Governor Enacts Accountant’s Protective Legislation

Banks and other third parties will have a much more difficult time asserting negligence claims against accountants under a new law recently signed by Governor Whitman. The law provides that, notwithstanding any other provision of law, no accountant shall be liable for damages for negligence arising out of and in the course of rendering any professional accounting service unless:

1. the claimant against the accountant was the accountant’s client; or

2. the accountant

   1. knew at the time of the engagement by the client, or agreed with the client at that time, that professional accounting services rendered to the client would be made available to a claimant who was specifically identified to the accountant;

   2. knew that the claimant intended to rely upon the professional accounting services in connection with a specified transaction; and

   3. directly expressed to the claimant, by words or conduct, the accountant’s understanding of the claimant’s intended reliance on professional accounting services.
In the case of a bank claimant there is an even more stringent rule: the accountant must acknowledge the bank’s intended reliance on the professional accounting service and the client’s knowledge of that reliance in a written communication.

The Act is effective from and after March 17, 1995 and applies to transactions entered into on or after that date.

The purpose of the statute is to shield accountants from claims asserted by parties other than their clients who allegedly relied upon the accountant’s professional accounting services to their detriment. The statute overrules case law in New Jersey to the effect that a third party (including a bank) relying upon the audit reports or other information prepared by an accountant, whose reliance was reasonably foreseeable, could have a third-party claim directly against that accountant in the event of negligent preparation of audit reports or other information.

It would appear that claims for fraud or other egregious actions against accountants would still be possible. Also, the Act's most stringent standard of requiring written agreement by the accountant to reliance on the accountant's professional accounting service is only applicable to banks, a term which includes commercial banks, savings banks, savings and loans and credit unions, but does not include insurance companies, finance companies or other lenders unaffiliated with banks. Those exempted lenders would still be subject to the more general limiting provisions of the Act.

Because the statute requires that the accountant acknowledge the bank’s intended reliance on the professional accounting service and the client’s knowledge of that reliance in a written communication, it appears that it will be very difficult for banks to hereafter assert claims against accountants in the event of negligent preparation of financial statements which are relied upon by lending institutions in a loan transaction or other financing. Banks could attempt to condition a closing of a financing upon the borrower's accountant affirmatively agreeing to allow its financial statements to be relied upon by the bank, but it is unlikely that such an approach would be agreeable to accountants.

Because direct client claims against accountants are preserved, it may be possible for banks in secured financings or otherwise to take an assignment of the client/borrower's potential claim against its accountant. However, this assignment may be of limited utility except in situations where the accountant's negligence harmed both the client/borrower and the lender.

In sum, the accountants have been granted broad immunity which may effectively shield them from third-party negligence claims.
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