

Controlling the Moral Hazard Created by Limiting Liability

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Abstract

Accounting firms may choose to organize either as Limited Liability Companies (LLC) or as Limited Liability Partnerships (LLP) to eliminate joint and several liability for their partners. However, before firms consider adopting either new entity form to limit tortious liability, the moral hazard problem associated with these entity choices should be evaluated. This article examines the issue of accountant liability and offers suggestions to reduce moral hazard while still protecting the accountant from personal liability.

Introduction

Accounting firms which choose to organize either as Limited Liability Companies (LLC) or as registered Limited Liability Partnerships (LLP) will eliminate joint and several liability for their partners. Without this risk of liability, these accounting firms may find that their goals and the goals of their partners diverge. They face a moral hazard.

The term, moral hazard describes situations in which the interests of a principal (e.g., the accounting firm) and agent (e.g., the accounting firm's partners) diverge. Partners, as rational agents, can be expected to maximize their own well being and if their self-interest conflicts with the accounting firm's interests, the accounting firm's interests will suffer. If an accounting firm chooses to practice as either an LLC or LLP the partners and the accounting firm's interests are more likely to diverge because, unlike an accountant who practices in a general partnership, an accountant who practices within an LLC or LLP, can act to shield his or her personal assets from liability. Once protected by this shield, partners may become somewhat less careful in their performance

of accounting services for the accounting firm. They may reduce their care in selecting either new partners or clients. Accounting firms should recognize the corresponding moral hazard and develop controls to deal with it.

This article briefly examines the issue of accountant liability by discussing duty of care and third party liability. It then discusses the new hybrid business forms which accountants are choosing to organize and how their choices may affect personal liability. Finally, the article examines how this entity choice creates a moral hazard and the alternatives available for controlling that moral hazard while still protecting the accountant from personal liability.

Accountant Liability

Typically, accountant liability emerges from an analysis based on tort. Even when liability based on a breach of contract is at issue, the contract serves primarily to define the duty owed by the accountant. Once that duty is defined, the breach of duty analysis is effectively identical un-

der either contract or tort. This permits the analysis of accountant liability to utilize the framework of a tort.

The tort may be characterized as fraud or negligence. If characterized as negligence, the following elements must be proven to recover:

Duty of Care: Existence of a duty arising under either common-law or contract; A breach of that duty by the accountant who fails to discharge his or her duty with reasonable care;

Causation: Factual causation (i.e., 'but for' the accountant's opinion, plaintiff would not have taken the action); Proximate causation (i.e., plaintiff's loss was a foreseeable consequence of the accountant's breach of duty); and

Damages: Damages suffered by plaintiff due to the accountant's breach.¹

If, instead, the tort is characterized as a fraud, the accountant must knowingly breach the duty of care.² Other elements of the tort remain essentially the same as for negligence. Because of this additional element, the majority of tort cases involving accountant liability are based on negligence (Kirby and Davies 1991). Consequently, the principal elements of negligence (i.e., duty and causation) are discussed briefly in the paragraphs which follow.

Duty of Care

The difference between a duty under contract and a duty under tort is that the duty under contract is imposed by an agreement; whereas, the duty under tort is imposed by law.³ However, "accompanying every contract is a common-law duty to perform with care, skill, reasonable expediency, and faithfulness the thing agreed to be done. A negligent failure to observe any of these conditions is a tort as well as a breach of contract."⁴

This common-law duty of a professional, as established by the *Restatement of Torts 2d*, has been stated as follows:

*Unless he represents that he has greater or less skill or knowledge, one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities.*⁵

If an accountant's conduct falls below this standard, risk of liability exists regardless of whether the action is brought in tort or contract.

