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Evidence -- Privileged Communications -- Accountant and Client

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Evidence—Privileged Communications—Accountant and Client

At common law no privilege for confidential communications between an accountant and his client was recognized.[1] Nor does an accountant-client privilege exist in the federal system.[2] Even

[1] Falsone v. United States, 205 F.2d 734, 739 (5th Cir. 1953), *cert. denied*, 346 U.S. 864 (1953); *In re* Fisher, 51 F.2d 424, 425 (S.D.N.Y. 1931); *see* Clayton v. Canida, 223 S.W.2d 264, 266 (Tex. Ct. App. 1949). The only privileges recognized at common law were the attorney-client privilege, 8 J. WIGMORE, EVIDENCE § 2290 (McNaughton rev. ed. 1961) [hereinafter cited as WIGMORE], and the husband-wife privilege, 1 E. MORGAN, BASIC PROBLEMS OF EVIDENCE 101 (1961). A substantial majority of jurisdictions have enacted statutes creating physician-patient and priest-penitent privileges, WIGMORE § 2286; See also 46 N.C.L. REV. —(1967). In recent years the attorney-client privilege has been extended to include the accountant when employed by the attorney, United States v. Kovel, 296 F.2d 918 (2d Cir. 1961). This extension of the attorney-client privilege was rejected as recently as 1949, however, in Himmelfarb v. United States, 175 F.2d 924 (9th Cir. 1949), *cert. denied*, 338 U.S. 860 (1949), where the accountant was hired by the attorney to aid in preparation of a tax fraud case. The court said that the presence of the accountant was a convenience and not indispensable as the presence of the attorney's secretary might be. *Accord*, Gariepy v. United States, 189 F.2d 459 (6th Cir. 1951). However, in *Kovel*, where the accountant, employed full time by the law firm, was held in contempt in the district court for refusing to testify concerning alleged tax violations of a client of the law firm, the court of appeals reversed, stating that "[T]he presence of the accountant is necessary. . . for the effective consultation between the client and the lawyer, which the privilege is designed to permit." 296 F.2d at 922. The privilege established in the *Kovel* case was extended to include the accountant's work papers in United States v. Judson, 322 F.2d 460 (9th Cir. 1963), where the attorney advised his client to obtain a net worth statement. The client engaged an accountant who prepared the statement and gave it to the attorney, who was then served with a subpoena *duces tecum* to produce the statement and the accountant's work papers. The Ninth Circuit reversed the position it had taken in *Himmelfarb*, holding that these documents constituted confidential communications within the attorney-client privilege. However, where the attorney is also an accountant, accounting services are not covered by the attorney-client privilege. Olender v. United States, 210 F.2d 795 (9th Cir. 1954); *In re* Colton, 201 F. Supp. 13 (S.D.N.Y. 1961); United States v. Chin Lim Mow, 12 F.R.D. 433 (N.D. Cal. 1952); *In re* Fisher, 51 F.2d 424 (S.D.N.Y. 1931). This narrow extension of the attorney-client privilege is recognized only when the client communicates first with an attorney who then retains an accountant. Furthermore, the accountant's services must consist of accounting work required by the attorney in giving legal rather than accounting advice. United States v. Kovel, 296 F.2d 918 (2d Cir. 1961); Olender v. United States, 210 F.2d 795 (9th Cir. 1954).

[2] United States v. Bowman, 236 F. Supp. 548, 550 (M.D. Pa. 1964); United States v. Culver, 224 F. Supp. 419, 434 (D. Md. 1963); *In re* Colton, 201 F. Supp. 13, 16 (S.D.N.Y. 1961); United States v. Stoehr, 100 F. Supp. 143, 162 (M.D. Pa. 1951); *In re* Borden Co., 75 F. Supp. 857, 860 (N.D. Ill. 1948).

though several jurisdictions have enacted statutes creating such a privilege, there is considerable doubt among the authorities that the privilege is in the public interest.[3] This comment is directed to the question of whether the need to protect the accountant-client relationship is sufficient to justify the incidental sacrifices in the effective administration of justice.

