When a CPA is retained, good practice dictates use of an engagement letter to set forth the scope and terms of the engagement. Although not required, engagement letters are recommended and can prevent misunderstandings and unforeseen liabilities. Because the primary purpose of an engagement letter is to establish an understanding between the parties, the engagement letter should generally address the following: 1) The parties to the agreement; 2) services to be performed; 3) Responsibilities of the parties; 4) termination of the engagement; 5) limitations on liability or damages; and 6) payment of services.

This article discusses past mistakes that may resurface with the submission and litigation of BP oil spill claims, and how to avoid these mistakes through properly drafted engagement letters. First, CPAs risk unanticipated liability by not expressly identifying the parties to the engagement. Second, a sufficient description concerning the services the CPA is to perform avoids subsequent confusion and misunderstandings. Third, by clearly stating the client’s responsibilities, the CPA can prevent future disputes based on misguided presumptions. This will be particularly helpful in situations where clients are under the mistaken belief that the CPA ultimately is responsible for the overall content and timely submission of an oil spill claim.

Fourth, having the ability to terminate the engagement under certain circumstances protects CPAs from clients alleging, for example, that the CPA’s untimely withdrawal from the claim submission process led to further damages. Fifth, expressly limiting the CPA’s liability or damages in the engagement letter further protects the CPA from foreseeable and unforeseeable claims. Finally, it is important to contemporaneously document the time the CPA incurred in performing the services in order to defend against potential fee disputes. Likewise, to avoid litigation and professional discipline, CPAs should comply with the professional code and the particular state’s rules and regulations regarding fee arrangements.

Establish Parties to the Agreement

In a consulting engagement, the engagement letter should clearly identify the parties to the engagement. Although this suggestion seems obvious, liability in consulting engagements can hinge on a proper recitation of who is a party to the engagement and who is not. For example, in the absence of express language in an engagement letter, a CPA who is hired by an attorney to perform litigation support or claim services may be found by a court to owe certain responsibilities to the attorney’s client. A properly worded engagement letter can help to limit the CPA’s responsibilities to others and discourage courts from extending the accountant’s liability beyond what was contemplated when the engagement was accepted.

Additionally, because litigation will be a possibility in each of these claims to BP and other insurers, clearly identifying the attorney as client, where possible, can provide the protection of the attorney-client privilege. This will prohibit disclosure of the CPAs work prematurely.

Describe Services to be Performed

Perhaps one of the most important parts of an engagement letter addresses the scope of services. There is a fine line between providing too much and too little information about the services to be performed. Excessive detail may open the CPA to charges that the engagement was not completed in its entirety, and that the engagement’s conclusions are not properly supported. For example, a practitioner who is hired as an expert witness, and who does not complete each and every task noted in the engagement letter, risks an adversary challenging the CPA’s credibility, opinions and testimony. On the other hand, broadly defining the scope of services may result in misunderstandings and disputes with clients and third parties regarding the specific tasks to be performed.

A recent Florida case exemplifies the problems that may arise by providing too little information in the scope of services section of an engagement letter. In Tropical Glass & Construction Co. v. Gitlin, CPA, the court held that a CPA firm could be liable for negligence for a performed service that was not within the scope of the services outlined in the engagement letter. 13 So. 3d 156 (Fla. 3d DCA 2009). Tropical retained a CPA firm to prepare Tropical’s annual tax returns. The CPA firm entered into two engagement agreements with Tropical during the course of the relationship, and the second engagement letter specifically included an exculpatory provision:

Our engagement cannot be relied upon to disclose errors, fraud or illegal acts that may exist. For these reasons, you, and any successors, employees or assigns, understand, acknowledge and agree that neither our firm nor any of its employees or agents shall be liable for any act(s), omission(s), negligence (including gross negligence), breach, mistake in judgment, claims or causes of actions, whether legal or equitable, injury or damages of any kind whatsoever, arising from our engagement…

Id. at 157.

Three years later, Tropical sued the CPA firm, alleging that it had negligently performed monthly bank reconciliations, and as a result, the defendants “failed to detect that Tropical’s bookkeeper had misappropriated Tropical’s funds for his own personal gain.” Id. at 157-58. The defendants argued that, pursuant to the terms of the second engagement letter, it had no duty to detect fraud by Tropical’s employees because the monthly

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Set Out Parties’ Responsibilities

Clearly stating the responsibilities of each party in the engagement letter prevents confusion and mistaken presumptions by the client. Most practitioners have encountered a client who failed to disclose relevant information or documentation that could materially alter the CPA’s conclusions. This frustration can be eased by including an affirmative duty on the client to provide the materials necessary for the CPA to complete his or her services.

