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ARGUMENT

A CLAIM FOR ACCOUNTING MALPRACTICE MAY NOT BE TRANSFERRED BY ASSIGNMENT OR SUBROGATION

A. National Union's Reliance on the Precedent of this Court and that of other Jurisdictions is Misplaced in that it Fails to Consider the Decisions of this Court Subsequent to Dantzler

Virtually the only Florida case that National Union relies on is the decision of this Court in Dantzler Lumber and Export Co. v. Columbia Casualty Co., 156 So. 116 (Fla. 1934). National Union's exclusive reliance on a case decided 63 years ago is misplaced given the significant developments in both the case law of this Court and Florida appellate courts, and the enactment of the Florida Evidence Code.

Although the Dantzler decision may support National Union's position, it has been superseded, if not overruled, by subsequent decisions of this Court, including this Court's decision in Forgione v. Dennis Pirtle, 701 So. 2d 557 (Fla. 1997) and Peat Marwick, Mitchell & Co. v. Lane, 565 So. 2d 1323 (Fla. 1990). As this Court has consistently stated: "This Court has never hesitated to revisit the common law when it becomes an anachronism and ceases to serve the cause of justice. [citations omitted]. '[F]or us to blindly adhere to an erroneous rule, merely because it has been declared in recent earlier decision, tends to enshrine and perpetrate the dead error of yesterday....'" Stephen Bodzo Realty, Inc. v. Willits Int'l Corp., 428 So. 2d 225 (Fla. 1983) (quoting in part Therrell v. Reilly, 111 Fla. 805, 151 So. 305 (1932)).

National Union fails completely to address this Court’s holding in Lane that “the basic principles for all professional malpractice actions should be the same,” which formed the basis for the finding in that case that the commencement of the statute of limitations in accounting malpractice actions should be the same as that in legal malpractice actions “absent a clear legislative intent to distinguish certain professions in the application of the limitations period.” 565 So. 2d at 1325. See also Coopers & Lybrand v. Trustees of the Archdiocese of Miami/Diocese of St. Petersburg Health & Welfare Plan, 536 So. 2d 278, 281 (Fla. 3d DCA 1988) (“the same analyses of foreseeability and causation undertaken when assessing damages in other professional malpractice actions should apply when calculating the measure of damages in an accountant malpractice action.”).

National Union also relies on a few Florida court decisions which have cited to Dantzler, such as Dade County School Board v. Radio Station WOBA, 731 So. 2d 638 (Fla. 1999). However, that case merely cited Dantzler for general principles regarding equitable subrogation, and did not in any way address the viability of Dantzler as applied to professional malpractice actions in light of the Lane and Forgione decisions. Similarly, the out-of-state decisions relied on by National Union which cite to and rely on Dantzler do not address the public policy concerns noted by this Court in Forgione. The Third District plainly recognized that later decisions of this Court call into question

whether Dantzler is still good law by certifying that question to this Court. For the reasons argued in KPMG's Initial Brief and in this Reply Brief, it is not.

B. KPMG's Position is in Harmony with the Position that the AICPA has Taken Regarding the Confidentiality of Client Communications and the Potential for Conflict in Subrogation Cases

National Union next argues that the position taken by The American Institute of Certified Public Accountants ("AICPA") is contrary to the arguments espoused by KPMG. In fact, it is National Union's position that is in conflict with the AICPA's rules governing the confidentiality of client communications and the potential for conflict in subrogation cases.

First, the AICPA's Code of Professional Conduct provides that: "A member in public practice shall not disclose any confidential information without the specific consent of the client." 2 AICPA Professional Standards, ET § 301.01.¹ This proscription against the disclosure of client communications is consistent with the Florida Evidence Code Section 90.5055 governing the accountant-client privilege (which is identical to Section 90.502 governing the attorney-client privilege). Thus, the AICPA has spoken to the same issue addressed by this Court in Forgione, which is the confidential relationship between a professional and a client.

¹ For the convenience of the Court, all of the AICPA Professional Standards cited by KPMG (as of June 1, 1998) are included as an Appendix to KPMG's Reply Brief.

