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## Is the Supreme Court Ready to Recognize Another Privilege? An Examination of the Accountant-Client Privilege in the Aftermath of *Jaffee v. Redmond*

Thomas J. Molony

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# Is the Supreme Court Ready to Recognize Another Privilege? An Examination of the Accountant-Client Privilege in the Aftermath of *Jaffee v. Redmond*

Thomas J. Molony\*

## Table of Contents

I. Introduction .....	248
II. Historical Consideration of the Accountant-Client Privilege in the Federal System .....	250
A. <i>Couch v. United States</i> .....	250
B. <i>United States v. Arthur Young &amp; Co.</i> .....	251
III. The Traditional Framework for Evaluating Privileges .....	259
IV. The <i>Jaffee v. Redmond</i> Framework for Evaluating Federal Privileges .....	261
V. The Accountant-Client Privilege in Light of <i>Jaffee v. Redmond</i> .....	265
A. Private Interests .....	265
B. Public Interests .....	271
1. Improved Financial Disclosures .....	271
2. Fairness in the Tax System .....	278
C. Benefit Derived from the Denial of Privileges .....	280
D. State Statutory Privileges .....	281
VI. Conclusion .....	286

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## I. Introduction

Recognizing evidentiary privileges undermines the general maxim of our legal system that the public has a right to obtain competent evidence.<sup>1</sup> Thus, courts should adopt new privileges only after determining, first, that sufficient interests exist which outweigh the evidentiary needs of the legal system<sup>2</sup> and, second, that adoption of a privilege is necessary to preserve those interests.<sup>3</sup> In 1996, the Supreme Court made such a determination in *Jaffee v. Redmond*<sup>4</sup> and recognized a federal psychotherapist-patient privilege.<sup>5</sup> Arguably, the decision established a framework for determining when other professional communications warrant privileged status under Federal Rule of Evidence 501 (Rule 501).<sup>6</sup>

The *Jaffee* framework provides a ray of hope for the accountant-client<sup>7</sup> privilege, which has historically encountered disfavor in the federal court system. In 1973, the Supreme Court noted in *Couch v. United States*<sup>8</sup> that no

1. See *Jaffee v. Redmond*, 116 S. Ct. 1923, 1928 (1996) (stating that "public has right to every man's evidence" (quoting *United States v. Bryan*, 339 U.S. 323, 331 (1950))). The Supreme Court noted that when it "examine[s] the various claims of exemption, [it] start[s] with the primary assumption that there is a general duty to give what testimony one is capable of giving, and that any exemptions which may exist are distinctly exceptional, being so many derogations from a positive general rule." *Id.* (quoting *Bryan*, 339 U.S. at 331).

2. See Steven Goode & M. Michael Sharlot, *Article V Privileges*, 30 HOUS. L. REV. 489, 489-90 (1993) (discussing when courts should recognize privileges); see also *Jaffee*, 116 S. Ct. at 1928 (supporting privilege recognition when other public interests "transcend" truth seeking interest).

3. See Goode & Sharlot, *supra* note 2, at 490 (asserting recognition of privilege must "foster" values privilege purports to protect).

4. 116 S. Ct. 1923 (1996).

5. *Jaffee v. Redmond*, 116 S. Ct. 1923, 1928 (1996); see *infra* notes 98-129 and accompanying text (discussing *Jaffee*).

6. See *Jaffee*, 116 S. Ct. at 1927-28 (discussing Rule 501). Rule 501 provides: Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience. However, in civil actions and proceedings, with respect to an element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness, person, government, State, or political subdivision thereof shall be determined in accordance with State law.

FED. R. EVID. 501.

7. This Note uses the terms public accountant, accountant, and auditor interchangeably to refer to a certified public accountant (CPA). For a general discussion of the accounting profession and the licensing requirements for CPA's, see DANIEL G. SHORT & GLENN A. WELSCH, *FUNDAMENTALS OF FINANCIAL ACCOUNTING* 10-13 (6th ed. 1990).

8. 409 U.S. 322 (1973).

accountant-client privilege exists in the federal courts.<sup>9</sup> Eleven years later in *United States v. Arthur Young & Co.*,<sup>10</sup> the Burger Court cited *Couch* to support its denial of work product protection to a public accountant's tax accrual workpapers.<sup>11</sup> These two decisions, combined with the perception that Rule 501 offers a conservative approach to privileges, led some commentators to suggest that the accountant-client privilege had no future in the federal system absent congressional action.<sup>12</sup> Such a conclusion proves premature in light of *Jaffee*, a broad decision that creates an opportunity for recognition of new privileges.<sup>13</sup>

This Note considers whether the majority's reasoning in *Jaffee* opens the privilege door wide enough to permit an accountant-client privilege to enter the federal courts. Part II discusses the historical treatment of the accountant-client privilege in the federal courts, including an evaluation of both the *Couch* and *Arthur Young* decisions.<sup>14</sup> Part III reviews the Wigmore approach to privileges, a long-standing framework commonly invoked in scholarly evaluations of privileged communications.<sup>15</sup> Part IV details the rationale underlying adoption of the psychotherapist-patient privilege in *Jaffee*.<sup>16</sup> Part V evaluates the accountant-client privilege through the lens of *Jaffee* by identifying private interests, public interests, benefits from denial of the privilege, and the impact of state enactments.<sup>17</sup> This Note ultimately concludes

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9. *Couch v. United States*, 409 U.S. 322, 335 (1973); see *infra* notes 18-31 and accompanying text (discussing *Couch*).

10. 465 U.S. 805 (1984).

11. *United States v. Arthur Young & Co.*, 465 U.S. 805, 817 (1984); see *infra* notes 32-83 and accompanying text (discussing *Arthur Young*).

12. See Gaylord A. Jentz, *Accountant Privileged Communications: Is it a Dying Concept Under the New Federal Rules of Evidence?*, 11 AM. BUS. L.J. 149, 149 (1973) ("[T]he Federal Rules offer a conservative approach to the privilege doctrine and are a retreat from the recognition of privileged communications in numerous professional relationships other than that of the attorney and his client."); Scot L. Kline, Note, *United States v. Arthur Young & Co.: Judicial Death Knell for Auditors' Privilege and Suggested Congressional Resurrection*, 71 CORNELL L. REV. 694, 694-95 (1986) (asserting that *Arthur Young* decision definitively precluded judicial recognition of accountant work product doctrine for tax accrual workpapers and suggesting Congress should provide such protection).

13. See *infra* notes 120-28 and accompanying text (suggesting framework that Court applied to permit psychotherapist privilege in *Jaffee* is applicable to other privileges, including accountant-client privilege).

14. See *infra* notes 18-83 and accompanying text (discussing history of accountant-client privilege in federal courts).

15. See *infra* notes 84-97 and accompanying text (discussing Wigmore approach to privileges).

16. See *infra* notes 98-129 and accompanying text (discussing *Jaffee* approach to privileges).

17. See *infra* notes 130-273 and accompanying text (evaluating accountant-client privi-

that the federal system is not yet ready to adopt an accountant-client privilege, even under *Jaffee's* broad analysis.

## *II. Historical Consideration of the Accountant-Client Privilege in the Federal System*

### *A. Couch v United States*

In *Couch v. United States*,<sup>18</sup> the Supreme Court considered the case of a restaurant owner who, after a number of years of giving her business records to her accountant for tax return preparation, faced an Internal Revenue Service (IRS) investigation of her returns.<sup>19</sup> Upon finding evidence suggesting that the restaurant owner's tax returns substantially understated gross income, the IRS issued a summons to the accountant for the production of any of the restaurant owner's business records in the accountant's possession.<sup>20</sup> The accountant refused to comply and transferred the records to the restaurant owner's attorney.<sup>21</sup> Consequently, the IRS requested that a federal court enforce the summons.<sup>22</sup> In response to the enforcement action, the restaurant owner claimed that the Fourth and Fifth Amendments to the Constitution barred production of the records due to "the confidential nature of the accountant-client relationship and her resulting expectation of privacy."<sup>23</sup>

Writing for the majority, Justice Powell dismissed the restaurant owner's privacy claim, finding that a taxpayer has no reasonable expectation of privacy when she transfers information to her accountant for ultimate disclosure in a tax return.<sup>24</sup> Powell noted that, although not controlling in the instant case, federal courts do not recognize an accountant-client privilege.<sup>25</sup> In contrast, Justice Marshall, although not directly advocating an accountant-client privilege, recognized that disclosure to accountants is similar to disclosure to attorneys,<sup>26</sup> professionals who traditionally have enjoyed privileged

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lege using *Jaffee* framework).

18. 409 U.S. 322 (1973).

19. *Couch v. United States*, 409 U.S. 322, 324 (1973).

20. *Id.* at 324-25.

21. *Id.* at 325.

22. *Id.*

23. *Id.* at 335. The restaurant owner also claimed that the Fifth Amendment's protection from self-incrimination barred production. *Id.* at 325.

24. *Id.* at 335. Powell also denied the self incrimination claim because the Fifth Amendment privilege is a personal one and the court was compelling the accountant, not the restaurant owner, to testify. *Id.* at 329.

25. *Id.* at 335 (stating "[a]lthough not in itself controlling, . . . no confidential accountant-client privilege exists under federal law, and no state-created privilege has been recognized in federal cases").

26. *Id.* at 351 (Marshall, J., dissenting).

communications with clients.<sup>27</sup>

Despite Justice Powell's admission that the lack of a federal accountant-client privilege did not control the Court's decision,<sup>28</sup> commentators often view *Couch* as authority for denying the privilege.<sup>29</sup> Furthermore, lower courts perpetuate this misconception by avoiding consideration of the circumstances of each case and citing *Couch* as the conclusive pronouncement that no accountant-client privilege exists in the federal system.<sup>30</sup> Rather than applying sound legal reasoning, these courts contribute to the phenomenon of "snowballing dicta."<sup>31</sup>

### B. United States v Arthur Young & Co.

In *United States v. Arthur Young & Co.*,<sup>32</sup> the Supreme Court revisited the accountant-client privilege and considered whether to grant work product protection to an accountant's tax accrual workpapers.<sup>33</sup> To comply with federal securities laws, Amerada Hess Corporation (Amerada Hess) engaged Arthur Young, a public accounting firm, to review its financial statements.<sup>34</sup> During the review, Arthur Young evaluated the corporation's stated tax liabilities and documented its findings in a series of workpapers.<sup>35</sup> Subsequent

27. See Harold N. Bynum, Note, *Evidence – Privileged Communications – Accountant and Client*, 46 N.C. L. REV. 419, 419 n.1 (1968) (noting that common law only recognized attorney-client privilege and husband-wife privilege); Charles Q. Jakob, Note, *Good Bad Press: Observations and Speculations About Internal Revenue Service Accountant-Informants*, 54 OHIO ST. L.J. 199, 202 (1993) (same); Scott W. Roloff, Note, *Accountant Work-Product Privilege Rejected: United States v. Arthur Young & Co.*, 38 SW. L.J. 1123, 1127 (1985) (stating that *Hickman v. Taylor*, 329 U.S. 495 (1947) recognized attorney work product privilege).

28. *Couch*, 409 U.S. at 335; see also Jakob, *supra* note 27, at 207 (stating that *Couch* did not present question of accountant-client privilege, but was Fourth and Fifth Amendment case); Roloff, *supra* note 27, at 1129 (noting that *Couch* Court "summarily" stated that no accountant-client privilege exists under federal law).

29. See Goode & Sharlot, *supra* note 2, at 490 n.11 (stating that Supreme Court has "held" that no accountant-client privilege exists under federal common law); Travis Morgan Dodd, Note, *Accounting Malpractice and Contributory Negligence: Justifying Disparate Treatment Based Upon the Auditor's Unique Role*, 80 GEO. L.J. 909, 931 (1992) (citing *Couch* as support for proposition that Supreme Court has rejected federal accountant-client privilege).

30. See, e.g., *Platypus Wear, Inc. v. K.D. Co.*, 905 F. Supp. 808, 811 (S.D. Ca. 1995) (citing *Couch* as conclusively denying accountant-client privilege in federal courts); *Coastal Fuels of Puerto Rico, Inc. v. Caribbean Petroleum Corp.*, 830 F. Supp. 80, 81 (D.P.R. 1993) (same); *United States v. Mullen & Co.*, 776 F. Supp. 620, 621 (D. Mass. 1991) (same); see Jakob, *supra* note 27, at 207 (indicating that courts blindly follow apparent precedent).

31. Jakob, *supra* note 27, at 207.

32. 465 U.S. 805 (1984).

33. *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-21 (1984); see Kline, *supra* note 12, at 695-700 (discussing audit process and content of tax accrual workpapers).

34. *Arthur Young*, 465 U.S. at 808.

35. *Id.*

to the review, the IRS performed a routine audit of Amerada Hess's tax liability over a three year period.<sup>36</sup> The audit revealed a questionable payment and triggered a criminal investigation of Amerada Hess's tax returns.<sup>37</sup> During the investigation, Arthur Young refused to comply with an IRS administrative summons requesting Arthur Young's Amerada Hess audit files.<sup>38</sup> Consequently, the IRS obtained enforcement of the summons in the United States District Court for the Southern District of New York.<sup>39</sup> The district court found that the information requested was both relevant and unprotected by any accountant-client privilege.<sup>40</sup>

The United States Court of Appeals for the Second Circuit reversed the district court ruling and recognized a limited accountant work product privilege.<sup>41</sup> In so doing, the court resisted the trend set by the United States Court of Appeals for the Ninth Circuit in *United States v. Gurtner*<sup>42</sup> and the United States Court of Appeals for the Tenth Circuit in *United States v. Wainwright*,<sup>43</sup> both of which denied protection to accountant-client communications without directly resolving the privilege issue.<sup>44</sup> Even though the Second Circuit did

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36. *Id.*

37. *Id.*

38. *Id.* at 808-09.

39. *Id.* at 809.

40. *Id.*

41. *Id.* at 810.

42. 474 F.2d 297 (9th Cir. 1973).

43. 413 F.2d 796 (10th Cir. 1969).

44. See *United States v. Gurtner*, 474 F.2d 297, 298 (9th Cir. 1973) (finding that accountant did not have sufficient working relationship with defendant's attorney to warrant application of attorney-client privilege to communications with accountant); *United States v. Wainwright*, 413 F.2d 796, 803 (10th Cir. 1969) (noting that defendant did not claim that his communications with his accountant were privileged because no accountant-client privilege exists under federal law).

