Limiting Auditors’ Defenses in Negligence Lawsuits: Recent Developments in the Audit Interference Rule

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Abstract - The objectives of this article are to: (1) define the audit interference rule (hereinafter “A.I.R.”) and describe its purpose; (2) summarize the historical case law pertinent to the A.I.R.; (3) delineate the U.S. states that recognize the A.I.R. from those that do not; (4) explain how the A.I.R. is impacted by the existence of a state’s comparative negligence statute; and (5) tell how recent developments in case law are affecting the A.I.R. The purpose of the A.I.R. is to limit the scope of an auditor’s contributory negligence defense in a negligence lawsuit filed by a client. The A.I.R. provides that the client’s negligence is a defense only when it has contributed to the accountant’s failure to perform his contract and to report the truth. New York was the first state to recognize the A.I.R.; other states adopting the rule include Illinois, Kansas, Mississippi, Nebraska, Oklahoma, Pennsylvania, Texas and Utah.

Keywords: audit, interference, rule.

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Limiting Auditors’ Defenses in Negligence Lawsuits: Recent Developments in the Audit Interference Rule

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Abstract: The objectives of this article are to: (1) define the audit interference rule (hereinafter “A.I.R.”) and describe its purpose; (2) summarize the historical case law pertinent to the A.I.R.; (3) delineate the U.S. states that recognize the A.I.R. from those that do not; (4) explain how the A.I.R. is impacted by the existence of a state’s comparative negligence statute; and (5) tell how recent developments in case law are affecting the A.I.R. The purpose of the A.I.R. is to limit the scope of an auditor’s contributory negligence defense in a negligence lawsuit filed by a client. The A.I.R. provides that the client’s negligence is a defense only when it has contributed to the accountant’s failure to perform his contract and to report the truth. New York was the first state to recognize the A.I.R.; other states that recognize the A.I.R. include Illinois, Kansas, Mississippi, Nebraska, Oklahoma, Pennsylvania, Texas and Utah. These states have either never recognized the A.I.R., or have abolished it: Arkansas, Florida, Michigan, Minnesota and Ohio. Recent case law has highlighted several developments in the A.I.R., including: (a) an auditor accused of professional negligence may be required to specifically state how the accountant’s failure to perform his contract and to report the truth. New York was the first state to recognize the A.I.R.; other states adopting the rule include Illinois, Kansas, Mississippi, Nebraska, Oklahoma, Pennsylvania, Texas and Utah. These states have either never recognized the A.I.R., or have abolished it: Arkansas, Florida, Michigan, Minnesota and Ohio. Recent case law has highlighted several developments in the A.I.R., including: (a) an auditor accused of professional negligence may be required to specifically state how the client’s alleged negligence interfered with the auditor’s ability to conduct the audit; (b) the A.I.R. may also be applicable whenever a third-party beneficiary of an audit, such as a bank, sues an auditor for professional negligence; (c) the A.I.R., which limits the scope of an auditor’s contributory negligence defense, has nothing to do with the separate in pari delicto defense which, if applicable, operates as an absolute bar to a claim based on equally wrongful acts of both parties; and (d) the court’s granting of a jury instruction on a client’s alleged contributory negligence should be the exception, not the rule.

Keywords: audit, interference, rule.

I. Objectives of the Article

The objectives of this article are to: (1) define the audit interference rule (hereinafter “A.I.R.”) and describe its purpose; (2) summarize the historical case law pertinent to the A.I.R.; (3) delineate the U.S. states that recognize the A.I.R. from those that do not; (4) explain how the A.I.R. is impacted by the existence of a state’s comparative negligence statute; and (5) tell how recent developments in case law are affecting the A.I.R.

II. The Audit Interference Rule

The Audit Interference Rule (“A.I.R.”) provides that “the negligence of an employer who hires an accountant to audit the business is a defense only when it has contributed to the accountant’s failure to perform his contract and to report the truth.”1 Under the A.I.R., “not all contributory fault of a plaintiff that is a proximate cause of an economic loss could be asserted as a defense. Instead, only contributory fault that affect[s] or interfere[s] with the audit could be considered.”2

III. The A.I.R. Limits the Scope of a Contributory Negligence Defense

The A.I.R. does not bar the assertion of a contributory negligence defense but merely limits its scope. Jurisdictions applying the A.I.R. allow auditors to blame their clients, but only for conduct that contributes to the auditors’ mistakes, instead of allowing auditors to blame clients for any conduct that causes economic losses of the firm.3 The A.I.R. will not make a significant difference in all cases. Most of the cases applying the rule have been characterized by a passive client who failed to make a diligent effort to discover employee misconduct that resulted in interference with the ability of the auditor to conduct the audit. However, if the employer has engaged in active wrongdoing, the A.I.R. will be inapplicable and the auditor will be allowed to

