon the assumption that a finding of gross negligence would sustain liability to the third party.[97]

This can be rather disturbing if one is concerned about the real issue—that is, scope of liability rather than degree of fault. It appeared as though a workable theory was developing to extend negligence liability beyond privity of contract in cases involving injury to commercial interests, just as it had previously developed in cases involving physical injury to interests of personality and property. But out of concern for the seemingly limitless consequences of extending liability for negligence to the usual reach of foreseeable risks in the *Ultramares* case, the theory of liability was shifted to fraud. This was not too disturbing when the fraud standard was consistently applied, even accepting the modified scienter notions that had been previously developed by some American courts. But when gross negligence ceased to be just evidence on the scienter question and became the basis of liability itself, this was an unfortunate turn of events. If the reason for rejecting negligence as the basis of liability in the first place was concern over the scope of liability, the problem is not solved by floundering about in the distinction between negligence and gross negligence. Yet that seems to be the direction in which we are headed. Even if the course goes the full round, as may be predicted, and gross negligence eventually is watered down to ordinary negligence in theory as well as practical effect,[98] the result is not

92. *Id.* at 126, 15 N.E.2d at 425. (Emphasis added.)
93. See dissenting opinion of Lehman, J., in State St. Trust Co. v. Ernst, 278 N.Y. 104, 123, 15 N.E.2d 416, 424 (1938); and commentaries cited note 90 *supra*.
94. 131 N.Y.S.2d 20, *aff'd without opinion*, 285 App. Div. 864, 137 N.Y.S.2d 829 (1954).
95. *Id.* at 25.
96. 224 F.2d 44 (2d Cir. 1955).
97. *Id.* at 45, n.1.
98. See Dohr, *Some Reservations on the State Street Trust Company Case*, 70 J. ACCOUNTANCY 218, 224 (1940): "Competent accounting authority has

necessarily good, because the question of scope of liability will still be unsolved.

Where did things go wrong? It would be easy to say that the mistake was made in not extending negligence liability to cover the *Ultramares* case,[99] but it is not that easy. On the facts of the *Ultramares* case there was a serious problem as to scope of liability. The defendants knew only that in the usual course of business the balance sheet would be exhibited to banks, creditors, stockholders, purchasers or sellers, according to the needs of their client. Nothing was known as to the person or persons to whom the copies might be shown or the extent or number of the transactions in which they would be used. "The range of the transactions in which a certificate of audit might be expected to play a part was as indefinite and wide as the possibilities of the business that was mirrored in the summary."[100]

This puts the distinction between *Ultramares* and *Glanzer v. Sheppard* on a much broader footing.[101] As the *Restatement* has pointed out, with manifest good sense,

> In the majority of situations the identity of the person for whose guidance the information is supplied is of no moment to the person who supplies it, although the nature and extent of the transaction for guidance in which the information is to be transmitted is vitally important. This is so since the risk of liability to which the supplier subjects himself by undertaking to supply the information, while not affected by the identity of the person for whose guidance it is given, is vitally affected by the nature and extent of the transaction in which it is to be used.[102]

This is a realistic basis for determining the scope of liability as to professional supplier of information. The important thing is that risk be limited to transactions of the scope in which it was intended to be used and with regard to which the task was undertaken and professional responsibility assumed. This may be a more restricted scope of liability than the usual range of foreseeable risks as applied in negligence cases involving physical harm to person or property.[103] For if one extends liability to loss in connection with all transactions in which the accountant's report might foreseeably be relied upon, the possibilities are almost limitless.

Judge Cardozo realized this and aimed for a more appropriate

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expressed the opinion . . . that the conduct which was held to be 'recklessness not amounting to a genuine belief' was in reality nothing more than ordinary negligence at most."

99. See note 83 *supra*.

100. 255 N.Y. 170, 171-72, 174 N.E. 441, 442 (1931).

101. That is, broader than the suggested distinction that the recipient of the certificate was known to the defendant in the case but not in the other. See note 82 *supra*.

