IN THE SUPREME COURT OF FLORIDA

FIRST FLORIDA BANK, N.A., f/k/a
FIRST NATIONAL BANK OF FLORIDA,

Petitioner,

v.

MAX MITCHELL & CO., P.A., and
MAX W. MITCHELL,

Respondents.

Case No.: **74,034**

DCA Case No.: **88-01128**

PETITIONER'S REPLY BRIEF

ON PETITION FOR REVIEW FROM THE DISTRICT COURT OF APPEAL,
SECOND DISTRICT OF THE STATE OF FLORIDA

ROBERT W. CLARK, ESQ.
OF
MACFARLANE, FERGUSON, ALLISON & KELLY
P.O. Box **1531**
Tampa, Florida **33601**
(813) **223-2411**
ATTORNEYS FOR PETITIONER

TABLE OF CONTENTS

TABLE OF CONTENTS CONT'D.

TABLE OF AUTHORITIES

CASE LAW: PAGE

STATUTORY LAW:

STATEMENT OF THE FACTS

The Respondents, Max Mitchell and Max Mitchell & Co. (hereinafter referred to as "Max Mitchell" or "Mitchell") claims that they are unaware of the factual correctness of a number of allegations made in Petitioner, First Florida Bank, N.A. (hereinafter referred to as "First Florida" or the "Bank") in the complaint and therefore ask this Court to assume other facts. Max Mitchell has never filed or offered any other evidence which contradicts the allegations of the complaint. First Florida's entire loan file has been produced to Max Mitchell's attorneys and they have failed to include any document from it which supports the uncertainty which they claim they face with respect to the allegations of the complaint or any document which would contradict the truthfulness and the validity of each and every allegation made in the complaint.

ARGUMENT I

THE FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' CONTENTION THAT IF THIS COURT HOLDS THAT THEY ARE LIABLE IN NEGLIGENCE TO KNOWN THIRD PARTIES THEY WILL BE LIABLE FOR ALL INACCURACIES IN FINANCIAL STATEMENTS IS INCORRECT AND ACCOUNTANTS WOULD ONLY BE LIABLE FOR THOSE INACCURACIES WHICH WERE NOT DETECTED AS A RESULT OF THE ACCOUNTANT'S FAILURE TO AUDIT THE FINANCIAL STATEMENTS IN ACCORDANCE WITH THE PROFESSIONAL STANDARDS SET FORTH BY THE ACCOUNTANT'S OWN GOVERNING BODIES.

The Amicus Curiae Brief of the Florida Institute of Certified Public Accountants (the "FICPA") contends that if this court holds that an accountant is liable in negligence to third parties whom the accountant intended would rely on its audits that the accountant would be liable for "a thoughtless slip or blunder ... may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class". See Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931). This has never been First Florida's position nor has it ever been the law. In order for negligence to be imposed upon an accountant, it must be shown that that accountant failed to comply with the professional standards set forth by the governing bodies for certified public accountants including the Florida Institute of Certified Public Accountants. The FICPA suggests that since accountants use statistical sampling and do not test every transaction that they would be liable in negligence for the failure to detect an irregularity in a financial statement which might result from transactions the accountant did not test. The FICPA knows this is not true. If the accountant can show that he

complied with the auditing standards of his profession and simply did not detect the irregularity, the accountant will not be held liable because he will establish to the fact finder that he complied with the standards of his profession and therefore exercised reasonable care. First Florida does not contend that Max Mitchell is liable to it in negligence solely because the numbers which appeared on the financial statement are inaccurate. Rather, it is First Florida's position that Max Mitchell is liable because he failed to perform the tests that are required by accounting standards and that his failure to perform those tests resulted in his failure to detect the inaccuracies in the C.M. Systems financial statements when he performed his audit. As the Supreme Court of California stated in International Mortgage Company v. John P. Butler Accountancy Corporation, 177 Cal.Ap. 3d 806, 223 Cal.Rptr. 218 (1986):

> "Thus, in issuing an opinion, the auditor is guarantying only that the numbers comply with the AICPA's standardized accounting rules and procedures, the GAAP. Further, the auditor is guarantying that he tested for GAAP compliance, using generally accepted auditing standards ("GAAS"). The auditor is not guarantying the client's records and resulting financial statements are perfect; only that any errors which might exist could not be detected by an audit conducted under GAAS and GAAP, thus, the auditor's degree of control over the client's records is unimportant; the auditor need only control his or her abilities to comply with GAAS and GAAP to a given audit situation."