2 Id. at 466. See also Cereal Byproducts Co. v. Hall, 132 N.E.27, 29-30 (Ill. App. 1956), note 22 infra. The issue of audit interference is an affirmative defense which is analyzed in terms of contributory negligence. The analysis involves numerous issues of fact, including whether any contributory negligence was substantial enough to relieve the auditor of liability. This last issue in particular may not be determined as a matter of law, and is an issue for the fact finder to decide. PNC Bank, Kentucky, Inc. v. Grant Thornton, 899 F.Supp. 1399, 1409-10 (W.D. Pa. 1994).
3 A federal district court in Kansas has observed that: “The weight of authority recognizes that accountants typically assume a duty to detect fraud or other irregularities, including those irregularities that are the result of, or at least made possible by, the client’s negligent conduct. In effect, the accountant assumes a duty toward the client to protect the client from certain of the client’s own negligent actions. Given these duties, it would be curious indeed if the accountant were then allowed to interpose as a defense the very injurious negligence of the client that the accountant has assumed a duty to discover and correct.” Comeau v. Rupp, 810 F.Supp. 1172, 1183 (D.Kan. 1992).
use an undiluted contributory negligence defense. On the other hand, if there is no evidence of any contributory negligence of the client, the A.I.R. is also inapplicable.

IV. HISTORY OF THE AUDIT INTERFERENCE RULE

a) New York: The National Surety Case

In 1939, the State of New York produced the first case to adopt the A.I.R. In National Surety Corp. v. Lybrand, the defendant accountants, who had been hired to audit the plaintiff stockbroker company, failed to discover that a cashier had been embezzling funds from the brokerage. In support of its decision to reject the accountants’ defense that the plaintiff had been contributorily negligent in running its business, the Court explained: "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." Later courts adopting the A.I.R. have agreed with the reasoning in the National Surety case; without such a rule, accountants would achieve complete immunity from liability for negligently failing to do a job their clients properly rely on them to do.

The National Surety’s A.I.R. continues to be good law in State of New York and has been applied in several subsequent cases.

b) Nebraska: The Lincoln Grain Case

The most frequently cited subsequent case adopting the A.I.R. is Lincoln Grain, Inc. v. Coopers & Lybrand in 1984. Lincoln Grain is popular enough to displace National Surety, at least on occasion, as the case that gives the rule its name. In Lincoln Grain, Coopers & Lybrand, had conducted an audit of Lincoln Grain’s financial statements. Part of its audit was to check the accuracy of the valuation placed upon the inventory of the firm’s Iowa division. The Iowa division was involved in the buying and selling of grain, but had no storage or shipping facilities. Its inventory consisted only of contracts to sell or purchase commodities. At the end of the fiscal year a value was placed upon the inventory by reference to the market price for the particular commodity as of that day.

On June 30, 1975, Lincoln Grain valued the inventory of its Iowa division at nearly $2 million, and included this valuation in compiling its financial statements. On September 12, 1975, Coopers & Lybrand issued an unqualified opinion on Lincoln Grain’s financial statements. In November of 1975, Lincoln Grain’s Treasurer became concerned with the large cash needs of the Iowa division and began to investigate. In early 1976 the manager of the Iowa division admitted to falsifying the inventory valuations. Later investigation determined that instead of having a nearly $2 million inventory as of June 30, 1975, the inventory only had a value of $143,000.

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4 FDIC v. Deloitte & Touche, 834 F.Supp. 1129, 1144 (E.D. Ark. W.D. 1992). But an undiluted contributory negligence defense cannot be used if a jurisdiction has adopted comparative negligence, see In re River Oaks Furniture, Inc., 276 B.R. 507, 549 (Bankr. N.D. Miss. 2001), where the client’s accountant, Kim Long, had intentionally manipulated the client’s financial records for five years. “In the opinion of the court, these manipulations were not minor, innocent mistakes. Not only did Long alter reconciliations in substantial amounts, she forged the underlying documents to which the. . .auditors were vouching. The lack of supervision at River Oaks permitted Long to perpetrate these acts at will.” Id. When the client’s Chief Financial Officer, Walker, became aware of her wrongdoing, he did not reveal it to anyone. In the Court’s opinion, his silence “directly hindered and delayed” the investigation of the fraud. Id. The Court held that: “The combined effect of all of these circumstances is tantamount to ‘audit interference’. Consequently, even if this court did subscribe to the National Surety philosophy, i.e., that the level of the client’s conduct must equal with ‘audit interference’ before comparative negligence principles can be applied, it would consider the acts of Long and Walker as comparative factors before assessing any damages in this proceeding.” Id. Therefore, under Mississippi law, the audit interference would be an offsetting factor in the determination of the auditor’s liability using the comparative negligence scheme.