While an accountant may offer a wide variety of professional services, each demanding specific skills and knowledge, the majority of litigation concerns the duty of care in performing a financial audit. In Statement of Auditing Standards (SAS) No. 53, the American Institute of Certified Public Accountants (AICPA) requires that an auditor "assess the risk that errors and irregularities may cause the financial statements to contain a material misstatement" and to "design the audit to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements" (AICPA 1990, §316.05). However, this Standard also indicates that the auditors' report "does not constitute a guarantee" (AICPA 1990, §316.08).⁶

Because an audit should detect such errors and irregularities only if material to the financial statements, the concept of materiality is important in establishing the duty of care. Materiality, however, is a relative term. The AICPA Auditing Standard provides that "[f]inancial statements are materially misstated when they contain misstatements whose effect, individually or in the aggregate, is important enough to cause them not to be presented fairly, in all material respects, in conformity with generally accepted accounting principles" (AICPA 1990, §312.04).

Courts have held that an auditor, usually, discharges his or her duty by complying with recognized industry standards.⁷ In performing an audit, these recognized industry standards include generally accepted accounting principles and generally accepted auditing standards developed by the AICPA. Yet, while compliance with industry developed standards has been held to be strong evi-

dence of due care, compliance with them is not controlling. Only the legislature and courts can establish controlling standards.⁸ Failure, however, to comply with accepted industry standards has been labeled "constructive fraud."⁹

Causation

The causation elements require that the plaintiff have justifiably relied on financial statements audited by the accountant¹⁰ and that such reliance was foreseeable by the accountant. The foreseeability of reliance by third parties who have not contracted with the accountant for services has presented the greatest extension of potential liability for accountants. The following two theories of foreseeability of third party users are currently widely used by the courts (Hanson and Rockness 1994).

Second Restatement of Torts §552 (majority rule) extends recovery to foreseen third parties who may not be specifically identified. If an accountant is to foresee use by a third party, the accountant must know a certain group or class of persons are to be supplied the financial information. The mere fact of an "ever-present possibility" of financial information use by lenders, investors, stockholders, creditors and others does not make these users foreseeable third parties.

Credit Alliance Corp. v. Arthur Andersen & Co.¹¹ extends recovery to known third party users who are specifically identified to the accountant and who the accountant understands intend to rely. When an accountant personally delivers audited financial statements to a third party, the accountant is liable to that third party for negligence.¹²

Limiting Liability

Accountants typically have practiced as partnerships,¹³ and each partner was jointly and severally liable for the torts of another partner.¹⁴ Extending accountant liability to third party users under either of the above theories increased the need for some method of protecting personal assets and for limiting accountants' potential risk for the torts of other partners. Several groups have re-

sponded to this need.

Beginning in 1988, the industry itself responded. The AICPA Auditing Standards Board modified the auditor's report in SAS No. 58. By modifying the report, the industry anticipated that auditors would more effectively communicate with users of their reports. A recent study, however, found a low satisfaction with both old and new standard audit report wording (Geiger 1994). The study, conducted in late 1989, was based on a survey of bankers who would be familiar with both old and new audit reports. The continuing low satisfaction of this user group supports a conclusion that "[m]ore work needs to be done to increase the reports' effectiveness for users (Geiger 1994, 60).

With the increase in liability awards, the insurance industry and accounting firms have also responded. Insurance premiums and deductibles have increased while the amount of insurance available has been cut substantially (Gossman 1988, 229; Kirby and Davies 1991, 593 ftm 181). Evidence is mounting that commercial insurers are abandoning the profession and that many accounting firms, who are still able to get insurance, are dropping insurance, and either no longer providing audit services or avoiding risky audits and industries (Dalton et al. 1994). Some firms incorporated a litigation risk premium into audit fees (Simunic 1980; Francis 1984; Francis and Simon 1987; Pratt and Stice 1994). Because contracts are entered into voluntarily, a premium would appear appropriate. The firms, however, were not successful in their efforts to use a premium to reduce liability costs because of the increasingly competitive environment in which the accounting firms and their clients have operated. Moreover, clients viewed the monitoring provided by the outside audit as an agency cost unrelated to their productive activities. As such, clients purchased audits at the lowest price.

A recent survey of former managers and partners from the largest national CPA firms, who had left their firms within the last three years, showed that concerns over litigation costs and risk appreciably influenced their decisions to leave.