102. RESTATEMENT, TORTS § 552, comment *g* (1938).

103. *Id.* at comment *a*.

scope of liability by shifting to the fraud theory.[104] The scope of liability in fraud is essentially what we have said the accountant's range of risk should be—that is, extending to the person or class of persons who were intended to rely upon the report in a type of transaction in which it was the maker's purpose to influence their conduct.[105] While the decision reached the right result as to scope of duty, it also shifted the standard for determining breach of duty—that is, from negligence to fraud, or from default of reasonable professional care to intent to deceive or cause harm. This shift was neither desirable nor was it necessary. It was not desirable, because the accountant seeks to add value and prestige to his services by widespread reliance upon his professional skill and integrity.[106] Therefore, the measure of his fault should be unreasonable failure of the skills held out for such reliance.[107] It was not necessary because scope of duty in the negligence formula could have been adapted to the more restricted limits,[108] while lack of reasonable care, or negligence, was still retained as the standard for determining breach of duty. In fact, this is what the drafters of the *Restatement* concluded that the law is,[109] based upon the negligence theory of *MacPherson v. Buick*[110] and *Glanzer v. Shepard*[111] within the limitations as to scope of liability imposed by the *Ultramares* case:

> § 552. INFORMATION NEGLIGENTLY SUPPLIED FOR THE GUIDANCE OF OTHERS. One who in the course of his business or profession supplies information for the guidance of others in their business transactions is subject to liability for harm caused to them by their reliance upon the information if (a) he fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting, and (b) the harm is suffered (i) by the person or one of the class of persons for whose guidance the information was supplied, and (ii) because of his justifiable reliance upon it in a transaction in which it was intended to influence his conduct or in a transaction substantially identical therewith.[112]

104. 255 N.Y. 170, 187, 174 N.E. 441, 447-48 (1931).

105. *Ibid.* RESTATEMENT, TORTS § 552, comment *a.* (1938): "As in the case of fraudulent misrepresentations the liability is confined to those who are intended to rely upon the information and who rely upon it in a type of transaction in which it is the maker's purpose to influence their conduct. This distinction does not come from the fact that the matter supplied is information rather than a tangible thing. It comes from the fact that it is supplied for guidance in a business transaction and not for guidance in a matter in which the safety of persons, lands or chattels is involved."

106. See Note, 31 COLUM. L. REV. 858, 867-71 (1931); Note, 36 IOWA L. REV. 319, 326-27 (1951); PROSSER, TORTS 738-39 (1st ed. 1941); 1 HARPER & JAMES, TORTS 545-47 (1956).

107. See notes 106 and 83 *supra.*

108. RESTATEMENT, TORTS § 552, comment *a* (1938); see 1 HARPER & JAMES, TORTS 545-47, 1043 n.24 (1956); Note, 28 COLUM. L. REV. 216, 218-9 (1928); Note, 36 IOWA L. REV. 319, 323 (1951).

109. RESTATEMENT, TORTS, Tent. Draft No. 13, 107-08 (1936).

110. See note 76 *supra.*

111. See note 77 *supra.*

112. RESTATEMENT, TORTS § 552 (1938). See note 109 *supra.*

This, it seems to me, is the correct approach to the third party liability problem, and it is regrettable that the cases since *Ultramares* have not pursued it rather than the tortured fraud theories that seem to have led us into the morass of gross negligence. An excellent opportunity to straighten things out was missed in the recent English case of *Candler v. Crane, Christmas & Co.*[113] For if ever there was a case in which there could be third party liability for negligence within the proper scope of liability, this was it. The accountants, without any investigation, had taken the word of a company official as to the existence of certain capital assets. In fact, the assets were not held by the company but in the name of the company official and were encumbered. The company directed the accountant to show his report to a third party who was interested in investing in the company, and loss followed from his reliance upon it. Here was *Glanzer v Shepard* all over again. But the majority of the court took the view that they were bound by the precedents of *LeLievre & Dennes v. Gould* and *Derry v. Peek.* They concluded that the only cases recognizing a duty of care as to misrepresentation, outside of privity of contract, were cases involving physical harm to either person or property. Of course, American decisions to the contrary, like *Glanzer v. Shepard,* were not binding precedent, and the English court ignored them. But ironically enough the majority of the court thought they found support for their conclusion in the *Ultramares* case.

The dissenting opinion by Denning, L.J., is far more convincing.[114] He submits that legal thinking at the time of *LeLievre & Dennes v. Gould* and *Derry v. Peek* was infected by two errors. The first was the notion that no one who is not a party to a contract can sue on it or on anything arising out of it. This led lawyers to suppose that if one of the parties to a contract was negligent in carrying it out, no third person who was injured by the negligence could sue. This error was corrected in the case of *Donoghue v. Stevenson.*[115] The second error was as to the effect of *Derry v. Peek,* that no action ever lies for a negligent statement, even though it is intended that the plaintiff should act on it and he does so to his loss. This error has been exposed by subsequent decisions which show that an action may lie for negligent misstatement, where the circumstances impose a duty to be careful. Such a duty should exist, he concluded, (1) where the defendant is a professional or expert whose occupation it is to examine and make reports which people other than their clients rely upon in the ordinary course of business; (2) the statement is made

113. [1951] 2 K.B. 164.
114. See Seavey, *Candler v. Crane, Christmas & Co.—Negligent Misrepresentation by Accountants,* 67 L.Q. Rev. 466 (1951).
115. [1932] A.C. 562, 48 T.L.R. (involving physical injury due to misrepresentation as to contents of a drug).

in a formal report, as distinguished from a casual statement; and (3) the defendant shows the report to the third party or knows that his client intends to do so, so as to induce action to be taken upon it; (4) in connection with transactions for which the accountants knew their accounts were required.

