Celebrity Clients HIGH PROFILE and HIGH RISK

By Sarah Beckett Ference, CPA

Money and fame: the aspirations of many; the reality of few. From movie premiers, award shows and exotic vacations to dating rumors, scandals and wild antics, the lives of the rich and famous are on display for public consumption now more than ever. Celebrities are used to their names appearing in the headlines, for both good and bad reasons. However, when CPAs accompany their celebrity clients in the news, it's usually related to the latter.

Consider the following claim scenario. An up-and-coming Los Angeles-based fashion designer received a big payday when his creation was worn by an A-list celebrity on the red carpet at a major movie premier and set the new summer trend. The designer's collection was coveted by all and he was an overnight social media darling. Buzz throughout the fashion industry was positive.

To celebrate the increase in wealth and positive future outlook, he decided to undertake a major renovation of his home to include a private design studio and runway. The designer asked his longtime CPA to manage the construction process, as he was busy working on the next big idea and making appearances at star-studded events. The cost of the renovations continued to rise as the designer's preferences changed, despite the CPA's verbal warnings that the changes would add significant cost. The end result of the project far exceeded the original budget.

Soon after completion of the renovation, a major European design house offered the designer its lead creative role, which required a permanent move to their European headquarters. The designer immediately put his house up for sale. The only offers received were far below the asking price and, in the designer's opinion, disrespectful to his "uniquely creative vision" expressed in the renovation. As a result, the designer took a significant loss on the ultimate sale of the house.

The designer brought a claim against the CPA alleging mishandling of the renovation, poor investment advice and mismanagement of funds.

You may have read about pop stars, actors and professional athletes being "driven to bankruptcy" due to the actions and advice of their accountants and financial advisers. When a celebrity or other high-profile individual or family experiences a decline in net worth, the CPA may be blamed for it.

Services provided to the rich and famous, as well as to wealthy individuals or families, may include a range of traditional accounting services, including tax planning and preparation, bookkeeping, payroll and financial planning. But what may start as a typical engagement could gradually expand to include nontraditional services, such as concierge services, administrative support for both business and personal assets, booking travel, overseeing construction on personal residences or vacation properties, or even walking the pooch (if only dog walking was a section of the CPA exam!).

While provision of services to high-profile clients provides the opportunity for interesting and rewarding work, CPAs should also be aware of the associated professional liability risks.

Claim Experience

Claim experience of the AICPA Professional Liability Insurance Program suggests that high-profile clients are a higher risk than others. When a claim involving this type of client arises, a red flag is raised.

There is a greater likelihood that the claim will be complex, lengthy, costly and require special handling. Why? The amount of damages asserted is larger than typical claims and may include unreasonable or inflated estimates of the client's loss. The larger claims can be attributed to the exponentially larger value of the client's assets and transactions associated with their extravagant lifestyle. Unreasonable damage assertions and high-value transactions can both add layers of complexity to already sensitive claims.

These clients usually have significant resources to aggressively litigate and pursue claims. In addition, the client may feel betrayed or personally wronged by the CPA. These feelings combined with the financial wherewithal can make the defense of a claim challenging, longer and more drawn out than typical claims. Some clients may even pursue a claim until a settlement is in excess of the CPA's insurance policy limit with the intention of making the CPA pay a portion of the settlement out of pocket as a "punishment."

While the client may be used to seeing his/her name in tabloids or trending on social media, the CPA likely is not. A well-publicized claim could result in disparaging remarks about the CPA or accusations regarding the quality of his/her services. Bad press risks damage to a firm's reputation.

Typical Client Profile

Risky clients can come in all shapes, sizes, backgrounds and industries. Characteristics that may be common among claims involving high-profile clients include the following.

Client's attitude regarding services. A client who merely shifts responsibility onto the CPA without ownership, accountability, oversight or even passing interest in the services, may lead to miscommunication and disputes. Clients who do not take the time to communicate with the CPA and understand the CPA's services are higher risk.

Public's perception of the client. A client with a public persona who draws admiration may garner sympathy in the court of public opinion, painting the CPA as a villain. Further, actors are trained to communicate their message effectively and may practice their talents on a judge or jury.

Clients' perception of themselves. Whether real or perceived, clients' view of themselves as a "celebrity" or someone important may lead to expectations of special treatment or a sense of entitlement.

CLAIM EXPERIENCE SUGGESTS THAT HIGH-PROFILE CLIENTS ARE A HIGHER RISK THAN OTHERS.