The evidentiary privileges in no way aid the ascertainment of truth.[4] To justify the establishment of a privilege, the general duty of every man to give all relevant testimony must be overcome, and any exemption from this duty must be regarded as an exception to the general rule.[5] Dean Wigmore's four fundamental conditions of social policy are generally recognized as necessary to the establishment of a privilege:

> (1) the communications must originate in a confidence that will not be disclosed; (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 community, ought to be sedulously fostered; and (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 proper disposal of litigation.[6]

In recent years several state legislatures have concluded that a privilege for the accountant-client relation satisfies these conditions. Fifteen states and Puerto Rico have enacted statutes conferring the status of privileged communications upon professional information obtained by accountants.[7] Although there

[3] J. CAREY & W. DOHERTY, ETHICAL STANDARDS OF THE ACCOUNTING PROFESSION 134 (1966) [hereinafter cited as CAREY & DOHERTY]; WIGMORE § 2286.

[4] C. MCCORMICK, EVIDENCE § 72 (1954); 16 TEXAS L. REV. 447 (1938).

[5] WIGMORE § 2192.

[6] *Id.* § 2285.

[7] *Arizona:* "[C.P.A.'s] and public accountants . . . shall not be required to divulge, nor . . . voluntarily divulge information which they have received by reason of the confidential nature of their employment. . . . [the section does not apply to criminal or bankruptcy matters]." ARIZ. REV. STAT. ANN. § 32-749 (Supp. 1966). *Colorado*: "A [C.P.A.] shall not be examined without the consent of his client as to any communication made by the client, to him in person or through . . . books of account and financial records, or his advice, reports or working papers given or made thereon in the course of professional employment. . . ." COLO. REV. STAT. ANN. § 154-1-7 (7) (1963). In Pattie Lea Inc. v. District Court, ——— Colo. ———, 423 P.2d 27 (1967), a state court for the first time was called upon to interpret a statute creating an accountant-client privilege. In this case the defendant corporations sought a writ of prohibition to prevent the taking of a deposition of a certified public accountant concerning his preparation of audits,

financial statements, annual reports and income tax returns for the defendants. The court determined that under the Colorado statute any confidential communications made by a client to a certified public accountant in the course of his professional employment fell within the statutory privilege.
Florida: "All communications between [C.P.A.'s] and public accountants and the person for whom such [C.P.A.] or public accountant shall have made any audit or other investigation in a professional capacity, and all information obtained . . . in their professional capacity concerning the business and affairs of clients shall be deemed privileged. . . ." FLA. STAT. § 473.15 (1965).
Georgia: "Any communication to any practicing [C.P.A.] transmitted to such accountant in anticipation of, or pending, the employment of such accountant shall be treated as confidential and not . . . divulged by said accountant in any proceedings. . . ." GA. CODE ANN. § 84-216 (1955).
Illinois: "A public accountant shall not be required by any court to divulge information or evidence which has been obtained by him in his confidential capacity as a public accountant." ILL. ANN. STAT. ch. 110½, § 51 (Smith-Hurd 1966).
Iowa: "The information acquired by registered practitioners . . . in the course of professional engagements shall be deemed . . . privileged, and except by written permission of the clients involved . . . shall not be disclosed . . . provided [the section does not apply to criminal or bankruptcy matters]." IOWA CODE ANN. § 116.15 (1949).
Kentucky: "A [C.P.A.] or public accountant shall not be required by any court to divulge information or evidence which has been obtained by him in his confidential capacity as such." KY. REV. STAT. § 325.440 (1962).
Louisiana: "No [C.P.A.], public accountant, or person employed by [a C.P.A.] or public accountant, shall be required to, or voluntarily . . . divulge . . . any communications made to him by any person employing him to examine, audit, or report on any books, records, or accounts . . . except by express permission of the person employing him. . . ." LA. REV. STAT. ANN. § 37:85 (1964).
Maryland: "Except by express permission of the person employing him . . . a [C.P.A.] or public accountant or any person employed by him shall not be required to . . . divulge . . . any communications made to him by any person employing him to examine, audit or report on any books, records, accounts or statements nor any information derived therefrom in rendering professional service; provided [the section does not apply to criminal or bankruptcy matters]." MD. ANN. CODE art. 75A, § 20 (1957).
Michigan: "Except by written permission of the client . . . a [C.P.A.] or public accountant . . . shall not be required to, and shall not voluntarily . . . divulge information . . . in connection with any examination of, audit of, or report on, any books, records, or accounts which he . . . may be employed to make. This section shall not be construed as prohibiting the disclosure of information to a third party having an interest in or relying on an opinion rendered by a [C.P.A.]." MICH. STAT. ANN. § 18.23 (Stat. Release 19, 1967).
Missouri: Statute was enacted in 1967 and the citation is not available.
Nevada: "An accountant cannot, without the consent of his client, be examined as to any communication made by the client to him, or his advice given thereon in the course of professional employment. . . ." NEV. REV. STAT. § 48.065 (1957).
New Mexico: "A certified or registered public accountant shall not be required by any court to divulge information or evidence which has been obtained by him in his confidential capacity as such. . . ." N.M. STAT. ANN. § 67-23-26 (1953).