5 In re Jack Greenberg, Inc., 240 B.R. 486, 519-20 (E.D. Pa. 1999). The auditor, Grant Thornton, was sued for professional negligence. In the auditor’s Motion For Summary Judgment based on the client’s contributory negligence, the Court noted that the A.I.R. served to limit the scope of the contributory negligence defense of an auditor. However, since there was no evidence that the client had been negligent, the A.I.R. was inapplicable. Id.


7 FDIC v. Deloitte & Touche, Note 4 supra at 563.

8 Id.

9 Two examples will be cited here: (a) in Shapiro v. Glekel 380 F. Supp. 1053, 1058 (S.D.N.Y. 1974), auditor Ernst & Ernst had allegedly negligently failed to detect inaccuracies in a client’s financial statements which had led a bankruptcy trustee to permit the firm’s directors to engage in an ill-advised program of acquisitions; the auditor asserted that the client’s CEO had knowledge of the actual financial condition and that the client was therefore contributorily negligent and could not recover; relying upon the National Surety case and New York law, the U.S. District Court held that the negligence of the client had not contributed to the accountant’s failure to perform his contract and the auditor’s motion to dismiss the complaint was denied; (b) in Hall & Co., Inc. v. Steiner & Mondore, 147 A.D.2d 225, 228, 543 N.Y.S.2d 190, 191-92 (1989), the auditor allegedly negligently failed to discover and bring to the client’s attention certain irregularities in the firm’s books, which prevented discovery of major embezzlements committed by the client’s bookkeeper; the auditor asserted affirmative defenses of contributory negligence and culpable conduct of the client, and the client asked the court to dismiss those defenses, but the court held that the defendant auditor had sufficient alleged negligent conduct on the part of the client which might have contributed to the loss of its money and to the auditor’s failure to detect the bookkeeper’s embezzlement; the court noted that the client had given the bookkeeper unsupervised check-signing authority without any internal controls, that this situation had allowed the malfeasance to occur, and therefore the client’s motion to disallow the auditor’s affirmative defenses was denied.


11 Id. at 304.

12 Id.
The auditor had failed to confirm that the actual commodity market prices used in valuation of the inventory were accurate. The auditor relied upon the market prices used by the firm and did not independently confirm those prices; this was the essence of the lawsuit based on professional negligence filed by Lincoln Grain against Coopers & Lybrand. However, at trial, the defendant auditor successfully used the defenses of assumption of the risk and contributory negligence. The auditor stated that the client had assumed the risk that an audit would not guarantee that employee fraud would be uncovered by the audit, and that the client had been contributorily negligent because it had failed to exercise proper oversight over its employees, thereby failing to detect the fraud in a timely manner.13

Lincoln Grain appealed the decision of the trial court to the Supreme Court of Nebraska. The Supreme Court reversed and remanded the case and ordered a new trial. The Court reasoned that the defense of assumption of the risk is “inapplicable to an action charging that an accountant negligently breached an agreement to render professional accounting services.”14 The Court buttressed this determination by stating that an auditor is “an independent, professional contractor engaged to conduct an independent audit; certainly it cannot be said that one who engages such an accountant assumes the risk that the accountant will fail to adhere to proper professional standards in performing”15 the audit. In the instant case, the auditor failed to follow proper professional standards regarding the confirmation of the value of the inventory.16

The Supreme Court also rejected the defense that the client had been contributorily negligent. Expressly following the National Surety case, the Court held that “accountants are not to be rendered immune from the consequences of their own negligence merely because those who employ them may have conducted their own business negligently. Allowing such a defense would render illusory the notion that an accountant is liable for the negligent performance of his duties.”17 Accordingly, the Court further stated that “the contributory negligence of the client is a defense only where it has contributed to the accountant’s failure to perform the contract and to report the truth.”18 Therefore, at a new trial, “whether Lincoln Grain was contributorily negligent in its dealings with the auditors and whether such negligence contributed”19 to the auditor’s failure to perform its audit in accordance with generally accepted auditing standards were questions of fact to be decided by the jury.20

V. OTHER STATES HAVE ADOPTED THE A.I.R.

In addition to New York and Nebraska, the A.I.R. has been adopted in Utah,21 Pennsylvania,22

