

LS, Inc. v Paul Iadanza CPA, P.C.

2008 NY Slip Op 30642(U)

February 29, 2008

Supreme Court, New York County

Docket Number: 0604059/2006

Judge: Shirley W. Kornreich

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY
JUDGE SHIRLEY WERNER KORNREICH

PRESENT:

PART 54

Index Number : 604059/2006

LS INC.

INDEX NO. 604059/06

vs
PAUL IADANZA CPA P.C.

MOTION DATE 11/1/07

Sequence Number : 001

MOTION SEQ. NO. 1

summary judgement

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

PAPERS NUMBERED

Answering Affidavits — Exhibits _____

1

Replying Affidavits _____

2, 3

4

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

**MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM
DECISION AND ORDER.**

FILED

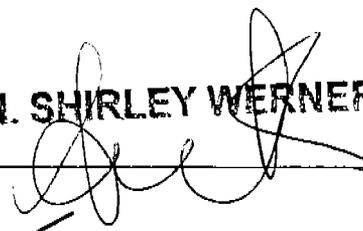
MAR 05 2008

NEW YORK
COUNTY CLERK'S OFFICE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 2/29/08

HON. SHIRLEY WERNER KORNREICH



J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

----- X
LS, INC.,

Plaintiff,

Index No.: 604059/06

-against-

DECISION
and ORDER

PAUL IADANZA CPA, P.C., and
DELLA FAVE, TARASCO & CO, CERTIFIED
PUBLIC ACCOUNTANTS, L.L.P.,

Defendants.

----- X
KORNREICH, SHIRLEY WERNER, J.:

FILED
MAR 05 2008
NEW YORK
COUNTY CLERK

This accounting malpractice action arises out of an audit performed in 2001 for the 2000 fiscal year by defendant Della Fave, Tarasco & Co., Certified Public Accountants, L.L.P. (DFTC) for plaintiff LS, Inc. (LS). In its complaint, LS alleges, *inter alia*, that the negligent audit performed by DFTC and subsequent reviews by defendant Paul Iadanza CPA, P.C. (PICPA) permitted LS' President William J. Cavanagh, Jr. (Cavanagh) and other officers, to embezzle approximately \$3,000,000 in corporate assets.¹ Some of the expenses allegedly misappropriated include the use of corporate credit cards to pay approximately \$800,000 worth of personal expenses, the use of corporate checks for approximately \$1,500,000 in unauthorized personal expenses, and the unauthorized purchase of a \$1,000,000 fishing boat, a house in Voorhees, New

¹In December 2005, an indictment was brought against Cavanagh in the United States District Court, Southern District of New York, charging him with several counts of mail fraud and conspiracy. LS' former controller, B. Tyrone Thompson, also was charged with mail fraud. Cavanagh and Thompson both pled guilty and were each sentenced to 18 months in Federal prison. Cavanagh was ordered to pay \$1,990,830.50 in restitution. Michelle Gluck, another former LS employee, pled guilty for her participation in the fraud by, *inter alia*, forging checks, and is currently awaiting sentencing.

Jersey, \$54,444 in clothing and \$50,750 worth of dental implants. DFTC, now, moves for summary judgment pursuant to CPLR §§ 3212 and 214, alleging that the complaint is time-barred against it by the three year statute of limitations. Plaintiff opposes.

I. *Background*

A. *EBT of Victor Della Fave*

DFTC's principal Victor Della Fave (Della Fave) avers the following. In December 2000, LS retained DFTC to perform an audit of its financial statements for the 2000 fiscal year (2000 Audit). DFTC was referred to LS by Paul Iadanza (Iadanza), who had a prior personal relationship with Cavanagh. Iadanza ran his own accounting firm entitled Paul Iadanza CPA, P.C. (PICPA). Iadanza, who was a tenant in DFTC's office space until approximately 2001, would frequently collaborate with DFTC on various financial and accounting matters. This collaboration between the two firms was of an "informal" nature where they would discuss accounting matters and act as "sounding boards" for ideas and recommendations. There were, however, "five or six engagements" or instances where PICPA's clients required services that it could not provide such as financial reporting, certified audits and more intricate tax work. In these instances, a more "formal business relationship" existed between the two firms. The 2000 Audit was such an instance. As stated by Della Fave:

The LS situation was dealt with more in the nature - of a fee for services [arrangement], insofar as [DFTC] accepted the arrangement to prepare [the 2000 Audit] and - arranged with Mr. Iadanza to assist us in performing that certified audit. So he worked as [DFTC's] assistant during the course of [the 2000 Audit]...[Iadanza] was only engaged to perform services. Specific audit tasks, for example, review the bank reconciliation, vouch...these particular bills, examine these particular bills. [Iadanza] worked as a - essentially a supervised employee under [Della Fave] personally.

EBT of Victor Della Fave pp. 20, 40. Della Fave personally was in charge of the 2000 Audit and stated he retained PICPA due to Iadanza's prior relationship with Cavanagh. DFTC paid PICPA by check for its services.