Because profits directly effect the compensation of partners, the partner group registered greater concern over the fact that ongoing litigation costs would continue to reduce profits (Dalton et al. 1994).

In 1993, the AICPA approved the practice of public accounting within an LLC (AICPA 1993, ET §505.01). LLCs are a "hybrid form of business entity that combines the liability shield of a corporation with the federal tax classification of a partnership" (Bishop and Kleinberger 1994, para. 1.01[1]). Subsequently, LLP's were created in response to the favorable tax classification of LLCs. LLPs, however, utilized general partnerships as the underlying business entity but created a partial liability shield (para. 1.03). Regardless of which of these organizational forms is chosen, joint and several liability for tortious conduct is eliminated. The accounting firm remains liable for the tortious conduct of its agents, and individual accountants remain personally liable for their own tortious conduct (para. 6.06[1] fn 229).

In the fall of 1994, announcements were made that KPMG Peat Marwick had settled litigation arising from bank failures for \$186.5 million and that Arthur Andersen had settled litigation with the State of California for \$1.7 million (Public Accounting Report 1994). At approximately this same time, the six largest national CPA firms adopted the new entity form (i.e., LLP). BDO Seidman chairman and CEO, Gary Wetstein, announced BDO's intention to change to LLP status stating: "The limited liability protection offered under an LLP, which is equivalent to the level afforded today's corporations, will put BDO on a level playing field with our larger competitors" (Public Accounting Report 1994).

Before accounting firms consider adopting one of the new entity forms to limit tortious liability, the agency costs and moral hazard associated with this choice of entity should be evaluated. Agency costs arise because contracts with agents are not costlessly written and enforced. In the case of an accounting firm, agency costs include the costs of structuring, monitoring and bonding the activities of its partners and employees who are

performing an audit or other accounting services on its behalf. A moral hazard is the agency problem which arises when the interests of the firm and its agents diverge.

Moral Hazard

It is important to understand that moral hazard is not the same as fraud although it can involve fraud. Moral hazard, however, does almost always involve ethical considerations. While a professional who accepts an engagement has a legal duty to perform with care, the actions required by that duty are not fully defined under either the contract or the common law of torts. The required action is determined by the professional's decisions which often are based on ethics. These decisions are generally complex and require the professional to weigh competing interests which may or may not be in the self-interest of the professional. It is the existence of competing interests which gives rise to the moral hazard as first introduced in the insurance literature. The term, moral hazard, within that literature and for purposes of this paper, describes situations in which the goals of a principal (e.g., the accounting firm) and agent (e.g., the accounting firm's partners) diverge. Partners, as rational agents, can be expected to maximize their own well being and if their self-interest conflicts with the accounting firm's interests, the accounting firm will suffer.

To reduce the risk of divergent interests, accounting firms must design contracts that will achieve a congruence between their goals as principals and the goals of their partners who as agents are performing the professional services. If accounting firms fail to do so, this lack of congruence will give rise to a moral hazard because: (i) the partners' actions that affect the care with which the professional services are performed cannot be costlessly observed by the accounting firm, and (ii) the uncertainty created by this lack of observation may mask the partners' failure to exercise reasonable care in their performance. Without appropriate contracts, accounting firms' monitoring costs will increase to reduce the uncertainty. When unmonitored, its partners' care will decrease because of the lack of congruent goals, and risk to the

firms, correspondingly, will increase regardless of the increased monitoring costs which they incur.

When practicing as a general partnership, each partner is jointly and severally liable for the tortious acts of other members of the firm. Accounting firms can rely on the dual threats of litigation and diminished credibility to create congruence between its goals and the goals of its partners. This can be illustrated by examining the external and internal agency relationships an accounting firm enters into when it contracts to perform an audit for a corporation.

The accounting firm enters an external agency relationship when it contracts to perform the audit. Corporate management relies on the threats of litigation and diminished credibility to create congruence between its goals and the goals of the accounting firm .

The accounting firm, in turn, enters an internal agency relationship when it contracts with its partners who perform the audit on its behalf. It also relies on threats of litigation and diminished credibility to create congruence between its goals and that of its partners because each partner is personally liable for the tortious acts of all members of the firm.