Id at 224.

It is First Florida's position that Max Mitchell's failure to comply with generally accepted accounting standards and generally accepted accounting principles promulgated by accountants' governing bodies resulted in his failure to detect the

inaccuracies in the financial statement of his client, C.M. Systems which caused First Florida to lose $500,000.00.

In the example given by the FICPA the accountant was required to value inventory. If the accountant complied with the required professional standards by using statistical sampling and reached an incorrect result as to the value of the inventory the accountant would clearly not be liable for negligence. The accountant would only be liable for negligence if the failure to detect the irregularity occurred because he had not complied with self-imposed professional standards. First Florida only contends that an accountant should be liable for distribution of inaccurate financial information which is not detected because the accountant did not follow the professional standards set forth by the accounting profession in the conduct of his audit. Frankly, it is hard to imagine any standard which could be more fair to a profession than to allow it to designate its own professional standards and then to be responsible only to the extent that it deviates from those self-imposed professional standards.

ARGUMENT II

CONTRARY TO THE CLAIMS OF THE FICPA, ACCOUNTANTS APPARENTLY ROUTINELY REASSURE INVESTORS AND LENDERS OF THE ACCURACY OF THEIR CLIENT'S FINANCIAL STATEMENTS IN ORDER TO INDUCE THE LENDERS TO MAKE LOANS TO THEIR CLIENTS AND INVESTORS TO INVEST IN THEIR CLIENTS.

The FICPA at page 6 and 7 claims that Max Mitchell's actions are not typical of accountants and are unrelated to an accountant's responsibility. The FICPA claims that if the

accountant delivers the financial statements to the Bank after the audit is completed that that does not constitute audit services and the accountant is therefore not responsible for negligence in connection with his audit. The FICPA claims that this is unique. However, virtually the same factual scenario occurred in Gordon v. Etue, Wardlaw, & Co., 511 So.2d 384 (Fla. 1 D.C.A. 1987). In that case, the accountants went and met with prospective investors and reassured the prospective investors that they had audited that the financial statements and that the financial statements had been prepared in accordance with generally accepted accounting principles. In reliance on those representations, the investors invested additional monies into the business enterprise. The financial statements turned out to be inaccurate and the business failed. The First District Court of Appeal held that the investors did not have a cause of action for negligence because they were not in privity with the accountants and certified virtually the same question as is now under consideration to this Court. If this Court holds that third parties to whom accountants deliver audited financial statements do not have a cause of action because of the absence of privity, it will be open season on the investing public and lenders by the accountants of this state. Thousands of innocent investors and creditors will be lured into investing money in business enterprises based on reassurances from certified public accountants who know that they cannot be held liable no matter how badly they have violated their own self-promulgated standards in conducting audits of their clients. In fact, both the FICPA, Pannell Kerr, who also filed an Amicus

Curiae brief and represents itself to be one of the world's largest accounting firms, and Max Mitchell, assert that they should not be responsible even for gross negligence or gross and reckless violations of their own self-created professional standards. In their view it is fairer for innocent persons who rely on their self espoused financial expertise at the accountant's request to suffer the losses.

