Before You Sue The Accountants

Daniel J. Hurson

Even if it looks like a strong case, be careful—there are some surprising defenses.

IN THE WAKE OF the corporate accounting scandals that have dominated the business news for the last few years, as well as recurring announcements of large settlements in class action suits against major accounting firms, the prospect of a malpractice case against an accounting firm would at first glance seem attractive. Juries are presumably more predisposed to view accountants with renewed skepticism, when hardly a news cycle passes without some reference to accounting fraud, investigations, and the occasional large-scale debacles like the demise of Arthur Andersen, not to mention the high-profile criminal prosecutions that have recently gone to trial.

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Indeed, among the players in these sagas, the accountants sometimes offer the best litigation target. The companies themselves have often tanked; the errant executives dismissed, awash in legal problems, and without insurance coverage; but the accountants (Andersen notwithstanding) live on and prosper. They are generally deep-pocketed and amply insured, and the surviving "big four" firms are vast international organizations with billions in revenues. Even the middle-tier accounting firms are substantial in their own right, and are recently acquiring more and bigger clients as the big four shed smaller clients. In fact, the big four are dropping clients at three times the rate they did in 2002, either because they present liability concerns or because the new accounting requirements imposed by the Sarbanes-Oxley Act have sharply increased audit fees charged by the big four and priced them beyond the budgets of many smaller-cap public companies. *Sorry, the Auditor Said, But We Want a Divorce*, New York Times, Feb. 6, 2005.

Your prospective client may be a bankruptcy trustee, or the board members of the audit client who has been required to restate past financial reports that were previously given clean audit opinions, or the injured company itself. (Many high-profile suits have been brought by investor classes under the federal securities laws, a subject beyond the scope of this article. The presumption here is that you will be representing an individual creditor, trustee, or company. For a good primer on all liability theories, see Richard P. Swanson, *Accountant's Liability*, ALI-ABA Course of Study Materials, May 2004.) Often, a third party such as a lender, supplier, or investor in an audit client who has relied on that firm's clean report on the audited financial statements to its detriment, will ask the logical question: "Can I sue the auditors?" It seems appropriate to sue for malpractice the very accountants who opined that all was right with the debtor's books. Any lawyer who has tried negligence cases, particularly professional malpractice, might think this another trip down familiar paths.

Not exactly. Accountant malpractice litigation is a minefield of arcane judicial doctrines layered over pleading and discovery traps that can bury the best plaintiffs' counsel. The accounting industry has, for decades, successfully worked the legislative chambers and litigated in the courts to dig itself a moat of judicial and statutory protection more daunting than that enjoyed by any other profession. Even if the plaintiff breaches the fortress, he will encounter the bewildering Alice-In-Wonderland worlds of generally accepted accounting principles ("GAAP") and generally accepted auditing standards ("GAAS"), whose spider webs of rules, interpretations, and literal "layers" make the federal tax code look simple. Accounting industry defense lawyers know this territory as if they learned it in grade school.

This article represents an effort to lay out some of the initial factors counsel should consider before taking on an accounting malpractice case. Reviewing the case law, it is clear that many cases that appear to be "good on the merits" have been dismissed or lost on summary judgment for failure to meet these often confusing and conflicting legal and factual hurdles.

CONSIDER THE CLIENT'S RELATIONSHIP TO THE ACCOUNTANTS • Initially, it is critical to understand the exact relationship between your client and the accountants, from which will flow the legal ground rules for the case. Many accountant malpractice suits involve litigation by unhappy clients against their auditors, often for bad tax advice, errors in GAAP accounting that require restatements of financial reports, or for failing to catch fraud such as embezzlement. We consider these below.

Foreseeable Plaintiffs

However, unlike the typical malpractice case against the doctor or lawyer, many of the largest-dollar accountant malpractice cases involve aggrieved third parties, such as investors in, lenders to, or sellers of goods or services to companies, audited by the accountant, that have subsequently failed financially. If traditional standards of negligence law applied, reasonably foreseeable victims, even those not in privity with the defendant accountant but who placed reasonable reliance on its professional opinions, should recover. But in almost all states, that is not the law of accountant malpractice. In fact, over the last 60 years or so, individual states have diverged markedly with regard to the liability of accountants to third parties. Some states require privity, others "near-privity," " but only handful apply the liberal standards of foreseeability familiar to products liability cases. A few states, New Jersey for example, have protected accountants by overruling liberal opinions by statute.

