

# Liability to Third Parties (Non-Clients)

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Because third parties rely upon the professional opinions of accountants, accountants may also owe a duty of care to third party non-clients such as creditors, lenders, purchasers, investors, stockholders and bondholders. The following 3 principles are used to determine whether a duty of care is owed to a third party.

## **Privity Principle**

Privity is the connection or relationship between two parties, each having a legally recognized interest in the same subject matter. Privity of contract is the relationship between the parties to a contract, allowing them to sue each other but preventing third parties from doing so. The Privity principle provides that an accountant owes a duty of care only to those persons who were to receive the primary benefit of the accountant's services; generally only those persons with whom the accountant has a contractual relationship. Based on this principle, liability for not exercising due care should extend only to those with whom the accountant has a services contract.

## **Restatement (Second) of Torts Principle**

Restatements are one of several influential treatises published by the American Law Institute describing the law in a given area and guiding its development, and they are highly regarded by courts as secondary authority. Many courts recognize that the Restatement (Second) of Torts Principle provides an intermediate standard for liability that falls between privity and general foreseeability. Under section 552<sup>1</sup> of the Restatement (Second) of Torts, accountants are liable to planned third party users of their financial reports, referred to as a known or the intended class. The accountant's liability is extended to:

- Those intended to use the data
- Those to whom the accountant knows the data will be provided by the client

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### **<sup>1</sup>RESTATEMENT OF TORTS (2D) §§ 552**

#### **§ 552 Information Negligently Supplied for the Guidance of Others**

(1) 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.

(2) Except as stated in Subsection (3), the 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.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

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## ***Foreseeability Principle***

The Foreseeability principle holds an accountant liable to reasonably foreseeable third parties, even if the accountant does not know about the third party, or the third party is not within the intended users of financial statements and reports. If the third party is within a class of persons who might reasonably be foreseen to rely on the accountant's financial statements for proper business purposes, and then detrimentally relies on these statements, then the accountant may be liable to this foreseeable third party. This principle significantly expands the number of individuals that can sue accountants.

TIP: Make sure your engagement letter specifies the third parties that may rely on your reports.

These sample engagement letters, checklists, and practice and consent forms are for illustrative purposes only. We recommend you use these letters and forms only after you have consulted with your attorney. Since your practice may be different than those described in the sample letters and forms, we recommend that you modify them to suit your individual practice needs. Use of these sample letters and forms is not intended to constitute a binding contract, does not constitute legal advice, and does not satisfy your obligation to do thorough research. © Gilsbar Specialty Insurance Services, L.L.C. and Date.