ARGUMENT III

THIS COURT SHOULD DISCOURAGE ACCOUNTANTS FROM REASSURING LENDERS AND INVESTORS ABOUT THE ACCURACY OF THE FINANCIAL STATEMENTS ACCOUNTANTS HAVE AUDITED BY HOLDING THEM LIABLE TO THOSE PARTIES AND THEREBY CAUSING ACCOUNTANTS TO CEASE SUCH CONTACTS WITH INNOCENT THIRD PARTIES RATHER THAN FORCING INNOCENT INVESTORS AND LENDERS TO TAKE LOSSES WHICH THE FICPA CLAIMS THEY ARE IN A BETTER FINANCIAL POSITION TO ABSORB THAN CERTIFIED PUBLIC ACCOUNTANTS.

The FICPA which is a voluntary organization comprised of certified public accountants who practice pursuant to legislatively enacted privileges contained in Chapter 473 of the Florida Statutes, contend that even if their members grossly violate professional standards in the conduct of their audits and then encourage investors to invest their hard earned money and banks to lend federally insured money that it is better for the investors, the banks, and ultimately the taxpayers when federally insured banks fail to take the loss because they are in a better financial position to do so.

The certified question before this court is whether an accountant who personally delivers audited financial statements to

a third party in order to induce that third party to make a loan to or invest in the accountant's clients knowing that the third party will rely on the financial statements should be responsible for negligence to the third party who suffers the loss as a result of the accountant's failure to use reasonable and ordinary care in preparing the financial statements. This is not liability "in an indeterminate amount for an indeterminable time to an indeterminate class" which concerned the court in ~~Ultramares~~. This is liability to a class which the accountant has voluntarily selected and knowingly encouraged to rely on the audited financial statements. If an accountant does not want to be liable to lenders and investors, would it not be fairer to hold accountants liable to third parties and therefore discourage accountants from meeting with and reassuring third parties about the financial statements rather than making lenders and investors suffer millions of dollars in losses when accountants' fail to live up to their own self-imposed professional standards.

The FICPA also claims you will create an insurance crisis if you hold that accountants can be liable to people they deliver their audited financial statements to and encourage to rely on them. If accountants do not want to be liable to third parties, all they have to do is stop delivering their audited financial statements to third parties and negotiating loans on behalf of their clients and luring investors into their clients' business enterprises. That by itself will stop spiraling insurance rates and save accountants money. It will also prevent lenders and investors from suffering a loss.

ARGUMENT IV

IT IS MORE EQUITABLE TO SHIFT LOSSES TO ACCOUNTANTS FOR THEIR FAILURE TO COMPLY WITH THEIR OWN PROFESSIONAL STANDARDS THAN TO SHIFT THOSE LOSSES TO NON-NEGLIGENT LENDERS AND INVESTORS WHOM THE ACCOUNTANTS ENCOURAGED TO RELY ON THEIR REPRESENTATIONS IN MAKING LOANS AND INVESTMENTS.

It is not equitable to allow certified public accountants who enjoy the privileges of a profession under Chapter 473, to hold themselves out as financial experts in auditing and to allow them to encourage reliance on their work and then to permit them to shift losses for their negligence in their area of expertise onto lenders and the investing public who are not experts in auditing and who have relied on financial statements audited by the accountants at the accountant's request. In its Amicus Curiae brief, the Florida Institute of Certified Public Accountants (the "FICPA") argues that it is more equitable to shift the loss for the negligence of an accountant to a non-negligent party such as a lender or an investor who was encouraged to rely on the financial statements by the negligent accountant. Accountants are accorded professional status by the laws of this state. See Section 473 of the Florida Statutes. Accountants are permitted to hold themselves out as experts in analyzing financial statements to determine their accuracy. Incredibly, the FICPA argues that it is fairer to shift the loss for the accountant's negligence to non-negligent parties such as banks and taxpayers for relying on accountants in the accountant's area of financial expertise which happens to be rendering opinions on the fairness of financial

