CPAS ACTING AS INTERIM CFO: HOW TO MANAGE THE RISK

By Alvin Fennell III and Joseph Wolfe

Connor Franklin was a CPA providing bookkeeping and tax services to a fast-growing online retailer named Cats Eats, which sold gourmet pet food.[1] One day, the owner told Franklin: "Business is booming! I want to hire a CFO, but I can't afford one yet. Can you step in on a temporary basis to help out?"

What should Franklin do? What would you do?

Franklin wondered if he might be getting in over his head. If something went wrong, could it get him in trouble? He briefly considered calling his insurance agent to find out if his professional liability policy would cover the services, but discarded the idea.

Franklin wanted to add "Chief Financial Officer Services" to his list of marketable skills, so he accepted the engagement. Over the next month, the owner increasingly relied on Franklin's experience and knowledge of the company's operations while he tended to growing the business. To make him feel like part of the "family," he had business cards printed up with Franklin's name, the company's cat paw logo and the title Chief Financial Officer.

As time went on, Franklin became more involved in Cats Eats' activities. Time demands on the owner were great; he was training 10 employees who had been added in just the past three months. The company had grown to more than 50 employees in less than a year, and he couldn't keep up with all of the day-to-day management activities or the tax, accounting and legal compliance requirements.

One day, the owner told him: "Put on your human resources hat. I want you to interview two job candidates for the new IT manager's job and give me your recommendation."

Franklin had interviewed and hired a number of employees over the years and felt he could handle this assignment. The first candidate was a 62-year-old woman who had provided IT support for Cats Eats since it was founded and had performed contract work for the owner for 20 years. The owner told Franklin she was undergoing kidney dialysis. The interview went well, but Franklin had some concerns about her qualifications to integrate the company's existing e-commerce platform with an ERP system the owner was considering purchasing.

The second candidate was a recent Stanford University graduate who was relatively untested, but had hands-on experience helping a friend with a system integration project for his online business. Franklin was impressed with his extensive knowledge of e-commerce business operations.

Following the interviews, Franklin told the owner: "I would recommend the Stanford grad. He has a lot less experience, but he's very knowledgeable, has done some system integration work and is willing to work for less money. He'll give your company more mileage in the long run. But I think you should interview both of them yourself and consult with an employment lawyer before making your decision."

The owner conducted a brief telephone interview with the recent graduate and hired him – without consulting his attorney. Several months later, the other candidate who interviewed for the position found out about the new hire and filed an age discrimination complaint against Cats Eats with the EEOC.

The owner immediately called Franklin. "The lawyers I have to hire to defend this are going to be expensive. You told me to hire the student! I hope you've got good insurance."

Franklin decided to terminate his engagement with the client and wrote off some unpaid fees. He forgot all about the client until a year later, when he was served with a lawsuit filed by Cats Eats. It turned out that the EEOC eventually issued a right to sue letter to the job candidate and she filed an employment practices lawsuit against Cats Eats.

The suit papers stated that Cats Eats was filing a cross-complaint for indemnity and contribution against Franklin and his CPA firm for the claims made against the company, alleging professional negligence. Cats Eats had already incurred more than $50,000 in defense costs in the employment practices case, which was still ongoing. At this point, Franklin called his insurance broker.

"I probably should have contacted you sooner," he said. Franklin's story ends with the words insurance professionals hate to utter and policyholders fear to hear: "You may have a coverage problem."

CPAs and Management Responsibilities

"Professional liability insurance policies generally exclude coverage for services rendered when the policyholder also performs management duties or assumes management responsibilities on behalf of the client," says Dave Sukert, JD, a senior vice president at Aon Affinity.

"It doesn't matter whether a formal title like CFO is used to describe these activities," said Sukert. Once an allegation is made that a CPA performed management duties for a client, it raises a potential insurance coverage problem associated with exclusions that exist in all professional liability policies. "CPAs are consultants. Once you start performing management duties, or your client thinks you are doing so, you've crossed the line."

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If Franklin had been hired as an individual by Cats Eats to serve as CFO, he would have been afforded coverage under the company's directors' and officers' liability insurance policy, presuming they maintained this coverage. But in this case, the owner of Cats Eats didn't want to incur the cost of either having a CFO on staff or purchasing additional insurance coverage. It was cheaper and easier to hire Franklin's CPA firm to render the services he wanted.

"The irony of these types of situations," said Sukert, "is that the CPA is accused of having made bad management decisions for the client, but doesn't receive the benefit of insurance coverage under the client's D&O policy. The CPA has also jeopardized insurance coverage under the CPA firm's professional liability policy. It's a lose-lose situation. They could end up footing the bill to hire their own attorney to assist them in disputing a coverage position taken by their professional liability insurer."

An Old Issue, Now an Emerging Risk

"This issue has been around for 20 years," said Ken Mackunis, president of the AICPA Professional Liability Insurance Program. "Today, many clients run their businesses online and with the technology available, they can ramp up business growth in months, rather than years. Many of these owners lack the skills to manage rapid business growth, so they turn to their CPA. It's a great new business opportunity."