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13 Id. at 303-304.
14 Id. at 306.
15 Id.
16 Id.
17 Id. at 307.
18 Id.
19 Id.
20 Id.
21 Fullmer v. Wohlfelder & Beck, 905 F.2d 1394 (10th Cir. 1990).
22 JewelCor Jewelers & Distrib., Inc. v. Corr, 542 A.2d 72, 80 (1988), appeal denied, 524 Pa. 608, 569 A.2d 1367 (1990). JewelCor filed a professional negligence suit against its subsidiary’s auditor, Ernst & Ernst. The trial court ruled that the auditor had not been negligent, and JewelCor appealed. One of the issues raised on appeal was whether the trial court had erred in its charge to the jury by instructing on the contributory negligence of Jewelcor. The appeals court noted that the proper standard to be applied in determining an accountant’s liability is the one enunciated in the National Surety case. The appeals court also noted that if it were to be found that the client was negligent and such negligence had contributed to the failure of the audit, then the auditor would not be liable. However, since the jury found that the auditor was not negligent, then the issue of contributory negligence became irrelevant, and the instruction to the jury on contributory negligence was harmless error. Accordingly, the trial court judgment was affirmed and the auditor was held not to have committed professional negligence. Id.
Texas, Illinois and Kansas. In Utah, the U.S. Court of Appeals for the Tenth Circuit concluded that Utah law would adopt the National Surety approach because “the more fundamental principle is that the accountant should not be absolved of the duty undertaken by him to one reasonably relying on his audit unless the plaintiff’s negligence contributed to the auditor’s misstatement in his reports.”

Two of the commentators who have considered the A.I.R. prefer adoption of the rule to the alternative of allowing accountants to assert an unrestricted defense based on a client’s negligence. See Menzel, The Defense of Contributory Negligence in an Accountant’s Malpractice Action, 13 Seton Hall L. Rev. 292 (1983); and Hawkins, Professional Negligence Liability of Public Accountants, 12 Vand. L. Rev. 797 (1959).

Furthermore, the Federal Deposit Insurance Corporation has recommended the adoption of the A.I.R.

VI. WHETHER ADOPTION OF A COMPARATIVE NEGLIGENCE STATUTE FOR AUDITORS CIRCUMVENTS A PREVIOUSLY ADOPTED AUDIT INTERFERENCE RULE

a) Some Jurisdictions Have Ruled That Circumvention Does Not Occur

In the Coopers & Lybrand case, the Illinois Supreme Court considered whether the common law A.I.R. had been abrogated by a statute that made comparative negligence applicable in tort actions against accountants. The Court ruled that the A.I.R. survived that legislation. After considering cases from other jurisdictions, the Supreme Court rejected the argument that the rule is inconsistent with principles of comparative fault. On the contrary, the Supreme Court held that application of the A.I.R. in auditing malpractice cases is in accord with recognized principles of comparative fault. The Supreme Court also rejected a related argument that, by “relieving the client from responsibility for negligence not directly affecting the audit itself,” the rule deserves public policy because it “minimizes the client’s duty of care and encourages clients to take unjustified risks despite their superior knowledge of those risks.”

The Supreme Court stated that other incentives and deterrents were available to control that type of risk taking, and that continued application of the A.I.R. would give the auditor incentive to take a more skeptical view of the client’s financial statements, thereby resulting in greater care by the client.

A federal district court in Louisiana, applying Texas law in an auditing professional negligence case, also opined that Texas’ A.I.R. is not incompatible with the Texas comparative negligence statute. This opinion was made notwithstanding the fact that the Texas statute provided that if a C.P.A. was sued for professional negligence, “a claimant may recover damages only if his percentage of responsibility is less than or equal to 50 percent.” Therefore, even in a state such as Texas which does not have a pure comparative negligence statute, i.e., one that only recognizes a limited percentage of plaintiff’s negligence in causation, the A.I.R. remains applicable. This court noted: “There is nothing inherently inconsistent between the audit

23 FDIC v. Deloitte & Touche, Note 3 supra.
24 Illinois Public Accounting Act, 225 ILCS 450/30.2.
25 Board of Trustees v. Coopers & Lybrand, Note 1 supra at 466.
26 Id. at 468.
27 Id.
interference rule and the doctrine of comparative negligence. The audit interference rule simply narrows the scope of client acts and omissions which can be considered to be ‘negligent’ for purposes of distributing loss. Nor does Texas’ statutory scheme for comparative negligence compel a conclusion that the audit interference rule no longer applies in suits alleging accounting negligence." \[36\]

Mississippi, \[37\] Oklahoma, \[38\] and Utah \[39\] have also ruled that the A.I.R. is not incompatible with the doctrine of comparative negligence.

