ACCOUNTANT-CLIENT PRIVILEGE STATUTES: A CLEAR NEED FOR REFORM

*by David A. Larson**

Introduction

The accountant-client privilege is being recognized by statute in an increasing number of states. This privilege was not recognized under the common law[1] and noticeable differences have arisen among those states that do grant the privilege. All of these statutes have serious and disturbing shortcomings. This article will address those shortcomings and recommend several necessary amendments. In the course of that discussion comments and comparisons will be made between the various state statutes, examining their similarities and assessing their differences. Finally, this article will focus upon the desirability of recognizing any privilege of this nature and suggest that the privilege should ultimately be abandoned. It is the author's intention that this discussion prompt legislators to review their existing statutes in order to determine whether either revision or repeal of the accountant-client privilege is necessary.

The Statutes

A. *Parties Protected*

On July 1, 1983, the State of Mississippi joined the growing number of states that recognize an accountant-client privilege.[2] Sev-

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[1] 8 J. WIGMORE, EVIDENCE § 2286 (McNaughton rev. 1961) ("[I]n the absence of statute to the contrary, a confidential communication . . . to an . . . *accountant* . . . is not privileged from disclosure.").

[2] MISS. CODE ANN. § 73-33-16 (1983) (effective July 1, 1983). The Mississippi statute provides that:

> (2) Except by permission of the client engaging a certified public accountant under this chapter, or the heirs, successors or personal representatives of such client, a certified public accountant and any partner, officer, shareholders or employee of a certified public accountant shall not be required by any court of this state to disclose, and shall not voluntarily dis-

eral characteristics of the Mississippi statute are especially noteworthy. The first of these is that the privilege is granted only to certified public accountants. Among the other states recognizing the privilege, this limitation has been adopted by Colorado,[3] Florida,[4] Michigan,[5] and Louisiana.[6] Consequently, public accountants and other practitioners in these states are precluded from invoking the privilege.

It is reasonable to expect that the scope of parties protected under the accountant-client privilege will not be expanded by the courts. An axiom of statutory construction is that statutes in derogation of the common law should be narrowly interpreted. The Court of Appeals of Indiana, in the course of interpreting that State's statute,[7] noted that privileges "such as the accountant-client privilege, which were unknown at common law, are particularly disfavored,

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close, information communicated to him by the client relating to and in connection with services rendered to the client by the certified public accountant in his practice as a certified public accountant. Such information shall be deemed confidential and privileged; provided, however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements, or as prohibiting disclosures in court proceedings or in investigations or proceedings under sections 73-33-5 and 73-33-11, when the services of the certified public accountant are at issue in such investigations or proceedings and the certified public accountant is a party thereto, or as prohibiting disclosure in the course of a practice review.

MISS. CODE ANN. § 73-33-16 (1983). Aside from Mississippi, twenty other jurisdictions recognize the privilege. They are Arizona, ARIZ. REV. STAT. ANN. § 32-749 (1976 & Supp. 1983-84); Colorado, COLO. REV. STAT. § 13-90-107 (1974); Florida, FLA. STAT. ANN. § 473.316 (West 1981 & Supp. 1983-84); Georgia, GA. CODE ANN. § 43-3-32(b) (1982); Idaho, IDAHO CODE § 9-203A (1979); Illinois, ILL. ANN. STAT. ch. 111, § 5533 (Smith-Hurd 1978 & Supp. 1983-84) Indiana, IND. CODE ANN. § 25-2-1-23 (Burns 1982); Iowa, IOWA CODE ANN. § 116.3(4)(c) (West Supp. 1983-84); Kentucky, KY. REV. STAT. § 325.440 (1983); Louisiana, LA. REV. STAT. ANN. § 37:87 (West Supp. 1984); Maryland, MD. CTS. & JUD. PROC. CODE ANN. § 9-110 (1984); Michigan, MICH. COMP. LAWS ANN. § 339.713 (West Supp. 1983-84); Missouri, MO. ANN. STAT. § 326.151 (Vernon Supp. 1984); Montana, MONT. CODE ANN. § 37-50-401 (1983); Nevada, NEV. REV. STAT. §§ 49.125 to 49.205 (1979); New Mexico, N.M. STAT. ANN. § 38-6-6 (1978); Pennsylvania, PA. STAT. ANN. tit. 63, § 9.11a (Purdon Supp. 1983-84); Puerto Rico, P.R. LAWS ANN. tit. 20, § 790 (1974); Tennessee, TENN. CODE ANN. § 62-1-116 (1982); and Vermont, VT. STAT. ANN. tit. 26, § 82 (Supp. 1983).

