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Top Liability Risks in CPA Firms

Public accounting firms face increasing risks due to the services they offer, the contracts they sign and the technology they use. Firm liability claims can average $80,000 in insurance deductibles and payouts, according to CPA Mutual, a national risk retention group and accounting firm liability coverage provider. Some of the most common liability risks can be avoided while the costs of others can be managed. Here are some of the most common liability risks and how to support claims management and proper coverage.

1. M&A Due Diligence
When a business deal goes south, the buyer or the seller could sue an accountant on the grounds of misrepresenting the financial records of either party or possibly showing partiality to one party over another in the representation of value, assets or profitability. At a minimum, firms must clearly document in the contract who is paying for services, the specific services engaged and the nature of the relationship between the accounting firm and each of the parties involved.

2. Business Valuations
Accounting firms may be sued if a party believes that business valuation services the accounting firm performed have understated or overstated the true value of a business. Even if the estimate of value or valuation is accurate, the accounting firm can incur substantial legal defense costs in lawsuits arising from shareholder disputes or divorces. Screen clients carefully for these services and develop a customized engagement letter just for business valuations.

3. Cultural Ethics

As accounting firms merge or acquire new practices, the culture and practices of the newly merged partners and staff may not match up. Lawsuits have occurred years after a merger due to siloed practices and inconsistent approaches to client screening and professional ethics. Partners need to be on the same page with professional standards. It's better for a partner to leave than endanger the entire firm with questionable clients or indefensible practices.

4. Billing Records

Accountants who consult on tax implications that tie to investments or estates can run into gray legal areas when they don't stipulate their role in conversations with their clients' investment advisors or attorneys. An innocent conference call, improperly documented, can create the appearance that the accountant was offering 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.

5. Verbal Reminders

Sometimes a friendly phone call is fine to remind a client about information required to meet a tax deadline. A better practice is to send written reminders to all parties involved. If the client or another party holds up the tax filing, firms need documentation to prove that the resulting extension or penalties are the client's responsibility. It may not prevent a lawsuit, but will often shorten the proceedings.

6. Client Fraud

This area of liability is often the first that accounting firms worry about, but it's not always so evident if the client relationship in question spans years. Business lawsuits have shown repeatedly that numbers don't lie, but people do. It is better to trust the accounting and audit processes and controls than to trust the people involved with them. When in doubt, discuss the red flags even with long-time clients you trust.

7. Multiple Tax Jurisdictions

Accounting firms that file client taxes in multiple local and state tax jurisdictions have run into trouble with obscure laws and schedules. Rather than be surprised by a hefty tax notice down the road, consult with local agencies or accountants in that jurisdiction to confirm proper filing as well as any available credits and exemptions.

8. Divorce
When marriages dissolve, accountants can be caught in the middle even when the negotiations seem amicable. It's best from a liability standpoint to develop separate contracts to handle any services with regard to business partner buyouts, valuations and future tax filings. Specify the services rendered and disclose any potential conflicts in advising one or both spouses.

9. Business Failures
Creditors will look for any opportunities to collect on debts in a business failure. Auditors need to clearly document advice to management and decisions regarding the financial stability of a company. At best, firms may choose to terminate their engagement with a company that appears likely to fail. It's a case-by-case decision, but potential insolvency can't be ignored.

10. Insufficient Caution
All of these examples point to the need for accountants to maintain a cautionary approach to tax and audit services as well as consulting. As firms diversify their services, they will run into increased potential conflicts and vulnerability to lawsuits. Maintain professional skepticism and think about how the work put forth could hold up in front of a jury – or not.