### VII. Other Jurisdictions have Ruled that Circumvention Does Occur

However, a federal court in Arkansas predicted that the Arkansas Supreme Court would disagree. The State of Arkansas had not adopted an A.I.R., but had enacted a comparative negligence statute. In a motion to dismiss, defendant auditor argued that the client’s interference would bar the plaintiff client’s claim. The U.S. District Court for the Western District of Arkansas disagreed and denied the motion to dismiss. The court weighed the pros and cons of an A.I.R. in conjunction with the state’s comparative negligence law and came to the conclusion that Arkansas would not adopt the A.I.R. \[40\] They noted that the National Surety case, which contained the nation’s first A.I.R., had been decided in a state with a contributory negligence law, providing that any negligence of plaintiff would completely bar recovery for plaintiff. In contrast, a comparative negligence statute such as the one enacted in Arkansas allows the court to assess damages according to the relative percentages of fault of the parties causing the harm. Since Arkansas had enacted a broad comparative negligence statute, there was less justification for the A.I.R. Therefore, the Arkansas federal court believed that the A.I.R. would be unsuitable for Arkansas. They reasoned that auditors are capable of harmful negligence just as much as clients are, and that the Arkansas comparative negligence law is capable of recognizing and distributing fault between parties whose misconduct contributed to an actionable loss. \[41\] The Arkansas Supreme Court had previously stated, “The purpose of our comparative negligence statute is to distribute the total damages among those who caused them." \[42\]

Accordingly, the court believed that the Arkansas comparative negligence statute could achieve this purpose in an auditor’s malpractice action, and that its application would not improperly protect auditors from liability for the portion of harm caused by their professional negligence. Furthermore, the court noted that accountants and auditors, like other professionals, are held to a standard of care which requires that they exercise the average ability and skill of those engaged in that profession. Failure to exercise ordinary care in conducting accounting activities may expose an accountant to allegations of negligence. Simultaneously, the persons who hire accountants, usually businessespersons, should also be required to conduct their business activities in a reasonable and prudent manner. Thus, the federal court concluded that the Arkansas Supreme Court would follow the traditional Arkansas rule of comparative fault in accounting malpractice cases, because such a rule would appreciate and work to enforce the respective duties of accountants and their clients. The court felt that neither party in these disputes requires or deserves exceptional protection or exceptional exposure to litigation and that a comparative fault law, unrestricted by the A.I.R., is capable of an evenhanded apportionment of liability for harm in this type of case. \[43\]

Similarly, the Supreme Court of Ohio has ruled that its comparative negligence statute removes the need for the A.I.R.; accordingly, the A.I.R., which came into existence during the period that contributory negligence was in place, has been abolished. A client had sued its auditor, Price Waterhouse, for professional negligence. At the trial court and at the court of appeals, Price Waterhouse had been precluded from asserting a comparative negligence defense and the A.I.R. had been applied to the case, resulting in a finding of liability for Price Waterhouse. The Ohio Supreme Court held that comparative negligence should have been allowed as a defense and that the A.I.R. was inapplicable, but the failure to allow comparative negligence as a defense was deemed to be harmless error; accordingly, the court of appeals’ decision was affirmed, and Price Waterhouse was liable to the client for its professional negligence. \[44\]

Other jurisdictions currently refusing to recognize the A.I.R. include Minnesota, \[45\] Florida, \[46\] and Michigan. \[47\] Like Arkansas and Ohio, these states reason that without the potentially harsh outcomes of a  

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36 Gulf Coast Bank & Trust Co. v. Statesmen Business Advisers, Note 34 supra at 5-6.
38 Stroud v. Arthur Andersen & Co. 37 P.3d 783, 789 (Okla. 2001). The court approved a jury instruction that in determining plaintiff’s negligence the jury could only consider negligence which interfered with the auditor’s provision of professional services. Id.
39 Fultiner v. Wohlfleit & Beck, Note 21 supra. The court ruled that the plaintiff’s “negligence in an accounting malpractice case is only a defense, or the basis of an offset where the plaintiff’s conduct contributed to the accountant’s failure to perform his work or to furnish accurate accounting information.” Id.
40 FDIC v. Deloitte & Touche, Note 4 supra at 1145-46.
41 Id.
43 FDIC v. Deloitte & Touche, Note 4 supra.
contributory negligence defense, an A.I.R. is not necessary or desirable because it would lead to undesirable consequences.48

