

The Evolution of Auditor Liability Under Common Law

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Societal changes have affected auditor liability through time, and the common law has often been a vehicle for implementing changes arising from cultural and economic shifts. Liability for negligence, and auditor liability within negligence, has changed during the course of the 20th century. Prior to *Ultramares v. Touche*, auditors were relatively shielded from lawsuits brought by third-parties (those other than the client) who claimed negligence on the part of the auditor. In the *Ultramares* decision, there was a potential opening towards the expansion of auditor liability to third-parties for negligent performance of audits via the introduction of two relatively new theories of law: (1) that the plaintiff might be able to claim as a third-party beneficiary of the contract between the auditor and the client, or (2) the auditor's negligence was heedless to such an extent that it amounted to constructive fraud. Based on this precedent, it appeared that legal liability of auditors might be extended beyond their clients to the third-parties who relied on audited financial statements. However, Chief Judge Cardozo's concern about an indeterminate liability to an indeterminate class of plaintiffs led to a conservative interpretation of the decision. Nevertheless, auditor's liability in certain jurisdictions has been gradually expanded to include third-parties and even foreseeable third-parties. Consequently, auditor's legal liability to third parties under common law remains somewhat ambiguous.

INTRODUCTION

The paper discusses the evolution of auditor's liability to third-parties (i.e. those who are not clients of the auditor) under the common laws of the states of the United States (US). The American legal system includes both statutory law (i.e. laws enacted by a duly constituted legislature and approved by the executive) and common law (i.e. the accumulated *corpus* of legal decisions rendered by judges and by courts). Beyond this primary distinction into statutory law and common law, the body of American law can be divided into criminal law (i.e. the prosecution of acts deemed criminal by a state or federal government) and civil law