***Restatement* Section 552**

Most states, with some important exceptions, follow the *Restatement (Second) of Torts*, section 552, which defines the tort of negligent misrepresentation, generally used in such actions, as follows:

If traditional standards of negligence law applied, reasonably foreseeable victims, even those not in privity with the defendant accountant but who placed reasonable reliance on its professional opinions, should recover. But in almost all states, that is not the law of accountant malpractice.

"One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

[T]he liability stated in Subsection (1) is limited to loss suffered (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction."

As noted by Professor Feinman of Rutgers Law School in a recent comprehensive analysis of auditor liability: "Courts that have adopted the *Restatement* rule regard it as prescribing an intermediate standard for liability between privity or near privity and foreseeability. As the

North Carolina Supreme Court stated in its much-cited opinion in *Raritan I* (*Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 367 S.E.2d 609, 617 (N.C. 1988)]:

"[Section 552] recognizes that liability should extend not only to those with whom the accountant is in privity or near privity, but also to those persons, or classes of persons, whom he knows and intends will rely on his opinion, or whom he knows his client intends will so rely. On the other hand, as the commentary makes clear, it prevents extension of liability in situations where the accountant 'merely knows of the ever-present possibility of repetition to anyone, and the possibility of action in reliance upon [the audited financial statements], on the part of anyone to whom it may be repeated.' *Restatement (Second) of Torts*, Sec. 552, Comment h. As such it balances, more so than the other standards, the need to hold accountants to a standard that accounts for their contemporary role in the financial world with the need to protect them from liability that unreasonably exceeds the bounds of their real undertaking."

Feinman, *Liability of Accountants For Negligent Auditing: Doctrine, Policy, And Ideology*, 31 Fla. St. U.L. Rev. 17, 42 (Fall 2003).

States That Follow The *Restatement*

According to Prof. Fineman's survey, as of Fall 2003, the following states follow the *Restatement* (or what amount to a similar analysis):

- Alabama;
- Alaska;
- Arizona;
- Colorado;
- Florida;
- Georgia;
- Hawaii;
- Iowa
- Kentucky;
- Massachusetts;
- Minnesota;
- Missouri (similar test);
- New Hampshire;
- North Carolina;
- North Dakota;
- Ohio;
- Pennsylvania (but not always);
- Rhode Island;
- South Carolina;
- Texas;
- Tennessee;
- Washington; and
- West Virginia.

Nebraska is "unclear." *Id.* n.165. Wisconsin and Mississippi courts have adopted a more liberal standard, applying general negligence principles of foreseeability. *Id.* at 40-41. California follows the *Restatement* but severely limits liability, narrowly interpreting the accountant's knowledge requirement by holding that the auditor must have "undertaken to inform and guide a third party with respect to an identified transaction or type of transaction." *Bily v. Arthur Young & Co.*, 834 P.2d 745, 767-69 (1992).This interpretation has the effect of "practically equating the knowledge requirement of section 552 with the intended beneficiary requirement of contract law." *Id.* at 30. (Another article that sets forth the law in multiple jurisdictions is Pecini, et al, *At the Interface of Law and Accounting: an Examination of a Trend Toward a Reduction in the Scope of Auditor Liability to Third Parties in the Common Law Countries*, 37 American Business Law Journal 171 (January 1, 2000).)

New York: The *Ultramares* Rule

New York has traditionally followed a restrictive test, set out initially in *Ultramares v. Touche*, 174 N.E. 441 (N.Y. 1931), historically the leading case establishing near-privity as a prerequisite of liability to third parties for the negligent performance of an audit. *Ultramares* essentially requires a party not-in-privity with the auditor but damaged by reliance on his negligently prepared financial statements to prove that the accountant actually defrauded him or that the accountant knew that this particular creditor or investor would rely on the statements. Thus, unlike other areas of tort law, in states following the New York rule, negligent accountants are not liable to reasonably foreseeable victims of their negligence. In New York (and anywhere else), a prudent investor or creditor should insist on discussing with the accountants before making a loan to the audit client the audited financial statements, and obtaining a "comfort letter" addressed to it, attesting to the financial statements. Nowadays, this rarely happens because the accountants know the law and are very reluctant to make such direct representations to third parties.

