

RISK MANAGEMENT: WHAT ACCOUNTANTS CAN DO TODAY TO PREVENT PROBLEMS TOMORROW

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After Enron, accountants nationwide are legitimately wondering what the ultimate effect on their practice will be. One thing that is certain is that plaintiffs' lawyers have been emboldened and that accountants will continue to be seen as deep pockets whenever financial transactions go sour.

It is no fun to be sued for malpractice. Even a defensible lawsuit in which you ultimately prevail will cost attorneys' fees below your insurance deductible, will intrude upon you and your colleagues' time, attention and emotions, and can hurt you and your firm's hard-earned reputation. The buzz around town will be that you got sued; the favorable resolution three years later will be yesterday's news and may be confidential in any event.

Your goal, then, is not to get sued in the first place. This article lists fourteen tips that you can incorporate into your practice today that will help you avoid malpractice claims and increase your chances of success in the unfortunate event that you are sued.

1. Don't promise the moon in your promotional materials. An accountant's promotional materials often promise the moon, and the stars too, or at least an army of resources in all fields. Plaintiffs' lawyer use these, as well as the accountant's written proposals and oral sales presentations, to expand the accountants' duties and as the basis for fraud claims saying the accountant misrepresented his qualifications and/or didn't deliver what was promised. Rarely do professionals understate their qualifications when drumming up new business, and sophisticated clients will become naïve and gullible plaintiffs in litigation. Take care to make accurate and realistic statements when marketing. Once the client is on board, manage its expectations and keep them realistic. If the chances of the IRS approving of your client's position are slim, say so up front.

2. Rigorously screen prospective clients. Many accountants who are sued will admit they never should have accepted the client in the first place. Thinking through the question of "Do we want this person or company as a client?" is the best claim prevention for all accountants, be they auditing Fortune 500 companies or preparing projections for a small business. The simple fact is that judges, juries, and the business community associate you with your client, especially after a disaster. Look at Enron. Avoid the temptation to take on risky clients. No matter how much you might need the work, resist the pressure to get new clients regardless of the cost -- there often is one. Set up a client screening committee or, at the least, have another partner look at the matter and apply the "smell test" so the decision to take on the client is independent and not driven by one accountant's desire to be a rainmaker. (Not only will this help prevent claims, but it will reduce your firm's collection problems.) Talk to any predecessor accountants. Trust your instincts, and don't be afraid to say no. Also consider your own expertise and qualifications. Is the timing for the engagement realistic for your firm? If you or your firm haven't done this type of work before, maybe you should refer the client elsewhere. Finally, conduct a similar analysis periodically on existing clients to decide if your firm should continue working with them.

3. Always use and update engagement letters. This letter is one of your best protections against a malpractice claim. For example, clients often view CPAs as guarantors that employees will not embezzle money. The client feels that my CPA is "watching out for me" and that therefore it need not maintain proper internal controls. Unless your engagement letter limits the scope of your responsibility, you will, at the least, have to incur the attorneys' fees to prove that you are not responsible for something. Prepare separate engagement letters for each matter you take on for the same client, and update those letters yearly and whenever the nature of your engagement changes. State specifically what you will and will not do. If you don't adequately describe the attest work, you may be held to the audit and not review

standard. Avoid broad descriptions like "general business advice." State your reliance on the client for any particular facts and state all appropriate disclaimers. If you're not supposed to detect fraud, say so. Consider limiting your liability to fees paid, requiring indemnification, or providing for arbitration rather than litigation. Do not rely upon a conversation to limit the scope of your engagement; memorialize it in a letter. Have the client sign and return a copy of that letter agreeing to its terms. In a very real sense, it is a contract that can insulate you from future liability.

4. Document client communications and advice. The best evidence in court is a document, not your hazy recollection of what transpired in a conversation three years ago. Document your advice, assumptions, and recommendations to the client with appropriate notes to the file and/or letters to the client. Remember that, in litigation, those notes and letters can be read to a jury and opposing counsel will rigorously scrutinize them. If you record concerns in your notes, make sure you do something about those concerns or they may come back to haunt you. Always date your internal notes. Avoid fragmentary notes that can later be misconstrued and taken out of context. Turn those notes into complete memoranda if they involve important issues. Always send a letter if the client is going to act upon your advice so that there is no question later regarding what the advice was and the assumptions it was based upon. Remember that a client who feels ignored is an unhappy client. Keep your client informed and return his phone calls.

5. Adopt a document retention policy and stick to it. After Enron, this is a no-brainer. Judges, juries and the public do not react well to document destruction. How long you retain documents isn't as important as consistently applying whatever policy you adopt. It's a matter of judgment but use the applicable statutes of limitation as a guide. Remember that in Arizona the two-year malpractice statute doesn't start to run until the client discovers its injury, which can be years after you performed the work in question. (In tax matters, the statute doesn't start running in Arizona until after the IRS issues a notice of deficiency.) Ten years is a safe rule, and perhaps indefinitely if you took on a risky client. If in doubt, keep the document. Remember to address e-mails in your policy; often they should be retained. Once you adopt a policy, stick to it. If you delegate closing files to support personnel, make sure they know and follow the policy. Even if the time is up, don't destroy documents if you have reason to believe a claim may be filed or a subpoena issued. Consider informing your client before you destroy any documents.

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