In *Gurtner*, the Ninth Circuit considered whether the trial judge should have stricken an accountant's testimony in a jury trial for failure to file federal income tax returns because the attorney-client privilege covered the taxpayer's communications with the accountant. *Gurtner*, 474 F.2d at 298. The court determined that, because the communications were not for the purpose of obtaining legal advice and because the accountant was not acting as a consultant for the attorney, the accountant's testimony did not constitute privileged information. *Id.* at 298-99. Furthermore, the court noted that the attorney-client privilege does not apply to consultations for the purpose of preparing tax returns even when an attorney performs such consultations. *Id.* at 299. Finally, the court concluded that even if the relationship between the accountant and the defendant's attorney was sufficient to apply the attorney-client privilege, the defendant waived the privilege by failing to assert it in a timely manner. *Id.*

In *Wainwright*, the Tenth Circuit considered the case of an individual charged with wilful tax evasion for understating taxable income. *Wainwright*, 413 F.2d at 798-99. Among other challenges, the defendant claimed that the trial court violated his Fifth Amendment right against self incrimination by permitting the defendant's tax preparer to surrender, in response to a

not follow its sister circuits, it acknowledged that its decision dealt with a conflict between the evidentiary interest involved in enforcing tax laws and the interest in complete financial disclosure for the protection of securities markets.<sup>45</sup> Ultimately, the Second Circuit determined that the interest in financial disclosure outweighed the IRS's evidentiary interest.<sup>46</sup>

First, the court examined the public disclosure interest that prompted Congress to enact securities laws requiring publicly held companies to obtain financial statement audits by independent accountants.<sup>47</sup> The appellate court concluded that Congress, by enacting these verification procedures in the Securities Exchange Act of 1934,<sup>48</sup> intended "management [to] feel free to cooperate with their auditors, and to disclose to them confidential information, such as the questionable positions taken on tax returns, and willingness to settle rather than litigate when these positions are challenged by the IRS."<sup>49</sup> The court suggested that a company might not disclose fully its tax positions to its auditors if the IRS could have access to the information and, consequently, gain the upper hand in tax litigation.<sup>50</sup> Furthermore, the court found that the only benefit of denying the privilege<sup>51</sup> was the efficiency in IRS investigations that would result from the IRS having the advantage of the tax accrual workpapers' "roadmap" to the best arguments for claiming deficient tax payments.<sup>52</sup> Although the court granted a privilege to accountant work product, it limited the scope of the privilege by making it inapplicable to extreme situations in which corporate records were otherwise unavailable.<sup>53</sup>

After the *Arthur Young* decision, other circuit courts undercut the Second Circuit's position on the accountant work product privilege. In *United States*

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subpoena duces tecum, a schedule prepared by the defendant. *Id.* at 803. The court noted that the defendant did not claim accountant-client privilege protection because federal courts do not recognize such a privilege and concluded that the defendant-prepared schedules were "merely cumulative of matters already in evidence and could not affect the substantial rights of the accused." *Id.* at 803, 804.

45. *United States v. Arthur Young & Co.*, 677 F.2d 211, 219 (2d Cir. 1982), *rev'd*, 465 U.S. 805 (1984).

46. *Id.* at 219-21; *see also Arthur Young*, 465 U.S. at 810 (citing Second Circuit decision).

47. *Arthur Young*, 677 F.2d at 219.

48. Securities Exchange Act of 1934, 15 U.S.C. § 78l(b)(1)(J)-(L) (1994).

49. *Arthur Young*, 677 F.2d at 219-20.

50. *Id.* at 220.

51. *Cf. Jaffee v. Redmond*, 116 S. Ct. 1923, 1929 (1996) (noting that one consideration for evaluating privileges is benefit derived from denying privileged status).

52. *Arthur Young*, 677 F.2d at 220.

53. *Id.* at 221. The court noted that the IRS would have to make "a sufficient showing of need to adequately justify invading the integrity of the auditing process." *Id.* It then determined that no such showing was made in the case. *Id.*



v. *El Paso Co.*,<sup>54</sup> the United States Court of Appeals for the Fifth Circuit denied application of the attorney-client privilege and the attorney work product doctrine to a tax pool analysis summoned by the IRS.<sup>55</sup> Also, in *International Horizons, Inc. v. Committee of Unsecured Creditors*,<sup>56</sup> the United States Court of Appeals for the Eleventh Circuit refused to apply Georgia's statutory accountant-client privilege to a bankruptcy case.<sup>57</sup> The

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54. 682 F.2d 530 (5th Cir. 1982).

55. *United States v. El Paso Co.*, 682 F.2d 530, 545 (5th Cir. 1982). In *El Paso*, a corporation asserted that the attorney-client privilege and the work product doctrine protected a tax pool analysis prepared by in-house attorneys for the purpose of estimating the contingent tax liability disclosed on the company's balance sheet. *Id.* at 533, 544. As an initial matter, the court found common ground with *Arthur Young* and determined that the material at issue met the relevance standard for an IRS administrative summons. *Id.* at 537-38. The court then rejected each of the corporation's privilege arguments. *Id.* at 538-45. First, the court decided that the attorney-client privilege did not apply because disclosure of the tax pool analysis to the independent auditor as a part of the annual audit constituted a waiver of the privilege. *Id.* at 540. It differentiated this case from *Arthur Young* and found that, because the corporation itself had prepared the tax pool analysis, extension of the *Arthur Young* work product doctrine to these circumstances would constitute an accountant-client communications privilege which did not exist under federal law. *Id.* at 540-41. Second, the Fifth Circuit rejected work product doctrine application to this case because in-house counsel did not prepare the tax pool analysis for litigation purposes but to support the tax contingency on the corporation's balance sheet. *Id.* at 543-44. Finally, the court rejected the corporation's argument that public policy favoring disclosure under securities laws warranted protection of the materials at issue. *Id.* at 544. It denied as speculative the corporation's assertion that failure to protect tax pool analyses from routine summonses would result in a hesitancy to prepare thorough analyses and a reluctance to turn over such analyses to public accountants. *Id.* The court relied on accountants' ethics and Securities and Exchange Commission (SEC) enforcement mechanisms to prevent such an effect. *Id.*

56. 689 F.2d 996 (11th Cir. 1982).

57. *International Horizons, Inc. v. Committee of Unsecured Creditors*, 689 F.2d 996, 999 (11th Cir. 1982). In *International Horizons*, the debtor's accountant refused to produce certain documents and workpapers, citing Georgia's statutory accountant-client privilege. *Id.* The court considered whether the Georgia provision was applicable, whether a federal common-law privilege should protect the workpapers, and whether public policy runs against disclosure absent application of a state or federal privilege. *Id.* First, in consideration of Rule 501's requirement that "with respect to an element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness, person, government, State, or political subdivision thereof shall be determined in accordance with State law," the court determined that the Rule did not require application of the state statutory privilege because the bankruptcy proceeding did not yet involve state claims warranting application of state procedure. *Id.* at 1002-03 (citations omitted). The court determined that application of the privilege when the action is entirely federal-law based would inhibit both the bankruptcy court's and creditors' access to information necessary to determine the financial condition of the debtor. *Id.* Second, the court recognized that Rule 501 allows federal courts to recognize new privileges, but found no "compelling justification" to depart from precedent which had "consistently rejected" an accountant client privilege. *Id.* at 1003-04. Third, the Eleventh Circuit rejected the proposition

Eleventh Circuit dealt an additional blow to *Arthur Young* in *United States v. Pennington*,<sup>58</sup> in which it denied an accountant work product privilege claim in a case involving a closely held corporation.<sup>59</sup>

In addition to the circuit courts' failure to adopt the Second Circuit's reasoning, at least one commentator, Lester Herzog, criticized the Second Circuit's recognition of an accountant work product privilege on several grounds.<sup>60</sup> First, Herzog asserted that the appellate court failed to provide

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that federal courts should recognize the state privilege under these circumstances because it poses no significant federal policy problems. *Id.* at 1004. The court found that application of the privilege would "completely undermine the important federal interest in providing bankruptcy courts and creditors with complete and accurate information regarding a debtor's financial condition." *Id.* at 1005. Also, the Eleventh Circuit recognized that even if federal courts recognized state accountant-client privileges in bankruptcy proceedings, lack of application of the privilege in other states or in federal criminal proceedings would still undermine Georgia's policy of promoting candid communications between accountants and clients. *Id.* Ultimately, the court required the accountant to turn over the workpapers. *Id.*

The decision in *International Horizons* accords with other federal decisions requiring disclosure of accountant-client communications to federal agencies based on significant federal policies. *See* *Wm. T. Thompson Co. v. General Nutrition Corp.*, 671 F.2d 100, 103-04 (3d Cir. 1982) (concluding that Pennsylvania accountant-client privilege statute did not permit accountant to avoid subpoena duces tecum to appear and to produce documents for both anti-trust and State law claims because "when there are federal law claims in a case also presenting state law claims, the federal rule favoring admissibility, rather than any state law privilege, is the controlling rule"); *FTC v. St. Regis Paper Co.*, 304 F.2d 731, 734 (7th Cir. 1962) (refusing to apply Illinois accountant-client privilege because privilege interfered with federal investigatory function and because relationship between client and accountant was not so highly valued as to warrant privileged status); *SEC v. Coopers & Lybrand*, 98 F.R.D. 414, 415 (S.D. Fla. 1982) (noting that state law privilege is not invoked under Rule 501 when matter is "fundamentally a federal [one] involving the enforcement of an investigatory subpoena relating to alleged securities laws violations").

58. 718 F.2d 1015 (11th Cir. 1983).

59. *United States v. Pennington*, 718 F.2d 1015, 1021 (11th Cir. 1983). In *Pennington*, the court considered whether to apply the Second Circuit's work product privilege to prevent the IRS from obtaining a closely held corporation's tax accrual workpapers. *Id.* at 1018. The court first determined that the workpapers were relevant and thus subject to the IRS summons. *Id.* at 1020. The court then rejected application of the *Arthur Young* work product privilege to the facts of the case. *Id.* at 1021. Citing the *El Paso* opinion, the court noted that the Second Circuit decision essentially created an accountant-client communications privilege that was explicitly rejected by the federal courts. *Id.* at 1021 n.8. Additionally, the Eleventh Circuit noted that the policy conflict in *Arthur Young* between tax laws and securities laws was not present in this case because federal securities laws do not apply to closely held corporations. *Id.* at 1021. It concluded that adoption of the privilege was not necessary to strengthen the audit process and to protect investor confidence. *Id.* The court intimated that such a policy decision, in any case, should be left to Congress. *Id.*

60. *See* Lester B. Herzog, *Protection of the Independent Audit Process: The Second Circuit Adopts a Limited Accountant's Work-Product Privilege*, 49 BROOK. L. REV. 1061, 1082-84 (1983) (criticizing Second Circuit opinion in *Arthur Young*).

substantive guidelines for future application of the privilege.<sup>61</sup> Second, he claimed that the court failed to consider whether the privilege extended to circumstances in which a corporation changes auditors.<sup>62</sup> Third, he criticized the opinion for failing to address whether the IRS could reach client-prepared tax accrual documents included in audit workpapers.<sup>63</sup>

The Supreme Court in *Arthur Young* did not address any of these deficiencies in its rejection of the Second Circuit's work product privilege.<sup>64</sup> Rather, Justice Burger noted that the circuit court's formulation of a work product privilege resembled the testimonial privilege denied in *Couch*.<sup>65</sup> Additionally, the opinion distinguished the interests involved in the attorney-client privilege from those involved in a similar accountant's privilege.<sup>66</sup> The Court dismissed the claim of possible adverse effects on securities markets from denying the privilege and relied instead on the public accountant's ethical duty not to issue an unqualified opinion on financial statements if management refuses to disclose matters that are material to the auditor's evaluation.<sup>67</sup> The Court found that permitting a work product privilege could, in fact, harm the audit process by distorting the essential public view that an auditor is independent

61. See *id.* at 1082-83 (asserting that decision leaves uncertain status of workpapers prepared for entities such as private corporations or limited partnerships which may or may not be subject to SEC regulation but upon whose audited financial statements investors rely).

62. See *id.* at 1084 (suggesting that if privilege did not extend to both current and prior auditors, corporations would remain unwilling to make full disclosure to their auditors).

63. See *id.* at 1085 (stating that "[t]he *Arthur Young* court also left unresolved the question of whether the privilege would apply when the auditor, in preparing the tax accrual workpapers, relied on the client's internally prepared tax accrual workpapers").

64. See *Arthur Young*, 465 U.S. at 821 (rejecting Second Circuit work product doctrine on grounds other than those raised in Herzog).

65. *Id.* at 817; see *supra* notes 18-31 and accompanying text (evaluating *Couch*).

66. *Arthur Young*, 465 U.S. at 817-18. "The [attorney] work-product doctrine was founded upon the private attorney's role as the client's confidential advisor and advocate, a loyal representative whose duty it is to present the client's case in the most favorable possible light." *Id.* at 817. In contrast, "[b]y certifying the *public* reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client." *Id.* "To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations." *Id.* at 818.

67. *Id.* at 818. An unqualified report indicates that financial statement disclosures are reasonably adequate. See JACK C. ROBERTSON, *AUDITING* 74 (7th ed. 1993). An auditor may not issue an unqualified opinion when the scope of an audit examination has been materially limited. *Id.* When management's refusal to let the auditor perform certain procedures materially limits the scope of an audit, the auditor must choose between a qualified opinion and a disclaimer of opinion. *Id.* Both opinions alert the public that disclosures may be inadequate. See *id.* at 79 (providing examples of both qualified opinion and disclaimer of opinion).

of her clients.<sup>68</sup> Furthermore, the Court concluded that access to the tax accrual workpapers does not provide an unfair advantage to the IRS, especially because Securities and Exchange Commission (SEC) actions and civil actions permit workpaper access.<sup>69</sup> Finally, the Court determined that the interest in having the national tax burden fairly and equitably distributed outweighs any benefit derived from adopting an accountant work product privilege.<sup>70</sup> The Court maintained that the policy choices involved in exempting audit workpapers from IRS administrative summonses are best left to Congress.<sup>71</sup>

Much commentary followed the Supreme Court's decision in *Arthur Young*. Many commentators criticized the Court's reasoning and asserted that the Court erred in failing to recognize an accountant work product privilege.<sup>72</sup> One commentator, however, although expressing concern over the Supreme Court's justification for denying the privilege, found the degree of public interest necessary to override the evidentiary needs of the IRS too high to support recognition of the privilege.<sup>73</sup>

Critics advanced several arguments to refute the Supreme Court's assertion that failure to recognize the privilege would not affect securities markets. First, they claimed that the Court improperly assumed that communications between corporate management and auditors would not diminish following denial of the privilege.<sup>74</sup> Second, they asserted that the

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68. *Arthur Young*, 465 U.S. at 819 n.15.