Almost all writers have agreed that within some such limits the accountant should be liable for negligence to those whose reliance he depends upon to give his professional services value.[116] And while accountants generally supported the result in *Ultramares*,[117] they have admitted a strong sense of responsibility to those who do rely on their reports.[118] As the profession matures and more widely accepted standards are developed, there is increasing evidence that the accounting profession will be ready to accept legal responsibility for maintaining professional standards, even as to persons other than their employers.[119]

III. EVALUATION

Any attempt at evaluating the negligence concept as applied to accountants would be incomplete if based upon the reported decisions only. Additional information should be gathered to ascertain the influence of the negligence decisions on actual practice within the profession. The close correlation noted between reported decisions and contemporary professional standards may prove nothing more than that the standards have been drafted to fit the decisions. Judgments

116. See notes 107 and 83 *supra*.

117. See Note, *Limitations on the Action for Negligent Misrepresentation*, 31 COLUM. L. REV. 858, 867-71 (1931).

118. May, *The Accountant and the Investor*, VAWTER LECTURES 26, 35 (1932); Andersen, *The Accountant and His Clientele*, VAWTER LECTURES 81, 93 (1932); Custis, *Accountancy as a Profession*, VAWTER LECTURES 17 (1932); COMMITTEE ON AUDITING PROCEDURE, AMERICAN INSTITUTE OF ACCOUNTANTS, STATEMENT ON AUDITING PROCEDURE No. 23 (rev. Dec. 1949); see Meek, *Liability of the Accountant to Parties Other Than His Employer for Negligent Misrepresentation*, 1942 WIS. L. REV. 371, 390-91 n.98; Note, *The Accountant's Liability—For What and to Whom*, 36 IOWA L. REV. 319, 324 (1951).

119. The arguments of professional accountants for and against third party liability are extensively sampled in SALMONSON, AUDITING STANDARDS, THE LAW AND THIRD PARTIES 283-93 (Ph.D. dissertation, Univ. of Mich., 1956). The author concludes:

"[A] majority of accountants were quite willing to accept responsibility to third parties if the responsibility were expressed only in terms of morals or ethics. However, this same majority probably fully agreed with the hue and cry raised against any decision, statute, or suggestion that accountants should be held legally responsible to third parties. . . . The accounting profession's apparent reluctance to accept legal responsibility to third parties must be looked upon as a detracting factor in the profession's struggle to gain full public recognition as a profession." *Id.* at 292-93.

"Accountants, whether they wish it or not, will sometime in the future be held liable to third parties for negligence. Imposition upon, and acceptance by, the profession of this legal liability should be construed a normal attribute of professional status, and will make the profession even more valuable to, and deserving of a place of honor in, our society." *Id.* at 306.

See also, LEVY, ACCOUNTANTS' LEGAL RESPONSIBILITY 4-5, 7 (1954).

which were never appealed, so as to make reported precedent may, nevertheless, have a great influence in shaping professional practices. Hearsay is common to the effect that accountants have leaned over backwards to settle cases which might create undesirable precedent if litigated.[120] If this is true, it should be known, because it may have fully as much to do with the way disputes are disposed of as the formal rules of law contained in the reported decisions. More information is also needed respecting the influence of insurance practices. One significant instance has already been noted in which insurance companies have adopted standards which would shift the risk of loss on terms slightly different from the decided cases.[121] Also there has been no attempt here to evaluate the effect of certain statutory developments, such as the Securities and Exchange Act, which has established a formal machinery for prescribing accounting practices and provided for third party liability in prescribed situations.[122]

Yet some tentative conclusions may be ventured, based upon the reported decisions. The expansive and flexible qualities of the negligence formula have been demonstrated once again in its adaptation to one more area of activity. After some rather halting attempts to break away from some of the strictures of contract, the negligence theory has virtually taken over disposition of malpractice suits involving accountants. On the whole, it has seemed to work rather well, except possibly in the area of third party liability. And that was not due to any inherent defect in the negligence concept, but rather to a failure to see the duty question in proper perspective within the negligence formula.