[3] COLO. REV. STAT. § 13-90-107(f) (1974).

[4] FLA. STAT. ANN. § 473.316(1)(a) (West 1981).

[5] MICH. COMP. LAWS ANN. § 339.713 (West Supp. 1983-1984).

[6] LA. REV. STAT. ANN. § 37:87 (West Supp. 1984).

[7] IND. CODE ANN. § 25-2-1-23 (Burns 1982).

and are therefore strictly construed in order to limit their application."[8]

Although under the Colorado,[9] Florida,[10] Michigan,[11] Lousiana,[12] Pennsylvania,[13] and Mississippi[14] statutes public accountants will not be able to invoke the privilege, there are select groups in those jurisdictions, other then certified public accountants, which are protected by the privilege. The privilege in those jurisdictions has been extended to groups which include partners, officers, shareholders, and employees of the certified public accountant. While these extensions may settle the question of privilege for these distinct groups, it should be noted that the specificity of these designations has significant consequences. If a certified public accountant has taken on a large amount of work or needs assistance on various routine matters, he or she may direct some work to a public accountant who is a stranger to the original accountant-client relationship. The courts are then left with the task of determining whether this third party should be treated as an independent contractor or as an employee. If the public accountant is treated as an independent contractor, the disclosure to him or her would be wrongful, resulting in a general waiver of the privilege.

Another troublesome situation could arise if the arrangement was non-pecuniary in nature. A third party accountant may have agreed, based upon personal friendship or professional courtesy, to respond to a specific question or problem posed by the original certified public accountant. Depending upon the precise nature of the conversation, a waiver could also result under these circumstances. The result may be different if the outside party who was contacted by the original certified public accountant was also a certified public accountant. In that situation, it might appear that a second, distinct privilege has been created. However, because the relationship was non-pecuniary, a strong argument can be made that the original cer-

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8 Ernst & Ernst v. Underwriters Nat'l Assurance Co., 178 Ind. App. 77, 85, 381 N.E.2d 897, 901 (1978); *see also* William T. Thompson Co. v. General Nutrition Corp., Inc., 671 F.2d 100 (3d Cir. 1982).

9 COLO. REV. STAT. § 13-90-107 (1974).

10 FLA. STAT. ANN. § 473.316 (West 1981).

11 MICH. COMP. LAWS ANN. § 339.713 (West Supp. 1984).

12 LA. REV. STAT. ANN. § 37:87 (West Supp. 1983-84).

13 PA. STAT. ANN. tit. 63, § 9.11a (Purdon Supp. 1983-84).

14 MISS. CODE ANN. § 73-33-16 (1983).

tified public accountant was never the "client" of the second, eliminating the possibility of a distinct privilege.

The considerable degree of uncertainty in this area would be resolved if the language identifying the protected group was amended. Legislatures should substitute the broader term "agent" to indicate that additional parties will be covered under a single certified public accountant's privilege.

B. *Subsidiary Functions*

A second difficulty with the accountant-client privilege arises when accountants perform subsidiary functions beyond private counseling and planning for individual clients. It is their "public attest" function that can be threatened by a broadly worded privilege statute. The Mississippi statute attempts to remove the potential conflict that exists with broadly drafted privilege statutes. The conflict arises in those instances where a client attempts to invoke the privilege in connection with the public attest function. The value and respect attached to a certified public accountant's professional examination of financial statements will be seriously diminished if the privilege is available in connection with such a report. In order to preserve the integrity of this function, the Mississippi Legislature chose to allow "the disclosure of information required to be disclosed by the standards of the accounting profession in reporting on the examination of financial statements."[15]

In addition, under the Mississippi statute, a certified public accountant will be allowed to disclose information acquired in connection with services rendered to a client when the certified public accountant is under investigation by the Board of Public Accountancy.[16] It is questionable whether such disclosures would be allowed under broadly phrased statutes, such as those found in Maryland[17] and Illinois.[18]

C. *The Criminal Offense Exception*

While a number of states have made an effort to avoid some of the problems that have arisen in connection with an accountant-cli-

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[15] *Id.*

[16] *Id.*

[17] MD. CTS. & JUD. PROC. CODE ANN. § 9-110 (1984).