VIII. Recent Developments

a) Specificity is Required in Asserting the A.I.R. as an Affirmative Defense

In order to invoke the A.I.R., an auditor accused of professional negligence is required to specifically allege how the client’s alleged negligence interfered with the auditor’s ability to conduct the audit. In a recent case, the auditor alleged that the client bank had failed to “adequately monitor and administer its loan to Sysix.” That general allegation of negligence was held to be insufficient to plead the narrow category of comparative negligence that is permitted under the A.I.R. The auditor’s allegation of the client’s “poor business practices” was not allowed to be asserted as a defense to the auditor’s negligent failure to discover and report the client’s noncompliance with several legal requirements.49

b) Whether the A.I.R. is Applicable to a Third-Party’s Claim against an Auditor

In Comerica Bank v. FGMK,50 an Illinois case, a bank filed a lawsuit against an auditor, alleging that the auditor had negligently performed an audit of its client, a party to whom the bank had made a loan. There was no contractual relationship between the auditor and the bank. The Supreme Court of Illinois had never considered whether the A.I.R. may be used by an auditor as an affirmative defense in such cases.51

Comerica Bank argued that the rule should not be limited to the auditor-client relationship. The bank contended that the Coopers & Lybrand court had signaled its willingness to extend the rule to claims against auditors by third parties by its citation to two cases in which the bank did that.52 Comerica said that application of the rule was appropriate because FGMK knew that the primary intent of the client in having the audit conducted was to influence the bank to grant the loan, and thus under the Illinois Public Accounting Act FGMK had a duty to the bank that was equal to the auditor’s duty to its client. Finally, the bank argued that, because the auditor failed to allege in its answer that the bank interfered with the audit, the policy underlying the rule extends to claims by third parties against auditors.53

In response, the auditor contended that the A.I.R. should not apply outside the auditor-client relationship. The auditor stated that the Coopers & Lybrand citation of the Fullmer case was not an implicit endorsement of expanding the reach of the rule. The auditor also argued that application of the A.I.R. to non-clients would be contrary to the policy underlying the rule. The auditor also denied that it owed the bank a duty.

The U.S. District Court declined to predict whether the Supreme Court of Illinois would apply the A.I.R. in an action brought by a third party (e.g., a bank) against an auditor. They said it would have been premature to do so because they only had to rule on the bank’s Motion To Strike the auditor’s affirmative defense of comparative negligence. Since additional discovery of the facts was needed to determine whether that affirmative defense was barred by the A.I.R., plaintiff’s Motion To Strike was denied.54 However, the Court was impressed with the fact that the Illinois Public Accounting Act made an auditor liable to a third party, regardless of the absence of privity of contract, if the auditor is “aware that a primary intent of the client was for the professional services to benefit or influence the particular person bringing the action.”55 Thus, it appears that the District Court leaned toward application of the audit interference rule to negligence cases filed by third parties against auditors.56

More recently, a Florida state district court opined that the Illinois A.I.R. would also apply to a third party. A bank that had made a mortgage loan to the client had sued the C.P.A. firm for damages because an unqualified audit opinion had been issued. The court held: “We find that, as a logical extension of Illinois law, there is no reason for a third party not to be considered in the position of a client. . .The client hired [the auditor] to provide audit services and specifically told [the auditor] a primary purpose for the special engagement was to provide the report to [the bank], a third party with an established interest in the financial soundness of the client.”57 Accordingly, the court ruled that the A.I.R. was applicable to the bank as well as the client. However, since there was no evidence of audit interference by either the bank or the client, the trial court had erred in not directing a verdict in their favor on the comparative negligence defense.58

c) The Parmalat Scandal: The Relationship between the A.I.R. and the in Pari Delicto Doctrine

Parmalat, an Italian dairy conglomerate known for its long shelf-life milk, began as a small dairy distributor in Parma, Italy and grew to a diversified, multinational food company by 1990. Beginning in the

48 FDIC v. Deloitte & Touche, Note 4 supra at 1146.
50 Id.
51 Id.
53 Comerica Bank v. FGMK, Note 49 supra at 5-6.
54 Id. at 6-7.
55 225 ILC S 450/30.1(2).
56 Comerica Bank v. FGMK, note 49 supra at 6-7. However, the District Court rejected the portion of the bank’s argument which relied on the Fullmer and Stroud cases. Neither of those decisions considered whether the audit interference rule should apply to claims outside the auditor-client relationship. Id. at 6.
58 Id.
late 1980s, however, the firm experienced financial difficulties including a 100 billion Italian lira loss as a result of the purchase and subsequent bankruptcy of a media company and an investigation for radioactive milk and related product recall and drop in consumer confidence. The firm needed constant infusions of cash to cover its losses and service its massive debt. But cash could be obtained only so long as Parmalat appeared to be a sound investment. To this end, insiders at Parmalat and its external auditor, Grant Thornton, devised schemes involving misleading transactions and off-shore entities that created the appearance of financial health. Loans obtained on the basis of these transactions were used to service debt and obtain more loans. These schemes were hidden in financial statements prepared by Parmalat’s directors and approved by its auditor, Grant Thornton. Parmalat continued its fraud until its massive collapse. When the firm was unable to pay maturing bonds in 2003, the firm’s stock price lost half of its value almost overnight and the firm was forced to declare bankruptcy. 59