statements. In the case before this Court, it was not the financial institution which sought out the bank. In this case it was the certified public accountant who requested and used his professional status as an expert in auditing to induce the Bank to make a loan to the accountant's client. It was not the Bank that claimed the financial statements were correct but the accountant who is licensed by this state to render such opinions. Under traditional legal principles, it would therefore be considered more equitable to shift the burden for the loss to the negligent party who knowingly and voluntarily caused it rather than the innocent party who relied on the financial expertise of the accountant. The FICPA's position can at best be characterized as arrogant. They take the position that whether their negligence is simple or gross and no matter how badly they violate professional standards and no matter how badly individual investors and lenders are harmed, it is fairer for innocent persons to suffer injury than for persons who negligently caused the loss and who encouraged reliance on their opinions to suffer for their own failure to comply with their own self-imposed auditing standards.

ARGUMENT V

THIS COURT SHOULD FORM A FUNDAMENTALLY FAIR STANDARD FOR LIABILITY AND MAKE ACCOUNTANTS AS A PROFESSIONAL GROUP HAVE SOCIAL RESPONSIBILITY FOR THEIR ACTIONS RATHER THAN COMPLETE IMMUNITY FROM ANY RESPONSIBILITY FOR VIOLATION OF THEIR SELF-IMPOSED STANDARDS AS THEY REQUEST.

The FICPA, Pannell Kerr, and Max Mitchell all argue that the accounting profession is fundamentally different from all other

professions and therefore must be treated in a unique manner. They then argue that accountants should only be liable to intended third party beneficiaries who exist at the time of the contract between the accountant and his client because that is the test which they contend has been promulgated with respect to abstractors and attorneys. One of their favorite arguments is that First Florida does not have a claim because they were not contemplated as a beneficiary of the audit contract at the time Max Mitchell performed the audit of C.M. Systems. Of course, the uniqueness of the accounting profession is that the audit report is never used by anyone until after it is completed and once it is completed it is then distributed to the parties selected by the client and the auditor. The FICPA, Pannell Kerr, and Max Mitchell contend that they should be treated like abstractors for the purposes of the third party beneficiary argument because they are the same for that purpose but not be held to the same standard of care because they are different from abstractors in that sense. The FICPA contends it should not be subject to jury trials. They treat the significant legal question involved as if it were some game. A professional group which refuses to accept any responsibility for its professional actions and that it intentionally causes the public and lenders to rely on to their detriment should not be granted absolute right of protection by this Court. It is as if an automobile driver would have the audacity to come before this Court and say that he should not be held liable for the damages incurred in an automobile accident because he closed his eyes before entering the intersection and

therefore had no idea how many people would be injured, their identity, the extent of their injuries, or the amount of the property damage which might be incurred. In fact, it is worse than that because in the case before this court, Max Mitchell knew exactly who he wanted to rely on his audited financial information and exactly what the loss would be. The briefs of the FICPA, Pannell Kerr, and Max Mitchell all claim that Ultramares dictates a result in their favor. Nothing could be further from the truth. The actual holding in Ultramares was that an accountant was not liable to parties that he did not know or could not reasonably ascertain. The Court of Appeals of New York explained Ultramares in European American Bank and Trust Co. v. Straughs and Kaye, 65 N.Y. 2d 536, 483 N.E. 2d 110 (N.Y. 1985). In explaining Ultramares, the New York Court of Appeals in European American adopted the following three part test in determining whether accountants could be held liable to creditors in the absence of contractual privity for the issuance of inaccurate financial reports. The court stated:

> "Before accountants may be held liable in negligence to non-contractual parties who rely to their detriment on inaccurate financial reports, certain pre-requisites must be satisfied:
>
> (1) The accountants must have been aware that the financial reports were to be used for a particular purpose or purposes;
>
> (2) In the furtherance of which a known party or parties was intended to rely; and
>
> (3) There must have been some conduct on the part of the accountants linking them to that party or parties, which evidences the accountants' understanding of that party or partys' reliance.