69. *Id.* at 820. The Court also noted that IRS administrative controls over the issuance of summonses assist in assuring fairness in the process. *Id.* at 820-21.

70. *Id.* at 815-16.

71. *Id.* at 820-21. In 1990, Senator William Armstrong (R-CO) sponsored an unsuccessful bill to amend Rule 501 to include a tax preparer privilege. S. 2452, 101st Cong. (1990). The amendment did not specifically mention or imply protection for audit workpapers because the confidentiality provision extended only to communications regarding the filing of a tax return. See 136 CONG. REC. S4275 (daily ed. April 5, 1990) (statement of Sen. Armstrong) (stating that "confidentiality would not apply to accounting matters unrelated to tax preparation"). Noting that the IRS has an unfair advantage in tax disputes, Senator Armstrong contended that the amendment would facilitate accountant-client communications. *Id.*

72. See Frank J. Magill, Jr., *The Accountant-Client Work Product Privilege: United States v. Arthur Young & Co.*, 38 TAXLAW. 457, 465 (1985) (asserting that Court failed to adequately address auditor concerns and merely adopted IRS's position); James A. Doering, Note, *Taxation—Creation of an Accountant Work-Product Privilege for Tax Accrual Workpapers. United States v. Arthur Young & Co.*, 104 S. Ct. 1495 (1984), 68 MARQ. L. REV. 155, 172 (1984) (concluding that Congress should enact statutory work product privilege in face of Court's failure to recognize such protection in *Arthur Young*); Kline, *supra* note 12, at 725 (same).

73. See Roloff, *supra* note 27, at 1138 (concluding that "government's right to enforce the tax laws is paramount" because it "must collect tax revenue to function").

74. See Magill, *supra* note 72, at 464-65 (suggesting that auditors began to notice unwillingness of clients to discuss questionable tax positions after IRS began summoning tax accrual workpapers); Doering, *supra* note 72, at 171 (noting that experience indicates that disclosure

Court came to the illusory conclusion that an auditor will always be able to determine when a client is not divulging necessary information, thereby enabling her to warn the public by issuing a qualified opinion or disclaimer of opinion.<sup>75</sup> Third, critics alleged that the Court incorrectly concluded that all public accountants are willing to use the threat of issuing less than an unqualified opinion to induce full disclosure by their clients.<sup>76</sup>

Additionally, critics attacked the Supreme Court's conclusion that recognition of an accountant work product privilege undermines the integrity of the audit process. Although most agreed that the role of an auditor is distinguishable from that of an attorney,<sup>77</sup> some asserted that comparing the professions merely sidesteps the more important question of whether audit workpaper protection best serves the public interest.<sup>78</sup> Others suggested that failing to recognize the privilege impairs public confidence in the audit process, causing the public to view accountants as adversarial to their clients rather than independent of them.<sup>79</sup>

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of workpapers to IRS has negative impact on auditor-client communications); Kline, *supra* note 12, at 709 (finding Court's analysis unpersuasive because it assumed quality of communication between auditor and client would not deteriorate with IRS access to workpapers).

75. See Kline, *supra* note 12, at 709 (asserting that Court improperly assumed auditors would notice diminishing communications). Determining that the client is not divulging all material information is difficult because the failure to divulge information manifests itself through a "general reluctance to volunteer information or to speak freely" rather than from an "outright withholding of information." *Id.* at 710. Also, an audit of tax liabilities does not involve a "complete independent source" of verification which can identify areas management is concealing. *Id.* at 710-11; see also Magill, *supra* note 72, at 464 (noting that auditor may be unable to detect when client is covering up questionable tax positions and asserting that clients may engage in such cover-ups hoping their positions will go undiscovered); Doering, *supra* note 72, at 171 ("[A]n auditor who does not know the information exists cannot know the information is missing; and as a result, the auditor will not be in a position to qualify the opinion."); Roloff, *supra* note 27, at 1136 ("The Court failed to consider the possibility that the accountant might not realize management was withholding information.").

76. See Roloff, *supra* note 27, at 1136 (suggesting that because public accountants are paid by their corporate clients, they are reluctant to issue less than qualified opinions).

77. See *id.* at 1133-34 (noting that privacy is essential for attorneys to ensure discovery of truth and protection of party's rights, but not for auditors to express opinions to public as to fairness of financial statements); Dodd, *supra* note 29, at 932 (noting that goal of audit is not to further client's interests but to further public interests and that role of accountant is more analogous to "role of a termite inspector in certifying that a structure is termite free" than to role of attorney).

78. See Magill, *supra* note 72, at 465 ("Just as an attorney-client privilege is necessary to achieve the goal of zealous representation under an adversary system, an accountant client-privilege may be necessary to reach the end of adequately protecting the investing public."); Roloff, *supra* note 27, at 1134 (asserting failure of comparison between role of attorney and role of accountant does not preclude recognition of privilege when compelling interest is present).

79. See Kline, *supra* note 12, at 714 ("If an auditor appears to be an adversary of the

Furthermore, critics argued that failure to recognize the accountant work product privilege is fundamentally unfair. First, they contended that permitting the IRS to review a taxpayer's tax strategies included in an auditor's tax accrual workpapers creates an improper balance in tax litigation because the taxpayer has no similar right to discover IRS litigation strategies.<sup>80</sup> Second, one critic suggested that failure to grant the privilege could cause taxpayers to perceive the system as unfair, jeopardizing the relatively high compliance rate necessary to preserve the self-assessed tax system.<sup>81</sup> Third, the same critic claimed that the Court failed to consider all interests involved when it concluded that fairness did not require recognition of the privilege.<sup>82</sup>

The commentary responding to the *Arthur Young* decision raised a number of compelling arguments in favor of recognizing a federal accountant-client privilege. Unfortunately, the prevailing legal climate at the time these arguments were advanced was not receptive to new federal privileges. *Jaffee*, however, indicates a new, more favorable climate in which these arguments could find more success.<sup>83</sup>

### III. The Traditional Framework for Evaluating Privileges

Although courts historically have shunned Professor Wigmore's approach to evaluating new privileges,<sup>84</sup> scholars have espoused his criteria.<sup>85</sup> Wigmore employed a careful analysis of the privilege issue, cautioning that granting new privileges is contrary to the public's right to "every man's evidence."<sup>86</sup> Courts traditionally have based their privilege decisions on the

company, the public may question the credibility of audit findings.").

80. *See id.* at 717-18 (stating that IRS knowledge of what client and auditor recognize as questionable tax positions creates imbalance in litigation); Roloff, *supra* note 27, at 1137 (noting that it is not practical for courts to permit taxpayer to discover IRS theories and strategies).

81. *See* Kline, *supra* note 12, at 719 (noting negative effects of taxpayers' lack of confidence in system).

82. *See id.* at 715 (asserting that Court only identified revenue collection as significant interest and failed to consider effect on public securities system, self-assessed taxing structure, and volume of tax litigation).

83. *See infra* Part IV (discussing the *Jaffee* framework for evaluating privileges).

84. *See* Jentz, *supra* note 12, at 159 (noting that courts have not recognized value of Wigmore approach).

85. *See, e.g.,* Denzil Causey & Frances McNair, *An Analysis of State Accountant-Client Privilege Statutes and Public Policy Implications for the Accountant-Client Relationship*, 27 AM. BUS. L.J. 535, 547 (1990) (citing 8 JOHN HENRY WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2285 (McNaughton rev. 1961)); Jentz, *supra* note 12, at 150 (same); Bynum, *supra* note 27, at 420 (same); Raymond C. Ruppert, Note, *Evidence: The Accountant-Client Privilege Under the New Federal Rules of Evidence – New Stature and New Problems*, 28 OKLA. L. REV. 637, 639 (1975) (same).

86. 8 WIGMORE, *supra* note 85, § 2192 (McNaughton rev. 1961); Jentz, *supra* note 12,

status of the communicators, rather than focusing, as Wigmore did, on the type of communication involved and the societal importance of the relationship between the parties.<sup>87</sup> To promote reasoned analysis, Wigmore advanced four criteria to determine when communications warrant a privilege:

(1) The communications must originate in a *confidence* that they 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 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.<sup>88</sup>

Wigmore's fourth criteria indicates the utilitarian nature of his approach.<sup>89</sup> Critics claim the framework is too malleable and that it justifies numerous new privileges.<sup>90</sup>

Anticipating consideration of the accountant-client privilege issue by the North Carolina General Assembly,<sup>91</sup> a 1968 study summarily rejected the privilege based on Wigmore's criteria.<sup>92</sup> As expected in any privilege debate,

at 150 (quoting 8 WIGMORE, *supra* note 85, § 2192); Ruppert, *supra* note 85, at 639 (same).

87. See Jentz, *supra* note 12, at 151 (noting that courts base privilege decisions on "communicators involved and their respective titles" and citing *Garipey v. United States*, 189 F.2d 459 (6th Cir. 1961) and *Olender v. United States*, 210 F.2d 795 (9th Cir. 1954), as examples).

88. 8 WIGMORE, *supra* note 85, § 2285. "Only if these four conditions are present should a privilege be recognized." *Id.*

89. See Causey & McNair, *supra* note 85, at 547 (commenting that Wigmore theory advances arguments for recognition of new privileges based on "the assumption that a testimonial privilege will perform a utilitarian function by promoting more effective performance of the professional duty").

90. See *id.* (stating that Wigmore's criteria can support "endless list of privileges, all of which impede the search for truth and justice"). Causey & McNair's analysis of the accountant-client privilege mentions a study of the psychotherapist-patient privilege in order to illustrate the pliability of the Wigmore criteria. See *id.* at 548 (citing Daniel W. Shuman & Myron S. Weiner, *The Privilege Study: An Empirical Examination of the Psychotherapist-Patient Privilege*, 60 N.C. L. REV. 893, 925 (1982)). The study determined that rejection of the privilege would not significantly deter patients from seeking help and that most patients were unaware of the privilege even though ten states had adopted a psychotherapist-patient privilege and forty-one states had adopted a psychologist-patient privilege. *Id.* Nonetheless, the Supreme Court extended a federal privilege to psychotherapists in *Jaffee*. See *infra* notes 98-129 and accompanying text (discussing *Jaffee*).

91. See *State v. Agnew*, 241 S.E.2d 684, 692 (N.C. 1978) (stating that North Carolina extends no accountant-client privilege).

92. See Bynum, *supra* note 27, at 422, 427 (noting that consideration of accountant-client privilege was trend in state legislatures and recommending that North Carolina reject privilege

the fourth condition was the battleground for the accountant-client privilege.<sup>93</sup> The study cited two primary reasons supporting its conclusion that recognition of the privilege would not result in an overall community benefit in audit performance.<sup>94</sup> First, the analysis contended that an auditor's ethical obligations adequately protect the public by requiring the auditor to issue a qualified opinion or disclaimer of opinion if corporate management knowingly or unknowingly withholds material evidence.<sup>95</sup> Second, the report suggested that granting a privilege is inconsistent with an auditor's obligation to maintain independence.<sup>96</sup> These arguments mirror those the Supreme Court advanced in *Arthur Young* and thus contain the same flaws noted by *Arthur Young*'s critics.<sup>97</sup>

#### IV *The Jaffee v Redmond Framework for Evaluating Federal Privileges*

One scholar who analyzed the accountant-client privilege recommended statutory enactment of the Wigmore criteria to facilitate a case-by-case approach to all privileges.<sup>98</sup> Although Congress has never acted upon this recommendation, the United States Court of Appeals for the Seventh Circuit in *Jaffee v. Redmond*<sup>99</sup> adopted a similar case-by-case approach to privileged

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because injury caused by permitting privilege is greater than benefit gained). Bynum admits that the first Wigmore criterion is satisfied because the privilege only protects confidential communications. *Id.* at 423. He also claims that the second criterion is met because the performance of accounting services by a public accountant requires the disclosure of "highly confidential financial details." *Id.* Furthermore, he concludes that the increased reliance of the public on public accountants is indicative of public opinion favoring the relationship, thus supporting Wigmore's third criteria. *Id.* Bynum is careful to note, however, that both the second and third criteria require evaluation in light of the fourth criterion, the point at which he asserts the accountant-client privilege fails the Wigmore test. *Id.* at 423-24.

93. See 8 WIGMORE, *supra* note 85, § 2286 (recognizing that fourth criterion is only one open to dispute in case of attorney-client privilege and that fourth criteria is often mistakenly determined to be satisfied in case of physician-patient privilege).

94. See Bynum, *supra* note 27, at 425-27 (citing reasons accountant-client privilege fails Wigmore's fourth condition).

95. See *id.* at 425 (stating that investors and creditors receive notice of entity's weakness through auditor's ethical obligation to issue qualified opinion or disclaimer of opinion if adequate information is unavailable).

96. See *id.* at 426 (noting that auditor ethical standards require independence).

97. See *supra* notes 67-68 and accompanying text (discussing similar *Arthur Young* arguments); *supra* notes 75, 79 and accompanying text (discussing possibility that auditors may not know when client is withholding relevant information and asserting that denial of privilege may create misperception that auditor is adverse to corporate management).

98. See Jentz, *supra* note 12, at 159-60 (advocating statutory adoption of case-by-case approach to privileges).

99. 51 F.3d 1346 (7th Cir. 1995).



communications between psychotherapists and their patients under Rule 501.<sup>100</sup> This approach was short-lived, however. Upon review, the Supreme Court concluded that the Seventh Circuit's fact-intensive methodology undermined the free flow of information between a psychotherapist and her patient by creating uncertainty as to the circumstances under which the privilege would be available.<sup>101</sup> The Court replaced the case-by-case approach with a broad and largely undefined psychotherapist-patient privilege that extends to communications with licensed social workers.<sup>102</sup>

The Court began its analysis of the psychotherapist privilege by recognizing that Rule 501 permits the Court to extend new privileges, but only when such extension is appropriate in light of the general principle that every citizen has a duty to provide relevant testimony.<sup>103</sup> The Court then examined the privilege using four primary areas of analysis.<sup>104</sup> First, the Court evaluated the *private interests* involved and determined that successful psychiatric

100. *Jaffee v. Redmond*, 51 F.3d 1346, 1357 (7th Cir. 1995), *aff'd*, 116 S. Ct. 1923 (1996). The appellate court favored balancing competing interests in each case to determine whether to apply the psychotherapist privilege. *Id.*, see also *Jaffee v. Redmond*, 116 S. Ct. 1923, 1926-27 (1996) (summarizing Seventh Circuit's rationale). In *Jaffee*, the Court addressed whether the federal system should adopt a psychotherapist-patient privilege and, in particular, whether to extend it to licensed social workers. *Id.* at 1925. *Jaffee*, administrator of the estate of a man who was shot by police officer Redmond, brought suit seeking wrongful death damages based on the excessive use of force in Redmond's encounter with the deceased. *Id.* at 1926. Redmond argued that a psychotherapist privilege protected the conversations she had with a licensed social worker following the incident. *Id.* The trial court rejected this argument and, upon the social worker's failure to provide full disclosure, instructed the jury that it could conclude that the contents of the conversations between Redmond and the social worker were inculpatory. *Id.* In its analysis of whether Rule 501 permits privileged communications in the field of psychotherapy, the Supreme Court considered private interests, public interests, the adverse effect on the evidentiary needs of the legal system, and the states' resolution of the issue. *Id.* at 1927-31. Ultimately, the Court affirmed the Seventh Circuit's reversal of the district judge's ruling and adopted a broad federal psychotherapist privilege extending to licensed social workers. *Id.* at 1931-32.

