Risk Management Tips for Tax Season

With the increasing complexities in tax law and regulations facing CPAs today, it is even more difficult to stay current on risk management and loss prevention practices. IMPACT presents the following overview of key liability areas, pitfalls and tips as a guide for tax practitioners heading into busy season.

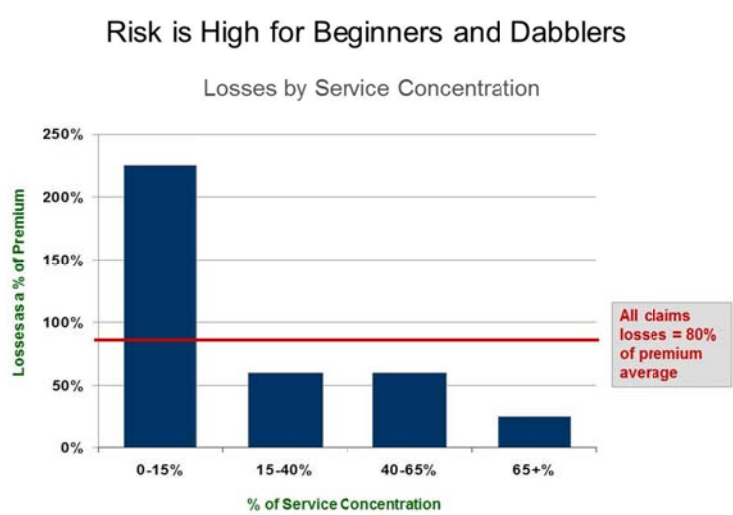
Client Assessment/Evaluation

If the firm needs to disengage from a tax client, it's better to do so in February than in April. Firms should evaluate all potential new clients and re-evaluate all current clients on a regular basis, at least annually.

Client evaluation enables the firm to better monitor engagements, consider any changes that might affect the professional relationship, and avoid situations that could escalate into crises. Three main considerations in the process are:

1) Is the engagement a good fit for the firm's expertise?

The firm should be: 1) capable of performing the services required by the accepted engagements, and 2) performing the services often enough to be proficient at them. CAMICO claims experience shows that firms "dabbling" in services outside of their areas of expertise are not practicing them often enough to become proficient. Services that represent less than 15% of a firm's service concentration produce disproportionately high loss ratios. (See chart, "Risk is High for Beginners and Dabblers.")



2) Is the client the type of client the firm would like to represent?

CPAs should communicate with predecessor accountants and third parties to obtain as much information as possible about the client. Are the client's expectations of CPAs reasonable? Does the client appropriately value CPAs' services and advice?

Background investigations are recommended for all significant engagements. Consider potential or actual conflicts of interest, as well as whether the CPAs' independence and/or objectivity are impaired in fact or appearance, especially when considering services for attest clients.

3) Is the client financially viable?

The answer to this question is critical, especially in avoiding fee collection problems and disputes. Much of the information you need can be obtained by:

- Interviewing the client and the client's key personnel, banker, attorney, predecessor accountants and auditors
- Running a credit check
- Examining the past three years of financial statements
- Examining the past three years of tax returns
- Examining prior CPA's management letters

Red flags and Warning Signs

Some of the warning signs that it may be time to disengage from certain clients include:

- Late or slow payments
- Difficult or uncooperative behavior
- Withheld information
- Changes in client's business
- Deteriorating client relationship
- Changes in the firm
- Potential conflicts of interest
- Requesting a discount before services commence

Conflicts of interest

Troublesome or emotionally charged scenarios often lead to conflict of interest allegations. Examples include entity dissolutions, acquisitions, trusts, bankruptcies, mergers, divorces, representing an entity and all or some of its owners, or any situation that involves or has the potential to result in opposing or unhappy factions.

When a client dissolves a partnership or files for divorce, you may feel compelled to disengage from one or both parties to avoid potential or actual conflict of interest. Continuing to prepare tax returns for a divorcing couple, for example, may be problematic, as each spouse could accuse you of preparing the return in a manner more favorable to the other spouse. Continuing to work with two former partners after dissolution presents a similar challenge, especially if the partners are not on amicable terms.

How to Disengage

Disengaging is good practice management, and knowing how to do it skillfully and professionally will help you grow your practice and avoid liability. When you decide to disengage, you should terminate the relationship professionally and formally, in writing.