are substantial variations among these statutes,[8] the overall trend is toward the creation of a broad accountant-client privilege. As this trend may soon come to the attention of the North Carolina General Assembly, an analysis of the privilege is desirable.

Pennsylvania: "Except by permission of the client . . . a [C.P.A.] . . . shall not be required to, and shall not voluntarily . . . divulge information . . . in connection with any professional services as a [C.P.A.] other than the examination of, audit of or report on any financial statements, books, records or accounts, which he may be engaged to make. . . . Provided [the section does not apply to criminal or bankruptcy matters]." PA. STAT. ANN. tit. 63, § 9.11a (Supp. 1966).
Puerto Rico: "No court shall require a [C.P.A.] or public accountant to divulge information or evidence obtained by him in his confidential capacity as such." P.R. LAWS ANN. tit. 20, § 790 (1961).
Tennessee: "[C.P.A.'s] . . . shall not divulge nor shall they . . . be required to divulge, any information which may have been communicated to them . . . by reason of the confidential nature of their employment. . . . [E]xcept [the section does not apply to criminal or bankruptcy matters]." TENN. CODE ANN. § 62-114 (1955).

[8] There are four major variations among the statutes. *First,* some of the statutes apply only to certified public accountants [Colorado, Georgia, Pennsylvania and Tennessee], whereas others extend the privilege to include "public accountants" or to public accounting generally. A certified public accountant is a public practitioner in accountancy who holds a certificate issued after he has met the statutory qualifications of the issuing state. The meaning of the term "public accountant" may vary somewhat from state to state. See note 15 *infra.* In most states a public accountant is a public practitioner in accountancy who is registered to practice after meeting certain prescribed statutory qualifications. In all cases the requirements for registration are considerably less than those for certification. *Second,* a number of the statutes specifically provide that the privilege is not applicable in situations involving criminal or bankruptcy laws [Arizona, Iowa, Maryland, Pennsylvania and Tennessee], whereas the others appear to apply to all situations. *Third,* some of the statutes specifically exclude certain types of accountancy services, whereas the others appear to apply to all such services. The Pennsylvania statute excludes information acquired by the C.P.A. in "the examination of, audit of or report on any financial statements, books, records or accounts. . . ." PA. STAT. ANN. tit. 63, § 9.11a (Supp. 1966). This is discussed in United States v. Bowman, 358 F.2d 421 (3d Cir. 1966). In 1967, Michigan amended its statute to include the following statement: "This section shall not be construed as prohibiting the disclosure of information to a third party having an interest in or relying on an opinion rendered by a certified public accountant." MICH. STAT. ANN. § 18.23 (Stat. Release 19, 1967). *Fourth,* several of the statutes are not clear as to whether the privilege inures to the benefit of the client or the accountant. In Dorfman v. Rombs, 218 F. Supp. 905 (N.D. Ill. 1963), the court interpreted the Illinois statute as creating an "accountant" privilege since the statute does not mention a "client". If the *Dorfman* decision is a proper one, the Arizona, Kentucky, New Mexico, Puerto Rico and Tennessee statutes are ostensibly open to similar interpretations. The other statutes refer to the "client" and generally require the client's consent before confidences may be divulged by the accountant. Such a statute has been interpreted as creating a "client" privilege. Weck v. District Court, —— Colo. ——, 408 P.2d 987 (1965).