101. *Jaffee*, 116 S. Ct. at 1932.

102. *Id.* The Court noted that because it was recognizing the privilege for the first time, "it [was] neither necessary nor feasible to delineate its full contours in a way that would 'govern all conceivable future questions in this area.'" *Id.* (citations omitted).

103. See *id.* at 1927-28 (noting that Rule 501 gives federal courts power to recognize new privileges based on "common law principles in the light of reason and experience" and implying that due consideration should be given to new privileges as they are warranted (citations omitted)). The Court recognized that "the common law is not immutable but flexible, and by its own principles adapts itself to varying conditions." *Id.* at 1927 (quoting *Funk v. United States*, 290 U.S. 371, 383 (1933)). The Court also noted that it has a continuing obligation to determine the viability of new testimonial privileges. *Id.* at 1928 (citing *Trammel v. United States*, 445 U.S. 40, 47 (1980)).

104. See *id.* at 1928-32 (analyzing psychotherapist issue based on private interests, public interests, effect on evidentiary needs of federal court system, and states' approach to issue).

treatment of individuals is a significant interest, with confidence and trust between the psychotherapist and her patient being necessary to achieve this end.<sup>105</sup> Second, the Court recognized that extension of a privilege must serve *public interests*.<sup>106</sup> The majority asserted that the psychotherapist privilege serves such interests by advancing the overall mental health of the nation.<sup>107</sup> Third, the opinion established that the evidentiary *benefits derived from denial of the privilege* are modest because denial of the privilege would chill confidential communications, especially when it was obvious that litigation would follow the need for treatment.<sup>108</sup> Fourth, the Court cited *state statutory privileges* granting some form of psychotherapist privilege in all fifty states to support the "reason and experience" condition of Rule 501.<sup>109</sup> Ultimately, the majority granted the privilege because the states confirmed the Court's finding that the benefits of the privilege exceed the costs.<sup>110</sup>

The majority's decision to grant a federal psychotherapist testimonial privilege extending to licensed social workers drew a scathing dissent from Justice Scalia.<sup>111</sup> Asserting that the price of granting the privilege is "occasional injustice," Justice Scalia attacked the opinion of the Court on several fronts.<sup>112</sup> First, he found insufficient evidence that the mental health of the nation represents a more compelling interest than the search for truth.<sup>113</sup>

105. *Id.* at 1928. The Court compared the psychotherapist privilege to the attorney-client and spousal privileges. *Id.* It concluded that "[e]ffective psychotherapy, . . . depends upon an atmosphere of confidence and trust in which the patient is willing to make a frank and complete disclosure of facts, emotions, memories, and fears" and that "the mere possibility of disclosure may impede development of the confidential relationship necessary for successful treatment." *Id.*

106. *Id.* at 1929 (quoting *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981)). The Court once again looked at the attorney-client and spousal privileges for comparative purposes, asserting that complete and honest communications between attorneys and their clients and between spouses further the public interest in "observance of law and administration of justice" and "marital harmony," respectively. *Id.* (citations omitted).

107. *Id.*

108. *Id.*

109. *Id.* at 1929-30. The Court feared that a failure to adopt a federal psychotherapist privilege would undermine the purposes of the state privileges. *Id.* at 1929. For citations of the state statutory psychotherapist privileges, see *id.* at 1929 n.11.

110. *Id.* at 1931.

111. See *id.* at 1932-41 (Scalia, J., dissenting) (arguing that majority's analysis of psychotherapist privilege was inadequate to support extension to licensed social workers).

112. *Id.* at 1932 (Scalia, J., dissenting).

113. *Id.* at 1934 (Scalia, J., dissenting). Scalia stated that he was uncertain when psychotherapy became so critical to the mental health of the nation. *Id.* (Scalia, J., dissenting) He claimed that the Court failed to support sufficiently its assertion that failure to grant the privilege would deter individuals from seeking the help they need, noting that the increase in the prominence of psychotherapy has occurred despite the fact that no privilege was available.

Second, he noted serious flaws in the Court's reliance on the experience of the fifty states.<sup>114</sup> Justice Scalia criticized the Court's reverse preemption argument that failure to recognize the psychotherapist privilege would impede important state policies<sup>115</sup> and explained that the state privileges vary greatly across the nation.<sup>116</sup> He also suggested that, because all of the state privileges are statutory, the psychotherapist privilege is better suited for legislative rather than judicial disposition.<sup>117</sup> Third, Justice Scalia criticized the Court's casual extension of the psychotherapist privilege to licensed social workers.<sup>118</sup> Such an extension, he claimed, flies in the face of the attorney-client privilege, which derives from professional status rather than the type of advice being given.<sup>119</sup>

The majority opinion and the dissenting opinion in *Jaffee*, when viewed together, indicate an atmosphere open to recognition of new privileges. The Court's willingness to grant a psychotherapist-patient privilege,<sup>120</sup> despite the fact that the common law did not do so,<sup>121</sup> represents an expansive reading of Rule 501 that does not limit recognition of privileges to those granted at common law but that focuses on the "*principles* of the common law in

*Id.* at 1934-35 (Scalia, J., dissenting).

114. *Id.* at 1935-36 (Scalia, J., dissenting).

115. *Id.* at 1935 (Scalia, J., dissenting). Scalia asserted that adjustment of evidentiary rules in the federal system to avoid a conflict with state policies violates stare decisis because the Court previously declined to recognize a privilege for state legislators in federal criminal proceedings despite the fact that such protection was available in similar state proceedings. *Id.* (Scalia, J., dissenting) (citing *Gillock v. United States*, 445 U.S. 360, 368 (1980)).

116. *Id.* (Scalia, J., dissenting).

117. *Id.* at 1935-36 (Scalia, J., dissenting).

118. *Id.* at 1933 (Scalia, J., dissenting). The dissent noted that five state legislatures have not extended the psychotherapist privilege to licensed social workers. *Id.* at 1936 (Scalia, J., dissenting). Also, Scalia stated that a majority of the states that do permit a privilege for licensed social workers do not do so through their psychotherapist privilege legislation, suggesting that the majority's extension to such workers from its general discussion of psychotherapists is inappropriate. *Id.* at 1938-39 (Scalia, J., dissenting). He compares this special legislation for licensed social workers to that gained by accountants. *Id.* at 1939 (Scalia, J., dissenting). Additionally, according to Scalia, five states recognize a privilege that provides virtually no protection at all due to gaping exceptions and the remainder of the state statutes vary widely in degree of protection and exceptions. *Id.* at 1939-40 (Scalia, J., dissenting).

119. *See id.* at 1933 (Scalia, J., dissenting) (asserting that numerous illogical extensions of attorney-client privilege result if privilege is framed as "legal advisor" privilege). Scalia suggests that the degree of skill required to be a licensed social worker in Illinois does not approach the level necessary to become a lawyer or a psychiatrist. *Id.* at 1937-38 (Scalia, J., dissenting).

120. *See supra* notes 103-10 and accompanying text (discussing *Jaffee* Court's approach to Rule 501).

121. *See* MCCORMICK ON EVIDENCE § 98 (Edward W. Cleary et al. eds., 3d ed. 1984) (stating that common law recognized no physician-patient privilege and asserting psychiatrist and psychologist privileges derive from physician-patient privilege).

light of reason and experience."<sup>122</sup> The majority established a general framework for analysis and gave some insight into the circumstances that warrant recognition of privileges.<sup>123</sup> The dissent further defined the degree of "reason and experience" necessary to justify a federal privilege by highlighting the level of variance among state enactments that the majority was willing to accept.<sup>124</sup> The Court's analysis is also significant because it effectively applies Wigmore's utilitarian framework and weighs the benefits of granting a privilege against the accompanying evidentiary loss.<sup>125</sup> Once again, Justice Scalia's dissent is helpful because it suggests that the factual basis supporting the Court's utilitarian analysis need not be incontrovertible.<sup>126</sup>

The *Jaffee* Court's broad reading of Rule 501 opens the door to other privileges, such as the accountant-client privilege, that courts summarily dismissed in the past due to common law constraints.<sup>127</sup> The majority's recognition that Rule 501 requires consideration of evolving circumstances suggests that the federal system periodically should re-evaluate previously rejected privileges.<sup>128</sup> Thus, although the *Arthur Young* Court applied a balancing approach to deny an accountant work product privilege,<sup>129</sup> the period of more than ten years since that decision justifies re-examination of the accountant-client privilege.

## V *The Accountant-Client Privilege in Light of Jaffee v. Redmond*

### A. *Private Interests*

The *Jaffee* Court recognized that effective psychotherapy requires an atmosphere of confidence.<sup>130</sup> In so doing, the Court implicitly invoked the

122. FED. R. EVID. 501 (emphasis added).

123. See *supra* notes 101-10 and accompanying text (examining majority opinion in *Jaffee*).

124. See *supra* notes 111-19 and accompanying text (examining Scalia dissent in *Jaffee*).

125. See *supra* notes 105-08 and accompanying text (discussing balancing approach *Jaffee* Court applied by analyzing public and private interests involved and benefits derived from denial of privilege); *supra* note 88 and accompanying text (stating Wigmore criteria).

126. See *supra* note 113 and accompanying text (pointing out flaw in majority's balancing of costs and benefits of granting or denying psychotherapist privilege).

127. See *Casey & McNair, supra* note 85, at 535 (stating "there was no accountant-client privilege at common law" (citing 8 WIGMORE, *supra* note 85, §§ 2290, 2332)); see also *United States v. Arthur Young & Co.*, 465 U.S. 805, 817 (1984) (supporting proposition that no accountant-client privilege exists under federal common law); *Couch v. United States*, 409 U.S. 322, 335 (1973) (same).

128. See *Jaffee v. Redmond*, 116 S. Ct. 1923, 1927-28 (1996) (indicating that Rule 501 directs federal courts to "continue the evolutionary development of testimonial privileges" (citations omitted)).

129. See *supra* note 70 and accompanying text (discussing conclusion in *Arthur Young* that balance of interests involved in accountant-client privilege weighed against privilege).

130. *Jaffee*, 116 S. Ct. at 1928.

first three Wigmore factors.<sup>131</sup> First, the Court limited its privilege consideration to confidential communications between a psychotherapist and her patient.<sup>132</sup> Second, it asserted that confidentiality is essential for the parties to have an effective relationship.<sup>133</sup> Third, the Court relied on the adoption of psychotherapist privileges by all fifty state legislatures as an indicator of positive public sentiment toward the psychotherapist-patient relationship.<sup>134</sup>

Similarly, one commentator concluded that the accountant-client privilege successfully fulfills the first three Wigmore criteria.<sup>135</sup> Presumably then, the accountant-client privilege should succeed under the *Jaffee* private interest test. Nevertheless, a detailed look at the accountant-client privilege in terms of *Jaffee* defies this presumption.

Like the psychotherapist privilege, the accountant-client privilege meets the first two Wigmore conditions as applied in *Jaffee*. The *Couch* Court recognized that information given to an accountant with an expectation of disclosure deserves no protection.<sup>136</sup> Thus, only confidential communications warrant privilege protection.<sup>137</sup> Moreover, the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct Rule 301 (Rule 301) supports the necessity of confidential communications in the accountant-client relationship by providing ethical protection for client confidences.<sup>138</sup>

131. Cf. *supra* note 88 and accompanying text (listing four Wigmore factors).

132. See *Jaffee*, 116 S. Ct. at 1929 (stating that Court was considering protection of confidential communications between psychotherapists and patients).

133. See *id.* at 1928 (claiming that it would be "difficult if not impossible for [a psychiatrist] to function without being able to assure confidentiality and, indeed, privileged communication," and that "confidentiality is a *sine qua non* for successful psychiatric treatment" (citations omitted)).

134. See *id.* at 1929-30 (discussing experience of states in adopting psychotherapist privilege).

135. See Bynum, *supra* note 27, at 423 (analyzing accountant-client privilege by using four Wigmore criteria and concluding first three criteria are met).

136. See *Couch v. United States*, 409 U.S. 322, 335 (1973) (stating that privacy is not expected when information is turned over to accountant for inclusion in tax return).

137. See Bynum, *supra* note 27, at 423 (stating that accountant-client privilege protects only confidential communications).

138. See ROBERTSON, *supra* note 67, at 140-41 (reproducing Rule 301 and noting need for confidential communications in accountant-client relationship). Rule 301 states:

A member in public practice shall not disclose any confidential client information without the specific consent of the client.

This rule shall not be construed (1) to relieve a member of his or her professional obligations under Rules 202 and 203, (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or

As in the psychotherapist-patient relationship, an accountant must be privy to sensitive client information in order to perform the audit function effectively.<sup>139</sup> To maintain access to such information, auditors must seriously consider their duty of confidentiality to their clients.<sup>140</sup> The exception to the AICPA confidentiality rule for validly issued subpoenas or summonses does not demean the importance of confidentiality in the audit context.<sup>141</sup> Rather, the provision is practical in that it avoids potential conflicts between accountants' ethical and legal duties.<sup>142</sup>

The *Jaffee* Court's private interest evaluation noted the similarity between the attorney-client relationship and the psychotherapist-patient relationship.<sup>143</sup> Likewise, accounting services and legal services are markedly similar to each other, especially when the services address taxation issues.<sup>144</sup> Thus, granting protection to communications made to an attorney and not granting protection to the same communications made to an accountant is inconsistent.<sup>145</sup> In *El Paso*, the Fifth Circuit admitted that it is difficult to dis-

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state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with or responding to any inquiry made by, the professional ethics division or trial board or the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.