[18] ILL. ANN. STAT. ch. 111, § 5533 (Smith-Hurd 1978).

ent privilege, a number of serious shortcomings still remain. Most of the privilege statutes are arguably in need of even greater reform. In the previous sections mention was made of specific instances where some states have attempted to draft a statute which restricts the circumstances under which the privilege may be invoked. These efforts included specific provisions directed at the public attest function, professional hearings and investigations, as well as the number and type of agents who can use the privilege. Unfortunately, not all jurisdictions recognizing the privilege have attempted to protect the public even to this degree.[19]

One area that is in urgent need of reform, the criminal offense exception, has now been addressed by six states.[20] Public policy dictates that the privilege should not be available where a client is being prosecuted for a criminal offense. Encouraging the criminally inclined to seek the advice of financial experts by assuring them that their communications will be protected would frustrate the role of prosecutors and law enforcement agencies. Although one may argue that it is the responsibility of the certified public accountant to withdraw before a criminal act can be completed, one can easily imagine the situation in which the client's unlawful intentions are not entirely apparent until the act has been completed. The client would then have the power to silence the certified public accountant with a claim of privilege. The privilege may be asserted regardless of the certified public accountant's own belief that disclosure is necessary, or society's general concern that crimes be identified and prevented.

The exception for criminal activity has been structured in two ways. In some jurisdictions, the statute has taken the form of a simple statement that the accountant-client privilege shall have no effect on the existing criminal laws.[21] In other jurisdictions, the exception has appeared as a statement that the privilege would not be available where the accountant's services were "sought or obtained to enable

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[19] *See, e.g.*, N.M. STAT. ANN. § 38-6-6(C) (1978); MD. CTS. & JUD. PROC. CODE ANN. § 9-110 (1984); ILL. ANN. STAT. ch. 111, § 5533 (Smith-Hurd 1978); KY. REV. STAT. § 325.440 (1983); MO. ANN. STAT. § 326.151 (Vernon Supp. 1984).

[20] ARIZ. REV. STAT. ANN. § 32-749 (1976 & Supp. 1983-84); NEV. REV. STAT. § 49.205 (1979); TENN. CODE ANN. § 62-1-116 (1982); MD. CTS. & JUD. PROC. CODE ANN. § 9-110 (1984); FLA. STAT. ANN. § 473.316 (West 1981); PA. STAT. ANN. tit. 63, § 9.11a (Purdon Supp. 1983-84).

[21] ARIZ. REV. STAT. ANN. § 32-749 (1976 & Supp. 1983-84); TENN. CODE ANN. § 62-1-116 (1982); MD. CTS. & JUD. PROC. CODE ANN. § 9-110 (1984); PA. STAT. ANN. tit. 63, § 9.11a (Purdon Supp. 1983-84).

or aid anyone to commit or plan to commit what the client knew or [reasonably] should have known [was/to be] a crime or fraud."[22]

The latter statement of the exception has broader implications. In the first instance, this statement covers both the criminal actions and civil fraud actions of the client. Second, the latter exception is more desirable because it more clearly seeks to both protect the public and discourage persons from seeking the assistance of accountants to pursue illegal ends. Nonetheless, attention must be given to the particular phrase, "knew or should have known was a crime or fraud." While individuals should know what actions are criminal, the legal system presumes that the public has knowledge of the law. Ignorance of the law does not protect individuals from criminal prosecution; everyone has an affirmative duty to familiarize oneself with the limitations placed upon his or her behavior. Accordingly, the situation cannot exist in which a client does not or should not have known a particular course of behavior was criminal. The language is superfluous.

The argument could also be made that while the word "anyone" includes the client, it may also refer to an independent third party. Thus, the argument states, the client should not be forced to make disclosures when the client did not or should not have known of the crime or fraud. Such a position, however, only serves to encourage wrongdoers to seek the assistance of certified public accountants through a third party, secure in the knowledge that the information acquired by the certified public accountant will be privileged upon the request of their unknowing third-party associate.

In summary, states currently lacking an exception for criminal offenses should consider adopting language that establishes that the privilege is unavailable where an accountant's services were *sought or obtained to enable or aid anyone to commit or plan to commit a crime or fraud*. States preferring to legislate in a more sweeping manner may be inclined to follow the lead of Maryland,[23] Tennessee,[24] Arizona,[25] and Pennsylvania,[26] and declare that the privilege will not have any ef-

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22 NEV. REV. STAT. § 49.205 (1979); FLA. STAT. ANN. § 473.316 (West 1981). The Nevada statute includes the terms "reasonably" and "to be" in its statute, whereas the Florida statute includes "was" in its statute.