The literature indicates that these threats are needed to achieve congruence of goals. For example, Melumad and Thoman (1990) suggest that auditors have little incentive to work hard and report truthfully without the threat of litigation. Similarly, Fama and Jensen (1983b, 336) suggest that unlimited liability is the toll extracted by the market as a bond against malfeasance by professionals when their service is sensitive to performance. If, however, an accounting firm adopts either an LLC or LLP organizational form, threats of litigation will become less effective for creating goal congruence in either the firm's external or internal agency relationships. While the accounting firm's assets remain at risk for the tortious liability of its partners and employees, a partner can now insulate his or her personal assets if the tortious act is committed by others within the firm.

Audit services, in particular, have value only if accounting firms convince the market of their competence and their independence. Because the perceived competence and independence of an accounting firm is directly related to performance of its partners, limiting the personal liability of partners by adopting an LLC or LLP organizational form may signal the market, as Fama and Jensen (1983b) suggest, that the firm is no longer bonded against malfeasance. If so, it may reduce the value of the accounting firm's services. The market may no longer be convinced that the accounting firm can either expect or demand that its partners exercise care in performing an audit. If the market further devalues the audit, partners will be under increasing pressure to maintain high billings and may be more likely to succumb to pressures from clients to reduce audit procedures and, correspondingly, further decrease the quality of the audit.

To maintain a high level of competence and independence, accounting firms have traditionally required that financial statements prepared for high risk or complex clients undergo a second review at the partner-level. This required monitoring and consulting concentrates tortious risk in those individuals who perform this service for the firm. The limited liability shield of the LLC or LLP will offer these important decision agents little protection. If risk averse, these individuals may choose to withdraw from these second review activities in the future resulting in further reduction in the quality of the services offered by the firm.

The general partnership form of organization with its joint and several personal liability makes at least two contributions to a partner's incentives to be competent and independent. First, the unlimited personal liability provides the malfeasance bond required to convince the market of the auditors independence. Second, the unlimited personal liability encourages mutual monitoring by the partners which enhances the competency of the firm. Adopting either an LLC or LLP form to limit tort liability may reduce the incentives of partners to act in the interest of the firm. While increased monitoring and consulting by the accounting firm will be required to maintain quality

accounting services which the market values, firms may choose to further discount the price of their services because of the highly competitive environment. To accomplish this, firms may choose to reduce the costs incurred for monitoring and consulting. Consequently, before adopting either an LLC or LLP form, firms should develop controls or incentives which will effectively reduce any moral hazard created. Accounting and finance literature provides guidance as to what controls and incentives may be effective for this purpose.

Forms of Control

Brand Name

An incentive that may cause a firm and its partners to continue to incur substantial monitoring costs, after individual liability is limited, may be the value of the professional reputation of the firm. Simunic and Stein (1987) have suggested that management signals favorable information to shareholders by selecting brand name auditors. This brand name or credibility factor is developed by accounting firms over time through fixed investments to minimize the occurrence of audit failures (e.g., careful selection of clients, investments in auditor training, and over-auditing). According to Simunic and Stein, the fixed investments are essential for auditor credibility which is utilized by the capital markets as a proxy for audit quality and will return to the accounting firm in the form of future quasi-rents. The accounting firm and its partners, then, could be expected to incur costs to monitor its individual auditors to protect the firm's credibility and the potential loss of quasi-rents.

Carr and Mathewson (1990), however, found that clients are more willing to pay a premium for a brand name auditor as their audit complexity increases; but, as client knowledge increases, the client is less willing to pay for a brand name. Considering their research, one may conclude that although the value of a brand name may be an effective incentive for the large international accounting firms, regional and local firms should question whether they have truly developed a brand name which may serve as a useful incentive in their environment. In an international accounting firm,

the size of client engagements, the complexity of issues and the reassignment of personnel force clients and other third parties to rely on the brand name to signal credibility. In a regional or local firm, the clients and third parties are more likely to have personal knowledge of the performance of individual partners. They will be less willing to pay for a brand name to provide a signal of certification and pedigree and will rely more on the known reputation of the individual partners who service them. Consequently, the value of the brand name may be of less significance to partners in local and regional firms and may not serve as an incentive for them to incur monitoring costs.

