

The Risk is Real for Accountants

The number of professional liability lawsuits brought against accountants and accounting firms continues to increase and can include allegations of malpractice, negligent misrepresentation, securities fraud and faulty business valuation.

The risk for your accounting firm is real and significant. So is the protection you can have with Accountants Professional Liability Insurance offered by Monitor Liability Managers. Here are just a few examples of the damage that a professional liability case can cause.

Professional Negligence/Audit Malpractice

An accounting firm was engaged to audit the financial statements of a software company. Even though the software company still owed the firm significant fees from prior accounting work, the accounting firm took on the new project. The company's CEO, knowing of a defect in a software product, allowed it to be shipped in mass quantities just prior to the close of the fiscal year. The firm's audit team, unaware of the defect within the shipped product, provided a "clean" opinion.

One of the software company's lenders sued the accounting firm claiming reliance on the audited financials. Although an "unclean hands" defense was proffered, the past due fees owed at the time of the audit led some to question the firm's independence. After lengthy litigation, the case settled for a six-figure sum.

Negligent Misrepresentation

A potential client who was disenchanted with his current tax accountant met with a new CPA. During the initial interview, he mentioned he wanted to alleviate the tax burden associated with a gain on the sale of property. In fact, he asked the CPA for advice regarding a "tax shelter" he had heard about at a dinner party. The CPA outlined the high risks associated with such a shelter. The potential client thanked the CPA and left his office. The CPA did not hear from this individual again.

Later, when the IRS challenged this individual's position, back taxes, penalties and interest were assessed. The individual sued many parties, including the CPA he had met with once. Although the CPA eventually was exonerated, the litigation resulted in a tremendous loss of billable time and his insurance deductible.

Fraud/Deceptive Trade Practices/Breach of Fiduciary Duty

A company sued its former accounting firm, alleging the firm's actions caused its bankruptcy. According to the suit, because the accounting firm resigned as auditor for the company and withdrew prior audit opinions, the company had to file for bankruptcy. The company is seeking damages of more than \$30 million.

Faulty Business Valuation/Succession Plan

A business owner of a thriving heavy machinery company decided he needed a succession plan. His goal was to leave the business to his eldest son, entitling his other son to the remainder of the assets. The owner's long-time CPA prepared a business valuation and advised him on succession planning.

After the business owner passed away, the eldest son quickly ran the business into bankruptcy. This son then sued the CPA for a number of claims, including a faulty business valuation. A retained expert confirmed that the CPA's valuation met the standard of care. Nonetheless, the opposing side's expert was highly critical, causing the CPA concern about a negative verdict in excess of his modest limits of liability. The case settled prior to trial, but not until after the CPA accrued considerable legal expenses.

Securities Fraud/Conspiracy to Defraud

An accounting firm was hit with three lawsuits stemming from the merger of two companies. The claimants were former directors and officers of one of the merged companies, who alleged the accounting firm committed securities fraud and engaged in conspiracy to defraud. The lawsuits stated the firm failed to disclose certain financial information about the other party to the merger, information that would have stopped the merger. Damages in excess of \$20 million are being sought.