23 MD. CTS. & JUD. PROC. CODE ANN. § 9-110 (1984).

24 TENN. CODE ANN. § 62-1-116 (1982).

25 ARIZ. REV. STAT. ANN. § 32-749 (1976 & Supp. 1983-84).

26 PA. STAT. ANN. tit. 63, § 9.11a (Purdon Supp. 1983-84).

fect upon existing criminal laws.

D. *Miscellaneous Exceptions*

The current accountant-client privilege statute in Nevada sets forth two further exceptions which should be adopted by the other jurisdictions which recognize the privilege.[27] The first exception is that the privilege cannot be invoked by a corporation in an action by a shareholder against the corporation based upon a breach of fiduciary duty, or in a derivative action by a shareholder on behalf of the corporation.[28] The statutes in other jurisdictions fail to reconcile the question of whether minority shareholders are entitled to acquire reports generated by the certified public accountants for internal management use. The Nevada statute clearly states that in an action by such shareholders against the corporation based upon a breach of fiduciary duty, or in a derivative action by the shareholder on behalf of the corporation, communications between the corporation and its accountant are not privileged.[29]

The Colorado privilege statute[30] does not have a specific provision which addresses either of the situations mentioned above. Yet the Colorado Supreme Court, in *Pattie Lea, Inc. v. District Court*,[31] ruled that the accountant-client privilege did not protect a corporation from disclosing to its own stockholders, in a derivative suit brought against the corporation, communications made by the corporation to its certified public accountant.[32] The court further held that

> [a] corporate entity acts only for its shareholders and no greater liberality will be applied to facts which determine privilege in the case of a corporation than would be applied in the case of a natural person or association of persons. . . .

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27 NEV. REV. STAT. § 49.205 (1979). The Nevada statute provides that there is no privilege "[a]s to a communication between a corporation and its accountant . . . [i]n an action by a shareholder against the corporation which is based upon a breach of fiduciary duty; or . . . [i]n a derivative action by a shareholder on behalf of the corporation." *Id.* § 49.205(6). The statute also does not recognize the privilege "[a]s to a communication relevant to a matter of common interest between two or more clients if the communication was made by any of them to an accountant retained or consulted in common, when offered in an action between any of the clients." *Id.* § 49.205(5).

28 NEV. REV. STAT. § 49.205(6) (1979).

29 *Id.*

30 COLO. REV. STAT. § 13-90-107(f) (1974).

31 161 Colo. 493, 423 P.2d 27 (1967).

32 *Id.*

. . . .

> Certified public accountants hired by a corporation are hired for the benefit of all of its stockholders and such employment forbids concealment from the stockholders of information given the accountant by the corporation.[33]

In view of the fact that other jurisdictions can anticipate that this issue will require resolution in the foreseeable future, legislators should take the initiative and adopt an exception similar to that adopted by Nevada.

The other exception included in the Nevada statute which should be considered by the other state legislatures concerns joint venturers who have retained a single certified public accountant. The issue of whether a privilege could be asserted by one joint venturer against the second was raised in the case of *Gearhart v. Etheridge*.[34] In that case the Georgia Supreme Court ruled that "[w]here an accountant is jointly employed a doctrine of limited confidentiality has been applied. All communications between the joint clients and the accountant are privileged as to all outside parties, but the privilege does not exist between the principals involved."[35] The Nevada Legislature made a similar determination by excepting from the privilege "communication relevant to a matter of common interest between two or more clients if the communication was made by any of them to an accountant retained or consulted in common, when offered in an action between any of the clients."[36]

The results in the preceding Georgia and Colorado cases were both predictable and logical. The Nevada Legislature has made the wise decision to save its citizens the expense and delay of having these positions judicially articulated.

The certified public accountant privilege may cause confusion in the area of bankruptcy. Bankruptcy is an area of federal concern and the federal courts have not looked favorably upon the privilege.[37] Arizona,[38] Maryland,[39] Tennessee,[40] and Pennsylvania[41] make it clear that

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[33] *Id.* at 498-99, 423 P.2d at 30.

[34] 232 Ga. 638, 208 S.E.2d 460 (1974).

[35] *Id.* at 640, 208 S.E.2d at 461.

[36] NEV. REV. STAT. § 49.205(5) (1979).

[37] *See, e.g.*, Wm. T. Thompson Co. v. General Nutrition Corp., 671 F.2d 100, 103-04 (3d Cir. 1982): "Under the federal common law there is no confidential accountant-client privilege. . . . We hold that where there are federal law claims in a case also presenting state law claims, the federal rule favoring admissability, rather than any state law privilege, is the controlling rule."