Dean Wigmore has embodied in his four fundamental conditions of policy the basic philosophy of a privilege against testimonial disclosure.[9] The accountant-client privilege satisfies the first condition in that only confidential communications are protected. The second condition, that this element of confidentiality is essential to the full maintenance of the relation between the parties, is also satisfied by the privilege because the client must disclose highly confidential financial details. However, it is important to consider the second condition as it relates to condition four. It is of little value to say that the privilege is necessary to the full maintenance of the relation when the status of the relation is only slightly less than satisfactory without the privilege. The importance lies in the incremental benefit gained from the establishment of the privilege, which must be weighed against incidental detriments to the administration of justice. The third condition, that the community opinion foster the relation, also appears to be satisfied since there is increasing reliance by the general public on the services of certified public accountants.[10] However, the extent to which the relation is to be fostered must also be a matter of degree and considered in relation with condition four. The state and national professional organizations of certified public accountants and state legislatures have recognized that it is in the public interest to foster the accountant-client relationship, and have gone to great lengths to do so.[11] The result is that the C.P.A. has attained the

[9] WIGMORE § 2285.

[10] J. CAREY, THE CPA PLANS FOR THE FUTURE 120-27 (1965) [hereinafter cited as CAREY].

[11] The American Institute of Certified Public Accountants has developed a strict code of ethics, AICPA, CODE OF PROFESSIONAL ETHICS (1967), and the state societies have adopted similar rules, CAREY 330. The states have fostered the accountant-client relation by the voluntary acceptance of a uniform C.P.A. examination, CAREY 464, and most states have granted statutory authority to boards of accountancy to form legally enforceable rules of professional conduct, CAREY & DOHERTY 8. Furthermore, there is a growing majority of states adopting "regulatory" licensing statutes, Heimbucher, *Fifty-three Jurisdictions*, 112 J. ACCOUNTANCY 42 (Nov. 1961). "The basic philosophy underlying the regulatory statutes is that the independent audit function is so affected with the public interest that all who engage in such practice should be required to meet certain statutory standards of qualifications and conduct." *Id.* Generally, these statutes restrict the use of public accountancy titles to those who have met the prescribed qualifications for certification as a C.P.A. To avoid retroactively depriving public accountants already in practice of their means of livelihood, these laws must provide for licensing this group. However, most regulatory laws do not provide for the continued licensing of public accountants. Thus, the practi-

status of a true professional and has been accorded the respect of the community.[12] The client is well protected against the voluntary disclosure of confiidential information by his C.P.A.[13] But is it in the best interest of the community to foster the relationship to such an extent that a court of law will be unable to compel disclosures of confidences?

The fourth and most important condition prevents justification of the accountant-client privilege. To satisfy this condition the benefits gained from the privilege must exceed on balance the detriments which may result in the administration of justice. Proponents of the privilege argue that the relationship will benefit in that the client's hesitancy to make full disclosure will be removed, thus making it possible for the C.P.A. to function more effectively. To show that this benefit is not of sufficient importance to satisfy the fourth condition, it is helpful to examine the three principal functions of the C.P.A.—taxation, auditing and management consulting services.[14]

The primary interest of C.P.A.'s who desire an accountant-client privilege is to promote full disclosure of information necessary for the preparation of income tax returns.[15] This is based on the premise that the privilege would protect clients who may be unjustly charged with fraud or need protection against "fishing expeditions."[16] Although the cases are somewhat inconsistent, the federal courts generally refuse to apply state accountant-client privileges in federal tax investigations.[17] Therefore, the privilege is virtually

cal effect of these laws is that ultimately the practice of public accountancy will be restrited to C.P.A.'s, CAREY 476. In the states that have not enacted regulatory laws, so-called "permissive" laws are in effect. These laws provide only for granting the C.P.A. title to those who qualify and permit anyone else to use similar titles such as "public accountant" and to perform all types of accountancy services, including independent audits. *Heimbucher, supra,* at 43.