In almost every reported case where accountants have been held liable, either to their clients or third parties, it is quite clear that there has been inadequate performance by the profession's own standards.[123] Liability has resulted in most cases from a failure in the investigative process, where loss could have been avoided by cross checking with other records which were available. Yet there is no suggestion that the accountant must cross check and verify every entry. The cases suggest two considerations as governing the extent to which verification must be made in the investigative process. One is the presence or absence of suspicious circumstances.

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120. See Note, *The Accountant's Liability—For What and to Whom,* 36 Iowa L. Rev. 319, 322 n.16 (1951).

121. See note 23 *supra.*

122. See Levy, Accountants' Legal Responsibility 45-50 (1954); Meek, *Liability of the Accountant to Parties Other Than His Employer For Negligent Misrepresentation,* 1942 Wis. L. Rev. 371, 383-88.

123. See Salmonson, Auditing Standards, The Law and Third Parties 181 (Ph.D. dissertation, Univ. of Mich., 1956): "[I]n every case on which sufficient information is available, the accountants' conduct was in violation of the profession's present generally accepted auditing standards prevailing at the time of the examination."

The other is the need for some reasonable sampling or testing technique, even in the absence of suspicious circumstances. Both considerations are consistent with the standards set by the accounting profession—that is, the accountant should first evaluate the system of internal control to ascertain to what extent it can be relied upon, and then obtain sufficient, competent, evidential matter upon which to formulate an adequate conclusion respecting the matter reported.

These professional standards have obviously been framed in flexible terms in recognition of the fact that the ultimate issue of reasonableness must be determined in each case according to the varied circumstances which arise. Such flexibility is desirable, even though it must be purchased at the price of some loss in certainty. If the standards leave room for judgment in each case, somebody has to decide. And under the negligence formula it will be the jury, guided by the expert testimony of professional accountants.

There are some who are concerned about leaving that much to the jury in a commercial matter where precision and uniformity are important.[124] But if the judge, the lawyers, and the professional witnesses all perform well their respective functions in guiding the jury, the jury will be applying auditing standards, not making them.[125] To be sure, this places a heavy burden upon the profession to strive for precise and generally-accepted standards and to present responsible and competent expert testimony as to professional standards. If they fail, there may well be cause for concern over juries deciding cases contrary to good professional standards.

But, as yet, there is no evidence—at least in the reported cases—of juries getting out of hand. A jury of accountants would have decided most of the cases the same way—that is, on the factual question of whether there was negligence,[126] though they might disagree with the courts as to whether there should be liability for such negligence in some of the defalcation and third-party liability cases. The defendant does not go before the jury in these cases as a rich, impersonal corporation who has inflicted injury upon a helpless plaintiff commanding all of the humanitarian sympathies of the jurors. Juries have shown their disposition to exonerate the

124. See Note, *Accountants' Liability*, 13 ST. JOHN'S L. REV. 310, 323, 326 (1939).

125. This is not like the usual negligence case, where custom or practice is only evidence of reasonable care. In a professional malpractice case it is consistently held that compliance with professional standards amounts to due care. See Morriss, *Custom and Negligence*, 42 COLUM. L. REV. 1147, 1163-67 (1942); 2 HARPER & JAMES, TORTS 979 n.6 (1956). Thus if the professional standards are clearly established, the jury's function is only to determine whether defendant's conduct came up to them.

126. See note 123 *supra*.

accountant in cases where the accountant could offer some reasonable explanation for the mistake he made.[127]

On the whole, I would conclude that the law has worked out the problem of auditors' liability on terms that the accounting profession can live with. And this is as much a tribute to the accounting profession as it is to the law. There may be need for improvement in the direction of establishing more uniform and generally accepted accounting standards. It has been argued that this single objective could possibly be realized more efficiently by administrative fiat,[128] but the reported cases, at least, suggest no cause for abandoning faith in the process of interplay between the profession and the jury under the common law negligence formula.

127. See C.I.T. Financial Corp. v. Glover, 224 F.2d 44 (2d Cir. 1955); O'Connor v. Ludlam, 92 F.2d 50 (2d Cir. 1937); Fidelity & Deposit Co. v. Atherton, 47 N.M. 443, 144 P.2d 157 (1943); Beardsley v. Ernst, 47 Ohio App. 241, 191 N.E. 808 (1934); O'Neill v. Atlas Auto. Fin. Corp., 139 Pa. Super. 346, 11 A.2d 782 (1940); *cf. In re* Kingston Cotton Mill Co., 2 Ch. 279 (C.A. 1896); Mead v. Ball, Baker & Co., 106 L.T.R. (n.s.) N.S. 197, 28 T.L.R. 81 (C.A. 1911).

128. See note 124 *supra*.