At a minimum, the disengagement letter should always contain clear statements, a description of the completed and remaining work, and a list of any due dates or filings. The client need not feel antagonized in any way. When done effectively, a disengagement can leave the client feeling like you have acted in the best interests of both parties.

CAMICO can review disengagement letters and help you sort through issues pertaining to client situations. Is the client still your client? If not, then a formal disengagement may be in order. Also consider withdrawing Power of Attorney authorizations to limit your professional liability.

Sample disengagement letters, client screening checklists for individual and corporate clients, information on background checks, and other tools and resources are available on the **CAMICO Members-only Site under Knowledge Tree (Reference Library),** under folders titled **"Client Screening"** and **"Disengagement Letters."**

Fee Issues

Fee collection issues can be managed proactively so that they are no longer a major problem for the firm. Here are some key steps to take:

- Communicate your expectations for prompt client payments and take action when payments are not prompt.
- Communicate your firm's policies regarding billing and payments in the engagement letter, including ***stop-work and disengagement provisions to be enforced*** if payments are not received in accordance with the policies.
- Bill on a timely basis, and do not allow fees to build up to the point where you believe you can no longer walk away from them. When unpaid fees become too large, they provide an incentive for the client to sue for malpractice, especially when the CPA has sued to collect fees.
- Simple fee disputes are better resolved through mediation and arbitration than through litigation. That's why CAMICO recommends mediation for all disputes as a first step and ***binding arbitration for fee disputes only*** as a second step. CAMICO also provides a premium credit to policyholders who agree to an alternative endorsement to their policy to exclude coverage for claims arising subsequent to suits for fees.

Suing for fees creates a high probability of a counter-suit by the CPA's client, usually alleging malpractice during the engagement in question. This escalates the situation from a simple fee dispute to a malpractice lawsuit. Lawsuits and countersuits almost always result in the CPA spending far more in attorney fees and in lost billable time than is warranted for the fees owed to the CPA.

The engagement letter becomes the CPA's first line of defense in fee and other disputes. It is in many respects a written contract between you and your client. It should clarify the understanding with the client, the services to be rendered, the scope and limitations of the engagement, the responsibilities of the client, and those of the CPA, in limiting language. Always obtain the client's signature on the letter.

Engagement creep: If an engagement expands beyond the terms of the engagement letter, draft a new engagement letter.

Guidance, tools and sample engagement and other letters can be found in the **Engagement Letter Resource Center** on the CAMICO Members-only Site.

Documentation

While the first document in any engagement should always be the engagement letter, good documentation of other aspects of the engagement is also invaluable for risk management purposes. The legal defense of a firm is usually much more successful and effective when based on what the firm has documented, rather than on recollections of the firm's personnel.

Documentation can also improve client communications, clarify the scope and areas of responsibility in certain engagements, address expectation gaps, provide value-added service to clients, and create potential new services. Inadequate or improper documentation, on the other hand, can be a costly mistake.

Jurors generally consider CPAs to be experts in documentation, and falling short of that expectation when faced with a liability suit may be viewed by the public as negligent and below the standard of care for the services rendered. Since the public generally places the burden to document on the CPA, even an informal email exchange documenting a brief telephone conversation can help.

The following are some documentation tips for tax season:

- **Always document significant meetings, communications and follow up.** Follow up with written communication in the following circumstances such as:
  - Change in the scope of an engagement (may require a new engagement letter)
  - Negative information (e.g., tax return is already late, client's failure to timely provide information, client is facing an audit)
  - Judgment calls (e.g., the former CPA took an aggressive position that client is aware of and has consented to)
  - Client to take material action on discussion
  - Conversations regarding transactions or amounts used for extension payments.
  - Do you due diligence in tax services

- **Obtain written confirmation of the amounts used for calculations**. For example, a confirmation can be sent to the client with the tax extension payment form, giving the client an opportunity to review the information and to change any information that appears incorrect, prior to April 15. The confirmation then serves as a record of the client's representations in case the client incurs a late payment penalty.

- **If you need information at the last minute** to complete a return, have the client send the data via e-mail or fax. The e-mail or fax becomes part of your records, support and documentation. Remind the client if they fail to cooperate with the request.

- **Use informed consent** letters in engagements such as Sub-S Corporation selections or conversions, estate tax planning, and aggressive or gray tax strategies, clarifying that CPA advises and informs, while the client decides. With this letter, it is difficult for claimants to make it appear that the CPA made the decisions and is responsible for the results.