Parmalat filed a lawsuit against the auditor, Grant Thornton, for professional malpractice. The complaint alleged that the auditor, acting in conjunction with top managers of Parmalat, established fictitious companies and structured fake transactions whose only purpose was to siphon off billions of dollars from Parmalat. As the firm suffered more and more losses from the looting, the managers sought to hide their acts with misleading manipulations and false transactions. According to the complaint, none of those transactions was intended to benefit Parmalat; instead, each was designed solely to facilitate the managers’ looting of the firm. The complaint alleged that Grant Thornton, the auditor, was continuously aware of the looting and assisted in its cover-up. Together with the corrupt managers, the auditor allegedly devised a scheme to use offshore companies to offload debt and manufacture the appearance of revenue. Initially, the scheme involved three shell companies that were used to hide Parmalat’s losses and to divert money to the managers. Later, in 1998, the managers and the auditor incorporated Bonlat, a subsidiary of Parmalat which became the principal vehicle for the fraud. Bonlat thereafter served to hold Parmalat off balance sheet liabilities that, had they been reflected on Parmalat’s consolidated balance sheet, would have shown that Parmalat was in substantially worse financial health than it was purported to be. Meanwhile, Bonlat booked fictitious revenue and carried a fake $4.9 billion balance in a Bank of America account on its balance sheet. Bonlat’s auditor, Grant Thornton, accepted a confirmation letter from Parmalat attesting to the $4.9 billion. Amazingly, the auditor did not make an independent confirmation. The auditor also accepted unquestioningly the legitimacy of a $600 million investment that Bonlat had allegedly made in a shell company set up by Parmalat. Grant Thornton did all of these things while continuing to issue unqualified audit opinions on Parmalat’s financial statements year after year. As a result of the professional malpractice, the complaint filed against the auditor alleged damages in the amount of $10 billion. 60

The auditor filed a Motion For Summary Judgment. Relying upon the affirmative defense of in pari delicto, Grant Thornton was able to convince the court that the unlawful acts of Parmalat’s managers must be imputed to the firm. The doctrine of in pari delicto is based on the law of agency. The acts of an agent are ordinarily imputed to the principal. In the instant case, Parmalat, the principal, hired the managers to serve as its agents. Whenever a principal uses an agent to act on its behalf, it does so at its peril; there is always a risk that the agent will not conduct himself as he is supposed to do, i.e., to keep the interests of the principal of paramount importance. The managers who looted Parmalat committed unlawful acts, but they were Parmalat’s agents, and their unlawful acts must be imputed to Parmalat. The law of torts will not allow a plaintiff with “unclean hands” to get legal relief from another party if that party has also participated in the unlawful or negligent acts. The court will not countenance a situation where one wrongdoer gets legal relief from another wrongdoer; in the instant case, Parmalat and Grant Thornton both committed wrongful acts. 61

Parmalat tried to counter Grant Thornton’s reliance on the in pari delicto doctrine in two ways. Firstly, Parmalat argued to the court that the “adverse interest” exception applied in this case, i.e., that in pari delicto was inapplicable because the agents committing the unlawful acts acted in their own interest and had abandoned the principal’s interest. The court ruled that the adverse interest exception was inapplicable because the agents did not totally abandon Parmalat’s interests; for example, those unlawful acts enabled Parmalat to obtain new infusions of capital, to expand its production facilities, to increase its product line to 10,000 items, and to increase its international presence from 5 countries to 30. The adverse interest exception requires total abandonment of the principal’s interest; partial abandonment, which exists in this case, is insufficient. 62

Secondly, Parmalat argued to the court that the A.I.R. precludes application of the in pari delicto doctrine to bar claims for accounting malpractice. The court noted that the A.I.R. permits an accountant sued for malpractice to assert his or her client’s negligence as a defense only where that negligence interferes with the accountant’s failure to perform his contractual obli-

60 Id. at 512-14.
61 Id. at 517-18, 530.
62 Id. at 518-25.
gations and to be truthful. It exists to limit the defense of contributory negligence, and may also be applicable in states that have adopted a comparative negligence statute. In other words, the A.I.R. may be asserted by an auditor or a client to limit or preclude the auditor’s liability for malpractice. But it has nothing to do with the separate *in pari delicto* defense which, if applicable, operates as an absolute bar to a claim based on equally wrongful acts of both parties. Accordingly, Parmalat was unsuccessful in its attempt to use the A.I.R. as a counterweight to the defendant’s reliance on *in pari delicto*; the A.I.R. is inapplicable in the context of *in pari delicto*. Therefore, since both grounds put forward by Parmalat failed to prevent the application of *in pari delicto* to this case, the court granted Grant Thornton’s Motion For Summary Judgment. Plaintiff Parmalat’s professional negligence lawsuit against Grant Thornton was dismissed.63

d) Granting a Jury Instruction on Client’s Contributory Negligence Should be the Exception, Not the Rule

