Accountant Malpractice Claims:

A Fact Sheet for CPAs and Counsel

Accountant malpractice claims continue to rise—particularly those involving CPAs who have allegedly failed to detect a fraud. What should accountants and their counsel know about the current landscape?

Do CPAs have a professional responsibility to detect fraud?

In a word, yes. Since 1997, in fact, the American Institute of CPAs (AICPA) has relied upon the "Consideration of Fraud in a Financial Statement Audit," standard for accountants. The standard holds that an "auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud."

Statements on Auditing Standards (SAS) and Generally Accepted Auditing Standards (GAAS) do not apply to non-auditing engagements. Doesn't that let CPAs off the hook for fraud detection?

The potential for professional liability remains strong. The Code of Professional Conduct governs at all times, and it states that CPAs should act with integrity, objectivity, due care, and a genuine interest in serving the public. Specifically, the essence of due care requires that the member perform all professional services to the best of their ability, not only for the interest of their client but also for their responsibility to the general public.

Are CPAs aware of their professional responsibilities?

Many are not. In fact, a number of more experienced CPAs who came to the profession before the AICPA standards took effect hold the mistaken belief they are not responsible for detecting fraud. Prior to 1997, CPAs had been taught that it was not their duty to look for fraud – only to let their clients know if they saw or suspected any "defalcations." The word "fraud" didn't even appear in leading accounting textbooks before then. Unfortunately for those accountants, jurors, judges, and most regulators are not behind the times: They have consistently said auditors have a duty to investigate when something in the books looks suspicious or unusual.

What are some of the types of malpractice claims CPAs face?

CPAs may face suits over fraud schemes that were not uncovered in a financial statement audit or review; fraud schemes that were not uncovered in a compilation engagement; failure to follow professional standards; failure to comply with regulatory procedures; failure to uncover or properly disclose conflicts of interest; fraud committed by the accountant; and negligence and/or gross negligence.

Are most CPAs truly at risk from a malpractice suit, or is it just bad actors who are sued?

Without fail, in almost all cases where a fraud has occurred, a company will sue its CPA (or consider suing them). This is true no matter what service the CPA has provided, including tax, consulting, and simple compilation services. It is becoming more a question of when than if auditors will be sued by one or more of their clients at some point during their careers, and they need to be prepared at all times.

But the company's executives gave their word that the numbers were true. Isn't that enough?

Hardly. A growing body of case law—including multimillion-dollar fines and career-devastating suspensions from practice—is demonstrating the risk for accountants who fail to adequately question the data and assumptions made by a company during the audit process.

Does showing one's work make a difference for a CPA?

CPAs should implement a "Three-D" rule in their relations with clients: document; document; document. Every communication to the client, every procedure performed, and every response received should be documented. Lack of documentation in the face of a malpractice claim does not give an accountant or counsel much of a leg to stand on as a defense, nor does it provide sufficient evidence for a jury to consider. While it can be tedious and time consuming, documenting is well worth the effort if and when questions arise.

How critical is an engagement letter between CPAs and their clients?

CPAs and their firms—especially those with a long, close relationship with a client—sometimes skip (or skimp on) an engagement letter. This is a mistake. The engagement letter should explicitly outline the expectations and limitations of the relationship for all services to avoid any uncertainty about which services are being provided and which are not. And after the letter has been signed, the accounting firm should stick to it to limit legal exposure.

How close is too close for a CPA firm and a client?

Developing cordial business relationships with clients is critical to the success of an accounting firm. However, engagement partners at accounting firms sometimes build too friendly connections to executives at a client company. That said, CPAs should always remember that they have professional standards to meet. For example, an engagement partner should not lead a client's audits for years on end. This is prohibited by the Public Company Accounting Oversight Board (PCAOB) for publicly-traded companies. Partners must be rotated out of an audit arrangement on a regular basis. A firm should be on guard for potential conflicts and always willing to inform a client of suspected fraud. If they hesitate, they could face substantial liability.

For more information on Accounting Malpractice Claims and our latest work, visit: www.ForensicStrategic.com.

Forensic Strategic Solutions is a national financial investigation firm that specializes in accounting and financial reporting issues, whether the alleged malpractice stems from fraud that was not uncovered by CPAs or from a failure by CPAs to follow professional standards. If you have any questions, please contact us for a consultation.

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