- **Aggressive or gray tax positions** may call for the client to provide you with an opinion from tax counsel confirming that the position has a realistic possibility of being sustained on its merits if challenged. If you're advising a client on a complex transaction or exchange, you may want to have your legal counsel review the documentation before passing it on to your client.

- **Fraud:** CPAs are not required to verify certain types of information, but if something looks irregular, a prudent course of action is to investigate, document, communicate, and get it right. Client and public expectations of CPAs have increased in recent years to the point where CPAs are expected to: 1) always detect fraud, and 2) advise and warn clients about their exposures to fraud. The public expectation to *always* detect fraud can be extremely difficult to meet, but the expectation to advise and warn is much less difficult. By advising and warning clients of their defalcation exposures, CPAs are able to minimize liability stemming from the expectation to detect fraud.

- **Internal control advisory letters:** Advise and warn clients about their exposures to defalcation. The letter: 1) warns about general risks, 2) suggests steps clients can take to reduce risks, 3) indicates the Association for Certified Fraud Examiners has found that only three percent of frauds in their most recent survey were initially detected by their external auditors, and 4) offers annual CPA services to address fraud risks. Examples can be found in the **Fraud Resource Center** on the **CAMICO Members-only Site** under "**Risk Management Tools and Engagement Letters**."

- **Documentation should be factual, professional, and without personal comments,** which may be inappropriate and damaging to the integrity of the documentation. Ask yourself whether you or your client would be harmed if the documentation was presented to the "ladies and gentlemen of the jury."

- **Do your due diligence in tax services,** as required in the Statements on Standards for Tax Services, under Circular 230 and other regulations**.**

Note changes in return due dates. The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 changed the due dates for partnership and corporate income tax returns as well as for FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), among other items. For more information, see "Return Due Dates Change" on the CAMICO Members-Only Site under Knowledge Tree, Risk Management, CAMICO Publications, IMPACT, 2015, IMPACT 104.

Early Reporting

Promptly report potential claims, including potential errors and omissions, to CAMICO. This will not only protect your full policy limits, but you may benefit from CAMICO's tax penalty abatement services, which provide legal expertise for abatement requests ranging from the simple to the complex.

Some policyholders worry about their premiums going up as a result of reporting a claim or potential claim, but CAMICO does not impose surcharges because a matter was reported before becoming a claim, or even because of claim reporting.

In fact, CAMICO encourages early reporting by **reducing the deductible by 50 percent, up to $50,000**, for any potential claim that is reported before a claim is made. Further, if CAMICO determines that it is appropriate to retain legal counsel to assist with a pre-claim situation, the legal expenses will be absorbed by CAMICO, and they will not impact the policy limits or be charged to the deductible.

Subpoena and consultation services are included in these pre-claims benefits. Early reporting helps our claims specialists achieve early, efficient and effective resolutions, thereby mitigating the impact of an error or omission.

As always, policyholders can call the Loss Prevention department at 1.800.652.1772, or email lp@camico.com.

DOL Employee Benefit Plan Audit Inspections

By Duncan B. Will, CPA/ABV/CFF, CFE

Special attention should be paid to a new consent form now accompanying document requests from the Office of the Chief Accountant (OCA) under the U.S. Department of Labor's (DOL) Employee Benefits Security Administration (EBSA). Recent OCA document requests now include a request for the CPA to consent to the release of the CPA's audit workpapers to other authorities. Many CPAs, believing they are required to sign the consent or not aware of its implications, are signing the consent.

CAMICO is discouraging practitioners from signing the consent. If signed, this consent would permit the DOL to forward the audit workpapers to state licensing boards, the National Accountancy of State Boards of Accountancy (NASBA), the American Institute of Certified Public Accountants (AICPA), and/or the Public Company Accounting Oversight Board (PCAOB). CPAs voluntarily accommodating this request would waive their rights to inspect or approve the workpapers in advance of being alerted to any preliminary DOL findings or the release of the workpapers.

EBSA representatives have stated that providing or withholding the consent has no impact on the DOL audit. Therefore, CAMICO sees no advantage and potentially significant disadvantages to providing this consent. Instead, CAMICO encourages practitioners to express their appreciation for the constructive feedback the EBSA inspection may provide, but respectfully decline to sign the consent before having an opportunity to consider and discuss the OCA inspection results.