During the 2000 Audit, Della Fave avers that issues arose regarding Cavanagh's purchase of the boat and some of the large credit card expenditures. Cavanagh not only gave DFTC his verbal assurance that all of the expenses were business related, he also sent a letter to Iadanza dated March 20, 2001 to memorialize the "business nature" of these expenses. Della Fave testified that the verbal assurance and letter served to close the issue as to the propriety of these expenses. As to the question of who should have been tracking and verifying whether or not these expenses had been classified appropriately, Dell Fave stated:

If he [Cavanagh] was doing something improper, the mechanism for that to be uncovered was for the board to take the financial statement, read it, and then call him to task on it. It's not for us to say, well, you are doing something improperly, because he follows the mandate of the board. We are not at the board meeting, so we don't know - a lot of mandates are verbal.

[T]he board should have created an audit committee, or at least had - put one person as a layer between them and the - where the auditors report to, precisely...to avoid these kind of problems, where the final person in charge [Cavanagh] ...is in fact, or may be in fact, steering money his own way.

Id. at 90, 105-106. The 2000 Audit was completed and delivered to LS on March 8, 2001.

Following the 2000 Audit, LS terminated its relationship with DFTC and retained PICPA to perform annual "reviews" of its financial statements from 2001 through 2004. During his EBT, Della Fave explained the differences that exist among the three different levels of financial reporting. Compilations are where a CPA will take a company's numbers and put them into a financial statement. A compilation is the lowest level of financial reporting. A review is the

second level, where the accountant makes a statement that he performed certain analytical tasks such as breaking down rent and other financial data. During the review, the accountant also must indicate that it did not audit the financial statements. The third and highest level of financial reporting, is an audit.

Della Fave averred that despite sending out an engagement letter to continue providing accounting services, his firm was not retained by LS to perform an audit of its financial statements in 2001. According to Della Fave, from this point forward, Iadanza took on LS' business by himself and performed a review only, not an audit. In regard to the nature of how Iadanza's review would work, Della Fave avers:

Also, [Iadanza] had [DFTC's] work papers to build on, so it was a - once the certified audit was done in '00, the following year became a very easy engagement so to speak. Second year, financial statements and second year engagements are...a lot - one generally is flushed out most of the issues in the first year, and basically the second...year...is a quantum leap easier than the first year...[The third year is] slightly...easier [than the second] but not as easy as being able to follow a certified audit.

A down-step in service is a review, which is what Mr. Iadanza did in the year 2001, where he followed our financial statements from the year...2000, and down stepped the services to a review.

Id. at pp. 29-30, 46. Della Fave did not testify as to any of the subsequent reviews performed by PICPA for LS in 2002-2004.

B. EBT of Paul Iadanza

Iadanza avers the following. During the year 2000, Iadanza was formally employed by his own firm, PICPA, but there were points in time where he would "informally" collaborate with DFTC on engagements where he needed work to be completed that his firm could not perform on its own. The 2000 Audit was such an occasion. In reference to the 2000 Audit, he

stated that DFTC paid PICPA for "whatever time [it] spent on the audit." He could not remember the exact amount of money paid to his firm by DFTC, only that it was less than \$30,000.

Following the 2000 Audit, Iadanza avers that PICPA provided accounting services to LS from approximately February 2001 through March 2004. He further averred that DFTC ceased providing services to LS following the 2000 Audit. PICPA provided LS with annual review statements, annual tax returns and various other forms of consultation. Each year, PICPA entered into an engagement letter with LS outlining the terms and conditions of what the review would cover and what the fee arrangement would be. According to Iadanza, PICPA only performed reviews because it was not "peer reviewed" and, therefore, was not qualified to perform any formal certified audits.

Regarding the reviews he performed for LS in 2001, 2002 and 2003, Iadanza avers that he based his reports on some of the information contained in the 2000 Audit papers. Initially, Iadanza took all of the files related to LS from DFTC in order to copy certain records because "[he] was handling the review statement for the following years [and needed] some of the stuff that was in [the 2000 Audit papers]." Specifically, Iadanza avers he used carryover schedules, depreciation numbers, and profit numbers from the 2000 Audit to assist him in preparing the annual review statements for the fiscal years 2001 through 2003. He also used miscellaneous expense schedules provided by LS' former controller B. Tyrone Thompson (Thompson) in combination with these other papers to assess whether or not to reclassify any expenses outlined in previous reports.

II. *Conclusions of Law*

A party moving for summary judgment must make a prima facie showing of entitlement to judgment as a matter of law by tendering sufficient evidence in admissible form, to demonstrate the absence of any material issues of fact. *Zuckerman v. City of N.Y.*, 49 N.Y.2d 557, 562 (1980). Once movant has made the requisite showing, the burden shifts to the nonmoving party to produce evidentiary proof in admissible form, sufficient to establish the existence of a triable issue of material fact. *Giuffrida v. Citibank Corp.*, 100 N.Y.2d 72, 81 (2003).