To enhance their brand name value, local or regional accounting firms may choose to lock-in their clients by negotiating anti-compete contracts with their partners and key employees. These contracts may either restrict partners or employees who leave the firm from soliciting or accepting clients of the firm or require them to pay the firm for clients which they continue to service after leaving the firm. Because these contracts represent a restraint of trade, courts will enforce them only if their scope is limited to provide reasonable protection to the accounting firm as promisee but not unnecessarily restrict the partners or employees as promisors.¹⁵ Validity of these contracts will vary from state to state and, consequently, regional firms should include in their contracts a provision which designates the state law which is to be applied.

Allocations

As was discussed previously, firms have traditionally required that professional services provided for high risk or complex clients undergo a second partner-level review. Because this second review is conducted by only a few decision makers within a firm, the residual liability is concentrated. Firm members may be unwilling to accept these positions and the quality of review may be further reduced. Consequently, the flight of many experienced and qualified auditors from the profession, documented by Dalton et al. (1994), will likely continue. Individuals remaining in the accounting profession who are willing to accept these posi-

tions may be more receptive to taking risks and, consequently, their review may not be of the highest quality.

Fama and Jensen (1983a, 306) suggest that this is exactly what will happen and that the costs of concentrating the residual liability in a few important decision makers will include the following:

The decision process will suffer because decision makers will be chosen on the basis of wealth and their willingness to bear risk; this will eliminate from the pool qualified decision makers who are risk averse.

The cost of risk-bearing services will increase as fewer decision makers bear the risk.

Similarly, Kandel and Lazear (1992), have suggested that for review (monitoring) activity to be effective, the reviewer's investment in that activity must be rewarded. If it is not, the reviewer will no longer invest in that activity. Accounting firms then may expect that reviewing partners will demand greater profit allocations in an LLC or LLP organizational form.

Firms may minimize this profit allocation increase by giving the reviewing partners the ability to affect the choices made by the partner who is being reviewed. Again, the work by Kandel and Lazear (1992) is helpful. For example, if the reviewing partner is able to exert pressure on the reviewed partner to alter his or her choices (i.e., choices which may have decreased quality and increased risk), the reviewing partner may be more willing to make the investment in the review process. He or she will have some control over the risk that he or she assumes through the review process. Correspondingly, the reviewing partner may then require a smaller profit allocation for engaging in the review activity. In order to exert this pressure on the reviewed partner, the reviewing partner should be able to influence the profit share the reviewed partner receives.

To encourage all partners to continue to engage in review and monitoring activities, a firm

who adopts an LLC or LLP form should consider how it allocates distributions, profits, and losses. First, it should pool net cash flows for distributions. Pooling will provide all members an incentive to undertake mutual monitoring and consulting (Fama and Jensen 1983b, 335). No single member will be encouraged to take-on inordinate risk because his or her cash flow will not increase inordinately. Second, profits and losses may be allocated differently than the cash flows and would be allocated to each partner's capital account to further bond the partner to the firm. For instance, risk associated with profits from high risk clients can be estimated, reserved and specifically allocated thereby reducing the profit share to the partner associated with that high risk client. This special allocation of risk of loss would decrease the partner's capital account and may require him or her to make a capital contribution to the firm. Correspondingly, a special allocation of profits could be made to partners involved in monitoring and consulting for high risk clients to provide an incentive for them to undertake this high-risk activity. These special allocations would increase that partner's capital account and, if not permitted to be immediately drawn against, would further bond the partner to the firm (Carr and Mathewson 1990).

To prevent a decision maker who benefited by increased cash flows for his or her risk-bearing services from escaping liability by leaving the firm, on-going members of the firm may seek to trace liability back to these decision makers. Woodward (1985, 606) suggests, however, that such a tracing would permit new decision makers to appropriate the wealth of former decision makers by managing assets in a risky way. This should not be the case if incentives and controls needed to control moral hazards remain effective.