Further, the interpretation relied on by National Union as purportedly condoning the subrogation of an accounting malpractice claim instead underscores the potential for an adverse impact of such an action on the relationship between an accountant and client. 2 AICPA Professional Standards, ET § 101.08 states that while a subrogation action against a member in the name of the client would not normally affect the member's independence, such actions "should be examined carefully, however, since the potential for adverse interests may exist if the member alleges in his defense, fraud or deceit by the present management." Id.²

In this case, there have been allegations of fraud and deceit against former BankAtlantic employees, and a federal action filed by BankAtlantic in which National Union is joined as plaintiff has been filed against BankAtlantic employees including Carol Plack, Wayne Fisher, and Ken Bittle. (R. 1043-1174, Tab C). Discovery in this case (were it permitted to proceed) might well implicate present management as being a part of the Sterling fraud. At the very least, issues of comparative negligence which have been raised place KPMG in the compromising position of proving the negligence of a client with which it has an ongoing relationship. The AICPA, while declining to

² Obviously, the AICPA interpretation does not hold that subrogation actions are appropriate under the law, since this is clearly outside the province of that association. The AICPA interpretation is intended only to provide guidance if state law permits such an action.

find that such an action will in all instances compromise an accountant's independence, cautions that in many instances it may. This cautionary interpretation hardly supports National Union's argument. Indeed, it is entirely in harmony with KPMG's position that to permit the transfer of accounting malpractice claims would undermine the confidential nature of the relationship between an accountant and its client.

C. The Public Policies that Preclude the Transfer of Legal Malpractice Claims are Equally Applicable to Claims for Accounting Malpractice

KPMG in its Initial Brief discussed fully the public policy reasons why accounting malpractice claims, like attorney malpractice claims, are not assignable. See Kozich v. Shahady, 702 So. 2d 1289 (Fla. 4th DCA 1997) (attorney malpractice claims not assignable based on public policy grounds); National Union Fire Ins. Co. v. Salter, 717 So. 2d 141 (Fla. 5th DCA 1998) (same public policy reasons prohibiting assignments of attorney malpractice claims are equally applicable to subrogation actions).

In its Answer Brief, National Union attempts to rebut the similarities between an attorney and an accountant in light of the factors set forth by this Court in Forgione. However, the issue before this Court is not whether attorneys and accountants are the same in all respects, since obviously there will be differences among various professionals due to the nature of each profession. Rather, the issue presented here is

whether under the factors espoused by this Court in Forgione, the same public policy rationale which precludes the transferability of attorney malpractice claims applies to preclude the transferability of accounting malpractice actions. KPMG submits these factors mandate equally against the assignability of claims for accounting malpractice.

National Union argues on page 8 of its Answer Brief that the requirements that an attorney and an accountant maintain independence emanate from different sources, and involve different analyses. National Union's argument fails to heed the inquiry mandated by Forgione. The issue is not whether there is a precise identity of interests between an accountant and an attorney, but whether the confidential nature of the accountant-client relationship and the duty owed to the client, which are the first two factors in Forgione, support a public policy against the transferability of such a claim.

First, National Union argues that an attorney-client relationship is a close, personal, and highly confidential relationship. As KPMG has consistently asserted, this same relationship exists between an accountant and its client. The attorney-client privilege in the Florida Evidence Code is identical to the accountant-client privilege, and both statutes protect as confidential communications between these professionals and their clients.³

³ In its Answer Brief on page 4, National Union maintains that the primary argument in favor of the Florida accountant-client privilege was that it would assist taxpayers in federal tax investigations, citing Charles W. Ehrhardt, Florida Evidence

Florida law recognizes the confidential relationship between an accountant and client as necessary to carry out the public policy of being able to consult with an accountant without fear that the communications will become public. Affiliated of Florida, Inc. v. U-Need Sundries, Inc., 397 So. 2d 764 (Fla. 2d DCA 1981); Green v. Harry Savin, P.A., 455 So. 2d 494 (Fla. 3d DCA 1984). See also Deloitte, Haskins and Sells v. So. Financial Holding Corp., 566 So. 2d 906 (Fla. 4th DCA 1990) (accountant-client privilege applies to financial records and workpapers in accountant's possession).⁴

Second, National Union argues that because the nature of the accountant-client relationship is not a strict fiduciary one, that this "major" distinction justifies a

§ 2022.1, page 359. First, this assertion is made by the author with no citation to legislative history or case law. Second, this assertion makes no sense since federal courts have refused to apply this state law privilege in federal tax proceedings. Falsone v. U.S., 205 F.2d 734 (5th Cir. 1953). In light of these federal decisions, and in recognition of the need for confidentiality of such accountant-client communications, Congress recently enacted a statutory privilege which protects confidential communications relating to federal tax advice to the same extent that a communication would be protected if it were between a taxpayer and an attorney. 26 U.S.C.A. 7525 (July 1998).