An action for professional malpractice must be commenced within three years of the date of accrual. CPLR 214(6). A claim for accounting malpractice “accrues upon the client’s receipt of the accountant’s work product since this is the point that a client reasonably relies on the accountant’s skill and advice [and is where] all the facts necessary to the cause of action have occurred and an injured party can obtain relief in court.” *Williamson v. Price Waterhouse Coopers, LLP*, 9 N.Y.3d 1, 8 (2007) quoting *Ackerman v. Price Waterhouse*, 84 N.Y.2d 535, 541 (1994). Here, plaintiff’s malpractice claim relating to the 2000 Audit against DFTC is deemed accrued on the date it received DFTC’s audit report on March 8, 2001. This action, however, was not commenced until November 22, 2006, well past the three year limitations period. Consequently, plaintiff’s action against DFTC is time barred unless the continuous representation doctrine serves to toll the three-year limitations period.

In *Williamson*, the Court of Appeals, for the first time, applied the continuous representation doctrine to an accounting malpractice action. The court used the same principles it had previously outlined in the medical and legal malpractice areas and stressed two points. There must be some “mutual understanding” between the parties to the engagement that the

auditors would provide further representation as to a past audit and “awareness” by the parties of a condition or problem emanating from a past audit warranting further representation.

Williamson, 9 N.Y.3d at 10-11. The court further wrote that the “nature and scope of the parties’ retainer agreement (engagement) play a key role in determining whether ‘continuous representation’ was contemplated by the parties.” *Id.* at 10. In the end, the *Williamson* court found that the continuous representation doctrine did not apply because each annual engagement letter between the parties contemplated separate and discrete auditing services each year; and once the defendant had performed the services for a particular year, no further work on that year was undertaken. *Id.* at 10-11; *see* Johnson, Supplementary Practice Commentaries, McKinney’s Cons Laws of NY, Book 7B, CPLR C214:6, at 57. Nonetheless, the court noted that the outcome would have been different had plaintiff “engaged defendant to provide corrective or remedial services (e.g., to reexamine a prior year’s financial statements or redo a prior year’s audit).” *Id.*

Similarly, the continuous representation doctrine does not serve to toll the three-year statute of limitations period in the instant case. The 2000 Audit was completed and delivered by DFTC to LS on March 8, 2001. LS rejected DFTC’s engagement letter to continue providing accounting services for the 2001 fiscal year. Both Della Fave and Iadanza testified that DFTC’s services to LS terminated upon the delivery of the 2000 Audit. As a result, there was no mutual understanding between the parties that DFTC would provide LS with any further representation as to the 2000 Audit. In sum, DFTC’s services to LS permanently ceased in 2001. From that point forward, Iadanza and his firm were solely responsible for LS’ accounting needs.

Plaintiff argues that DFTC’s representation of LS continued through 2004 contending that Iadanza was employed by DFTC until he was terminated by LS in 2004. Plaintiff does not provide evidentiary support for this conclusory allegation. In fact, Dell Fave’s and Iadanza’s

affidavits refute this allegation. In addition, the evidence demonstrates that PICPA and DFTC were separate and distinct accounting firms, collaborating on the 2000 Audit, but not working together thereafter. From 2001 to 2004, PICPA performed reviews, not audits, pursuant to separate engagement letters, and was paid directly. Thus, even if the court were to accept the fact that Iadanza and PICPA were “employed” by DFTC during the 2000 Audit, any employment relationship that existed between the two firms terminated upon completion of the 2000 Audit on March 8, 2001. Moreover, PICPA performed separate and discrete work pursuant to its own engagement letters. Nothing in this record shows that the parties contemplated further auditing work related to 2000, by DFTC.

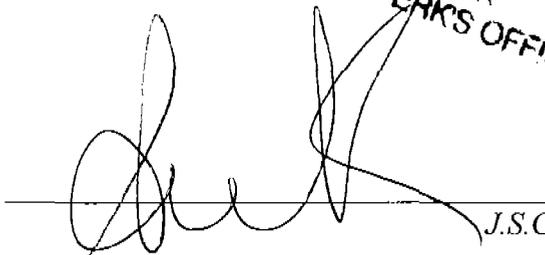
Hence, here as in *Williamson*, “[g]iven [DFTC’s] lack of awareness of a condition or problem warranting further representation and the fact that no course of representation was alleged, the purpose underlying the continuous representation doctrine would not be served by its application here.” *Id.* Plaintiff’s remaining arguments have been considered and are found to be without merit. Accordingly, it is

ORDERED that the motion for summary judgment is granted and the complaint is hereby severed and dismissed as against defendant Della Fave, Tarasco & Co., Certified Public Accountants, L.L.P., and the clerk is directed to enter judgment in favor of said defendant; and it is further

ORDERED that the remainder of the action shall continue.

ENTER

DATE: February 29, 2008
New York, NY


J.S.C.

FILED
MAR 05 2008
NEW YORK
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