5 Ways Firms Can Better Prepare As Legal Claims Rise Against CPAs

Since 2000, on the heels of several corporate scandals and financial reporting fiascos, judges have been less likely to throw out cases against CPAs than they once were. Judges grant fewer motions for summary judgment and seem to require additional discovery before rendering decisions on cases.

According to CPA Mutual, a national risk retention group and accounting firm liability coverage provider, firm claims with actual expenses paid have increased by 41 percent since 1998. Accounting firms can expect, on average, to experience one liability matter per every 38 employees each year.

It's not that public accounting firms are less cautious in their practices. CPAs are an easy mark to go after in lawsuits because they carry professional liability insurance. Add to that a labor shortage in the profession, and overburdened managers and partners are faced with increasing risk to place qualified team members on engagements. "There is nothing worse for firm owners than to hear a staff member explain at deposition, 'I had no idea what I was supposed to do, and there was no one on the job to answer my questions,'" says Bill Thompson, President of CPA Mutual.

When it comes to diligent risk management against a legal claim, purchasing liability coverage isn't enough. The time and expense of a lawsuit can disrupt firm operations and cause clients to question their choice of advisor. In addition to the right coverage, accounting firms can add the following strategies to practice management. These steps can improve the odds of avoiding claims, and at the very least properly manage them.

Invest in consistent staff training.

Plaintiffs attorneys like the idea of "kids" doing audits, that is, less experienced auditors. Firms need to have enough senior-level staff people to adequately supervise each engagement. Before adding a new client, think long and hard about whether you have the right people to take on the engagement. For quality control, make sure that qualified staffers are positioned at every level and phase of the engagement.

Update and enforce document retention policies.

Paper and electronic files are discoverable in a lawsuit. These include workpapers, but also e-mails, text messages, instant messages, blogs and any other message stored electronically. The firm's document retention policy should include electronic communications even on personal home computers and phones used for business. Remember, Arthur Andersen wasn't found guilty of performing a bad audit – it was found guilty of a cover-up based upon one bad e-mail! Train staff on saving client and firm communications in all forms.

Review communication protocols.

Remind staff that anything they write – regardless of its form – may be discoverable. When in doubt, speak about sensitive information in person and determine how to communicate it to the client or other staff. Electronic documents are extremely expensive to produce, and there is a very complex set of rules for their retention and safekeeping once a claim is imminent or threatened. This alone will require the help of an attorney.

Revise contracts and invoices.

One of the most dangerous liability risks to CPA firms today is contract language. Firms are adding a number of specialized service niches in order to differentiate and compete, but they are not updating their letters of engagement and invoicing to clarify the exact nature of services rendered or the CPA's role in the engagement. Firms run into problems in areas such as consulting on tax implications that tie to investments or estates. An innocent conference call, improperly documented, can create the appearance that the accountant offered investment or legal advice. If the client's investments or estate runs into trouble, the accounting firm must be able to clearly demonstrate its role.

Choose insurance providers carefully.

As claims statistics worsen, insurance companies that recently entered the accounting market only to grab market share will be heading for the exits. It happened in the mid-'80s and then again the early 2000s, so CPAs should not be surprised if they receive a non-renewal letter in the mail informing them that the company to whom they have paid premiums all these years won't be around to service their claims. The last thing CPAs want to deal with is claim litigation serviced by an insurance company that no longer serves their market.

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