



## **Professional Liability: The Growing Threat, and the Need for Protections**

**By Brian S. Kern, Esq. (6/02)**

Countless lessons can be learned from the unfolding of Enron and Anderson, not the least of which regard liability and the associated consequences it can entail. Risk management and insurance for accounting firms has transformed from a mere nuisance (if funded at all,) to a critical factor in ensuring that years of hard work are not sacrificed by a single inadvertent error. The infinite reach of liability has been demonstrated by the Enron ordeal, and most businesses are reacting accordingly. Still, however, many individuals and firms continue to overlook the necessity of a solid risk management program, and, more importantly, a proper professional liability insurance policy.

One reason why the Anderson fiasco has not instilled awareness in many individuals and firms can be explained by disassociation. The mammoth size of Anderson has led people to believe that although problematic, it is a situation that could never happen to them. To be sure, Anderson was a company engaged in countless derivative transactions and partnerships. Many small accounting firms do not even perform audits. But while such arguments may carry sine weight, there is a bigger picture that should not be missed.

Few people were aware of the extent of Enron's troubles, and no one could have predicted that the company's own decadence would also cause the demise of a "Big 5" accounting powerhouse. For years to come, attorneys and employees will debate the manner in which the justice department reacted, and whether it is was appropriate. Yet while the debate may rage, the invaluable message for all firms can be reduced to the common cliché of "You just never know."

### **Protecting Against the Unexpected**

In the broadest sense, insurance was designed to transfer risk and provide protection for the unexpected. There is simply too much chance when someone assumes he or she is invincible to all unforeseen risk factors. "Given the Enron debacle, America's litigious nature, and the challenges facing the accounting industry, malpractice insurance is duly required of every CPA firm for its own protection," states tax specialist Michael C. Deo, CPA. But even with a valid insurance policy in force, most policyholders still may not know what coverages their respective policies include or exclude.

Typically, the only time the contents of a policy is reviewed is when a claim is made or filed. Unfortunately, most firms, regardless of their size, tend to assume that an annual premium payment translates into full error and omission protection, despite the wide variety of prospective claims that can be encountered. Without proper research and understanding,

considerable gaps may be left unfilled. One area of substantial insufficiency with some accountant malpractice policies pertains to the breadth of coverage. For example, some policies extend coverage to include acts performed in the capacity of a trustee, executor, conservator, guardian and receiver, while others do not.

Other issues that should generate concern are commonly concealed in the midst the overwhelming fine print. Upon examination, it can be discovered that most policies do not seek input for the selection of a defense counsel, and some specifically state that the company is not required to consult the insured before settling a claim. Further reading can also disclose whether defense is provided for in regulatory inquiries, what the overall cost is for an extended reporting period (or tail), and especially whether vicarious liability or first dollar defense is offered.

### **Technology and Associated Risks**

A more recent limitation that has surfaced in current accountant malpractice policies is whether the coverage encompasses new technology. The Internet has created vast opportunities for businesses to expand, but has also stretched the expansive reach of liability, and most policies have yet to adapt to this fact. Countless seminars are offered to demonstrate how accountants can utilize the Internet. To compete with developing global accounting firms and their mass-marketing efforts, smaller firms now are forced to develop websites, install expensive on-line software, and use e-mail to conduct what were once face-to-face meetings. Amid this fierce race to not only retain current clientele, but also increase customer-base, many accountants are now vulnerable to a whole new aspect of liability.

One important consideration is that any text which is e-mailed to clients can be considered binding by law because it is "in writing." The instant a CPA sends a written message, each word becomes a potential liability. To put this into perspective, imagine email as a phone conversation with a client that is being tape-recorded and that will be permanently stored. Emailing clients should elicit as much caution as sending out information on new tax laws or furnishing clients with company research reports. Additionally, firms are ultimately responsible for the confidentiality of their client's records, maintaining secure websites, and programs or services they recommend. Luckily, coverage for these forms of liability exists, but many policies also do not yet offer it. Yet another consideration is while exposure from the Internet remains a rapidly developing issue to be settled by trial lawyers and the legal system, you should be confident knowing that your money will not be used to set a legal precedent. Long before an intricate issue ends up in a vicious courtroom battle though, a firm should consider the value of the price of a policy.

If the cost of malpractice insurance, which is solely a hedge against potential risk sometime in the future, is too expansive for the budget of a small accounting firm, then the concept of insurance has failed. Historically, smaller sized accounting firms were placed in the same risk classes as the larger ones, causing incomprehensible premiums for many CPAs. Insurance companies now are responding by offering policies tailored to each specialized firm. Some companies now assess firms based on the number of employed CPA's, the breakdown of their activities, whether they represent publicly traded companies, etc. Because of these new underwriting guidelines, and the prices that they reflect, it is an ideal time for a firm to analyze their current policy, the extent of its coverage, and the premium it is paying.

As a practice, CPAs and their firms take numerous steps to reduce the possibility of a lawsuit. The prevalence of engagement letters and the recent push for more cautious accounting testifies to that. The accounting profession must now continue to organize and educate itself to protect against opportunistic lawyers and disgruntled clients. The image of the accounting profession, tainted by the rampant, recent accusations of dishonesty, makes it an even larger target for plaintiffs and trial lawyers in an already litigious society. More than ever, CPAs need to evaluate the entire spectrum of services they offer, avoid all inherent conflicts-of-interest, provide only the most sound advice, develop disciplined methods of risk management, and make sure that they protect themselves with comprehensive professional liability insurance.

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