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>> COMMENTARY

10 ways to avoid a lawsuit

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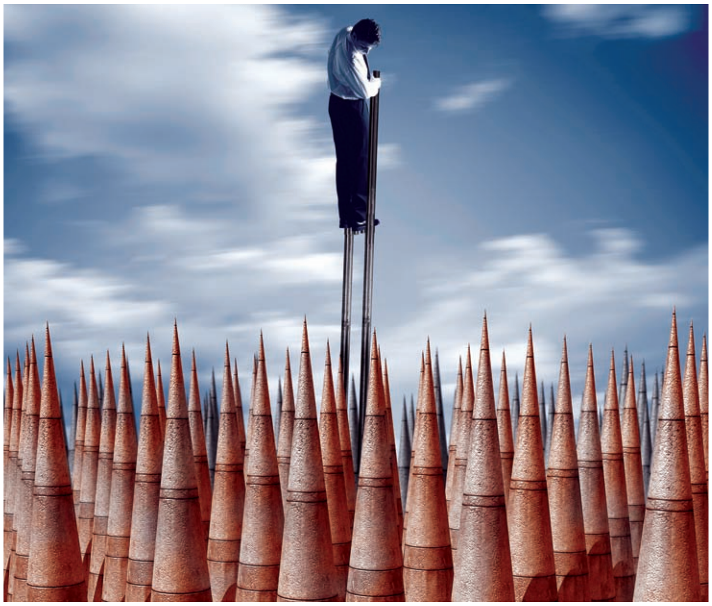
There has been a proliferation of constituencies targeting the accounting profession. In civil actions, accounting firms face increasingly large claims by a variety of plaintiffs, including shareholders, bondholders, lenders and other creditors, litigation and bankruptcy trustees, and clients.

In criminal prosecutions, accountants have been charged with a host of crimes, including conspiracy, bribery, perjury, mail fraud, wire fraud and forgery. These actions and prosecutions are arising from myriad sources, including federal and state securities laws, Securities and Exchange Commission enforcement actions, Internal Revenue Service rules and regulations, Department of Labor regulations, and state licensing boards. The heightened enforcement standards of the SEC and the Public Company Accounting Oversight Board have created a new environment for auditors.

We have identified numerous ways that accounting firms can minimize litigation risks.

Ten of those ways are:

1. Refine client intake. Minimizing litigation risk begins with client intake. Research potential clients before agreeing to perform services. In addition to traditional client due diligence, Internet and public filing searches often reveal litigious behavior or those with questionable pasts. Be wary of clients repeatedly switching accounting firms, and consider seeking access to their prior accountants before agreeing to perform services. Revisit and update risk assessments, and consider whether to continue providing services to existing potentially problematic clients (e.g. late payers, those with a history of litigious behavior, or those involved in risky ventures).



2. Use engagement letters to set scope and limitations. Always use and update engagement letters. Engagement letters often are obtained when a client relationship begins, but thereafter firms may not be diligent in obtaining engagement letters for each new service performed, or when a service, such as an audit, is performed again. Failure to obtain an engagement letter for new services may result in a plaintiff arguing that the accountant took a more expansive role, with additional duties, beyond what they understood they were undertaking.

An engagement letter should include, at a minimum, the reason for engagement and services to be provided; the limitations on the scope of engagement and services; the specific obligations of accountant and client; and a statement that the services provided and any opinion or work product is for the benefit of, and is to be used only by, the client and/or third parties specified by name. You should also consider arbitration or other dispute-resolution clauses and a jury waiver, as well as limitation-of-liability and indemnification provisions (there are differences in state and federal law regarding the enforceability of these types of provisions).

3. Diligently manage documents. Increasingly, plaintiffs are seeking to establish liability by claiming shoddy document management and retention of documents during an engagement and subsequent litigation. Plaintiffs argue that unorganized or missing documents are evidence of fraud, recklessness or negligence.

Accordingly, know and fulfill document retention (including electronic documents) and management obligations during and after an engagement. Also, become familiar with the litigation hold requirements of applicable state and federal rules of civil procedure.

4. Communicate objectively. Accountants work with numbers to provide their services, but lawyers suing accountants focus more on the words in e-mails and workpapers than on the numbers themselves. During litigation, an accountant does not want to say: "I know sitting here today it looks like I did/said /wrote *x*, but that's not what I meant or intended, and everyone involved knew that."

In order to minimize the ability of plaintiffs to use communications in ways that were not intended, accountants must communicate in a clear, objective way. An accountant should avoid personal opinions (as opposed to professional judgment, which often is necessary), off-hand remarks, speculation, decision trees, and "if/as/when" comments. Much in the same way that numbers do not contain emotion, accountants' documentation of the steps performed and services provided should avoid emotion and contain brief, objective facts. Consider training auditors on objective communication.

5. Follow the rules. Make sure that the right team with appropriate training and experience is assigned to each engagement. The team should be aware of and have access to the most accurate and current audit manuals and audit alerts, and should consider the appropriate audit and accounting guidance for a specialized industry, as well as any specific state or federal regulations. If the firm has internal experts for a specialized industry, utilize them early in the engagement in a proactive manner, not just when problems or questions arise.

6. Follow the audit plan or agreed-upon procedures, and document each step. It is essential that accountants follow the audit plan or agreed-upon procedures, and document each step, including their plan for performing the services, and the reasons for selecting the number and type of items tested or analyzed. Documentation of accountants' conclusions, as well as evidence of appropriate supervision or review, is also necessary. Accountants should not rely on auditing by conversation, and should obtain and document the competent evidential matter examined.

7. Answer all queries. If the client or staff accountants raise questions or express concerns on an engagement, be sure to address their questions or concerns, and document how the issue was resolved. Failure to document how they were addressed can subject the actual resolution to varying interpretations and recollections years later in litigation.

8. Temper reliance on management representations. Because management is often the source of corporate wrongdoing or faulty accounting, an accountant's undue reliance on management representations, without additional testing, may be viewed harshly by judges and juries through the lens of 20/20 hindsight. Be wary of management that expects or implies that you should solely rely on their representations, and test management's representations where appropriate.

9. Avoid communications with non-clients. Accountants may be asked to meet with or talk to lenders, creditors or other third parties about a company's financial condition. Doing so can, in certain circumstances, subject an accountant to potential liability for alleged misrepresentations or aiding and abetting. To limit potential third-party lawsuits, accountants should avoid the appearance of privity, and avoid communications with non-clients.

10. Consult firm risk management personnel and/or in-house counsel early. When disagreements with clients or other problems arise, early consultation with risk management personnel and counsel can also mitigate litigation risks. **AT**

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