[12] CAREY 485.

[13] J. Carey, *Professional Ethics and the Public Interest,* 102 J. ACCOUNTANCY 38, 41 (Nov. 1956).

[14] CAREY & DOHERTY 18.

[15] CAREY 327.

[16] *Id.*

[17] In Falsone v. United States, 205 F.2d 734 (5th Cir. 1953), *cert. denied,* 346 U.S. 864 (1953), the Fifth Circuit refused to apply the Florida accountant-client privilege statute and enforced a summons which compelled an accountant to testify and to bring all documents relating to the client's income tax return. *Accord, In re* Albert Lindley Lee Memorial Hospital, 209 F.2d 122 (2d Cir. 1953), *cert. denied,* 347 U.S. 960 (1954). *But see* Baird v. Koerner, 279 F.2d 623 (9th Cir. 1960), where an attorney refused to dis-

useless in the area of taxation. Even if this were not the case, it is doubtful that the privilege would encourage disclosures, the protection of which would be in the public interest. If the taxpayer gives the C.P.A. full and accurate information, his taxes will be computed correctly by a competent practitioner. In the event of a spot-check, all deductions could be readily explained without doing injury to the accountant-client relation. The same is true for an unintentional failure to disclose certain information since payment of the deficiency would likely end the matter. If non-disclosure and hence underpayment by the taxpayer is intentional, it is in the public interest to insure that correct taxes are paid and that a tax fraud does not go unchecked. Therefore, an accountant-client privilege does not inure to the benefit of the honest citizen, but would assist the perpetrator of a tax fraud.[18] In the area of taxation there is little, if any, benefit which inures to the relationship as a result of the privilege.

The auditing or attest function of the C.P.A. "results in the expression of an opinion by an independent expert that a communication of economic data by one party to another is fairly presented."[19] The position that corporate management will be unduly hesitant to make disclosures to an auditor if the court can compel the auditor to disclose confidences appears to be unfounded. If adequate information is not made available to the auditor, he must render a qualified opinion or disclaim certain aspects of the enterprise's operation. Such an opinion can only serve as notice to potential investors and creditors of a possible weakness in the enterprise. The economic pressures on corporate management to secure a favorable opinion is sufficient to overcome any hesitancy to disclose material information. It is true that management is reluctant to

close the name of his client to an internal revenue agent. The Ninth Circuit applied the attorney-client privilege to reverse a civil contempt judgment against the attorney. The court held that this was a "civil" case as opposed to an administrative proceeding. *Compare Baird* with FTC v. St. Regis Paper Co., 304 F.2d 731 (7th Cir. 1962), where the court attempted to explain the inconsistency between *Falsone* and *Baird*. But in Colton v. United States, 306 F.2d 633, 636 (2d Cir. 1962), *cert. denied*, 371 U.S. 951 (1963), the Second Circuit said that "[W]e do not agree . . . that a hearing held by the Internal Revenue Service . . . is a 'civil action' governed by state evidence law . . . or that state law should govern for any other reason." See Comment, *Accountants, Privileged Communications, and Section 7602 of the Internal Revenue Code*, 10 ST. LOUIS U. L. J. 252 (1965).

[18] 37 CHI. BAR RECORD 291 (1956).