With regard to the BP claims process, the practitioner should make clear that the client has a duty to provide the CPA with any transmittals or communications received from or provided to BP, because the CPA typically will not communicate directly with BP. Additionally, many clients filing a BP claim will assume that because the CPA is involved with preparing the claim, the CPA is thereby responsible for the timely filing of the claim. To avoid this assumption and potential liability for untimely submissions, the CPA should point out in the engagement letter that, although he or she is assisting the client in preparing the claim, the client ultimately remains responsible for the timely submission of the requested documentation and the claim itself. The client’s breach of its duties under the agreement may provide a basis for terminating the engagement, relieving the CPA of liability if the client attempts to hold the CPA responsible for an incomplete or untimely claim.

Terminating the Engagement

Engagement letters should provide practitioners with the option to withdraw from the engagement if necessary, and the engagement letter should state certain acts or omissions by the client that would warrant a CPA’s withdrawal. In other words, the letter should provide that the practitioner will have the right to terminate the engagement without being held responsible for any consequences if certain contingencies occur, and the practitioner should list those contingencies.

Common grounds for terminating an engagement include a CPA’s conclusion that the client has provided untruthful information, is being dishonest or is uncooperative. Any of these events could substantially affect the CPA’s conclusions. By addressing these in the agreement, the CPA may avoid liability that otherwise would result from withdrawal. This means, for example, that a client would be barred from later alleging that the CPA’s untimely withdrawal from the BP claims process led to further damages. Hold harmless provisions are another way for practitioners to avoid or limit liability.

Limit Liability and Damages

Many engagement letters, especially for litigation services, include “hold harmless” provisions which seek to limit the practitioner’s liability or the amount of damages, or provide for indemnification or contribution. For example, a provision in an engagement letter may place a limit or cap on certain types of damages, such as consequential, incidental or punitive damages, should a court find that the practitioner breached the engagement agreement. CPAs, however, must continue to be cautious because these contractual provisions apply only to the parties of the agreement. Therefore, a limitation on damages provision may not limit damages owed to a third party who reasonably relied on the CPA’s work. CPAs should be aware that a third party, such as BP, may rely upon the information they assemble. If that third party reasonably relies on the information to its detriment, the CPA may face liability, depending on the nature of the service provided and state law.

While hold harmless and indemnity provisions are important, courts will refuse to enforce them unless the language is clear and unequivocal. In Kitchens of the Oceans, Inc. v. McGladrey & Pullen, LLP, the court held that a hold harmless agreement included in the engagement letter between a CPA firm and its client was unenforceable because it did not clearly state that the firm was being indemnified for its own negligence. 832 So. 2d 270, 273 (Fla. 4th DCA 2002). In this case, the client sued an accounting firm for negligence in the firm’s audit of certain financial statements because the auditors failed to detect an ongoing embezzlement scheme by one of the client’s employees. The auditors responded that the engagement letter between the client and the auditors, which included a hold harmless provision, barred the negligence claim: [Client] hereby indemnifies [auditors] and its partners and employees and holds them harmless from all claims, liabilities, losses, and costs arising in circumstances where there has been a knowing misrepresentation by a member of [client’s] management, regardless of whether such person was acting in [client’s] best interest. This indemnification will survive termination of this letter. Id. at 271. The Court disagreed with the auditors and explained that >>>
“contracts of indemnification which attempt to indemnify a party against its own wrongful acts are viewed with disfavor in Florida and shall be enforced only if they express an intent to indemnify against the indemnities’ own wrongful acts in clear and unequivocal terms.” Id. at 272; see Van Tuyn v. Zurich Am. Ins. Co., 447 So. 2d 318, 320 (Fla. 4th DCA 1984) (explaining that if an exculpatory clause is to be effective, it must clearly state that it releases the party from liability for its own negligence).

The Court distinguished the hold harmless provision in this case from other cases that have upheld provisions releasing a party from liability for its own negligence. For example, in Winn Dixie Stores, Inc. v. D & J Construction Co., the court held the indemnity agreement covered the claim made against Winn Dixie upon which it was seeking contractual indemnity from D & J. 633 So. 2d 65, 65-66 (Fla. 4th DCA 1994). The indemnity agreement was clear and unequivocal and covered “any claim or loss arising in any manner . . . notwithstanding such accident or damage may have been caused in whole or in part by negligence of you [Winn Dixie] or any of your servants, agents or employees.” Id.; see Joseph L. Rozier Mach. Co. v. Nilo Barge Line, Inc., 318 So. 2d 557, 557-58 (Fla. 2d DCA 1975) (holding sufficient provision that “[c]ustomer shall defend, indemnify and hold forever harmless Lessor…against all loss, liability and expense…due or claimed to be due to any negligence of Lessor, employees or agents of Lessor or any other person.”)