⁴ In its Answer Brief at page 4, footnote 1, National Union takes issue with KPMG's contention that some form of the accountant-client privilege has been in existence since 1931. As KPMG points out in its Initial Brief at page 13, no evidentiary privilege was recognized prior to the enactment of Section 90.5055 in 1978, but the substantive right of confidentiality of accountant-client communications was in fact contained in the predecessor statute to Section 473.16, which was enacted in 1931.

departure from the public policy factor relied on by this Court in Forgione. Whether or not the relationship is a strict fiduciary one is not the relevant inquiry, where Florida cases and other authorities have consistently recognized the duty of care owed by an accountant to its client. Coopers & Lybrand v. Trustees of the Archdiocese of Miami/Diocese of St. Petersburg Health & Welfare Plan, 536 So. 2d 278 (Fla. 3d DCA 1988) (auditor owes a duty of care to its client to conduct audit in accordance with generally accepted auditing standards); Security Pacific Business Credit, Inc. v. Peat Marwick Main & Co, 79 N.Y. 2d 695, 597 N.E. 2d 1080, 586 N.Y.S. 2d 87 (Ct. App. 1992) (when accountants conduct a traditional financial audit, they undertake a duty of due care in the performance of their engagement to the party which has contracted for their services). This duty is also recognized in 1 AICPA Professional Standards, AU § 230.01 (due professional care is to be exercised in the planning and performance of the audit and the preparation of the report).

National Union erroneously places its reliance on federal cases which hold that there is no accountant-client privilege under federal law, and which emphasize an accountant's duty to the public. Although clearly no such privilege exists under federal law, United States v. Arthur Young & Co., 465 U.S. 805 (1984), the Florida Legislature has enacted one in this state, in recognition of the confidential nature of the relationship between an accountant and its client. Moreover, the public duty

recognized in federal cases has been rejected by this Court in First Florida Bank v. Max Mitchell & Co., 558 So. 2d 9 (Fla. 1990). In Max Mitchell, this Court, while departing from the strict privity requirement previously existing, severely limited the liability of an accountant to a member of the public to instances in which the accountant had “actual knowledge” that the party will rely on the advice given. The same standard is applicable to suits by third parties against attorneys. Cf. Angel, Cohen and Rogovin v. Oberon Investment, N.V., 512 So.2d 192 (Fla. 1987) (in decision pre-dating Max Mitchell, court similarly limited attorney’s liability to third party only under narrowly-defined third-party beneficiary exception).⁵

The emphasis placed by National Union and the Third District on the accountant’s “public responsibility” also does not address the issues raised by KPMG in its Initial Brief that audits of public companies are only a small percentage of work performed by accountants, and that the vast majority of accountants do not perform such tasks. The Third District’s decision would give rise to the assignment or

⁵ National Union’s reliance on the AICPA’s response to the report of the American Bar Association’s Commission on Multidisciplinary Practice does not support its argument that the legal and accounting professions are substantially dissimilar. The concerns expressed in that letter are primarily addressed to the potential for claims against accounting firms for the unauthorized practice of law, and concerns about the impact of rules governing conflicts of interest and solicitation of clients. They have no bearing on the confidential relationship and duty of loyalty elements addressed in this Court’s decision in Forgione.

subrogation of claims that have no public attributes, but instead involve personal services and require the disclosure of communications that Florida law deems to be confidential and not subject to disclosure.

Finally, National Union concedes that the limitation on substitution, which is the third factor discussed in Forgione, is imposed on both attorneys and accountants. It argues, however, that because the limitations arise from different sources - - the law of agency restricts substitution of an attorney whereas substitution of an accountant is limited by the “well established rule of law that no contract for personal services can be assigned without the consent of the parties” - - this Forgione factor is not met. (Answer Brief at 13, note 12). This is a distinction without a difference. Although this Court in Forgione considered the limitation on substitution to be an important factor, it placed no significance on the origin of this limitation. National Union’s concession that the limitation on substitution factor applies equally to accountants and attorneys recognizes that the accountant-client relationship is a personal one as opposed to a commercial relationship, and satisfies the third element of the Forgione decision.

D. This Case in Fact Illustrates the Public Policy Reasons that Prohibit the Transfer of Accounting Malpractice Cases

The public policy which precludes the transfer of accounting malpractice cases by assignment is best illustrated by the conflicts that arose in this case. Contrary to

National Union's assertions, these conflicts are in fact borne out by the record and KPMG's Initial Brief contains record citations for each fact alleged.