483 N.E. 2d 118.

The court explained that that did not represent a departure from the principles articulated in Ultramares. Therefore, under Ultramares a cause of action would be permitted by First Florida for negligence and gross negligence. Mitchell knew that the financial reports were to be used by the Bank for the purpose of lending money to his client since he personally delivered the financial statements to the Bank, negotiated the loan, and answered all questions the Bank had about the financial statements. Since Mitchell requested the loan on behalf of his client and delivered the financial statements to the Bank, it was clearly Mitchell's intent that the Bank rely on the financial statements in considering the loan to his client. The delivery of the statements to the Bank by Mitchell, his negotiation of the loan on behalf of his client, and his answers to inquiries by the Bank concerning the financial condition of his client clearly link Mitchell to the Bank within the meaning of European American.

The assertions by the FICPA, Pannell Kerr, and Mitchell that First Florida does not have a cause of action within the meaning of Ultramares is simply incorrect and not supported by any fair reading of Ultramares and European American. Max Mitchell tries at this late date to restate the facts by essentially saying that they don't know whether C.M. Systems actually borrowed $500,000.00 or how much C.M. Systems owed to other financial institutions or what other credit inquiries were made by First Florida Bank, N.A. Since there are no contrary affidavits in the file, and in fact Max Mitchell has never filed an affidavit in connection with this

case, it should be properly assumed by this court that the allegations of the complaint are true.

Mitchell, Pannell Kerr, and the FICPA all claim that First Florida was not an intended beneficiary of the financial statements. They seek to create distinctions without differences. It is undisputed that Mitchell delivered the financial statements to the Bank, negotiated the loan on behalf of and at the request of his client, answered all questions about the financial situation of his client and that he was acting on behalf of his client at the time he did all of the foregoing. They take great comfort in the fact that this occurred after the audit was completed. Presumably, they believe that the court's decision in First American Title Insurance Company, Inc. v. First Title Service Company of the Florida Keys, Inc., 457 So.2d 467 (Fla. 1984) would have been different had the purchaser's name been left blank on the title commitment and then after closing inserted on the final policy. It is not disputed at all that the audit was performed for the purpose of providing third parties with reasonable assurance that the financial condition of C.M. Systems was accurate. The only item not decided by the client and the accountant at the conclusion of the audit was who they would show it to and who they would harm if the accountant was negligent or grossly negligent.

Mitchell, Pannell Kerr, and the FICPA all cite numerous cases holding that as a general proposition, an accountant is not liable in negligence to third parties. However, few, if any, of those cases except Gordon involve personal participation by the

accountant in the actual negotiation of the credit facility or the investment. Generally, the cases deal with the situation which was of concern in Ultramares which was when the client distributes the statement to a third party whose identity is unknown to the accountant.

CONCLUSION

First Florida urges this Court to reverse the order of the Second District Court of Appeal which affirmed the trial court's summary judgment entered in favor of Max Mitchell and to remand this case to the trial court for a trial on whether Max Mitchell was negligent or grossly negligent in his audit of C.M. Systems which was distributed to First Florida by Max Mitchell and relied on by First Florida in extending credit to Mitchell's client, C.M. Systems.

Respectfully submitted,

ROBERT W. CLARK, ESQ.
Florida Bar No. 256463
Macfarlane, Ferguson, Allison & Kelly
Post Office Box 1531
Tampa, Florida 33601
Telephone No. (813) 223-2411
Attorneys for Petitioner

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by regular U.S. mail to JOHN N. JENKINS, ESQ., Marlow, Shofi, Smith, Hennen, Smith & Jenkins, P.A., P.O. Box 10430, Tampa, Florida 33679-0430, to KENNETH R. HART, ESQ., P.O. Box 391, Tallahassee, Florida 32302, to ALBERT0 A. MACIA, ESQ., 1428 Brickell Avenue, Miami, Florida 33131, and to GERALD F. RICHMAN, ESQ., Courthouse Center, 26th Floor, 175 N.W. First Avenue, Miami, Florida 33128-1817, this 17 day of July, 1989.

ATTORNEY