Background

The EBSA 2014 Audit Quality Study's findings (http://www.dol.gov/ebsa/pdf/2014auditreport.pdf) were the worst of the last four such studies – 39% of the 400 audits in the study were found to have generally accepted auditing standards (GAAS) deficiencies. Many CPAs believed the DOL's Audit Quality Study was flawed. However, a team of peer reviewers engaged by the AICPA to audit ninety (90) "must-select" engagements found 43% had at least one major deficiency. Forty-eight (48) of the 90 audit engagements were ERISA engagements. These inspection results influenced the AICPA's recent audit quality initiative and may have prompted the DOL to seek these consents. All of the individuals engaged to review the audits were subject matter experts (SMEs), though not necessarily peer reviewers. Most of the SMEs were past or present members of the executive committees of the AICPA's audit quality centers and/or the expert panels who collaborate on the AICPA audit guides. These experts were engaged to independently review the same "must-select" engagements reviewed by peer reviewers so that the AICPA could evaluate the peer reviewers' performance (level of expertise). The AICPA Peer Review Board's 64-page 2015 Annual Report on Oversight can be found at http://www.aicpa.org/interestareas/peerreview/resources/transparency/downloadabledocuments/annrptoversight2015.pdf.

The AICPA and DOL selected engagements were mutually-exclusive. The DOL sample came from audits filed with 2011 submissions to the DOL's eFast2 system. The 48 ERISA engagements selected as part of AICPA's oversight process were for later periods. Even if the engagements were for the same year-end, the AICPA would have had no way of knowing whether they were included in the DOL's study, as the DOL keeps such information confidential.

The AICPA Ethics Technical Standards Department of Labor Subcommittee reviews audits referred to the AICPA by the DOL. This subcommittee can sanction AICPA members found not to have complied with professional standards or regulatory requirements.

It is critical CPAs auditing employee benefit plans possess the experience and qualifications to perform these audits. CAMICO strongly encourages firms practicing in this arena to be active members of the AICPA Employee Benefit Plan Audit Quality Center (EBPAQC) (http://www.aicpa.org/interestareas/employeebenefitplanauditquality/pages/ebpaqhomepage.aspx). The EBPAQC requires member firms to obtain specific employee benefit plan training, conduct internal inspections of their audit practice, and be peer reviewed. The EBPAQC has an abundance of resources available to its members to help them better perform their EBP audits. However, being a member of the EBPAQC is like a gym membership — you have to use the resources to obtain the benefits.

CAMICO also encourages CPAs performing or interested in performing pension plan audits to acquire and utilize the AICPA's annually updated Audit Risk Alert and the authoritative Audit & Accounting Guide on Employee Benefit Plans.

Loss Prevention Advice When the DOL Selects Your Audit Workpapers for Inspection

1. Don't sign the CONSENT FOR DISTRIBUTION OF INFORMATION included within the DOL document request materials.
2. Have a qualified auditor unrelated to the engagement and experienced in employee benefit plan audits assess whether he/she:
    a. understands the nature, timing, and extent of procedures performed;
    b. understands the results of the procedures performed and the evidence obtained;
    c. understands the conclusions reached on significant matters; and
    d. is able to agree or reconcile the accounting records with the audited financial statements. [AU-C 230 requirement]
3. When deemed necessary, add contemporaneously dated explanations to the workpapers to meet AU-C 230 documentation requirements.
4. Consider stamping each page of your workpapers "CONFIDENTIAL." Doing so reinforces the confidential nature of the workpapers and that consent has not been granted to disseminate the workpapers beyond the OCA.
5. Take care to provide the DOL with ***all*** audit documentation within the initial submission of audit workpapers. Many auditors have omitted workpapers thought not to be needed only to receive a critical response indicating their workpapers didn't meet U.S. generally accepted auditing standards (GAAS). **~~Less is more.~~**
6. Consider obtaining a power of attorney from the Plan sponsor so that preliminary DOL audit correspondence is sent directly to the CPA firm. The use of a POA expedites the inspection process and reduces the likelihood that OCA preliminary findings (frequently the result of difficulty identifying the location of audit work performed) unnecessarily distress the Plan sponsor.
7. Seek the advice of CAMICO's Loss Prevention department before sending a written response to the DOL inspection findings. Argumentative/disrespectful communications often prompt disagreeable/harsh responses. So, even when frustrated, control your urge to voice your frustration. CAMICO recommends written responses to the DOL:

- be respectful,
- express an appreciation for the DOL's constructive feedback,
- indicate steps the firm will take to improve future EBP audits, and
- inform the DOL representative of where in the previously provided audit workpapers the representative will be able to locate the audit evidence thought to have been lacking.