2 AICPA PROFESSIONAL STANDARDS, ET § 301.01 (American Inst. of Certified Pub. Accountants 1993) [hereinafter PROFESSIONAL STANDARDS].

139. See ROBERTSON, *supra* note 67, at 142 (stating that accounting services require access to "information about salaries, products, contracts, merger and divestment plans, [and] tax matters"); *cf.* *Jaffee v. Redmond*, 116 S. Ct. 1923, 1929 (1996) (noting that effective psychotherapy requires complete disclosure from patient).

140. See ROBERTSON, *supra* note 67, at 142 (asserting that one should not break confidentiality rule without good reason because free flow of information is so important to accounting function).

141. See 2 PROFESSIONAL STANDARDS, *supra* note 138, ET § 301.01 (providing exceptions to confidentiality requirement).

142. CALIFORNIA SOCIETY OF CPA'S EDUCATION DIVISION, PROFESSIONAL ETHICS FOR CERTIFIED PUBLIC ACCOUNTANTS 128 (1993) (noting that decision to disclose information in face of subpoena or summons involves difficult ethical considerations and that accountants should comply with validly issued subpoena or summons only after consulting with legal counsel).

143. See *Jaffee v. Redmond*, 116 S. Ct. 1923, 1928 (suggesting that both relationships require "confidence and trust" (citation omitted)).

144. See *Jentz*, *supra* note 12, at 151-52 (stating that granting privilege in circumstances when accounting and legal services overlap is "reasonable and logical"); Ruppert, *supra* note 85, at 646 (recognizing accountants and attorneys perform similar services for their clients).

145. See *Jentz*, *supra* note 12, at 159 (stating that granting privilege to attorney and not to accountant when same facts surround communications is illogical); Ruppert, *supra* note 85, at 648 (asserting that "[t]here is no reason why a communication to one professional should be privileged while the same communication to a different professional is not privileged").

tinguish accounting work and legal work in giving tax advice.<sup>146</sup> This is not to say that communications related to tax return preparation deserve protection. To the contrary, courts consistently have recognized that preparation of tax returns is not within the scope of legal advice, and thus no attorney-client privilege exists even when an attorney prepares a return.<sup>147</sup>

However, one cannot dismiss the accountant-client privilege simply because the attorney-client privilege does not extend to tax preparation services.<sup>148</sup> Attorneys enjoy a privilege for work product prepared in anticipation of tax litigation.<sup>149</sup> Nevertheless, although the *El Paso* court conceded that imminent litigation is not necessary for work product protection, it concluded that inside counsel's preparation of documents substantiating a company's tax accrual amount remained unprotected because counsel did not prepare them to aid in future litigation.<sup>150</sup> Because an auditor's examination of a company's tax accrual involves the same type of legal analysis that inside counsel performed in *El Paso*, the Fifth Circuit decision appears to weigh against the accountant-client privilege.<sup>151</sup> In fact, *El Paso* did not even address the propriety of the accountant-client privilege, but merely adhered to a long held standard that no privilege is available when an attorney performs an accounting function.<sup>152</sup> Although the court clearly distinguished each profession's motivation for engaging in certain tax analyses, *El Paso* indirectly supports recognition of the accountant-client privilege by highlight-

146. *United States v. El Paso Co.*, 682 F.2d 530, 539 (5th Cir. 1982); see *supra* note 55 and accompanying text (discussing *El Paso*).

147. *El Paso*, 682 F.2d at 539; see also *United States v. Davis*, 636 F.2d 1028, 1043 (5th Cir. 1981) (asserting that attorney-client privilege does not apply to attorney tax preparation services); *Canaday v. United States*, 354 F.2d 849, 857 (8th Cir. 1966) (same); *Olender v. United States*, 210 F.2d 795, 805-06 (9th Cir. 1954) (same); *Bynum*, *supra* note 27, at 424-25 (discussing undesirability of accountant-client privilege for tax preparation services).

148. See *Ruppert*, *supra* note 85, at 646-47 (asserting that courts should not deny protection merely because client consulted tax accountant rather than tax attorney).

149. *El Paso*, 682 F.2d at 542 (noting that "work product doctrine focuses only on materials assembled and brought into being in anticipation of litigation").

150. *Id.* at 542-43 (citing *United States v. Davis*, 636 F.2d 1028, 1040 (5th Cir. 1981)).

151. Compare *id.* at 543 (noting tax accrual analysis involves "weighing legal arguments, predicting the stance of the IRS, and forecasting the ultimate likelihood of sustaining [the company's] position in court") with *Kline*, *supra* note 12, at 697-98 (stating that audit procedures for evaluating corporation's tax accrual involve evaluating legal uncertainties).

152. See *United States v. El Paso Co.*, 682 F.2d 530, 534 (5th Cir. 1982) (stating that accountants, not attorneys, generally prepare tax pool analyses); *Jentz*, *supra* note 12, at 157 (stating that courts have denied attorney-client privilege when attorney was performing accounting function); *Ruppert*, *supra* note 85, at 647 (same); see also *Kenneth Winter & Robert Carney, Dealing Without an Accountant-Client Privilege*, 53 TAX'NFOR ACCT. 356, 362 (1994) (implying that attorney can protect communication with client merely by characterizing it as legal advice rather than tax advice).

ing the similarity in the content of those analyses.<sup>153</sup>

Like *El Paso*, the *Arthur Young* Court denied protection of the work product doctrine to tax accrual workpapers, citing the distinction between an attorney as an advisor and advocate and an accountant as a "public watchdog."<sup>154</sup> Although public accountants performing audits must be impartial, they nonetheless perform advisory functions.<sup>155</sup> Likewise, an attorney's role as an advisor to her client involves a level of impartiality.<sup>156</sup> In fact, one commentator asserts that recently expanded attorney liability under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 transforms bank attorneys into administrative "watchdogs."<sup>157</sup> Arguably then, as both professions have evolved, their roles have become more congruent.

Recognition of an accountant-client privilege would yield several incidental benefits devolving from the similarity between the accounting and legal professions. First, the privilege would benefit the courts by eliminating the need for judicial determinations as to whether an attorney is sufficiently involved in an accountant-client relationship to warrant protection of communications or whether an attorney is performing an accounting function that deserves no protection.<sup>158</sup> Second, attorneys would profit by no longer having

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153. See *El Paso*, 682 F.2d at 543 (noting that tax pool analysis involves legal analysis).

154. *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984).

155. See 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 220.02 (stating that auditor independence requires "judicial impartiality"); *id.* AU § 380 (describing auditor's communications with client's audit committee). An auditor must inform the audit committee about proposed corrections to the financial statements identified during the course of the audit. *Id.* AU § 380.09. Thus, an auditor must advise the audit committee of appropriate accounting methods regardless of whether management accepts the advice. Auditors must also notify the audit committee of any disagreements with management whether or not the parties resolved the disagreements satisfactorily. *Id.* AU § 380.11.

156. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-5 (1986) [hereinafter MODEL CODE] (asserting that attorney should give professional opinion as to ultimate viability of claim when advising client, but may continue representation when client wishes to act to contrary as long as activity is legal); MODEL RULES OF PROFESSIONAL CONDUCT Rule 2.1 (1996) [hereinafter MODEL RULES] (stating that "lawyer shall exercise independent professional judgment and render candid advice"); *id.* at Rule 3.1 (indicating that lawyer is not unbounded advocate of her client but must find appropriate basis for client's action).

157. Robert G. Day, Note, *Administrative Watchdogs or Zealous Advocates? Implications for Legal Ethics in the Face of Expanded Attorney Liability*, 45 STAN. L. REV. 645, 650-51 (1993) (claiming that policy of chief legal counsel for Office of Thrift Supervision transforms lawyers "from partisan client representatives or advocates to regulatory agency 'watchdogs'").

158. See Ruppert, *supra* note 85, at 648 (arguing that permitting accountant-client privilege eliminates need for determining whether work is done for attorney by accountant or by attorney performing accounting function).



to concern themselves with the issue of whether the services they provide constitute unprotected accounting functions.<sup>159</sup> Third, clients would benefit by receiving better quality legal services when such services border on accounting services because they can freely disclose information without the fear that a court will deny protection to the communications.<sup>160</sup> Finally, accountants would gain an advantage by no longer having to consider whether they should refer their clients to attorneys for adequate evidentiary protection.<sup>161</sup>

Even though the accountant-client relationship resembles the attorney-client relationship and satisfies Wigmore's first two criteria, the accountant-client privilege falters under *Jaffee's* method for measuring Wigmore's third criterion – public support of the relationship.<sup>162</sup> The SEC, by requiring that public companies have an audit performed annually, has recognized that public accountants perform an important societal function.<sup>163</sup> Moreover, increased use of public accounting services evidences a positive public view of the relationship's importance.<sup>164</sup> Such evidence, however, is insufficient to sustain the privilege under *Jaffee's* gauge of public opinion – the laws of the fifty states.<sup>165</sup> To date, only twenty-seven United States jurisdictions recognize an accountant-client privilege,<sup>166</sup> a number far short of the unanimity of states adopting a psychotherapist-patient privilege.<sup>167</sup> Granted, the number of states adopting the accountant-client privilege is not insignificant, and the lack of uniformity among the psychotherapist privilege statutes indicates that the Court does not require a national consensus to

159. See *id.* (noting that attorneys benefit from accountant-client privilege).

160. See *id.* (noting benefit to clients by recognizing accountant-client privilege).

161. See *Winter & Carney, supra* note 152, at 362 (noting that lack of accountant-client privileges causes difficulties in accountant's referral decisions).

162. See *supra* note 88 and accompanying text (stating Wigmore criteria); *supra* note 109 and accompanying text (discussing *Jaffee's* consideration of state privilege enactments).

163. See Regulation S-X, 17 C.F.R. § 210.3-01 to -02 (1997) (requiring annual audit for public corporations).

164. See *Jentz, supra* note 12, at 157 (indicating that accountants now offer broad scope of services); *Bynum, supra* note 27, at 423 (noting increase in reliance on public accounting services); *Dodd, supra* note 29, at 914 (noting that public accountants perform audits for variety of reasons including compliance with SEC or other legal requirements, extension of credit, and mere peace of mind that client's internal controls operate properly); *Ruppert, supra* note 85, at 647 (stating that "role and importance of the accountant has grown as our society's financial record-keeping has become more highly complicated and technical").

165. See *infra* notes 243-70 and accompanying text (discussing treatment of privilege by states).

166. See *infra* note 253 (listing state accountant-client statutory provisions).

167. See *Jaffee v. Redmond*, 116 S. Ct. 1923, 1929 (1996) (stating that all 50 states have adopted psychotherapist privilege in some form).

support recognition of a privilege.<sup>168</sup> Even so, too few states have enacted meaningful accountant-client privileges, suggesting that the privilege fails under *Jaffee*.<sup>169</sup>

### B. Public Interests

The *Jaffee* Court employs Wigmore's fourth criteria by measuring public interests that a privilege serves against the detrimental effect of the privilege on the court system's evidentiary needs.<sup>170</sup> Rather than making a detailed inquiry into the public interests involved, the *Jaffee* opinion merely concludes that the psychotherapist privilege facilitates appropriate treatment of those with mental or emotional conditions, thereby enhancing the mental health of the nation.<sup>171</sup> Intuitively, the accountant-client privilege serves a similar function by encouraging the free flow of information and thus enhancing the financial health of the nation by promoting accurate disclosure.<sup>172</sup> Additionally, adoption of the accountant-client privilege purportedly promotes fairness in the tax system.<sup>173</sup> Although these two lines of public interest arguments were unsuccessful in the past, *Jaffee* calls for a re-evaluation of them "in light of reason and experience."<sup>174</sup>

#### 1. Improved Financial Disclosures

Perhaps the most compelling argument in favor of the accountant-client privilege is that it will encourage full disclosure and allow public accountants to better serve both their clients and the public.<sup>175</sup> The thrust of this argument

168. See *id.* at 1936 (Scalia, J., dissenting) (noting majority's concession that states have not enacted uniform psychotherapist privileges).

169. See *infra* notes 243-70 and accompanying text (discussing state accountant privileges and concluding that they insufficiently support *Jaffee*'s requirements).

170. See *Jaffee*, 116 S. Ct. at 1929 (evaluating public interests and evidentiary benefit resulting from denial of privilege); *supra* note 88 and accompanying text (listing Wigmore criteria); *infra* notes 233-42 and accompanying text (discussing evidentiary benefit from denying accountant-client privilege).

171. *Jaffee*, 116 S. Ct. at 1929. The Court emphasized that the circumstances of the case present a particular public interest in having police officers who can seek effective treatment when necessary. *Id.* at 1929 n.10.

172. See ROBERTSON, *supra* note 67, at 5 (asserting that audit function makes entity's financial statements reliable, "help[ing] make capital markets efficient and help[ing] people know the consequences of a wide variety of economic decisions").

173. See Kline, *supra* note 12, at 714 (suggesting that failure to recognize accountant-client privilege interferes with fairness of tax system).

174. See *Jaffee v. Redmond*, 116 S. Ct. 1923, 1927 (1996) (citing Rule 501).

175. See Jentz, *supra* note 12, at 157 (asserting that privilege will promote full disclosure to benefit both clients and public); Ruppert, *supra* note 85, at 647 (same). But see Bynum,

is that protection of accountant-client communications promotes an atmosphere of confidence and trust which motivates clients to reveal more information to their accountants.<sup>176</sup> Accountants are then able to evaluate the information to determine if it requires disclosure.<sup>177</sup> A survey conducted on a random sample of six hundred corporate officers confirms the validity of this argument.<sup>178</sup> The study overwhelmingly indicated that absence of the privilege inhibits accountant-client communications and that recognition of the privilege would improve accountant-client relationships.<sup>179</sup>

To understand the public disclosure argument, an understanding of the audit process itself is necessary.<sup>180</sup> Quality audit services require the free flow of information between a public accountant and her client.<sup>181</sup> Auditing involves impartially obtaining and evaluating evidence to determine if the amounts and representations included in a client's financial statements accurately reflect the economic realities underlying them.<sup>182</sup> An auditor does not evaluate all of the evidence supporting financial statement amounts, but rather, based on the auditor's judgment, examines enough evidence to provide a reasonable basis for her opinion.<sup>183</sup> Auditors obtain evidence underlying

*supra* note 27, at 424-25 (acknowledging argument that privilege results in increased disclosure, but concluding that nature of audit services warrants no privilege).

