Managing Risk: Why You Need Accountants Professional Liability Insurance

Good accountants can get involved in bad situations. Even a seemingly trivial misunderstanding regarding the scope of an engagement can escalate into a potentially costly lawsuit. The reality is liability claims often don't result from true negligence but rather as a consequence of disgruntled clients or even bad luck.

This is where Accountants Professional Liability (APL) Insurance steps in. APL coverage helps accountants and accounting firms manage the often high costs of defending against a liability claim.

The reasons why some accounting firms go without this crucial coverage can range from false security to not wanting to spend money on "something that may never happen." To illustrate just how easy it is for an accountant to get involved in a risky situation, we present some real-life examples.

Including a Marketing Message in Your Engagement Letter

Risk Scenario: George's accounting practice thrived in his town's small business community and he particularly enjoyed a long-term relationship with a client who owned an auto parts distributor. For this client he performed bookkeeping and compilation services. As he did with his other clients, George had this client sign a new engagement letter annually. After 10 years of serving the auto parts distributor, George decided to make sure the client knew of the full array of accounting services he could offer. He inserted a paragraph within the engagement letter detailing these available services.

Unfortunately, the client's business took a negative turn, resulting in bankruptcy. He sued claiming George failed to meet the standards of an audit engagement. The case went to court and George's lawyer based his defense on the fact that only a bookkeeping and compilation engagement existed. The client countered that his understanding was that George was conducting the expanded services advertised in the most recent engagement letter. George's desire to market his services led to client confusion regarding the exact services he would receive and a costly malpractice case.

Final Thought: A CPA should not view the engagement letter as a marketing opportunity. This can lead to potential claims that the services detailed are actually part of the scope of engagement.

Suing a Dissatisfied Client to Collect Unpaid Fees

Risk Scenario: Sue, a CPA and well-respected member of her accounting firm, was engaged to audit the financial statements of a software company. During this engagement, the company's long-time bookkeeper was discovered to have set up bogus vendor invoices to skim money from the company. Although the amount of the embezzlement failed to meet materiality thresholds, the software company's management decided not to pay the final $2,500 invoiced for services performed. Sue and her firm, acting on principle, sued for the money owed. The client counterclaimed for failure to detect the defalcation.

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The case was finally settled with no payment on either side but only after years of litigation expense and lost billable time.

Final Thought: Think long and hard before suing for fees. A client who has received a bad result will most likely counter sue. Remember…no business ever collects 100 percent of its receivables.

Disengaging from a Difficult Client

Risk Scenario: Jim, a CPA, performed tax preparation services for a difficult client for a couple of years. After the client failed to comply with Jim's multiple requests for records, Jim sent a letter in March 2006 to the client terminating the engagement. This allowed the client more than 30 days for retaining a new tax preparer. Two years later, Jim found himself embroiled in litigation because of this former client. Apparently, the client had not filed his 2005 tax return in a timely manner and he alleged that it was Jim's fault for failing to file an extension for him.

Final Thought: When terminating an engagement, make sure the letter not only outlines the scope of engagement and work completed but also details any pending work-in-progress, including items needing to be completed and any upcoming deadlines.

Not Getting APL Coverage Until After a Problem Arises

Risk Scenario: Carl, an independent accountant, let a potentially litigious client slip through his screening process. After the first year of performing a tax engagement, the client filed a complaint with the state licensing board. Carl, uninsured, paid more than $5,000 to a local lawyer to handle the grievance. After being exonerated by the licensing board, Carl purchased APL Insurance coverage. Shortly after, the client sued Carl over the same issues filed with the licensing board. Carl's new insurance carrier denied the claim since it was related to the licensing board situation that occurred prior to Carl purchasing the APL policy. Defense expenses forced Carl to declare personal bankruptcy.

Final Thought: Lack of insurance can prevent accountants from defending themselves even when the case has no merit. Do not wait until a situation surfaces before buying your first Accountants Professional Liability policy.

The Solution

Accountants not only need to consider how best to protect their reputations but also their livelihoods. Monitor's Accountants Professional Liability coverage is designed to suit a wide variety of accounting practices — from CPA and general accounting firms to tax professionals. We offer comprehensive APL coverage with competitive premiums.

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