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RISK MANAGEMENT FOR ACCOUNTANTS IN EMERGING PRACTICE AREAS

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Historically the largest malpractice exposure for accountants has been in audit work (for the larger firms that emphasize this work) and in tax work (for most of the other firms in the country). Accountants today, however, have expanded beyond these traditional areas and are developing new specializations and offering a diverse range of services. For example, accountants now serve as mediators and arbitrators, offer other litigation support services, and perform a variety of consulting or management advisory services ("MAS").

While, after Enron, some firms may decide to scale back some of these services if they are also serving as auditors, the vast majority of firms likely will continue to practice in these expanded areas. These areas are not risk free and, in fact, offer new grounds for concern from a risk management perspective beyond those found in the traditional attest and tax areas. This article points out a few of the potential risk management traps that accountants should be aware of when practicing in these non-traditional areas.

1. Tell your client that your firm's in-house consultant is not a CPA. Accounting firms sometimes hire people who are not CPAs to staff their engagements, and frequently the employees who do consulting work are not accountants. If that is the case, make it clear to your client up front that non-accountants are doing some of this work for you. Your engagement letter should state the qualifications of the people doing the work -- otherwise the client may be led to believe the consultant is a CPA, which can form the basis for a fraud claim or can expand the scope of the firm's duties. Take the steps now to prevent your client from arguing in court that he hired your firm so that qualified CPAs would do his work only to find out that you lied to him and put people who didn't have that expertise on the engagement.

2. Multiple standards of care can apply to the consultant who is also a CPA. If the consultant is a CPA, he runs the risk of being held to a higher standard of care than the consultant who does not have an accounting background. A consultant is held to the standard of care of an industry professional. If the consultant is a CPA, however, he can also be held to the AICPA's Management Advisory Services Practice Standards, which are not industry-specific and in some instances impose a higher standard of care. In addition, if your firm has internal quality control procedures designed for audit or tax engagements (workpaper maintenance, manuals, second partner review) either follow them, design new ones for consulting engagements, or state in your engagement letter that they don't apply -- otherwise, a plaintiff will argue that you didn't comply with the firm's own standard. Don't set yourself up for a

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malpractice claim by leaving open the possibility that the second partner review your firm requires on attest engagements somehow applies when advising a client about purchasing a new software system.

3. An accounting firm consultant may be considered a fiduciary. A consultant usually is not a fiduciary. Indeed, many consulting engagements are one-shot deals where the consultant does not have the opportunity to develop a close relationship with the client. But things can be different if the consultant is also a CPA. If your firm has a long-standing relationship with the client, it may be held to the higher fiduciary standard of care on a consulting engagement. That would require the accountant to act with "utmost loyalty" and in the best interest of the client. Under the law, even Donald Trump can be a financial neophyte in this circumstance. A fiduciary also has the burden of proving in court that the transaction was fair to the client.

4. Remember that the knowledge of one person in your firm is imputed to the others. Accounting firms that offer a wide variety of services to their clients can run into problems when, for example, a consultant learns something that might be pertinent to the tax returns but does not communicate that information to the tax partner. Under the law, if one employee of your firm knows something then that knowledge can be imputed to everybody in the firm. Information learned in a consulting engagement (e.g., that the client is losing a large account) may be relevant to the audit or tax engagement and vice versa. Since the consultant's knowledge can be imputed to the tax partner there needs to be a clear line of communication. Consider requiring partners to make inquiries about other engagements for the same client to see if there is any information they need to know about. It may be worthwhile, for example, to have a member of the audit staff review the workpapers from the consulting engagement to make sure nothing slips between the cracks.

5. Beware of conflicts of interest. Consulting can compromise auditor independence. After Enron, you don't want to expose your firm to the allegation that you had a conflict of interest. Take the concept of independence seriously on all engagements, not just audits. Indeed, the AICPA MAS Standards say that "practitioners must act with integrity and objectivity and be independent in mental attitude." Can you do consulting work for a competitor of your audit/tax client? Think such questions through before a plaintiff's lawyer makes you look foolish in front of a jury.

6. If you perform a variety of services for a client, use disengagement letters to make clear when specific engagements end. Under the "continuing relationship doctrine," your client is your client until you cease doing any work for it. For example, a one-time consulting engagement, unless properly terminated, can be deemed to continue if the firm is still doing annual audit or tax work, with a duty to disclose subsequently acquired information. To absolve yourself of the duty to disclose information that your auditors learn four years after the consulting engagement ended, send a proper disengagement letter at the conclusion of the consulting engagement stating that the engagement has concluded and disclaiming any responsibility to update your report. The "continuing relationship doctrine" can also extend the accrual date of the statute of limitations on the consulting engagement if your firm continues to

do annual audit or tax work. Again, you can avoid this by sending a proper disengagement letter for the consulting engagement.

7. <u>You may have increased exposure under the securities laws</u>. Accountants who prepare financial information or projections for securities offerings are more likely to be deemed to have "knowledge" of misrepresentations and omissions if they have an extensive (audit, tax, etc.) relationship with the issuer. Not only is the knowledge of one person in the firm imputed to all others, but the longer the firm has had a relationship with the client the more likely it is that the firm had access to information that a plaintiff later says was misrepresented to it during the offering. A one-time consultant will not have this problem.

8. <u>You have exposure to third parties</u>. In Arizona, accountants can be liable not just to their clients, but also to those to whom the accountant intends to supply information or those to whom the accountant knows the client intends to supply the information. Thus, non-client lenders, investors, acquirers, etc. can sue accountants. Don't make it easier for these potential plaintiffs. Disclaim responsibility to non-clients in your engagement letter. If a prospective lender calls to say he'll lend based on your consulting report, don't say that's fine. Investors finance a company for any number of reasons; it's only in hindsight that all they relied on was you. Don't let them escape the responsibility of doing their own due diligence.

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