

Accountability

Issue XVIII

Simple ways to avoid litigation:

1. Confirm it in writing.

You served your client for more than twenty years. You attended the baptism of his first child, his daughter's marriage and play golf with him every month. You helped him grow his business from a back office to a large multi-location operation with a turnover in excess of several million dollars. He was always creative and more interested in the increasing volume than the day-to-day minutia – that's where you came in. He relied heavily on one individual, an old-line bookkeeper that had been with him since the beginning. She was his right hand, his pillar of strength. She made sure the bills were paid and the IRS was kept off his back. She was the gatekeeper of the checkbook and bank statements. Once a year he would check in with her (usually before tax time) to make sure everything was okay. He trusted her implicitly.

Each year during the audit, you mentioned that he might consider splitting responsibilities or have someone else control the checkbook. You even told him about employee dishonesty insurance (just in case). He always shrugged off your remarks saying "it wasn't necessary" or "she's been with me forever". You let it go at that; after all, he was a friend as well as a client.

And then it happened.

You received a letter from his attorney asking for copies of your work papers. Then a large public accounting firm called you asking for information about specific aspects of the assignment. You telephoned your client, three times. He never returned your calls.

Three weeks later the local sheriff appeared at your office and served you with a writ. It appeared that the loyal and reliable bookkeeper had been siphoning off funds over a period of years. First she took small amounts, but

progressively became more daring. She had been smart and created counterfeit invoices which were supported by the references in the check register. The checks however, were payable to her but had been destroyed when she opened the bank statements. With no one to question her, she had used the money to fund a lavish lifestyle and expensive vacations abroad - all at your client's expense. Over time she had taken hundreds of thousands of dollars.

Your client had called in his attorney after the bank questioned one exceptionally large check. The bookkeeper was on vacation at the time. He was now looking for someone to blame for his problem. You were "it".

Over the last year we have seen two claims of this nature and have witnessed similar situations in the past. Failure to detect fraud is a common claim made against a CPA and represents a significant catastrophic loss exposure. However, in both cases the CPA instinctively felt that something was wrong (or could go wrong); in both cases, the CPA failed to follow his gut by forcing the issue with the client or at the very least, documenting the file and confirming in writing that the potential problem had been discussed and discounted by the client. Criminals can find many devious and creative ways to hide their acts. Often they are extremely tough to discover. It is not the intent of this article to discuss failure to detect fraud, but to point out that if you feel something is wrong, it probably is. Consequently it is fundamentally important to point this out to clients and confirm this in writing.

Even if you have a close relationship with your client, this is likely to evaporate when large amounts of money are at stake.

Please note: the use of engagement letters to limit exposure to claims will be the subject of future newsletters.
