

**Precedent Setting Securities and
Accounting Negligence Case is Affirmed**

Arthur Young and Company, now known as Ernst & Young, a Big Six accounting firm, found out the hard way the importance of following accounting guidelines and securities laws. After an intensely fought trial and appeal, Arthur Young was required to pay Mariner Corporation \$4.4 million, including attorneys fees and interest, for violations of state and federal securities laws, common law fraud and negligence.

Greg Barnhart, with help from Marcia Dodson and others at Searcy Denney Scarola Barnhart and Shipley, P.A., sued Arthur Young on behalf of Mariner Corporation, an investment company now known as Boca Raton Capital. The lawsuit involved Arthur Young's role in Mariner's buyout of Dielco, Inc. Mariner thought they had found in Dielco a likely acquisition candidate. What Mariner did not realize when examining the Arthur Young prepared selling memorandum and financial statement was that Arthur Young had contracted with the sellers of Dielco for a secret contingent fee based upon the sale of Dielco. Arthur Young had just started a "merger and acquisition" department to take advantage of the large commissions generated in such sales.

Under Florida law, CPA's are forbidden from accepting contingent fees because their independence could be impaired. A CPA certifies his independence as an accountant and must be completely above board. This was not the case with Arthur Young. Their secret fee structure was designed to give the accountants considerable incentive to obtain the highest possible price for Dielco. No fee would be obtained if the sale was not closed.

As a condition of the purchase, Mariner's sophisticated investors required an audit of Dielco's financial statement. The purchase price was based upon a contractual agreement of a minimum net worth which was to be confirmed by the audit. Arthur Young was retained by Mariner to do the audit since it was already familiar with Dielco's books and records. The accounting firm's financial interest in the Dielco sale remained undisclosed.

Based upon Arthur Young's assurances in the audit, Mariner purchased the company's stock. Arthur Young received its \$50,000 commis-

sion. Dielco turned out to be a lemon and promptly went out of business.

The flattering audit was flawed in several respects, including the overstatement of net worth. The audit confirmed a net worth which exceeded Mariner's minimum requirement by a mere \$67. The audit contained factual inaccuracies and omissions which greatly inflated the value of Dielco. Barnhart successfully argued that the accountants' anticipated contingent fee impaired their ability to remain

Continued on Pg. 5

independent and impartial in conducting the audit, leading to their violation of a number of accounting principles.

After a well publicized trial in Ft. Lauderdale, a jury returned a verdict against Arthur Young on every count, including an award of punitive damages. The jury found that the irregularities and misrepresentations in the audit were responsible for the sale of Dielco and its eventual downfall and liquidation.

The Fourth District Court of Appeal affirmed the jury verdict in a precedent-setting opinion. The court ruled that accountants could be held directly responsible under the Florida Securities Acts for illegal actions in the sale of a business involving the transfer of stock. The decision made it clear that CPA's are not exempt from liability when rendering services in connection with the regular practice of accounting.

The decision sent shock waves around the accounting profession. Barnhart stated "A jury, trial court judge and now the appellate court judges have told CPA's and particularly large CPA firms that their obligation to the public must remain true. This is a very important decision for large and small businesses and for anyone who uses CPA's. It is a wake up call for CPA's who are trying to make a fast buck by representing both sides against the middle."

Note: A prominent educational firm is using an adaptation of this case in a seminar currently being conducted throughout Florida to teach CPA's what not to do when representing their clients. ■