Substantial assets at risk. High-net-worth clients, by definition, have income, assets or participate in transactions that are significantly higher in value than typical clients.

Common Quality Control Issues

Any client or engagement involves some level of risk for a CPA and not all high-net-worth clients are high risk. However, a high-net-worth client is likely to be high risk if one or more of the above factors are present.

The following are common findings among claims related to high-profile clients:

- The engagement letter covering the scope of agreed-upon services is insufficient or absent. An engagement letter may have been issued initially, but not reissued annually or revised for changes in scope.
- Services are rendered to multiple family members either as individuals, owners of businesses and/or beneficiaries of various trusts. This relationship complexity can result in potential and actual conflicts of interest that need to be properly identified and managed.
- Services are managed and even delivered by individual senior members of the firm, with minimal oversight by other firm personnel. This places unnecessary pressure on one person to resolve any problems that arise without the help of colleagues. In addition, lack of monitoring prevents an important check on service quality.
- A partner's book of business may consist of a handful of high-net-worth clients, each generating individually significant fees. For this reason, the partner may treat the client's interests as paramount, creating a threat to his/her objectivity.

Risk Management Recommendations

While services to high-profile clients present some unique challenges, the related risks can be mitigated. Consider the following quality control policies and procedures to help address professional liability risks.

Client acceptance and continuance. The sophistication of clients and their related knowledge of financial affairs can

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vary widely. Clients may have inherited wealth, be successful entrepreneurs or be entertainers or athletes earning large sums over a short career. Be sure to understand clients' service expectations, level of financial sophistication, and desire and availability to manage their financial affairs. CPAs should also conduct sufficient inquiry to determine who the clients will be now and who may become clients at a later time, particularly for large, affluent families.

Upon identifying prospective clients, screen them and determine their service needs. For example, do they require investment, tax and estate planning advice? If personal concierge services are desired, what will be the scope of services? Do they have other professional advisers? Are complex estate and trust matters involved? Is the prospective client responsive and cooperative or more dismissive and demanding in the acceptance process?

It is important to determine whether the firm has professionals on staff qualified to meet their service needs or the ability to develop the necessary expertise and identify the need for third-party service providers. Also consider requiring approval by a second partner or oversight committee before accepting or continuing high-profile client relationships.

Address conflicts of interest. Conflicts of interest can develop when CPAs serve a combination of multiple family members, their business interests or their trusts. Investment, tax and estate planning advice rendered to one family member may conflict with the interests of other family members. Thus, it may become necessary to refrain from rendering some services to family members and to advise them to engage their own advisers. CPAs should continuously monitor the situation as services expand and renew, and relationships change.

Execute the engagement. Restrict engagement activities to those defined in the engagement letter. An engagement letter loses its value if services expand beyond the original scope and an amendment to the engagement letter is not executed. If the client requests additional services or the scope changes, execute written change orders, make engagement letter amendments or send email correspondence. For major changes, execute a new engagement letter.

Oral advice or key decisions made by the client should be documented in the work papers and in a written communication to the client, noting the client's responsibility for acting on recommendations made. Consider including both the meeting date and the names of participants in your documentation. Billing narratives should align with the services rendered, as they can provide additional evidence of the firm's adherence to the agreed-upon engagement parameters. Every aspect of the engagement should be documented in as much detail as possible to mitigate the risk of a client's fuzzy memory.

Avoid the assumption of management duties. Clients may travel extensively or otherwise be unavailable to make day-to-day business decisions and they may expect the CPA to act on their behalf in their absence. The client may wish to delegate decision-making authority to the CPA under certain circumstances. If such responsibilities are contemplated, discuss it with the client and consult with legal counsel and your professional liability insurance carrier about documenting the agreement to make management decisions on the client's behalf, including engagement letter provisions to help mitigate risk.

Professional liability insurance policies may limit or exclude coverage when a CPA assumes the role of management at a client. Review the details of your policy with your insurance agent or broker.

Supervise the relationship. Often, services to high-net-worth individuals or families are managed or delivered by a CPA firm's senior members. At the request of the client, the engagement team may be limited to a small number of staff to protect the client's privacy. However, engagement monitoring and quality should not be sacrificed for a client's desire for anonymity.

Refine engagement letters.