Capital Accounts

Even with the adoption of an LLC or LLP organizational form, the threat of litigation, which Melumad and Thoman (1990) suggest is needed to assure truthful reporting and which Fama and Jensen (1983b) suggest is a bond against malfeasance, continues. The firm's net assets remain

fully at risk, and while a partner's individual liability is limited by the adoption of an LLC or LLP form, it is not eliminated. Since no liability is ever completely unlimited, (i.e., the assets subject to liability will be exhausted), the threat of litigation and its resulting liability may continue to serve as an incentive if the assets at risk are substantial, although no longer unlimited. This would suggest that non-equity partners should not be permitted.

In an LLC or LLP, the net assets of the firm, as reflected by the capital accounts for all its partners, are at risk for any tortious liability. The lack of direct involvement by partners in a malfeasance will protect their personal wealth but not their capital accounts within the firm. If the firm requires each partner to maintain substantial capital accounts, the potential loss of the capital account may be a sufficient incentive to each partner to encourage their involvement in the mutual monitoring and consulting needed to control moral hazard (Carr and Mathewson 1990).

One obvious problem with this alternative is determining how much each partner must contribute to satisfy the capital requirement under an LLC or LLP. If capital requirements are set too high, they will impede entry into the business much as unlimited liability may have done (Carr and Mathewson 1988). For capital to be an effective bond, each partner's capital should be sufficiently high to satisfy that partner's greatest potential liability. Yet, if the capital requirements were placed this high, the adoption of an LLC or LLP organizational form to reduce liability would become meaningless.

While a partner's individual risk, as well as profit share, may be weighed by the firm in setting an individual partner's maximum capital account requirements, the firm should also consider requiring minimum capital contributions for all partners. By requiring a minimum capital contribution based on the risk and profit expectations of the firm as a whole, the firm would provide an incentive for all partners to engage in monitoring and consulting activities.

After determining the amount of the re-

quired capital accounts, firms should next consider how these capital requirements are to be funded. For instance, if accounts receivable and work in process reduce the required capital contributions, firms should be careful to first evaluate these assets to determine if they are overvalued. Any associated risk should be considered in their valuation.

The third capital account issue that firms must consider is whether all partners should be required to restore their capital accounts in the firm if their accounts are depleted. If partners are required to do so, an individual partner's personal assets would become indirectly subject to liability because they would be needed to meet any capital restoration call. The threat of litigation would again become an incentive for monitoring and consulting.

To illustrate how a capital restoration call would operate, assume a firm and its partners directly involved with an audit are found liable for malfeasance in a tort action and damages are awarded. Under the LLC or LLP rules, the personal wealth of the firm members directly involved, as well as the firm's capital, are at risk and would be available to pay the damages. Unless other incentives exist when joint and several liability is eliminated, those firm members protected by the liability shield would not wish to restore their depleted capital accounts within the firm because these accounts could also become subject to the damage award. Without capital, the firm may be forced to dissolve. Under these circumstances, employees of the firm will lose their positions and as they are less likely to have established individual professional reputations, they may find that the stigma of the malfeasance attaches to them making it more difficult for them to obtain new positions. In that event, use of an LLC or LLP will have indirectly shifted the liability to the employees of the firm (Woodward 1985, 607) and if employees recognize this potential liability, they may be less willing to seek employment in a firm which practices as an LLC or LLP. If, however, firms organized as LLC or LLPs requires partners to restore their capital accounts, liability will not be shifted to the employees.

Conclusion

Before adopting either an LLC or LLP organizational form to limit tortious liability, accounting firms should evaluate the agency costs associated with their choice of entity. These agency costs arise because contracts with agents are not effortlessly written and enforced. In the case of an accounting firm, agency costs include the costs of structuring, monitoring and bonding the activities of its partners and employees who are performing an audit or other accounting services on its behalf. If agency costs are not effectively addressed by the accounting firm, a moral hazard may go unchecked.