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"The good news," Mackunis said, "is that CPAs do not have to decline this type of work. It is possible for a CPA to render the services needed by the client, but practitioners should seek guidance in addressing the liability exposures and framing their role before agreeing to perform these services."

The client may not fully understand what services they need. They may need consulting and controller-type services to manage day-to-day accounting and tax functions, rather than a CFO. When CPAs frame the engagement as consulting, accounting and tax services, they minimize the risk that the client will expect them to assume management duties or functions. Once the client regards you as a decision maker, your liability exposures change.

"If your client actually needs a temporary CFO," said Mackunis, "consult with both your lawyer and your insurance broker about potential legal and insurance coverage issues before deciding how to proceed."

Depending on the circumstances, it may be appropriate to have your lawyer draft an independent contractor agreement that limits your legal liability and present this to the client for consideration. When doing this, clearly communicate that you will be working as an independent contractor to the client's firm and that your CPA firm will not render these services, and confirm this in writing.

While this will result in payment of income taxable to you individually, it may be a more effective way to protect both you and your CPA firm from liability under the circumstances and help out the client.

Risk Management Guidelines for CPA Firms

Be specific when you market your services. The work needed by these types of clients usually consists of traditional tax, accounting and consulting services. Promoting managerial or CFO services in advertising materials creates an expectation that you can serve in a senior management role for clients. A more effective means of communicating about your services is to promote it as "... outsourced tax, accounting and consulting services."

Do NOT make managerial decisions. Regardless of whether the individual rendering services is an owner or an employee of the CPA firm, it is important to stay in a consulting role. Provide written recommendations to the client, requiring the client to make all management decisions, and to provide their decision and instructions in writing. Emails can be written quickly and serve as important evidence in the event of a misunderstanding or dispute later. Franklin did all his communicating by phone. If there had been an email chain confirming the conversations he had with the business owner, the lawsuit by the client likely never would have been filed – and if it did, the written communications would have served as critical evidence both in defending Franklin and in avoiding a coverage issue.

Do NOT sign contracts for the client. Binding agreements and contracts should be left to the business owner. Only parties vested with the necessary written legal authority should enter into agreements on behalf of a business.

Clarify your role in the engagement letter. Issue an engagement letter that clearly defines the scope of services to be rendered. Clearly state the professional standards that apply to the services to be performed. In most cases, these will be the Statements on Standards for Consulting Services (SSCS) and the Statements on Standards for Tax Services (SSTS). During the engagement, the client may also request that financial statements be prepared or compiled for their use; these services are subject to the Statements on Standards for Accounting and Review Services (SSARS). When new services are added, issue an updated engagement letter that describes them and lists the applicable professional standards. Have the client sign and date the letter before rendering these services.

Stay within your scope of practice. Once the scope of services has been defined, do not stray into performing services not covered by the professional standards listed in the engagement letter. Review the content of SSCS, SSTS and SSARS. Performing management duties or making management decisions for a client are not within the scope of these standards.

Document, document, document. Document all conversations and recommendations in both the working paper file and a written communication to the client. Be concise when explaining your recommendations and providing the client with information needed to make business decisions. Specify the client's responsibility for making final decisions based on your recommendations.

Delegate responsibility to someone within the firm. Whenever possible, request that the client assign an executive with sufficient time and expertise to oversee all services provided by the CPA firm. Have this individual communicate the tasks to be performed, evaluate the adequacy and results of services rendered, and accept responsibility for all decisions made. In Franklin's case, this responsibility fell on the owner.

Do NOT take the title of CFO. Avoid referring to yourself as a client's "temporary" or "outsourced" controller or CFO. Controller and CFO are managerial titles and roles. Unlike Franklin, do not allow the owner to provide you with business cards or include office signage that lists you as CFO.

My Client is a Friend. He/she Would Never Sue Me

"We hear this all the time," said Sukert. "As a friend, you want to help. You want the business. Be careful. A CFO is a senior executive with responsibility for managing the financial affairs of a company. Your job is to analyze financial information and provide business recommendations to the client."

While the scope may also include performing accounting services, preparing financial statements, or providing tax advice and preparing tax returns, it's important to clearly describe the scope in the engagement letter. If the client wants to add services, issue an updated engagement letter before rendering the services.

It's not unusual for small business owners to attempt to deflect business decisions that are difficult or involve areas where they lack experience. However, they should not be delegating these responsibilities to their CPA firm. Bear in mind that even when a CPA-client relationship has been close for many years, that can change when clients find themselves facing a lawsuit or are in dire financial straits. Mindsets can change and in the event of a lawsuit, engagement letters and written communications serve as important evidence in proving what was agreed to, and what occurred.

If you receive an offer to work as an interim CFO or controller, call your professional liability insurance broker. Have a conversation. Come away with a plan to avoid putting yourself and your CPA firm at risk. Work with these simple precautions in mind and you'll better protect yourself, your CPA firm and your stress levels.

[1]Connor Franklin is a fictional character. His story, though typical of the risks of accepting work as a temporary CFO, is used for illustrative purposes only.

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