Missouri has enacted a comparative negligence statute, but that statute only applies in cases involving personal injury or death or damages to property. The comparative negligence statute is inapplicable to cases related solely to economic loss, such as professional negligence cases; in those cases, contributory negligence is still applicable.64 However, Missouri has neither adopted nor rejected the A.I.R.65 Although not specifically adopting the rule, a Missouri appeals court recently gave the A.I.R. a nod of approval: “The audit interference rule thus represents nothing more than a narrow example of the broader judicial sensitivity we have already advised must be employed in professional negligence cases to avoid permitting contributory negligence to unfairly shift the duty undertaken by a professional back to the client. . . . The defense of client contributory negligence should be unavailable as a matter of law when the alleged client negligence was a failure to discharge a responsibility within the scope of the professional’s duty. That is, a client cannot, as a matter of law, be contributorily negligent for the same acts or omissions that constitute the professional’s negligence. . . . To conclude otherwise would discourage clients from relying on the professional assistance the client has sought, placing the client in the dilemma of having to worry about whether he will be later held contributorily negligent for relying on the professional to protect the client’s interest. . . . As the scope of the contributory negligence defense should turn on the duties the professional has undertaken to the client, it follows that the exact parameters of those duties must be defined in professional negligence cases in light of the particular circumstances of each case through jury instructions.”66

Within that context, the court placed constraints on when a jury instruction on a client’s contributory negligence is allowed in a professional negligence case against an auditor: “Great care must be taken by the trial court in such cases to avoid submitting a contributory negligence instruction that presumes a duty a client has not undertaken, that shifts to the client a duty undertaken by the professional, and that effectively negates the professional’s obligation to perform its duties by ignoring the very reason the client sought out the professional’s assistance in the first place. We also emphasize the importance in professional negligence economic loss cases of carefully defining the scope of the duty undertaken by the professional. Professionals are not insurers against error and can only be liable for mistakes that arise out of a duty specifically undertaken to a client and a corresponding failure to perform within the applicable standard of care. Though we cannot anticipate every scenario which will present itself to trial courts in the future, we suggest that by virtue of the principles herein discussed, it will be . . . the exception, and not the rule, where clients may be considered at fault for a professional’s purported failure to perform duties undertaken to the client.”67

IX. Conclusions

a) The purpose of the A.I.R. is to limit the scope of an auditor’s contributory negligence defense in a negligence lawsuit filed by a client.

b) The A.I.R. provides that the client’s negligence is a defense only when it has contributed to the accountant’s failure to perform his contract and to report the truth.

c) New York was the first state to recognize the A.I.R.; other states adopting the rule include Illinois, Kansas, Mississippi, Nebraska, Oklahoma, Pennsylvania, Texas and Utah.

d) These states have either never recognized the A.I.R., or have abolished it: Arkansas, Florida, Michigan, Minnesota and Ohio.

e) Recent case law has highlighted several developments in the A.I.R., including:

i. an auditor accused of professional negligence may be required to specifically state how the client’s alleged negligence interfered with the auditor’s ability to conduct the audit;

ii. the A.I.R. may also be applicable whenever a third-party beneficiary of an audit, such as a bank, sues an auditor for professional negligence;

63 Id. at 531-32.

64 Children’s Wish Foundation International, Inc. v. Mayer Hoffman McCann, No. WD 70616 (Mo. App., W.D. 2010), pp. 41-42. However, other jurisdictions (e.g., Mississippi) do provide that their comparative negligence law is applicable to cases with only economic loss, such as auditors’ professional negligence cases. In re River Oaks Furniture, Inc., 276 B.R. 507, 546 (N.D.Miss. 2001).

65 Id. at 35.

66 Id. at 45-47.

67 Id. at 54. (Emphasis added.)
iii. the A.I.R., which limits the scope of an auditor’s contributory negligence defense, has nothing to do with the separate *in pari delicto* defense which, if applicable, operates as an absolute bar to a claim based on equally wrongful acts of both parties; and

iv. a court’s granting of a jury instruction on a client’s alleged contributory negligence should be the exception, not the rule.

References Références Referencias

**Journal Articles**


**Legal Cases**


**Statutes**