The New York Court of Appeals strongly reaffirmed the restrictive rule in 1985, finding the auditor not liable to a plaintiff not in privity who lent money to the accountant's client, who relied on an erroneous audit. *Credit Alliance Corp. v. Arthur Andersen & Co.*, 483 N.E. 2d 110, 118-19 (N.Y. 1985). Even though the accountant was alleged to have known that the client showed the report to the lender to induce the loan, there was no allegation that the audit was prepared for that purpose nor of any direct accountant/plaintiff dealings, thus no "linking conduct." The "New York courts have applied the [*Credit Alliance*] criteria rigidly, requiring proof that the accountant was retained to further a particular purpose in which the third party was involved, and that there was an adequate nexus or linking conduct between the accountant and the third party." Feinman, supra, at 36.

Even fraud claims seem to fare better than negligence claims in New York if they allege the auditors' "reckless disregard or blindness to the nature of the client's financial condition." *DaPuzzo, et al v. Reznick, Fedder and Silverman*, 788 N.Y.S. 2d 69 (N.Y. App. Div., 1st Dept., 2005). Recent New York appellate opinions have reemphasized the need for "linking conduct" between the third-party plaintiff and accountant to sustain a negligence charge, noting that even the accountant's explicit knowledge that the plaintiff would rely on the audit is insufficient. *Houbigant, Inc. v. Deloitte & Touch, LLP*, 753 N.Y.S. 2nd 493 (N.Y. App. Div. 1st Dept. 2003). It would appear that pleading fraud is advised, if at all supportable, because that charge is more likely to survive dismissal and entitle the plaintiff to get into discovery, after which the negligence count might be reconsidered. The Enron/Andersen debacle has undoubtedly pushed the courts to more serious consideration of auditor malpractice claims, even in conservative jurisdictions such as New York.

States That Follow The New York Rule

New Jersey and Wisconsin have rejected the *Ultramares* rule, but New Jersey reinstated the rule by statute in 1995. The New York rule has been more or less followed by state and federal courts in:

- Arkansas;
- Connecticut;
- Delaware;
- Idaho;
- Indiana;
- Maryland;
- Montana;
- Virginia; and
- (On occasion) Nebraska.

In evaluating the viability of a case to be filed by a former client against its own auditor for malpractice, privity is obviously not a concern.

Statutory Versions Of The Restrictive Rule

In addition to New Jersey, a few states have adopted the restrictive rule or something close to it by statute:

- Arkansas;
- Illinois;
- Kansas;
- Louisiana;
- Michigan;
- Utah; and
- Wyoming.

Typically, these statutes provide "that an accountant is liable in negligence to a party in the absence of privity only if the accountant was aware that the benefit to the third party was a primary purpose of the client, or if the accountant identifies the third party who is intended to rely on its work by sending a writing [such as a "comfort letter"] to that effect to both the client and the third party." Feinman, supra, at 38.

Consider The Contacts

These significant legal thresholds, which in certain states may doom an otherwise viable third-party case to near-certain dismissal, require counsel to evaluate carefully the contacts, if any, between the potential client and the accountant, how and to what extent the client can prove it relied on the audit, and whether the client falls into the "class" protected by the *Restatement*, when it applies. The best scenario is one in which the client has directly been assured by the accountant, either orally or in some form of direct communication (such as a meeting or a comfort letter), that the audit client's financial statements pass muster under GAAP and contain no material misstatements. A single phone conversation may not be enough.

As noted above, auditors try to avoid giving such comfort to third parties unless they absolutely have to (such as to primary lenders to the client), and their audit reports and engagement letters normally limit the parties who can rely on them to the client and no one else. Likewise, some states by statute require an expert affidavit to be filed with the complaint, opining with respect to the existence of negligent auditing.

Justifiable Reliance

Although the focus must be on what linking conduct exists between the accountants and the third-party client, counsel cannot overlook the requirement, even in states adopting *Restatement* section 552, to show "justifiable reliance" on the plaintiff's part. This test cannot be met by the generalized kind of reliance used in federal securities cases, such as the "fraud on the market" theory. Prevailing case law indicates "actual reliance" is needed. In Georgia, for example, such proof even requires "some evidence that a plaintiff exercised due diligence in discovering the truth." *White, et al v. BDO Seidman, LLP, et al*, 549 S.E.2d 490, 494 (Ga. App. (2001)). Reliance is difficult to prove regarding bad investments or loans made before the release of the allegedly defective audit. Your potential client should be examined as to his reliance, and any facts in support should be pled in detail in the complaint. A credible decision-maker at the client who can say she reviewed and relied on the audit reports is a plus.