As set forth in the Initial Brief, KPMG continues as BankAtlantic's auditors to this day. (R. 1175-1188). The Covenant Not To Execute which is of record in this case (as an Exhibit to KPMG's Motion for Partial Summary Judgment which is not at issue in this appeal), reflects that BankAtlantic sued National Union in federal court when the surety denied coverage under its bond. (R. 1043-1174, Tab F). The Covenant Not To Execute represents a settlement between BankAtlantic and National Union. In that document, National Union agreed to pay up to \$18 million to BankAtlantic for losses from the Sterling portfolio, and the parties agreed that National Union would be re-aligned as a plaintiff in the federal action and that 13 defendants would be joined, including BankAtlantic employees. However, because BankAtlantic would not join KPMG, its then and present auditor, as a defendant, National Union extracted an assignment of this claim in return for the payment of up to \$18 million. For National Union to assert that BankAtlantic "voluntarily assigned" this claim is an overstatement at best.

As a result of National Union's suit against KPMG, in this case KPMG has been forced to take a position regarding the accountant-client privilege which is at odds with that asserted by its client BankAtlantic. KPMG has raised the issue of comparative

negligence on the part of BankAtlantic, and may at some point discover fraud or other gross mismanagement on the part of BankAtlantic which would cause it to raise defenses which are even more antagonistic to its current client. (R. 734-750). To maintain the integrity of the accountant-client privilege, and to maintain the close, personal, and highly confidential relationship between an accountant and its client, the public policy concerns addressed in Forgione require a finding that accounting malpractice claims are not transferable by assignment or subrogation.

E. The Public Policy Issues Raised by The Surety Association of America Miscomprehend the Nature of an Accountant's Duties Vis-a-vis the Duties of the Client

The Surety Association of America (“SAA”) argues in its amicus brief that the position advocated by KPMG would adversely affect the public interest in that it would increase the cost of required fidelity insurance, and therefore the cost of operating a bank, because it would shift the loss caused by the negligence of a bank’s accountant onto a party that could not have prevented it. The SAA concludes that if KPMG can shift the loss caused by its negligence onto someone else’s insurance, it has no financial incentive to incur the costs necessary to reduce the incidence of fraud.

The SAA’s argument reflects its misunderstanding of the relationship between an accountant and its client. It is the client, through management, that has the primary responsibility for adopting sound accounting policies, maintaining an adequate and

effective system of accounts, safeguarding assets, and devising and implementing an effective system of internal accountant control that provides reasonable assurance of properly prepared financial statements. Paul Munter and Thomas A. Ratcliffe, Applying GAAP and GAAS § 24.02 (1997) (citing to SAS No. 1, Responsibilities and Functions of the Independent Auditor, AU § 110.02 (Nov. 1972)).⁶

The Statement on Auditing Standards (“SAS”) 1 confirms in 1 AICPA Professional Standards, AU § 110.03 that the financial statements of an entity are management’s responsibility. The auditor’s responsibility is to express an opinion on the financial statements. The entity’s transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. The auditor’s knowledge of these matters and internal control is limited to that acquired through the audit. Thus, the fair presentation of financial statements in conformity with generally accepted accounting principles is an integral part of management’s responsibility. The

⁶ See also Dan L. Goldwasser and Thomas Arnold, Accountants’ Liability § 1.2 [A] (auditor does not examine each and every transaction undertaken by its client during the course of an audit, but relies heavily upon the client’s system of internal controls); Irving Kellogg and Loren B. Kellogg, Fraud, Window Dressing and Negligence in Financial Statements § 5.01 (because the balance sheets and the income and cash flow statements are the results of manipulation that starts with entries in the accounting records, the persons in charge of those records - - the decision makers - - are the ones who bear the ultimate responsibility for fraud).

auditor's responsibility for the financial statements audited is confined to the expression of an opinion on them.

The SAA argues that fidelity insurers inquire about and rely on audited financial statements of their prospective insureds in underwriting the risk to be assumed under their insurance. If so, this presents an even more compelling reason why this risk should be borne by the insurer of the party who is responsible for its own internal controls and for the preparation of the financial statements, which is management (and which in this case is BankAtlantic). National Union as BankAtlantic's surety properly bears the risk of a loss caused by management's failure to implement internal controls to prevent negligent or fraudulent conduct. In fact, as a surety it is in the best position to ensure that the bank maintains adequate internal controls by conditioning the issuance of its policy on this requirement. KPMG's liability, if any, is secondary and its insurer should not bear the burden of paying for losses caused by the negligence or fraud of the primary wrongdoer.⁷