[19] Bevis, *The CPA's Attest Function in Modern Society*, 113 J. ACCOUNTANCY 28 (Feb. 1962).

disclose more information than is necessary for fear that competitors will benefit from these disclosures. These fears appear unjustifiable as modern managements "seem to be able to find out in one way or another what they want to know about their competitors."[20] As a practical matter, it does not appear that an auditor's effectiveness would be greatly enhanced by a privilege. Furthermore, some writers and legislators have expressed concern that the privilege is inconsistent with the auditor's independence.[21] The auditor's code of ethics requires that he remain independent and disclose to the public any material finding necessary to prevent a misleading financial statement. Suppose an auditor makes a finding that affects the client's financial position and its disclosure may prove detrimental to the client. Will the fact that this finding is privileged against disclosure in a court of law affect the auditor's determination of whether it should be disclosed to third parties? Might the auditor be tempted to gamble for the protection of the client? To forego any adverse effects, two states have specifically excluded the auditing function from the privilege.[22]

Management services rendered by C.P.A.'s are generally internal services such as inventory valuation policies, depreciation procedures, advice on investment problems and many other such services.[23] Management often desires these services when faced with a problem beyond the scope of the accountants inside the corporation, or it may merely desire an independent analysis of a problem. Since the services rendered are to be used internally, these services cannot be distinguished from the work done by inside accountants. As agents of the corporate principal, inside accountants have a fiduciary duty of non-disclosure of confidential information.[24] The C.P.A. rendering management services, as an agent of the corporate client or as a professional practitioner subject to his code of ethics, has a similar duty of non-disclosure. In the face of litigation, no privilege is recognized for confidential communications between the corporate principal and the inside accountant. Such a privilege is obviously not in the public interest since it would insulate virtually all business transactions. No jurisdiction has a statute creating

[20] CAREY 144.
[21] CAREY & DOHERTY 134.
[22] Michigan and Pennsylvania. *See* note 8 *supra.*
[23] CAREY & DOHERTY 107.
[24] W. SEAVEY, LAW OF AGENCY § 152 (1964).

an employer-employee privilege.[25] How then can a privilege be justified between a management services consultant and a corporate client?

In the report of the American Bar Association's Committee on the Improvement of the Law of Evidence in 1937-38,[26] the committee recommended a strict application of existing privileges and recommended against further recognition of so called "novel privileges." Since that date several jurisdictions have failed to heed these recommendations. Most of the statutes noted above have been enacted since 1938. The American Institute of Certified Public Accountants has not adopted a position either in favor of or in opposition to the privilege since it may be detrimental to the profession's interest.[27] State C.P.A. societies are not affiliated with the Institute and it is these societies that sponsor privilege legislation. However, legislators are faced with the realities that the privilege is (a) virtually useless in the area of taxation, (b) of negligible benefit, and possibly a hindrance, to the effectiveness of the audit function, and (c) unwarranted as to management consultants. The benefits gained by the accountant-client relation due to the privilege are slight, and do not exceed on balance the injury that would inure to the effective administration of justice.

HAROLD N. BYNUM

Evidence—Privileged Communications—The New North Carolina Priest-Penitent Statute

In 1967 the North Carolina General Assembly enacted a new priest-penitent[1] privilege statute.[2] The statute is the second of its

[25] WIGMORE § 2286.
[26] 63 ABA REP. 570, 595 (1938).
[27] Letter from Timothy T. McCaffrey, state legislation Manager, AICPA, to Harold N. Bynum, Sept. 14, 1967.

[1] Usage of the term "priest-penitent" is common as a characterization of the relationship which exists between any clergyman of any religious faith and one who receives his professional aid. 97 C.J.S. *Witnesses* § 263 (1957). One of the most liberal extensions of this group to whom the privilege is applied is found in Reutkemeier v. Nolte, 179 Iowa 342, 161 N.W. 290 (1917), in which admissions of fornication by a young woman before a Presbyterian body of elders were held a confidential communication.

[2] N.C. GEN. STAT. § 8-53.1 (1967):

> No priest, rabbi, accredited Christian Science practitioner, or a clergyman or ordained minister of an established church shall be competent to testify in any action, suit or proceeding concerning any