These cases emphasize that a CPA attempting to avoid liability through a hold harmless provision in an engagement letter must clearly and unequivocally explain the liability or damages the CPA seeks to avoid and the client agrees to forgo. Courts also are reluctant to enforce these provisions if they appear unconscionable, such as when there is significant disparity between the potential exposure at issue and the limitation of liability (i.e., clause limits losses to $100,000 in fees paid to the CPA when the client’s potential exposure is $10,000,000).

Establish the Fee Arrangement

BP oil spill claims may present a difficult environment for CPAs in terms of managing collection risk. Many clients simply will be unable to pay the CPA’s fees until the client receives payment from BP. It is unclear how quickly BP will pay submitted claims, and because the payments will be remitted directly to the client, the CPA is at a disadvantage in securing payment. Additionally, some CPAs likely will charge a contingent rather than an hourly fee for their work. Even if that is permissible under AICPA and local board of accountancy rules, juries likely will frown on such an arrangement if a claim later develops. To defend their fees if they come under attack in a claim, or if the client challenges the fees later, CPAs need to document in their working papers the time they incur in performing services, even if they charged fixed or contingent fees.

Although most clients will value and appreciate the assistance their CPA provides, a CPA occasionally may be faced with an unscrupulous client who will seek to avoid paying the CPA after the claim is paid. So, in some instances, CPAs may need to consider promissory notes, personal guarantees or other forms of security for fee payment.

The engagement letter should specifically state how the CPA is to be paid. For CPAs hired as expert witnesses, the engagement letter should include a special provision to guarantee payment if a trial judge concludes that the CPA is an unqualified expert. The U.S. Supreme Court holds that a trial judge decides whether an expert is qualified to testify by determining whether he or she has the minimum qualifications, which include special knowledge, skill, experience, training and education in the area he or she is expected to testify. See Kumbo Tire Co. v. Carmichael, 526 U.S. 137 (1999); Daubert v. Merrill-Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993). Some clients will attempt to avoid paying a CPA retained as an expert if a trial judge later determines the CPA is unqualified to testify.

To protect against this attack, a CPA should consider attaching a curriculum vitae (CV) to the engagement letter. By attaching the CPA’s qualifications, a client cannot later claim that it did not know of the CPA’s qualifications, or lack thereof, should a Court make such a determination. The engagement letter should also include a provision stating that if a Court determines that the practitioner is not qualified to be an expert, then that determination is not a breach of the agreement. By including this provision, a CPA will still be entitled to payment under the agreement despite a Court’s determination that the CPA is unqualified to render testimony in the case.

Contingent Fees Prohibited for Certain Services

Each state has its own specific rules regarding fee arrangements for performing a professional service. CPAs should conduct careful research regarding the state’s individualized rules and regulations before charging a contingent fee for their services.

Rule 302 of AICPA’s Code of Professional Conduct states that a CPA shall not receive a contingent fee from the client if the CPA performs “an audit or review of a financial statement,” a compilation of a financial statement that the CPA reasonably expects a third party will rely on if the compilation report does not disclose a lack of independence; “an examination of prospective financial information;” or the preparation of a tax return or refund claim not subject to substantive review.

Florida has its own rules with which CPAs must comply when deciding fee arrangements with clients. For example, Florida Administrative Code, Rules 61H1-21.003 and 61H1-21.005, specifically address contingent fees by CPAs. These rules state that a CPA may not accept a contingent fee for audits, review or compilation services; services for any prospective financial data, including forecasts and projections; or tax filings. However, a contingent fee is acceptable for services performed if the taxing authority has begun an audit on a tax filing. The reasoning behind this is that any findings from the audit will be considered those of the taxing authority. Additionally, CPAs are prohibited from accepting contingent fee engagement in connection with any service defined under Fla. Stat. § 473.302(8)(a). These services include preparing an opinion on financial statements or attesting as an expert to the reliability of financial information.

A CPA interested in charging a contingent fee in connection with services for a BP oil spill claim should ensure that the fee arrangement complies with the ethical rules of the profession, and the rules and regulations of the particular state. FCT

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