To reduce the risk of individuals within the firm taking actions that deviate from the interest of the firm (i.e., due to moral hazard), controls must provide incentives for these individuals to accept the unlimited liability that necessarily accompanies the consulting and monitoring needed to maintain high quality service within the firm. Such controls might include: (1) enhancement of firm brand name; (2) special allocations including; distributions based on pooled cash flows, specific allocation of risk of loss resulting in capital account decrease and corresponding capital call, and special allocation of profit share for those associated in monitoring or consulting for high risk clients; (3) requirement of substantial capital accounts. With these incentives in place, firms should be able to adopt LLC or LLP forms to limit liability and, yet, effectively control the moral hazard that this limited liability creates.

Suggestions for Future Research

Surely the liability protections designed by the LLC and LLP forms will be tested in the courts. Court case outcomes should be examined in three to five years to compare protections afforded LLC's and LLP's in contrast to partnership firms. In the meantime, the moral hazard problem could be examined more rigorously with mathematical modelling. Such analytical modelling would need to be firmly grounded in agency theory. □

Footnotes

1. Vernon J. Rockler & Co. v. Glickman, Lsenberg, Lurie & Co., 273 N.W.2d 647, 650 (Minn. 1978); Speiser et al. (1985 et seq., §§9:3, 11:1-11:3 and 15:209).
2. Prosser and Keeton (1984, §105, 728); Speiser et al. (1985 et seq., §32.36).
3. L.J. Vontz Constr. Co. v. State, 432 N.W.2d 7, 11 (Neb. 1988); *Am. Jur. 2d* (1994, §20).
4. Lincoln Grain v. Coopers & Lybrand, 345 N.W.2d 300, 305 (Neb. 1984).
5. §299A, at page 73; cited with approval by Richard v. Staehle, 434 N.E.2d 1379, 1384 (Ohio App. 1980); Kemmerlin, v. Wingate, 261 S.E.2d 50, 51 (S.C. 1979).
6. Because auditors are not trained to detect irregularities such as forgeries or collusion, properly performed audit procedures cannot typically detect these irregularities; O'Reilly et al. (1990, 90).
7. Greenstein, Logan & Co. v. Burgess Mktg., Inc., 744 S.W.2d 170, 185 (Tex. Ct. App. 1987); First Nat'l. Bank v. Crawford, 386 S.E.2d 310, 313 (W.Va. 1989); Speiser et al. (1985 et seq., §15:109).
8. Bily v. Arthur Young & Co., 271 Cal. Rptr. 470, 474; Maduff Mortgage Corp. v. Deloitte Haskins & Sells, 779 P.2d 1083, 1086 (Or. 1989).
9. National Surety Corp. v. Lybrand, 9 N.Y.S.2d 554, 562 (App. Div. 1939).
10. Drabkin v. Alexander Grant & Co., 905 F.2d 453, 455 (D.C. Cir.), cert. denied, 111 S.Ct.559 (1990); Greenstein Logan & Co. v. Burgess Mktg., Inc., 744 S.W.2d 170, 196 (Tex. Ct. App. 1987); Lincoln Grain, Inc. v. Coopers & Lybrand, 345 N.W.2d 300, 30 (Neb. 1984); Delmar Vineyard v. Timmons, 486 S.W.2d 914 (Tenn. Ct. App. 1972).
11. 65 N.Y.2d 536, 493 N.Y.S.2d 435, 483 N.E.2d 110 (1985).
12. First Florida Bank v. Max Mitchell & Co., 558 So.2d 9 (Fla. 1990); St. Paul Fire & Marine Ins. Co. v. Touche Ross & Co., 507 N.W.2d 275 (Neb. 1993).
13. "In 1990, there were...6,891 certified public accountancy partnerships with 36,973 partners," Bishop and Kleinberger (1994, para.

6.06[1] ftm 225).

14. "Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership or with authority of his co-partners, loss or injury is caused to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act." *Uniform Laws Annotated*, Uniform Partnership Act (1969, §13).
15. *Am. Jur. 2d* (1994, §11).

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2. American Institute of Certified Public Accountants, *Professional Ethics Standards*, 1993.
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