⁷ To the extent the SAA implies that a rule against the transferability of an accounting malpractice action will result in a careless audit, there are a number of reasons why this argument lacks merit. There are substantial regulatory provisions requiring the careful planning and execution of an audit. If an audit is not performed in accordance with GAAS, there may be a cause of action against the accounting firm by its client. To the extent that National Union seeks to elevate its status as a surety to require a duty higher than that owed by an accountant to its client, its argument must fail, where it has no contractual agreement with the accountant nor has it paid the accountant any fee. An accountant has a duty to its client in accordance with Florida

In fact, in the Standard Form No. 24 of the SAA (Attached as Appendix A1-A4 to the SAA's brief), the application not only has a section directed to questions regarding the bank's audit procedures, it also has a separate section with questions regarding the bank's internal controls other than audit procedures. Thus, it is highly questionable whether the insurer relies upon the auditors' opinion on the financial statements to determine whether a prospective client has implemented a proper system of internal controls.⁸

The SAA maintains that National Union was paid to assume the risks of certain losses suffered by BankAtlantic, it was not paid to assume the risk of losses caused by the negligence of KPMG. It argues that through careful hiring, training and supervision, KPMG can reduce such losses. The SAA completely overlooks that BankAtlantic took the position that its own employees were the perpetrators of the Sterling fraud, and that BankAtlantic management was responsible for the hiring,

law, and to third parties only as strictly limited by the Max Mitchell decision. National Union may not attain a higher status as a paid surety.

⁸ An auditor's report on financial statements does not represent, expressly or implicitly, an assessment of the company's internal control environment. See 1 AICPA Professional Standards, AT § 400.79 (purpose of consideration of internal controls is to enable auditor to plan audit and determine tests to be performed). Indeed, an auditor may assess an internal control audit risk at the maximum level - - meaning that the auditor can place little or no reliance on internal controls - - and still express an unqualified audit opinion on the financial statements. 1 AICPA Professional Standards, AU § 319.47.

training and supervision of those employees. The SAA's argument reduces the client's incentive to ferret out the fraud of its employees, if it can shift its loss to another's surety.⁹

If, as the SAA asserts, one objective of the law is to reduce the incidence of loss by placing it on the party in the best position to efficiently avoid it, then the loss should be placed on BankAtlantic and/or its insurer, since it was BankAtlantic which had the primary financial incentive to make expenditures in hiring, training and supervising its employees to prevent bank fraud. The argument that KPMG is in a superior position than BankAtlantic to prevent a fraud that it claimed was perpetrated by BankAtlantic's own employees makes no sense.¹⁰

⁹ In BankAtlantic's Proof of Loss filed with National Union, BankAtlantic itself took the position that the loss was caused by dishonest activities on the part of BankAtlantic employees Ken Bittle, Wayne Fisher, and Carol Plack. (R. 1043-1174, Tab E). National Union initially disputed the Proof of Loss, but ultimately resolved the issue by entering into the Covenant Not To Execute which resolved the claims between the two parties. (R. 1043-1174, Tab F).

¹⁰ The Statement on Auditing Standards ("SAS") 82, effective for audits of financial statements for periods ending on or after December 15, 1997, recognizes that although the exercise of due professional care allows the auditor to obtain reasonable assurance that the financial statements are free of material misstatements, whether caused by error or fraud, absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Because of these characteristics of fraud, particularly those involving concealment and falsified documentation, even a properly planned and performed audit may not detect a material misstatement. 1 AICPA Professional Standards, AU § 230.10 -.12.

CONCLUSION

This Court should not heed National Union's request that it blindly adhere to the Dantzler decision, particularly where more recent decisions of this Court reflect a modern trend to treat all professional malpractice cases similarly, and where the public policy which prohibits the transfer of legal malpractice claims applies similarly to claims for accounting malpractice. The concerns raised in the amicus brief do not dictate a contrary result where it is BankAtlantic that is in a superior position to prevent the fraud of its own employees, and its surety properly bears the risk of that loss. For these reasons, this Court should answer the question certified by the Third District Court of Appeal, and reverse that decision on a holding that Dantzler is no longer controlling and that accounting malpractice claims are not transferable by assignment or subrogation.

CERTIFICATE OF SERVICE

WE HEREBY CERTIFY that a true and correct copy of the foregoing was served via U.S. Mail this 17th day of November, 1999 to James F. Crowder, Jr., Esquire, Russell Yagel, Esquire, KIMBRELL & HAMANN, P.A. Suite 900, Brickell Centre, 799 Brickell Plaza, Miami, Florida 33131-2805, and Daniel S. Pearson, HOLLAND & KNIGHT LLP, 701 Brickell Avenue, Miami, Florida 33131.

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