The following suggested protocols may assist in defining engagement parameters:

- Obtain a signed annual engagement letter defining the scope of all service needs.
- Consider using an appendix to the traditional engagement letter terms and provisions that lists, in table format, the menu of services and the respective service description, frequency, client responsibilities and deliverable.
- When practical, have the client designate an individual with sufficient time and expertise to oversee all services the CPA firm provides, communicate the day-to-day tasks to be performed, evaluate the adequacy and results of services rendered, and accept responsibility for all decisions made.
- Where permissible, include language in the engagement letter that limits damage or requires alternative dispute resolution, such as mediation or arbitration. In addition, consider including a waiver of the client's right to a jury trial to mitigate the risk of the "dazzle" factor.
- Issue separate engagement letters for each individual and business and for each service, since these clients may own and operate multiple businesses for which tax, accounting and related services may be required. If a single engagement letter must be issued, clearly identify each business and the services to be rendered.
- Meet in person with the client at least annually to discuss the service needs, answer any questions and review the engagement letters. More complex engagements may require more frequent communication with the client.
- Document meetings with correspondence to the client to memorialize the discussion and identify any misunderstandings.

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Firm management should institute appropriate controls to monitor the relationship with the client and the performance of services. When multiple services are delivered to one client, the client's reliance on the CPA may increase and may raise the risk of compromising the practitioner's objectivity. The requirement to adequately plan and supervise the performance of professional services extends to all firm personnel – even partners.

Another Claim Scenario

Consider how a focus on quality and risk management could have changed the outcome of the following scenario. A CPA was engaged as the business and investment manager for a successful actor. In an effort to cultivate a tech-savvy reputation, the actor verbally instructed the CPA to "put some cash in start-ups."

As directed, the CPA converted a portion of the client's assets – cash, gold and precious jewels – into equity positions in a number of start-up companies. Among the investments were a promising mobile phone application, a recycler of outdated technology and, oddly, a real estate investment partnership. The plan was approved via a brief text message conversation while the actor was shooting on set in New Zealand.

Less than two years after the investment in the start-ups, the actor entered into divorce proceedings with his equally famous wife. As part of the divorce proceedings, the CPA was asked to complete a valuation of a number of the actor's investments, including the "tech start-ups." While most of the investments maintained stable or modest increases in value, the real estate investment partnership value had declined significantly.

The actor asserted, through media interviews and later included in the claim against the CPA, that he never approved of the investments and that minimal due diligence was performed by the CPA on the start-up investments. The actor also alleged fraud, as there was a large discrepancy in the value of the gold and jewels sold to make the investments and the actual cash invested. The actor suggested the CPA had pocketed the difference in values, particularly when it was learned that the real estate investment partnership was established by the son of one of the CPA's partners. The CPA, his partner and his partner's son were all accused of syphoning the actor's funds through the investment for personal enrichment.

Unfortunately, the CPA's version of events presented a different reality than what was expressed by the actor and his attorney in interviews and written in the gossip columns. The CPA asserted he repeatedly requested an engagement letter and written instructions from the client throughout their years of working together, but the actor insisted he would only work with professionals that he could trust with a handshake. The CPA regularly requested in-person meetings to discuss strategies, results and outlook of the actor's financial future, but was stonewalled by the actor's agent or assistant. Instead, the CPA was forced to communicate with the actor through the ambiguity of text messaging.

As for the real estate investment partnership, the CPA made the investment at the direction of the actor. The actor had met his partner's son at the firm's holiday party and, after a brief discussion, told the CPA, "The kid is going to make it big; let's get in on the action." The CPA was hesitant to make the investment on behalf of the actor, so a minimal contribution was made with the intent of pleasing the client. It was completed at the same time as the tech investments to lessen the impact of fees associated with converting non-cash assets to make the investments.

Finally, the fraud accusation was partially due to the attorney's misunderstanding of the basis of accounting used in the actor's personal financial statements versus the tax return and primarily due to a conversion loss on the non-cash assets used to make the investments. Unfortunately, due to the lack of documentation and the actor's skillful ability to paint himself as the victim, the CPA's version held little weight in final settlement of the claim.

Taking the Precautions

All clients and engagements present some level of risk to a CPA firm. With the proper vetting and quality control procedures, those risks can be addressed.

In some instances, the engagement may involve more detailed procedures, engagement letter provisions that limit the CPA firm's losses, a larger engagement team, more experienced staff or a more in-depth engagement quality review. Other engagements may be too risky and need to be avoided entirely.

Celebrities may have more money and fame than the average client, but that should not exclude them from the same level of the firm's scrutiny in acceptance, continuance and execution of an engagement. Focus on risk management and leave the headlines to the celebrities!

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