

CAD-03119  
SUPREME COURT  
FILED

AUG 27 1992

Robert Wandruff Clerk

DEPUTY

C O P Y

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

ROBERT R. BILY, )  
 )  
 Plaintiff and Respondent, )  
 v. )  
 ARTHUR YOUNG & COMPANY, )  
 )  
 Defendant and Appellant. )

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J. F. SHEA CO., INC., et al., )  
 )  
 Plaintiffs and Appellants, )  
 v. )  
 ARTHUR YOUNG & COMPANY, )  
 )  
 Defendant and Appellant. )

S017199

(Ct. of Appeal  
No. H003695)  
(Super. Ct.  
No. 536562)

We granted review to consider whether and to what extent an accountant's duty of care in the preparation of an independent audit of a client's financial statements extends to persons other than the client.

Since Chief Judge Cardozo's seminal opinion in Ultramares Corp. v. Touche (N.Y. 1931) 174 N.E. 441 (Ultramares), the issue before us has been frequently considered and debated by courts and commentators. Different schools of thought have emerged. At the center of the controversy are difficult questions concerning the role of the accounting profession in performing audits, the conceivably limitless scope of an accountant's liability to nonclients who may come to read and rely on audit reports,

SEE DISSENTING OPINION

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and the effect of tort liability rules on the availability, cost, and reliability of those reports.

Following a summary of the facts and proceedings in this case, we will analyze these questions by discussing the purpose and effect of audits and audit reports, the approaches taken by courts and commentators, and the basic principles of tort liability announced in our prior cases. We conclude that an auditor<sup>1/</sup> owes no general duty of care regarding the conduct of an audit to persons other than the client. An auditor may, however, be held liable for negligent misrepresentations in an audit report to those persons who act in reliance upon those misrepresentations in a transaction which the auditor intended to influence, in accordance with the rule of section 552 of the Restatement Second of Torts, as adopted and discussed below. Finally, an auditor may also be held liable to reasonably foreseeable third persons for intentional fraud in the preparation and dissemination of an audit report.

I.

Summary of Facts and Proceedings Below

This litigation emanates from the meteoric rise and equally rapid demise of Osborne Computer Corporation (hereafter the company). Founded in 1980 by entrepreneur

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<sup>1/</sup> This case arises in the context of an engagement of a firm of certified public accountants to perform an audit and render a formal, written report. We will use the terms "auditor" and "accountant" interchangeably and in this context.