[38] ARIZ. REV. STAT. ANN. § 32-749 (1976 & Supp. 1983-84).

the privilege has no application in bankruptcy proceedings. This policy entitles disadvantaged creditors to an unrestricted examination of a debtor's financial condition.

An exception to the privilege should also be recognized in the context of divorce proceedings. One spouse should not be able to avoid an equitable alimony obligation or child support award by shielding his or her actual financial condition behind the accountant-client privilege. As of the date of this publication, no state legislature has provided such an exception to its accountant-client privilege.

The Privilege Is Suspect

Perhaps the accountant-client privilege should be questioned in any form, regardless of possible amendments and revisions. In one sense, the privilege actually imposes a burden upon the accountant. Accountants must make greater efforts to protect against casual or inadvertent disclosure which would result in the possible waiver of the privilege.

In determining whether a privilege should be recognized, courts have frequently relied upon the classic treatise on evidence by Wigmore.[42] Wigmore takes the position that any privilege worth recognition must satisfy a four part test:

> (1) The communications must orginate in a *confidence* that they will not be disclosued.
>
> (2) This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relation between the parties.
>
> (3) The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*.
>
> (4) The *injury* that would inure to the relation by the disclosure of the communications must be *greater than the benefit* thereby gained for the correct disposal of litigation.[43]

Privileges have long been recognized for both attorneys and physicians. A testimonial privilege may be perceived as extremely desirable because it singles out one's group for special treatment, and correspondingly enhances professional stature. The accountant-client privilege, however, cannot satisfy the four part test set forth by Wigmore.

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39 MD. CT. & JUD. PROC. CODE ANN. § 9-110 (1984).
40 TENN. CODE ANN. § 62-1-116 (1982).
41 PA. STAT. ANN. tit. 63, § 9.11a (Purdon Supp. 1983-84).
42 8 J. WIGMORE, EVIDENCE § 2285 (McNaughton rev. 1961).
43 *Id.* (emphasis in original).

With respect to the second prong of Wigmore's test, accountants have independent standards that insure a substantial degree of confidentiality. Absolute confidentiality is not essential to the accountant-client relationship. Accountants attract clients because of their particular skill and knowledge in the field and that attraction remains unaffected by the statutory grant of a testimonial privilege.

With regard to the fourth prong of the test, the justification for the recognition of a privilege for communications made to a physician is rather apparent. The fear is that if a patient does not fully disclose the circumstances leading to injury or sickness, the consequences of this non-disclosure could range from ineffectual treatment to the patient's death. An attorney operates within an adversarial system where, presumably, the truth will be identified by opposing litigants advocating their respective positions. If an attorney is not completely apprised of a client's situation, his or her ability to properly represent the client is significantly compromised and the search for truth becomes illusory. An accountant, however, performs services of a different order. It is possible that the client will not receive the best financial advice if a certain disclosure is not made to the accountant. However, that financial loss cannot outweigh the benefits of full disclosure, nor can it compare with the possible loss of life or the inability to determine the truth, the respective justifications of the privileges for physicians and attorneys.

The privilege must be accompanied by numerous exceptions in order for it to be acceptable. Even with a carefully structured statute, however, new problems will continue to arise. The potential problems arising in the divorce situation have yet to be addressed by state legislation. Nonetheless, the potential injury to one spouse who is forced to reveal his or her financial condition cannot outweigh the obvious injustice that the other spouse would suffer by failing to receive a necessary support award.

After creating exceptions for the public attest function, joint venturers, minority shareholders, criminal actions, bankruptcy proceedings, and divorce proceedings, while recognizing the possibility of additional exemptions, the privilege becomes rather illusory. Even if all of the shortcomings in a particular privilege statute could be resolved, we must be aware of the fact that the accountant-client privilege is not available in all states. Consequently, disclosures protected in one office may lose that protection in a neighboring locality.

Conclusion

If a state has decided to enact or retain an accountant-client privilege, several exceptions must be included. Legislators, however, must continually address the fundamental question of whether these statutes, even when carefully drafted, should be retained. In light of the limited protection a properly drafted statute will provide, the fact that the protection is not available in all states or in all courts, the concern that a new statute will increase the potential civil liability of accountants for wrongful disclosure, and the possibility of ethical conflicts, it is this author's view that the accountant-client privilege should ultimately be abandoned.