176. See ROBERTSON, *supra* note 67, at 142 (stating that managers are unlikely to reveal sensitive information if they cannot rely on auditors to keep information confidential); Kline, *supra* note 12, at 711-12 (asserting that privilege "foster[s] an environment conducive to full and free communication").

177. See Kline, *supra* note 12, at 709 (noting that auditor's evaluation of information impacts disclosure).

178. See generally G. Stevenson Smith, *Do Executives Believe They Have a Right to Privileged Communications with Their CPAs?*, 19 MID-ATLANTIC J. BUS. 15 (1981) (discussing survey of 600 corporate officers regarding their views of accountant-client privilege).

179. See *id.* at 19-21 (indicating that over 60% of corporate officers surveyed believe that "potential courtroom disclosures inhibit CPA-client communications" and that approximately 75% believe that privilege "would help a CPA's relations with his client").

180. See A.A. Sommer, Jr., *United States v. Arthur Young & Co.. The Implications for Auditors*, in 16TH ANNUAL INSTITUTE ON SECURITIES REGULATION 111, 113-15 (PLI Corp. L. & Practice Course Handbook Series No. B4-6694, 1984) (discussing basics of audit process prior to analyzing *Arthur Young*); Doering, *supra* note 72, at 159-61 (same); Kline, *supra* note 12, at 695-97 (same).

181. See ROBERTSON, *supra* note 67, at 142 (recognizing that free flow of information is important for auditor to provide quality service).

182. See *id.* at 8-9 (providing American Accounting Association definition of auditing); Dodd, *supra* note 29, at 914 (stating that audit involves use of evidence to verify information on financial statements); Kline, *supra* note 12, at 695 (noting that audit involves testing financial statements).

183. See 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 508.08 (requiring that audit report include statement that audit includes examination of evidence supporting financial

many of these financial statement assertions through communications with management.<sup>184</sup> An audit also includes assessing the accounting principles used and significant estimates made by management, as well as an evaluation of the financial statements as a whole.<sup>185</sup> The end result of an audit is the audit report. The report states that the accountant conducted the audit in accordance with generally accepted auditing standards (GAAS) and gives the public accountant's opinion as to whether the financial statements fairly represent the entity's financial position in accordance with generally accepted accounting principles (GAAP).<sup>186</sup> Logically, if a client feels free to communicate with her auditor, the auditor will have more information to use to form an appropriate opinion on the financial statements.<sup>187</sup>

Although corporate clients pay their auditors, the primary objective of an audit is to inform creditors and the investing public about the financial well-being of an entity.<sup>188</sup> Public companies engage auditors in order to comply with SEC requirements.<sup>189</sup> Alternatively, nonpublic companies obtain audit services to facilitate raising capital.<sup>190</sup> To foster the reliability of auditors'

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statements "on a test basis" and statement that audit provides "reasonable basis for [the] opinion); ROBERTSON, *supra* note 67, at 48 (noting that audit report states that audit provides reasonable basis for opinion)

184. See 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 329.21 (stating that when evaluating deviations from expected financial statement relationship in performance of analytical procedures, auditor should inquire of management as to differences but should ordinarily corroborate response with other evidence); *id.* AU §§ 333.01, 333.03 (stating that auditor must obtain written representations from management and that "[i]n some cases," such as when client intends to discontinue line of business, "the corroborating information by the application of auditing procedures other than inquiry is limited"); *id.* AU § 334.07 (suggesting management inquiry as audit procedure for related party test work); *id.* AU § 431.04 (asserting that, when evaluating adequacy of disclosures, auditor receives confidential information without which auditor would have difficulty making her assessment); *id.* AU § 435.07 (stating that auditor should inquire of management as to methods of determining segment disclosures).

185. *Id.* AU § 508.08.

186. *Id.* AU §§ 410.01, 508.08. Four types of audit opinions may be issued: unqualified, qualified, adverse, and disclaimer. See generally ROBERTSON, *supra* note 67, at 68-95 (discussing reports on audited financial statements). "GAAS represent the minimum professional standards for conducting an audit." Kline, *supra* note 12, at 696 n.10 (citing 1 PROFESSIONAL STANDARDS AU § 150.02).

187. See *supra* notes 175-79 and accompanying text (arguing that open communications between accountant and client improve disclosures).

188. See ROBERTSON, *supra* note 67, at 5 (noting that client pays fee, auditee is entity being audited, auditee and client are generally same entity, and audits serve capital markets).

189. See Sommer, *supra* note 180, at 113 (noting that SEC regulations require filing audited financial statements); Dodd, *supra* note 29, at 914 (recognizing that clients engage auditors to comply with SEC); Kline, *supra* note 12, at 695 (asserting that various SEC regulations require audits).

190. See Dodd, *supra* note 29, at 914 (recognizing that clients engage auditors for credit

opinions, the AICPA Professional Standards (Standards) require auditors to be independent of their clients both in fact and in appearance.<sup>191</sup> Even so, the Standards warn auditors not to assume a prosecutorial role.<sup>192</sup> When performing an audit of a publicly held client, a public accountant must meet a more stringent independence requirement, but the regulations do not suggest that accountants should take an adversarial position relative to their clients.<sup>193</sup>

Because federal courts consistently have rejected the argument that recognition of an accountant-client privilege aids in communications and thereby promotes more accurate disclosures, a thorough analysis must address the disclosure argument's purported flaws.<sup>194</sup> Opponents of the privilege argue that it is unnecessary for effective disclosure because an accountant's ethical standards require her to issue a qualified opinion or disclaimer of opinion when management limits the scope of an audit.<sup>195</sup> These opinions, they argue, inform the public that the company is not disclosing all of the information that it should disclose.<sup>196</sup> Furthermore, opponents assert that the threat of issuing less than an unqualified opinion is enough to induce management disclosure.<sup>197</sup>

purposes); Kline, *supra* note 12, at 695 (noting that private lenders and investors often require audited financial statements prior to granting credit or investing).

191. 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 220.03; see Kline, *supra* note 12, at 697 (asserting that auditor must be "disinterested professional").

192. 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 220.02; see Kline, *supra* note 12, at 697 (stating that "independence does not connote an adversarial relationship between an auditor and the company").

193. See Regulation S-X, 17 C.F.R. 210.2-01(b) (1997) (stating SEC independence requirements); RONALD J. MURRAY ET AL., THE COOPERS & LYBRAND SEC MANUAL § 17033 (6th ed. 1993) (stating that SEC has higher independence requirements which prohibit auditor from performing record keeping services for client, extend to certain litigation matters, and provide "additional limitations on business relationships").

194. See *supra* notes 54-59, 67-68 and accompanying text (discussing federal court rejection of public disclosure argument).

195. See *United States v. Arthur Young & Co.*, 465 U.S. 805, 818 (1984) (asserting that accountants cannot ethically issue unqualified opinions if management materially limits scope of their tax accrual examination); Bynum, *supra* note 27, at 425 (noting auditor's obligation to issue qualified opinion or disclaimer of opinion if auditor has inadequate information); Kline, *supra* note 12, at 709 (citing *Arthur Young*); cf. Causey & McNair, *supra* note 85, at 550 (noting that accountants are unlike other professionals who claim privilege because accountant's business is public disclosure).

196. See *Arthur Young*, 465 U.S. at 818 (noting that issuance of qualified opinion, adverse opinion, or disclaimer of opinion informs public of possible problems in company's financial statements); Kline, *supra* note 12, at 709 (presenting *Arthur Young* Court's argument that "[t]he absence of an unqualified opinion immediately warns creditors and investors").

197. *Arthur Young*, 465 U.S. at 818-19; see Bynum, *supra* note 27, at 425 (asserting that management's desire to obtain unqualified opinion prompts effective disclosure).

This line of argument is not persuasive because an accountant's ethics cannot promote disclosure if she is unaware that the client is not disclosing completely.<sup>198</sup> An auditor's primary source of evidence for certain necessary disclosures, such as those relating to management's intention to discontinue a line of business or to refinance debt, is an inquiry of corporate executives.<sup>199</sup> Similarly, when evaluating tax accruals, an auditor cannot glean all questionable client tax positions from a completely independent source.<sup>200</sup> Knowing that accountants cannot independently identify certain information and fearing use of the information against the corporation in future lawsuits, management could conceal sensitive material requiring disclosure.<sup>201</sup> Such a tactic involves no risk to management and allows them to conceal information unless the auditor somehow senses incomplete disclosure and threatens to issue less than an unqualified opinion absent full disclosure.<sup>202</sup> In the tax accounting field, instead of actively withholding such information, clients could wait to develop tax strategies until they face litigation and have the protection of the attorney-client privilege.<sup>203</sup>

A second flaw in the theory that ethical standards adequately ensure proper disclosure is that the argument assumes that accountants will uphold their ethical standards and refuse to issue unqualified opinions when they have insufficient evidence.<sup>204</sup> This assumption ignores the effect that client payment of the audit fee has on the audit process.<sup>205</sup> Client compensation of auditors is particularly relevant as audit market competitiveness increases.<sup>206</sup>

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198. See Magill, *supra* note 72, at 464 (arguing that *Arthur Young* Court improperly assumed that auditors would be able to detect if client is not disclosing fully); Doering, *supra* note 72, at 171 (same); Kline, *supra* note 12, at 709 (same); Roloff, *supra* note 27, at 1136 (same).

199. See 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 333.03 (recognizing that some circumstances limit procedures other than management inquiry); ROBERTSON, *supra* note 67, at 1062 (noting that management inquiry is primary procedure for determining management's intention to refinance debt).

200. See Kline, *supra* note 12, at 711 (stating that procedures other than inquiry will not completely identify all "potential tax liabilities").

201. See Magill, *supra* note 72, at 464 (noting that corporation might hide suspect tax positions to avoid risk of disclosure in future litigation).

202. See *id.* (asserting that client "may feel that it cannot lose by covering up information").

203. See Roloff, *supra* note 27, at 1137 (stating that taxpayer might choose to wait to rationalize tax positions until IRS challenges positions).

204. See *id.* at 1136 (asserting that *Arthur Young* assumed "that the accountant will unhesitatingly bite the hand that feeds him").

205. See *id.* (speculating that client payment of accountant hinders issuance of appropriate opinions).

206. See John C. Burton, *The Evolutionary Revolution in Public Accounting*, 52 BROOK.

One commentator suggests that the audit market's highly competitive nature has spawned opinion shopping, a phenomenon in which a corporation searches for an auditor who will issue the type of opinion it wants.<sup>207</sup> The importance of obtaining and maintaining client relationships in this environment may seriously impede adherence to ethical standards.<sup>208</sup> Hence, audit scope limitations may not always result in auditors issuing qualified opinions or disclaimers of opinion when warranted.<sup>209</sup> Of course, this opinion shopping phenomenon also supports the argument against the accountant-client privilege, indicating that even if accountants had more information available to them, their reliance on fees might inhibit proper disclosure.

While flawed, the argument that the audit process itself is enough protection for the securities markets is not completely without merit. The ethical standards do require that an auditor obtain sufficient evidence to support her opinion.<sup>210</sup> If the client materially limits the scope of the audit, the standards require the auditor to issue a qualified opinion or disclaimer of opinion.<sup>211</sup> Granted, under some circumstances a client may conceal information, hoping that the auditor will not discover it.<sup>212</sup> Nonetheless, more important to the accountant-client privilege than management's failure to disclose information is the reason behind this failure. If management fears financial statement disclosure of the information, privileged communications will do nothing to encourage disclosure because an auditor remains ethically bound to issue a qualified or an adverse opinion if the client does not agree to disclose all necessary information in the financial statements.<sup>213</sup> Thus, the accountant-client privilege encourages communications between accountants and their

L. REV 1041, 1043 (1987) (stating accounting profession operates in very competitive market).

207. See Mindy Jaffe Smolevitz, Note, *The Opinion Shopping Phenomenon: Corporate America's Search for the Perfect Auditor*, 52 BROOK. L. REV. 1077, 1103 (1987) (suggesting that opinion shopping occurs "[w]hen a company switches auditors in an effort to improve its financial position and surveys several accounting firms to solicit their views on specific accounting issues to ensure that the desired result will be obtained"). Smolevitz contends that competition creates an environment "hospitable" to opinion shopping. *Id.* at 1105.

208. See *id.* at 1109 (suggesting that opinion shopping may cause auditors to compromise their independence).

209. See *supra* note 67 and accompanying text (indicating accountant's ethical duty to issue less than unqualified opinions for audit scope limitations).

210. 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 150.02.

211. See *id.* AU § 508.40 (stating that scope limitations "may require [an auditor] to qualify his opinion or to disclaim an opinion").

212. See *supra* notes 201-02 and accompanying text (suggesting that clients may hide information on chance that auditor will not notice its absence).

213. See 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 508.55 (stating that auditor must issue qualified or adverse opinion if client fails to disclose information necessary "for a fair presentation in conformity with generally accepted accounting principles").

clients only under the narrow circumstances when the client fears the detrimental effect of sensitive information discoverable in future litigation.<sup>214</sup> This future litigation concern is particularly significant for tax accrual workpapers analyzing litigation positions.<sup>215</sup> Auditors, however, can minimize a client's exposure to the adverse effect of discovery of information by limiting workpaper documentation to descriptions of procedures performed on the tax accrual and broad conclusions as to the adequacy of disclosure.<sup>216</sup> Thus, the auditor's flexibility in documentation provides some protection against any diminishing communications that resulted from the Supreme Court's denial of the accountant-client work product privilege in *Arthur Young*.<sup>217</sup>

Critics also responded to the claim that the privilege results in better disclosure by asserting that the privilege is detrimental to public reliance on audited financial statements because it interferes with an accountant's independence.<sup>218</sup> This argument misses the point of the independence requirement and improperly assumes that permitting privileges and requiring independence are mutually exclusive concepts. It is true that the SEC and AICPA both require auditors to be independent in fact and in appearance.<sup>219</sup> Interpretation of the independence rules, however, indicates concern over public accountants having direct or indirect financial interests in their clients.<sup>220</sup> Unlike the

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214. See Causey & McNair, *supra* note 85, at 549 (stating that recognition of privilege will only enhance relationship between accountant and client in limited circumstances because relationship is already subject to ethical confidentiality requirements).

215. See Doering, *supra* note 72, at 160-61 (stating that auditor must determine likelihood of IRS audit and potential for any additional tax or penalties); Kline, *supra* note 12, at 709-10 (noting that tax accrual workpapers emphasize weak points in tax position).