Duncan Will is the loss prevention manager and an accounting and auditing specialist for CAMICO. He leverages his more than 30 years of experience in accounting, including public accounting, forensic accounting, consulting, and audit and tax compliance, when working closely with CAMICO loss prevention specialists to manage the department's efforts to deliver to policyholders the high-touch, high-quality CAMICO experience.

War Story 105: Co-Trusteeship, Potential Conflict of Interest

Your longtime client, Tom Thornburg, worked non-stop for more than four decades to build a successful chain of health food stores worth about $75 million. You have been providing tax, accounting and consulting services to Tom for the past 25 years and during that time you and Tom have developed a strong friendship and deep mutual respect for one another.

You and Tom have had many opportunities over the years to socialize both professionally and personally, and you have seen first-hand some of the struggles Tom has had with his family dynamics. Married three times, Tom has five children in total; his oldest is 42 and his youngest is just 8 years old. His current wife is 28 years his junior and the mother of their youngest child. Suffice it to say she does not get along at all with Tom's four adult children, especially his oldest, Nicholas. She also has not seemed to enjoy spending time socially with any of Tom's long-time acquaintances, including you.

Tom put his assets into a family trust 10 years ago, when he married his current wife. At the time, he appointed both you and his son Nicholas as co-trustees of the trust, with all of his children and his current wife as beneficiaries. As you did not believe that the duties and responsibilities of a co-trustee would be that significant, and given the long history of your relationship with Tom, you did not feel it was necessary over the years to issue a separate engagement letter to clarify the scope and limits of the work you would need to perform as a co-trustee; you have been under the impression that Nicholas would take the lead with most of the trustee duties and you would just be his back-up if required. In addition, since you have been performing tax services for Tom's four adult children for several years, the formality of documenting any additional services related to the trust responsibilities did not seem necessary given your close relationship with them.

Two years ago Tom suffered a severe heart attack, and since then his health has not been good; he has put most of the day-to-day business operations in the hands of his son, Nicholas. Tom was agitated during a phone call with you last week. He was extremely concerned about the deteriorating relationship between his current wife and his adult children, especially Nicholas. Tom shared that since his health crisis, he and his wife have been having some marital difficulties and he suspects that she may be having an affair. He further shared that his wife has verbally accused his son of mismanaging the family business, stating that Nicholas has been negligent in his duties to provide regular accountings to all the beneficiaries of the family trust. Tom is not sure how far she plans to go with her allegations but strongly suspects that she is seeking the advice of an attorney. Tom also believes that she may allege improprieties by you, and pursue legal actions given your role over the years as trusted advisor to the family and your obligations and duties as a co-trustee.

What should you do now?

A. You should do nothing for now; you are not responsible for any alleged mismanagement of the family business, nor were you asked by Nicholas to provide regular accountings to the beneficiaries.
B. You should immediately contact both Tom and Nicholas and inform them that you will be formally disengaging as a co-trustee since you have performed no significant services in that capacity since the trust was put in place.

C. Before taking any actions or disclosing any information to any of the parties, you should consider sending all parties a conflict-of-interest consent and require the parties to sign their acknowledgment before deciding what to do next.
D. Call Tom's wife as a friend and "neutral party" to the family and help try to diffuse the tension between the family members.

Feedback:

A. Incorrect. Doing nothing in this situation is unwise. CAMICO claims experience shows that one of the most common sources of risk in trusteeships is a lack of understanding by the trustee or co-trustee regarding their fiduciary duties and responsibilities. In this situation, you have a fiduciary duty as co-trustee to the trust for the benefit of its beneficiaries. Trustees must adhere to laws and regulations governing their role as a fiduciary. While serving as a fiduciary, a CPA must also adhere to professional standards. The standard of care for a CPA serving as a fiduciary is higher than that of a non-CPA, non-professional serving as a fiduciary. Therefore, in hindsight, you should not have taken a "back seat" in this co-trustee relationship with Nicholas, as proactive and careful management of trust issues are essential to avoiding major problems. Consequently, you are now faced with potential liability exposure if this dispute escalates. You should immediately contact CAMICO for guidance regarding your next steps.