WHEN YOUR POTENTIAL CLIENT WAS THE AUDITOR'S CLIENT • In evaluating the viability of a case to be filed by a former client against its own auditor for malpractice, privity is obviously not a concern. These cases are normally filed as professional negligence or breach of contract cases, or both. Although these cases have not attracted as much judicial attention as the third-party actions, they still constitute the majority of cases filed against accountants.

Audit Engagement Letter

The first order of due diligence here is to carefully review the audit engagement letter, which is the contract under which the audit was undertaken. Audit firms are increasingly loading up these letters with self-serving protections, including waivers of jury trial. Some audit engagement letters now require arbitration in lieu of litigating in court. (Clients should be cautioned against agreeing to such a limitation on their rights.)

Engagement letters usually contain language making clear that the audit is not designed to provide absolute assurance that fraud will be detected and set out in some detail the limits of the auditing process. (However, SAS 99, the new auditing standard relating to finding fraud, sets out extensive requirements for the auditor and can be very useful to establish a standard of care regardless of the language of the engagement letter.) This language will usually be the core of the auditor's defense at trial if the allegation is failure to find fraud. Also ask to see the Management Representation Letters, normally sent to the accountants annually by top company management, which represent to the accountants that the financial information provided is accurate and there is no fraud. These letters may go into specific detail regarding certain transactions or accounts that are of concern to the accountants. The auditors may have worked with friendly management to draft or revise these letters to their liking before they are formally sent to them by management. In subsequent litigation alleging failures to catch fraud, embezzlement, or other wrongdoing, the accountants normally use such letters to claim that management defrauded them, too.

Audit Plan

Review as well the Audit Plan, usually submitted annually to the audit committee of the board by the accounting firm. It should outline what the accountants commit to do in their audit, and may contain some broad language pledging that the auditors will carefully review specified areas of risk. These documents can be very useful in establishing a duty of care for the negligence claim, and can be used as well to show that the accountants failed to conduct a proper GAAS audit.

Management Letter

Another key document that should be initially reviewed when evaluating the case is the Management Letter from the accountants, also delivered annually to the audit committee, which is supposed to set forth all the areas of "reportable conditions" wherein the accountants review issues that need attention from the company. Review prior audit year letters as well to see if the same issues are repeated. Historically, accounting firms have been reluctant to find serious "material weaknesses" that could preclude a clean audit report, but they usually find any number of "reportable conditions."

Sarbanes-Oxley Section 404

Under section 404 of the Sarbanes-Oxley Act, accountants have to review their clients' internal controls much more carefully and make a separate audit opinion report on the adequacy of (and management's assessment of) internal controls. Early indications are that many companies will either be reporting "material weaknesses" in their financial reports or at least finding "deficiencies" with internal controls that are reported to the audit committee. These matters must be corrected by management, and if they linger, the auditors may bear some responsibility if such issues can be shown to have contributed to later financial problems. *Accounting Rule Exposes Problems But Draws Complaints About Costs*, The Wall Street Journal, p. A1, March 2, 2005.

If the accountants report on an area of concern that later becomes an issue in a restatement of the financials and in subsequent litigation, for example, too many adjustments coming at the end of the quarters, the accountants may take the position in defense that they identified the issue for management and satisfied their duties under GAAS. The best defense for the accountant is to show a warning to management of the areas of risk, even if the accountant never found the specific misstatement. However, if the accountants did find the problem area, warned management about it, but never insisted to the board that appropriate corrections be made, they may be liable.

Minutes Of Audit Committee

In addition to the auditor's letters, minutes of the audit committee should be reviewed, as well as notes taken by audit committee members, and board minutes, to see if the company was put on notice of problems. The audit committee should be interviewed critically and in depth; in a malpractice suit, they are sure to be deposed and their actions put under a microscope by auditors' counsel. A frequent auditor defense tactic is to argue that the audit committee was "asleep at the switch" (although this ploy is risky because the accountants are supposed to be evaluating the audit committee's competence as part of the audit).