216. See 1 PROFESSIONAL STANDARDS, *supra* note 138, AU §§ 9326.11-9326.12 (noting that auditor may use her judgment in determining extent of documentation in workpapers and that such documentation may take memorandum form).

217. See Magill, *supra* note 72, at 464-65 (noting that communications began to diminish after IRS started summoning tax accrual workpapers); Doering, *supra* note 72, at 171 (stating that "disclosure of a CPA's tax accrual workpapers results in strained communication between the auditor and the corporation undergoing the audit"); Kline, *supra* note 12, at 709 (criticizing *Arthur Young* Court for assuming that denial of privilege would not adversely affect accountant-client communications).

218. See *United States v. Arthur Young & Co.*, 465 U.S. 805, 818 (1984) (stating that public accountants perform "public watchdog" function requiring "total independence from the client at all times"); see also Jentz, *supra* note 12, at 157 (recognizing argument that privilege would hinder audit function by destroying public confidence furthered by independence requirement); Bynum, *supra* note 27, at 426 (stating argument that privilege is inconsistent with independence); Kline, *supra* note 12, at 712 (disagreeing with *Arthur Young* conclusion that privilege would impair public perception of independence).

219. See *supra* note 191 and accompanying text (noting that auditors must be independent in fact and appearance).

220. See Regulation S-X, 17 C.F.R. § 210.2-01(b) (1997) (stating accountant is not independent if she has "any direct financial interest or any material indirect financial interest"



unquestioned practice of corporations paying for their own audit services, which certainly raises financial independence concerns,<sup>221</sup> the accountant-client privilege does not implicate the *financial* independence rationale underlying the SEC and AICPA requirements. Also, because the independence standards mirror rules in the legal profession, such requirements are not conclusively incompatible with privileged status.<sup>222</sup>

## 2. Fairness in the Tax System

The second major line of argument in favor of the accountant-client privilege maintains that it promotes fundamental fairness in tax litigation by denying the IRS access to the taxpayer's litigation and negotiation strategies.<sup>223</sup> After the *Arthur Young* decision, a proponent of the privilege asserted that if the public views the tax system as unfair, noncompliance with tax laws could impair federal revenue collections.<sup>224</sup> Furthermore, he speculated that tax litigation would increase as a result of the decision.<sup>225</sup> He theorized that the IRS would use the tax accrual workpapers that indicate a company's worst case scenario for tax liability as the starting point in negotiations, thus attempting to gain a higher settlement than they otherwise would have and inducing corporations to opt for litigation hoping that they might achieve more success in court.<sup>226</sup>

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in her client); 1 PROFESSIONAL STANDARDS, *supra* note 138, AU § 220.03 (asserting substantial financial interest in auditee or involvement in auditee decision-making impairs appearance of independence); MURRAY ET AL., *supra* note 193, § 17032 (listing financial and employment relationships incompatible with independence as delineated by SEC); ROBERTSON, *supra* note 67, at 128-30 (listing direct financial circumstances and employment relationships hindering independence).

221. See *supra* note 188 and accompanying text (stating that client payment for audit services is standard practice even though much of benefit of services accrues to public).

222. See MODEL CODE DR 5-103(A) (mandating that attorney may obtain proprietary interest in litigation only under limited circumstances); *id.* EC 5-7 (stating that attorneys should employ contingent fee arrangements only when beneficial to client); *id.* DR 5-104(A) (stating lawyer may not enter into business position adversarial to client); *id.* Canon 9 ("A lawyer should avoid even the appearance of professional impropriety."); *id.* DR 5-101(A) (stating that client must consent to lawyer's representation if "financial, business, property, or personal interests" might affect lawyer's professional judgment).

223. See Kline, *supra* note 12, at 714 (asserting that permitting IRS access to tax accrual workpapers is unfair because it gives IRS preview of taxpayer's litigating and negotiating positions).

224. See *id.* at 718-19 (citing former IRS Commissioner and other commentators to support proposition that taxing system depends upon perceived fairness by taxpayers and asserting that denial of privilege could result in noncompliance).

225. See *id.* at 719 (claiming that IRS access to tax accrual workpapers could lead to higher level of corporate tax litigation).

226. See *id.* at 720-71 (suggesting that "IRS may use [workpapers] as a starting point in

Opponents of the privilege contend that the interest in obtaining the correct tax amount and the interest in preventing tax fraud ultimately prevail over the fairness arguments because the government must have tax revenue to function.<sup>227</sup> This argument, however, fails to address the claim that denying the privilege adversely impacts revenues through increased noncompliance.<sup>228</sup> In the short-term, however, the noncompliance argument has proved invalid because the corporate noncompliance rate in the years after *Arthur Young* remained relatively stable.<sup>229</sup> Also, opponents claim agency procedures restricting the circumstances under which the IRS can summon workpapers sufficiently guarantee fairness in the system.<sup>230</sup> Although this protection is available, the procedures are not legally enforceable and continued IRS compliance is uncertain.<sup>231</sup> Finally, the validity of the argument that denial of the privilege results in an increase in tax litigation is questionable. Even though the number of tax cases filed in tax court from 1980 to 1990 increased by slightly more than six thousand, from 22,009 to 28,507, the cause of the increase is unclear.<sup>232</sup> Considering the fact that the anticipated effects of *Arthur Young* on the tax system have proved either incorrect or inconclusive, the tax system fairness arguments alone are insufficient to support the *Jaffee* public interest analysis.

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negotiations, thus attempting to force a compromise at a higher amount of tax than would have been attempted without such information," making litigation more cost-efficient option).

227. See Bynum, *supra* note 27, at 425 (concluding that accountant-client privilege does not benefit honest citizens, but instead benefits those who commit tax fraud); Roloff, *supra* note 27, at 1138 (asserting that government interest in enforcing tax laws and collecting revenue is more important than benefits gained from accountant-client privilege).

228. See Kline, *supra* note 12, at 718 (asserting that "[e]rosion of taxpayer confidence in fairness of the federal taxing system may jeopardize federal revenue collections").

229. Compare *id.* at 719 (recognizing that compliance rate in 1981 was approximately 85%) with Graeme S. Cooper, *Analyzing Corporate Tax Evasion*, 50 TAXL. REV. 33, 38 (1994) (noting that estimates of unpaid taxes for 1992 ranged between 10-15%). The fact that the noncompliance rate has remained relatively stable does not necessarily mean that the failure to recognize a privilege has not had an adverse effect on revenues. Many other factors also influence the noncompliance rate. See *id.* at 35-36 (listing six sources of noncompliance).

230. See *United States v. Arthur Young & Co.*, 465 U.S. 805, 820-21 (1984) (noting that IRS has "tighten[ed] its internal requirements for the issuance of summonses"); Sommer, *supra* note 180, at 1124-25 (noting that IRS procedures permit summoning tax accrual workpapers only under "unusual circumstances").

231. See Kline, *supra* note 12, at 716 (asserting that IRS procedures provide no legally enforceable rights and that 1984 study showed "significant increase in IRS requests for tax accrual workpapers")

232. See Nina J. Crimm, *Tax Controversies: Choice of Forum*, 9 B.U. J. TAXL. 1, 78-79 (1991) (stating increase is result of many factors including "tremendous increase in the number of taxpayers seeking to resolve tax controversies through litigation before judges with tax expertise").

### C. Benefit Derived from the Denial of Privileges

Combined with consideration of the public interests at issue, *Jaffee's* evaluation of the benefits derived from denial of a privilege completes the analysis under Wigmore's fourth criterion.<sup>233</sup> The Court concluded that only minimal benefits would result from denial of the privilege because denial would chill communications between a psychotherapist and her client in those cases in which litigation was likely to develop from the circumstances bringing about the need for treatment.<sup>234</sup> Hence, the evidence that theoretically would derive from denial of the privilege would never come into being.<sup>235</sup>

The Second Circuit in *Arthur Young* accepted this "chilling effect" argument, but the Supreme Court eventually rejected it.<sup>236</sup> The *Arthur Young* Court concluded that the nature of the audit process does not permit chilled communications because accountants must have a requisite amount of information to issue an unqualified opinion.<sup>237</sup> As discussed above, however, this conclusion fails to address those circumstances in which an auditor does not know management is limiting the scope of the examination.<sup>238</sup> At the very least, the *Jaffee* opinion reflects an openness to the chilling effect argument not present in *Arthur Young*. This openness improves the prospects of a federal accountant-client privilege.

In his dissent in *Jaffee*, Justice Scalia criticized the chilling effect argument by seriously questioning whether individuals would fail to be completely truthful with their psychotherapists out of fear of later disclosure of those communications in court.<sup>239</sup> In contrast to Scalia's claim regarding the psychotherapist privilege, corporate executives indicate that the lack of a privilege does in fact inhibit communications between a public accountant and her client and does have a detrimental effect on financial disclo-

233. See *Jaffee v. Redmond*, 116 S. Ct. 1923, 1929 (1996) (evaluating public interests and evidentiary benefit resulting from denial of privilege); *supra* note 88 and accompanying text (listing Wigmore criteria); *supra* notes 170-232 and accompanying text (evaluating public interests derived from granting accountant-client privilege).

234. *Jaffee*, 116 S. Ct. at 1929.

235. *Id.*

236. See *United States v. Arthur Young & Co.*, 465 U.S. 805, 817 (1984) (citing Second Circuit's conclusion that failure to grant work product protection to tax accrual workpapers would have "chilling effect" on communications as argument supporting testimonial privilege not recognized in federal system).

237. *Id.* at 818.

238. See *supra* notes 198-203 and accompanying text (arguing that self-verifying nature of audit process is not complete protection against client's failure to disclose relevant information).

239. *Jaffee v. Redmond*, 116 S. Ct. 1923, 1934 (1996) (Scalia, J., dissenting).

tures.<sup>240</sup> Because corporate executives are often the source of accountant-client communications, they are in a good position to judge how the lack of a privilege affects those communications.<sup>241</sup> Thus, the chilling effect argument is supportable in the accountant-client context, making way for a conclusion that the interests in granting the privilege outweigh the minimal costs to the evidentiary system. Of course, the experience of the states must buttress this conclusion.<sup>242</sup>

#### D. State Statutory Privileges

After weighing the benefits of granting the psychotherapist privilege against the costs, the *Jaffee* Court turned to the states for confirmation of its conclusion.<sup>243</sup> Giving considerable weight to the fact that all fifty states had granted a psychotherapist privilege and that a vast majority had extended a privilege to licensed social workers, the Court expressed concern that a failure to adopt a federal privilege would frustrate the purposes of state enactments.<sup>244</sup> The fact that the scope of the privilege varies from state to state did not affect the majority's conclusion.<sup>245</sup> Furthermore, the Court concluded that the consensus among the states was "reinforced" by the fact that the psychotherapist privilege was among the nine specific privileges suggested by the 1972 Judicial Conference Advisory Committee prior to Congress's adoption of Rule 501.<sup>246</sup>

Justice Scalia's dissent in *Jaffee* accentuates the level of deviation among the state privilege statutes extending to licensed social workers, thus indicating the minimal level of consensus that the majority was looking for to support its own cost-benefit analysis.<sup>247</sup> Justice Scalia noted that although all

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240. See Smith, *supra* note 178, at 21 (indicating that approximately 60% of corporate executives believe lack of privilege inhibits communications and only 22% believe that lack of privilege does not inhibit financial disclosures).

241. See *supra* note 184 and accompanying text (noting that management inquiry is source of audit evidence).

242. See *Jaffee*, 116 S. Ct. at 1929-30 (indicating that "decisions of the States bear on the question whether federal courts should recognize a new privilege or amend the coverage of an existing one" (citing Trammel v. United States, 445 U.S. 40, 48-50 (1980))).

243. *Id.* at 1929-30.

244. *Id.* at 1930.

245. *Id.* at 1930 n.13; see *id.* at 1935-37 (Scalia, J., dissenting) (disputing unanimity of state judgments regarding psychotherapist privilege).

246. *Id.* at 1930; see R. EVID. FOR U.S. CT. & MAG., 56 F.R.D. 183, 230-61 (1972) (listing proposed federal rules of evidence, including privileges for required reports, attorney-client, psychotherapist-patient, husband-wife, clergyman-communicant, political vote, trade secrets, state secrets and other official information, and identity of informer); see also Goode & Sharlot, *supra* note 2, at 494 n.17 (listing proposed privileges).

247. See *Jaffee v. Redmond*, 116 S. Ct. 1923, 1935-40 (1996) (Scalia, J., dissenting)

fifty states permit a psychotherapist privilege, five states do not extend the privilege to licensed social workers.<sup>248</sup> Also, Justice Scalia asserted that four state statutes include so many exceptions that they hardly constitute a privilege.<sup>249</sup> Additionally, he argued that the Washington statute does not truly provide a privilege because it requires disclosure in response to a subpoena.<sup>250</sup> Finally, Justice Scalia revealed that the states adopting substantial privileges for licensed social workers include varying exceptions that make the privilege inapplicable under certain circumstances.<sup>251</sup>

Like the statutes extending a privilege to licensed social workers, state accountant-client privileges vary considerably.<sup>252</sup> Currently, twenty-six states and Puerto Rico grant some form of accountant-client privilege.<sup>253</sup> Of those twenty-seven United States jurisdictions, thirteen merely codify an accoun-

(discussing variations in statutory psychotherapist privileges).

248. *See id.* at 1936 (Scalia, J., dissenting) (noting "that five of the state legislatures that have seen fit to enact 'some form' of psychotherapist privilege have elected not to extend *any form* of privilege to social workers").

249. *See id.* at 1939 (Scalia, J., dissenting) (referring to majority's citation of balancing approach to privileges granted by Maine, New Hampshire, North Carolina, and Virginia); *see also* ME. REV. STAT. ANN. tit. 32, § 7005 (1964); N.H. REV. STAT. ANN. § 330-A:19 (1995); N.C. GEN. STAT. § 8-53.7 (1986); VA. CODE ANN. § 8.01-400.2 (Michie 1992).

250. *Jaffee*, 116 S. Ct. at 1939 (Scalia, J., dissenting); *see* WASH. REV. CODE § 18.19.180 (1994).

251. *See Jaffee*, 116 S. Ct. at 1939-40 (Scalia, J., dissenting) (noting that state statutory licensed social worker privileges include exceptions for cases involving homicide, crimes inflicting injuries upon persons, violations of any law, and harmful acts).