B. Incorrect. Jury standards place a higher responsibility on CPAs to do the right thing and to act as the "watchdog" in all engagements. Disengagement at this point does not eliminate the potential exposure of this situation if allegations are made by the wife regarding your lack of oversight. Clients that have dysfunctional family relationships are common sources of risk for CPAs. In retrospect, given the evidence of the dysfunction in Tom's family life, it would have been beneficial to contact CAMICO for some risk management guidance regarding how to manage the risks associated with rendering services in conjunction with your role as a co-trustee.

C. Correct.
The Integrity and Objectivity Rule of the AICPA *Code of Professional Conduct* (ET 1.100.001 paragraph .01) addresses CPAs' responsibilities regarding ethical conflicts. ET 1.110.010 details the responsibilities of CPAs in public practice when faced with potential conflicts of interest. These responsibilities include assessing whether an actual conflict exists; assessing whether actual threats can be reduced to an *acceptable level*; disclosing the threat to affected clients; and obtaining clients' informed consent. Other regulatory requirements such as Circular 230 may be more restrictive than the Code and should be considered in the threat analysis.

Because of the breadth and scope of the tax and accounting services you have rendered to the family members over the years, as well as the elevated fiduciary duty you have as a CPA/co-trustee, you must clearly understand the dynamics among the family and related beneficiaries and address any issues that could result in potential or actual conflicts of interest. Given that you are already blessed with the knowledge of the situation, you are already caught in the middle and it's time to talk with CAMICO to obtain guidance regarding appropriate informed consent agreements to be sought from the parties. If, after speaking with a CAMICO advisor, it is determined that you have an actual conflict, they can advise you regarding your next steps.

D. Incorrect. This would not be a good idea as you are NOT a neutral party in this situation. Statutory and common law require a fiduciary to be impartial to all beneficiaries unless the governing document provides otherwise. It would be extremely misleading to now “act” as a neutral party given the potential dispute among the wife and the parties. As a CPA acting as fiduciary, you must be vigilant regarding any perceived or real conflicts of interest.

“War Stories” are drawn from CAMICO claims files and illustrate some of the dangers and pitfalls in the accounting profession. All names have been changed.

Latest Engagement Letters Book Available

The 11th edition of the *CPA's Guide to Effective Engagement Letters* is now available. It includes a CD of the electronic versions of all letters, the suggested wording, and the comments, along with risk management case studies. CAMICO policyholders can access many of the letters from the **Engagement Letter Resource Center** on the homepage of the **Members-Only Site** at www.camico.com.

The book has been updated throughout and includes:

- A new chapter on preparation of financial statements in accordance with SSARS No. 21
- Updated review and compilation letters that comply with SSARS No. 21
- Revised peer review letters for system reviews and engagement reviews
- Revised expanded tax engagement letters

Also included in the 11th Edition are new and updated case studies. Several of them are offered in a multiple-choice format, with answers and feedback for incorrect responses. Topics include:

- Conflict of interest regarding financial advice
- A set of three ethical dilemmas
- Voicemail/e-mail fraud and investment advisory services
- Fee dispute with an audit client
- Embezzlement involving a firm merger and audit services

The book is available for purchase from CCH, and CAMICO policyholders can receive a 20 percent discount. To access the order form, visit the Members-Only site and, under **Reference Library,** click on **CAMICO Partnerships/CPA's Guide to Effective Engagement Letters.**

Be sure to visit the Engagement Letter Resource Center, located under "Resource Centers" on the CAMICO Members-Only Site. You'll find tools and checklists that provide step-by-step guidance through the letter-writing process. The resource center also includes an engagement and disengagement letter checklist and links to 118 sample engagement letters, including the new and revised letters.

For assistance call 1.800.652.1772 and ask for the MarCom department.

Webcasts Can Be Scheduled Throughout the Year

CAMICO offers several hours of free CPE to its policyholders each year through webcasts. We provide education on risk management specifically for CPA firms, brought to you by our experts, many of whom are CPAs themselves. You won't find this level of expertise and depth of risk management content anywhere else.

We don't have a formal schedule of webcasts from late January through end of April, but we are happy to schedule webcasts for individuals or firms upon request throughout the year. To request a webcast, please email lp@camico.com and we will contact you to coordinate a mutually convenient date and time.

Policyholders can also go directly to LearnLive's website to enroll in webcasts and view the most up-to-date schedule. Simply go to https://university.learnlive.com/camico. If you already have a LearnLive account, log in with your username and password (note: this may be different from the username and password you use to access the CAMICO Members-Only Site at www.camico.com). To create an account, click New Student Registration and fill out the form. The company pass code is 508101.