List Of Unadjusted Differences

Another area that should be reviewed is the list of unadjusted differences presented by the auditors to the audit committee with the annual audit. These are accounting entries the auditors conclude are wrong, and should be adjusted up or down, but which, in combination, do not amount in the auditor's and management's opinion to a net material difference and thus are not required to be booked at all. This is an auditing concept that surprises judges and jurors, who may not grasp the overall materiality issue and assume that all errors should be corrected. If some of these items later become the subject of the dispute, the auditors will correctly claim that they brought them to the attention of the audit committee. In general, the auditors will always default to the argument, correct so far as it goes, that the financial statements are prepared by and are the responsibility of management.

Talk To Internal Auditors

It is also useful to talk to the internal auditors, and to talk to accounting department personnel below the level of the CFO and controller who may have interacted with the auditors, to get some sense of what questions were being asked and what the auditors were being shown and told. In a recent case I litigated, the auditors let their hair down with the internal auditor (who, after all, spoke their language) about the problems both were having getting financial data from the managers. If you can find and talk to former members of the audit team (there is considerable turnover in the ranks of young audit staff) you may hit a home run if they reveal concerns shared with senior auditors but which were ignored to preserve the client relationship.

AVOIDING THE IMPUTATION DEFENSE • In any case filed by or on behalf of a company against its former auditor involving any element of management misconduct, the accountants will surely seek to put the plaintiff on trial. In the world of accountant malpractice, the legal doctrines surrounding imputation have exceptions and exceptions to the exceptions, and these vary from state to state. Familiar doctrines such as in pari dilecto, unclean hands, comparative negligence, and agency law have been conjoined, refined, and expanded as defenses in the accounting malpractice arena. Be careful to review relevant state law in all these areas, even if there are few cases specific to accountants. Often, the law relating to other professionals (particularly lawyers) will be relevant, as will be agency law in general.

So as not to paint too dark a picture, many accounting malpractice cases do survive the motion to dismiss, and often, once discovery begins and accounting work papers are obtained, auditor negligence is exposed, and many cases settle favorably.

Managerial Wrongdoing

Some cases arise in the context of bankruptcy trustees, receivers, or governmental agencies stepping into the shoes of the client, typically a now-bankrupt corporation. Other cases involve new management suing on behalf of a still-viable company, or in the context of a debtor-in-possession at a bankrupt but reorganizing entity. All varieties generally involve some fact pattern of management wrongdoing. Whatever the posture of the plaintiffs, the accountants have a cornucopia of legal doctrines to pull out in their defense.

Judge Posner more or less crystallized the primary "imputation" defense in his now-infamous decision in *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir.), *cert. denied*, 459 U.S. 880 (1982), articulating what amounts to a complete defense for negligent accountants if wrongdoing can be imputed to the client's former management. Although *Cenco's* core holding has been repeatedly distinguished, including by the same court several years later in *Schact v. Brown,* 711 F.2d 1343 (7th Cir.), *cert denied*, 464 U.S. 1002 (1983), legally imputing the bad acts of the management to the company to bar it from suing the accountants who allegedly failed to discover those very acts remains a viable defense.

State-Law Dependent

These cases turn exclusively on state law, and they borrow heavily from doctrines developed in master-servant and agency case law. Thus, if it can be shown that errant managers acted exclusively for their own benefit and not for the benefit of the corporation, there is an "adverse interest exception" to the general rule, and suit will be allowed against the negligent accountants. This is akin to acting outside the scope of employment in agency law.

However, there is an exception to the exception, the "sole actor rule," which bars the adverse interest exception in which the sole or dominant shareholder, or group of shareholders (such as family members) commits the wrongdoing. Such conduct has generally been found to bar suit, often in cases brought by trustees, receivers, and regulators such as the FDIC, who "step into the shoes" of the debtor and can only bring such cases as the debtor might have had available at the time of the filing of bankruptcy. *FDIC v. Ernst & Young,* 967 F.2d 166 (5th Cir. 1992). Even then, however, there is some case law to the effect that if there exists even a single honest director or decision-maker in management or among its shareholders who was innocent of the fraud and, had the accountants done their job, could have stopped it, that is sufficient to allow the corporation to sue, even when the management had been engaged in fraud. (These defenses are generally analyzed as a question of standing. For a good recent discussion of the issue, as well as damage theories that may be available to the corporate client, *see Official Committee of Unsecured Creditors v. Lafferty & Co.*, 267 F.3d 340 (3rd Cir. 2001).)