252. *See Causey & McNair, supra* note 85, at 535 (noting that state accountant-client privileges vary both in scope and in exceptions); Jentz, *supra* note 12, at 152 (stating that "statutes vary considerably both in substance and in statutory construction"); Bynum, *supra* note 27, at 422 (noting substantial variations among statutes); Ruppert, *supra* note 85, at 639 (asserting that statutes are not uniform).

253. ARIZ. REV. STAT. ANN. § 32-749 (West 1956); COLO. REV. STAT. ANN. § 13-90-107(1)(f) (West 1997); CONN. GEN. STAT. ANN. § 20-281j (West Supp. 1997); FLA. STAT. ANN. § 473.316 (West 1991 & Supp. 1998); GA. CODE ANN. § 43-3-32 (1994 & Supp. 1997); IDAHO CODE § 9-203A (1990); 225 ILL. COMP. STAT. ANN. 450/27 (West 1993); IND. CODE ANN. §§ 25-2.1-14-1, 25-2.1-14-2 (Michie 1996); KAN. STAT. ANN. § 1-401 (1991 & Supp. 1996); KY. REV. STAT. ANN. § 325.440 (Michie 1995); LA. REV. STAT. ANN. § 37:87 (West 1988); ME. REV. STAT. ANN. tit. 32, § 12279 (West 1964); MD. CODE ANN., CTS. & JUD. PROC. § 9-110 (1995); MASS. GEN. LAWS ANN. ch. 112, § 87E (West 1996 & Supp. 1997); MICH. COMP. LAWS ANN. § 339.713 (West 1992 & Supp. 1997); MISS. CODE ANN. § 73-33-16 (1972); MO. ANN. STAT. § 326.151 (West 1989); MONT. CODE ANN. § 37-50-402 (1997); NEV. REV. STAT. §§ 49.185, 49.205 (1995); N.M. STAT. ANN. § 38-6-6 (Michie 1978); 63 PA. CONS. STAT. ANN. § 9.11a (West 1968 & Supp. 1995); P.R. LAWS ANN. tit. 20, § 790 (1988); R.I. GEN. LAWS § 5-3.1-23 (1956); TENN. CODE ANN. § 62-1-116 (1997); TEX. REV. CIV. STAT. ANN. art. 41a-1 (West 1969 & Supp. 1998); VT. STAT. ANN. tit. 26, § 82 (1989 & Supp. 1997); WASH. REV. CODE ANN. § 18.04.405 (West 1989 & Supp. 1997).

tant's ethical confidentiality rule either by containing an exception for validly issued subpoenas or by making the privilege inapplicable to court proceedings.<sup>254</sup> Thus, only fourteen jurisdictions offer privileges that protect accountant-client communications from discovery in court proceedings.<sup>255</sup> Even these fourteen jurisdictions vary in their approaches. Some grant a very broad privilege, whereas others provide exceptions for criminal proceedings, bankruptcy proceedings, disciplinary matters, compliance with professional standards, or civil proceedings in which the information is vital to the defense of the accountant.<sup>256</sup>

Courts have interpreted the meaningful privilege statutes somewhat consistently. First, state courts have recognized that the purpose of the statutes is to enhance accounting services by permitting the free flow of information between an accountant and her client without fear of future disclosure in

254. ARIZ. REV. STAT. ANN. § 32-749 (West 1956); CONN. GEN. STAT. ANN. § 20-281j (West Supp. 1997); KAN. STAT. ANN. § 1-401 (1991 & Supp. 1996); KY. REV. STAT. ANN. § 325.440 (Michie 1995); LA. REV. STAT. ANN. § 37:87 (West 1996); ME. REV. STAT. ANN. tit. 32, § 12279 (West 1964); MASS. GEN. LAWS ANN. ch. 112, § 87E (West 1996 & Supp. 1997); MISS. CODE ANN. § 73-33-16 (1972); MONT. CODE ANN. § 37-50-402 (1997); R.I. GEN. LAWS § 5-3.1-23 (1956); TEX. REV. CIV. STAT. ANN. art. 41a-1 (West 1969 & Supp. 1998); VT. STAT. ANN. tit. 26, § 82 (1989 & Supp. 1997); WASH. REV. CODE ANN. § 18.04.405 (West 1989 & Supp. 1997); *see also* Causey & McNair, *supra* note 85, at 538 (noting that those states with exceptions for valid subpoena or summons convert privilege to statutory confidentiality rule); Jakob, *supra* note 27, at 202 (same).

255. *See* Causey & McNair, *supra* note 85, at 538-39 (noting that only fifteen jurisdictions have privileges barring court testimony); Jakob, *supra* note 27, at 203 (stating that "fifteen statutes, however, create a testimonial privilege"). Since these two articles were written, Kansas revised its statute to include an exception for a validly issued subpoena, reducing the number of "true" privilege states to fourteen. *See* KAN. STAT. ANN. § 1-401 (1991 & Supp. 1996) (providing that "[n]othing in this section shall be construed as limiting the authority of this State or of the United States or any agency of this state or of the United States to subpoena books or accounts, financial records, reports or working papers or other documents and use such information in connection with any investigation, public hearing or court proceeding").

256. *See* Causey & McNair, *supra* note 85, at 539 (noting that privilege statutes may contain no exceptions or may contain "exceptions for criminal proceedings, disciplinary matters, or professional standards"); Jentz, *supra* note 12, at 152-53 (citing some statutes that define privilege broadly and others that include exceptions for criminal actions, bankruptcy actions, or actions where information is material to accountant's defense); Ruppert, *supra* note 85, at 640 (same); *cf.* COLO. REV. STAT. ANN. § 13-90-107(1)(f) (West 1997); FLA. STAT. ANN. § 473.316 (West 1991 & Supp. 1998); GA. CODE ANN. § 43-3-32 (1994 & Supp. 1997); IDAHO CODE § 9-203A (1990); 225 ILL. COMP. STAT. ANN. 450/27 (West 1993); IND. CODE ANN. §§ 25-2.1-14-1, 25-2.1-14-2 (Michie 1996); MASS. GEN. LAWS ANN. ch. 112, § 87E (West 1996 & Supp. 1997); MICH. COMP. LAWS ANN. § 339.713 (West 1992 & Supp. 1997); MO. ANN. STAT. § 326.151 (West 1989); NEV. REV. STAT. §§ 49.185, 49.205 (1995); N.M. STAT. ANN. § 38-6-6 (Michie 1978); 63 PA. CONS. STAT. ANN. § 9.11a (West 1968 & Supp. 1995); P.R. LAWS ANN. tit. 20, § 790 (1988); TENN. CODE ANN. § 62-1-116 (1997).

litigation.<sup>257</sup> According to some, the purpose behind the privilege is analogous to the purpose behind the attorney-client privilege.<sup>258</sup> Second, states have narrowly construed the statutory privileges because the common law did not recognize an accountant-client privilege.<sup>259</sup> Third, all states except for Illinois have held that the client holds the right to exercise the privilege.<sup>260</sup> Fourth, courts have held the privilege inapplicable to ongoing or future crimes.<sup>261</sup>

Overall, judicial interpretations of statutory accountant-client privileges are relatively sparse and deal with different issues.<sup>262</sup> For instance, in Illinois and Pennsylvania, the privilege is only available to accountants registered under their respective state laws.<sup>263</sup> Additionally, both states recognize that application of the privilege rests on whether the parties rely on the statutory

257 See, e.g., *Neusteter v. District Ct.*, 675 P.2d 1, 5 (Colo. 1984) (stating that purpose of statute is to protect client confidences and encourage transmission of information without fear of disclosure in future litigation); *Gearhart v. Etheridge*, 208 S.E.2d 460, 461 (Ga. 1974) (same); *Ernst & Ernst v. Underwriters Nat'l Assurance Co.*, 381 N.E.2d 897, 902 (Ind. Ct. App. 1978) (same); *Dixon v. Bennett*, 531 A.2d 1318, 1329 (Md. Ct. Spec. App. 1987) (same); *McNair v. Eighth J. Dist. Ct.*, 885 P.2d 576, 578 (Nev. 1994) (same); *Federal Ins. Co. v. Arthur Anderson & Co.*, 816 S.W.2d 328, 331 (Tenn. 1991) (same).

258. See *In re* October 1985 Grand Jury No. 746, 530 N.E.2d 453, 457 (Ill. 1988) (finding attorney-client privilege similar to statutory accountant-client privilege because both cover confidential communications and encourage full disclosure); *Federal Ins. Co. v. Arthur Anderson & Co.*, 816 S.W.2d 328, 330 (Tenn. 1991) (concluding that relationship between accountant and employer is similar to that between attorney and client, thus requiring "highest personal trust and confidence"). But see *First Community Bank v. Kelley, Hardesty, Smith & Co.*, 663 N.E.2d 218, 222 (Ind. Ct. App. 1996) (claiming that attorney's duty to be zealous advocate distinguishes her from accountant).

259. See, e.g., *Rubin v. Katz*, 347 F. Supp. 322, 324 (E.D. Pa. 1972) (asserting narrow construction of accountant-client privilege statutes because they are in derogation of common law); *First Community Bank*, 663 N.E.2d at 221-22 (same); *In re A Special Investigation # 202*, 452 A.2d 458, 462 (Md. Ct. Spec. App. 1982) (same); *People v. Simon*, 436 N.W.2d 695, 699 (Mich. Ct. App. 1989) (same); *McNair v. Eighth J. Dist. Ct.*, 885 P.2d 576, 578 (Nev. 1994) (same).

260. See Dale R. Crider, *The Contours of the Illinois Accountant's Privilege*, 81 ILL. B.J. 92, 92 (1993) (stating that Illinois privilege belongs to accountant and not client); Jentz, *supra* note 12, at 153 (noting that privilege is generally client's); cf. Ruppert, *supra* note 85, at 640 (stating that allowing accountant to exercise privilege does not conform to policy behind privilege).

261. See *Casey & McNair*, *supra* note 85, at 541 (citing *United States v. Zolin*, 491 U.S. 554 (1989)).

262. See Jentz, *supra* note 12, at 154 (noting limited number of judicial interpretations of accountant-client privilege statutes); Ruppert, *supra* note 85, at 641 (same).

263. See Martin R. Bartel, *Pennsylvania's Accountant-Client Privilege: An Asset with Liabilities*, 30 DUQ. L. REV. 613, 618 (1992) (noting that Pennsylvania privilege is only available to those accountants holding state license); Crider, *supra* note 260, at 92 (stating that privilege is only available to accountants licensed in Illinois).

protection.<sup>264</sup> Also, in Pennsylvania, although no privilege extends to disclosures required by auditing standards, the statute appears to protect documents underlying those disclosures.<sup>265</sup> Colorado courts extend a good cause exception to the privilege in shareholder derivative actions.<sup>266</sup> Furthermore, Florida recognizes an exception to the accountant-client privilege when two clients retain an accountant in common, regardless of whether the two clients were present at the time of the communication in question.<sup>267</sup>

As indicated above, these variations among the state privileges do not preclude recognition of a federal privilege under *Jaffee*.<sup>268</sup> However, the sheer numerical difference between the fourteen states offering meaningful accountant-client privileges and the forty states enacting appreciable licensed social worker privileges weighs against recognition of a federal accountant-client privilege at this time.<sup>269</sup> Such a limited number of state enactments insufficiently supports the *Jaffee* approach to the "reason and experience" requirement of Rule 501.<sup>270</sup> Additionally, the privilege lacks the support of the 1972 Advisory Committee, which did not recommend a federal accountant-client privilege.<sup>271</sup> The Advisory Committee also did not recommend a privilege applying to licensed social workers.<sup>272</sup> Nonetheless, the Court's extension of the privilege to licensed social workers through analysis of the psychothera-

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264. See Bartel, *supra* note 263, at 620 (stating that Pennsylvania statute requires expectation of applicability to communications); Crider, *supra* note 260, at 94 (discussing case in which statute did not apply because accountants did not appear to rely on Illinois privilege).

265. Bartel, *supra* note 263, at 627; see 63 PA. CONS. STAT. ANN. § 9.11a (West 1968 & Supp. 1995) (Pennsylvania accountant-client privilege).

266. *Neusteter v. District Ct.*, 675 P.2d 1, 6 (Colo. 1984); see also Alan W. Anderson & Elizabeth E. Brown, *Colorado's Accountant-Client Privilege*, 24 COLO. LAW. 283, 284-85 (1995) (discussing *Neusteter*).

267. *Transmark, USA, Inc. v. State Dep't of Ins.*, 631 So. 2d 1112, 1116-17 (Fla. Dist. Ct. App. 1994).

268. See *supra* notes 247-51 and accompanying text (noting variations in state psychotherapist privileges).

269. See *Jaffee v. Redmond*, 116 S. Ct. 1923, 1939 (1996) (Scalia, J., dissenting) (asserting that ten states have "illusory" privilege for licensed social workers).

270. See *id.* at 1929 (noting that fifty states had enacted psychotherapist privilege, indicating consensus for "reason and experience" purposes); see also Earl C. Dudley, Jr., *Federalism and Federal Rule of Evidence 501: Privilege and Vertical Choice of Law*, 82 GEO. L.J. 1781, 1823-24 (1994) (asserting that because majority of states have not enacted accountant-client privileges, accountant-client privilege is easy case in which to find that federal enforcement interests are paramount to state privilege interests).

271. See *supra* note 246 and accompanying text (noting that *Jaffee* Court found Advisory Committee's recommendations persuasive in psychotherapist context and listing those privileges recommended by Committee).

272. See *supra* note 246 (listing privileges suggested by Advisory Committee).



apist privilege provides a basis for the social worker privilege in the Advisory Committee recommendations that the accountant-client privilege does not have.<sup>273</sup>

### VI. Conclusion

*Jaffee* indicates a new approach to granting privileges under Federal Rule of Evidence 501, that appears to be evolving toward that used by Wigmore. Nonetheless, the federal system is not ready for the accountant-client privilege. Arguably, significant public and private interests exist in favor of the privilege. Furthermore, the Supreme Court is now amenable to the chilling effect argument that granting the privilege only minimally affects the evidentiary system. Nevertheless, a majority of the states remain unconvinced that the benefits of a meaningful accountant-client privilege exceed the costs. Unless and until these state legislators change their minds, the federal system will refuse to recognize an accountant-client privilege, and *Couch*'s dicta will continue to snowball.<sup>274</sup>

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273. See *Jaffee*, 116 S. Ct. at 1931 (asserting that psychotherapist privilege covers "licensed social workers in the course of psychotherapy").

274. See Jakob, *supra* note 27, at 207 (asserting that federal courts create phenomenon of "snowballing dicta" by consistently citing *Couch* as authority to deny accountant-client privilege).

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# ARTICLES

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