

Auditor's legal liability to third parties

Experience, Human Nature



Increased liability of other professionals to nonprofits users of their services

II. Lack of fairness of Imposing the burden of economic loss on

Innocent financial statement users III. Assumption that expanded liability will

cause auditors to improve their auditing procedures v. Auditors have the

ability to obtain liability insurance v. Increased audit and insurance premium

costs can be passed on to the client 4. Reasonably foreseeable third parties

(used by MS, NJ, WI) a. Ore expansive definition regarding the legal standing

of who can sue the auditor I. Allows broader class of (stockholders or

stockbrokers, for example) might say regarding accuracy of financial reports

Reflection While WI, NJ and MS have a very expansive definition of who

ought to be able to have legal standing to sue auditors for audit reports of

financial statements if the auditor appears to have been negligent or

committed fraud, there must be some balance struck to protect both

auditors and third parties that may rely on audit reports.

The Restatement Standard, as used by most states, appears to strike that

balance, holding auditors accountable for potential negligence or fraud, while

still allowing them to obtain liability insurance to limit their exposure to legal

claims. Chapter 20, problem 20-27 a. What elements must be established by

Musk to support a cause of action based on negligence?

Since state law applicable to this action follows the Ultramarine decision,

which sets the standard for auditor negligent liability by a third party

according to priority, in which a contract or specific agreement exists

between the two parties, Musk would need to show that a contract existed

between Apple and Musk to have legal standing to bring a suit against Apple.

B. What elements must be established by Musk to support a cause of action based on a Rule 10b-5 violation?

If Musk has established that it can sue under Section 11(b), it must prove the following:

1. Apple made a material, factual misrepresentation or omission
2. Musk relied on the financial statements . Musk suffered damages as a result of reliance on the financial statements
4. Apple acted with intent to deceive, defraud, or with knowledge of a false representation) c.

Is Apple's assertion regarding lack of priority correct with regard to Musk's causes of action for negligence or fraud? Regarding negligence, Apple's assertion regarding Musk's lack of priority is correct according to the standard set by the Ultramarine decision. There was no contract between Apple and Musk. However, regarding the fraud charge, the priority requirement does not apply. If the plaintiff can show gross negligence or fraud, the auditor can still be held liable for damages.

As stated in the problem, Apple was aware that Astor was selling inventory at prices substantially less than cost, so it should have known that the inventory valuation provided by Astor should not have been trusted, and should have conducted its own valuation of inventory. While the application of the Ultramarine decision will make it difficult to hold Apple liable for negligence under common law, that decision does not hold weight when considering fraud or gross negligence. In that case, Musk may be able to collect damages on the basis of Rule 10b-5.