Look For Misconduct Before Filing The Complaint

Thus, a careful review must be made before filing of all facts regarding any wrongdoing within the company to determine if a complaint can be crafted that will survive the motion to dismiss on imputation. Each state's law in this area has evolved in its own way, and even extensive management wrongdoing is not necessarily fatal. But it is very risky for plaintiff's counsel, in deciding whether to sue and in drafting the complaint, to focus mostly on the accountant's negligence and overlook the imputation traps. Accountant defense counsel, who lives in this forest, will surely endeavor to put the focus back on management in the motions, and of course at trial, if needed. With distressing frequency, the tactic works. In a recent example, the Michigan Court of Appeals imputed wrongful conduct to the management, found insufficient allegations to support the adverse interest exception, and upheld dismissal of the complaint, even in the face of allegations accepted as true on the motion that the accountants knew or should have discovered serious accounting irregularities leading to nearly $200 million in investor losses. *MCA Financial Corp. et al v. Grant Thornton, LLP, et al,* 687 N.W. 2d 850 (Mich. App. 2004).

CONCLUSION • So as not to paint too dark a picture, many accounting malpractice cases do survive the motion to dismiss, and often, once discovery begins and accounting work papers are obtained, auditor negligence is exposed, and many cases settle favorably. Throughout the go-go '90s, accountants focused more on business development than on proper auditing and sometimes allowed themselves to slip into a lax and accommodating relationship with aggressive clients. The disastrous results of such toxic combinations have filled the headlines in the last few years. Major accounting firms have repeatedly been hit with multimillion-dollar SEC fines and class settlements.

No doubt the myriad requirements of the Sarbanes-Oxley Act will help to put the accounting industry, and its clients, back on track. Clearly, in the present climate auditors appear to be putting considerably more effort into finding fraud. Nonetheless, these new requirements, and the heightened scrutiny, create potential auditor liability, particularly for failure to identify internal control weaknesses that later may permit fraud to occur or go undetected.

What remains clear is that these cases are often expensive to bring and fiercely defended. The watchword is care and caution in evaluating the facts and determining if your state's law will give you and your client a fair bite at what can still be a very big apple.

PRACTICE CHECKLIST FOR
Before You Sue The Accountants

Although accounting mistakes and malfeasance can cost a business dearly, it can be extremely difficult to maintain suit. If you have a likely case of accounting negligence, do some careful review before filing the complaint.

- Was your potential client in privity with the accounting firm, such as being an audit client? If so, review the engagement letter and any other correspondence with the accountants to understand the nature of the contract and what remedies the client may have waived.

- Review the Management Representation Letter sent to the accountants, the Representation Letter sent from the accountants to management, and notes and minutes of the board of directors and the audit committee, to learn what management knew (and was advised) regarding accounting issues. Talk to internal auditors and accounting personnel.

- Review the financial statements carefully, particularly the notes to the financial reports, to understand how the issues now in dispute were treated in the financial statements with the auditors' concurrence, and what was disclosed in the public filings, if any. You may need the limited services of a forensic accountant in this endeavor.

- Consider state law carefully in drafting the complaint. There may be causes of action available under consumer protection statutes. Suits for negligence and breach of contract may be duplicative. Consider the impact of your state's comparative negligence regime on your chances of recovery, especially if there is wrongdoing at the client's end. Prepare the client for a possible counterclaim. Check for any statutory requirement that an expert affidavit must be attached to the complaint.

- If the potential client is a third party, not in privity with the auditors, review your state law to see if it follows the *Restatement (Second) of Torts*, section 552, the New York rule, something in between, or if there is a specific statute that might protect accountants.

- Whatever the law, review carefully all contacts between accountant and client, and consider whether the client was within the class of those whom the accountant should expect to be relying on the audits. Review with the client all facts supporting specific reliance on the audits, and allege them in the complaint.

- Determine if you will have "imputation" problems. Know all facts relating to fraud or other wrongdoing at the client. Do you have a client who was wholly controlled by bad actors (even if they are now gone)? Was the audit committee negligent? If you have management bad acts that will be imputed, can you use the "adverse interest" exception, or the "sole innocent director" exception? Can you prove the bad actors were acting solely for their own behalf? Check state and federal law for your jurisdiction on these tricky issues.