Risk Management Tips for the Tax Practitioner

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CAMICO has been developing risk management solutions for CPAs for more than 37 years, and we recognize and understand the challenges facing CPA firms navigating each tax season's nuances. For example, the pandemic years' economic and tax relief programs had complex, wide-ranging impacts on CPAs, tax practitioners, and their clients.

Although most agree that the current tax season has signs of returning to normalcy after the pandemic-induced chaos of recent years, CPA firms continue to face unique challenges and risks they should not ignore. For example, in addition to trying to keep up with the increasing complexities of evolving tax law and regulations (e.g., state pass-through entity taxes, K-2s/K-3s), and ongoing challenges working with the IRS and other taxing authorities, many firms are experiencing significant capacity challenges as they struggle to find and retain qualified talent to support and meet their clients' service needs.

CAMICO recognizes that it can be difficult to stay current on risk management and loss prevention practices when dealing with these significant challenges. With more than 60% of CAMICO's claims originating from tax-related matters, addressing and managing the risk stress points associated with problematic clients can significantly improve a firm's risk profile.

Now, more than ever, CPA firms need to be proactive, not reactive. To mitigate these risks, firms need to prioritize performing the "right services" for the "right clients."

Considering the following questions may help you identify client scenarios that may pose higher risk to your firm.

1. Is the client still a "good fit?"

Proactively evaluate your client list. From a timing perspective, there is no better time than **now** to review your client list. Do so before the final phase of tax season to decide whether clients remain a good fit for your firm. Disengaging from clients that do not meet that threshold — ideally after they have paid their bills — will better position you going forward.

CAMICO's experience indicates the following are red flags of potential problem clients which, if not managed appropriately, will present elevated risks to firms:

- Difficult or uncooperative behavior (e.g., withholding critical information, argumentative and/or disrespectful to firm members)
- Changes in client's business
- Deteriorating client relationship (e.g., not taking your advice, is not responsive, acting in a way that suggests compromised integrity)
- Potential conflicts of interest
- Constantly questioning your fees and/or requesting a discount before services commence
- Late, slow or partial payments

Pay particular attention to difficult or manipulative clients who are slow in accommodating your requests, do not return your calls, or are otherwise non-responsive. When a client seems unwilling to provide you with the information needed to complete an engagement, assess the underlying cause — is the problem merely sloppy recordkeeping, or is the client deliberately delaying or withholding information? Be cautious in situations where it appears that documents are deliberately withheld, or you are urged by a client to proceed without appropriate or sufficient documentation.

Abrupt changes in a client's behavior may be indicative of a failing business, financial problems, substance abuse, or other personal problems. Trying to uncover the source of the problem could be beneficial, but whatever you do, don't ignore the warning signs of a deteriorating relationship. And always be on the lookout for potential conflicts of interest. It is extremely important to examine potential or actual conflicts of interest from each party's point of view, considering the client's perspective as well as those of other owners, investors, partners, beneficiaries, spouses, etc.

Conflicts of interest have long been a major factor in professional liability claims against CPAs. Part of the problem is that if CPAs are not proactive and sensitive to their existence, potential conflicts of interest are not perceived before the incidents that trigger these claims. If potential conflicts are identified, you must assess whether you can objectively represent the parties involved and if you determine you can, assess whether there are reasonable safeguards to eliminate or reduce the threat to an acceptable level. If unsure, contact CAMICO. We will work with you to address your potential conflict of interest dilemmas.

2. Is the engagement a good fit for the firm's expertise?

In CAMICO's experience, firms who dabble have a much higher risk of having a claim. Learning the art of saying "no" to clients is an important, but often overlooked, risk mitigation tool.

If clients seek your help with transactions and/or activities outside your comfort zone or skillset [… *did someone mention Employee Retention Credit ("ERC") or virtual investment opportunities such as non-fungible tokens ("NFTs") …?],* you will be better served suggesting they seek the advice and counsel of professionals with expertise in those areas.

It is important to recognize, embrace and maintain your competencies. As such, it is critical that CPAs never feel compelled to dabble in practice areas outside of their expertise. Frankly, this rule is fundamental to our profession as the preeminent standard of the Code of Professional Conduct's General Standards requires CPAs to only undertake professional services they can reasonably expect to complete with professional competence.

Advising clients regarding ERC and their digital asset transactions are opportunities for some firms, but unfortunately these opportunities also pose considerable liability exposure for firms who lack the requisite skills and dabble — tread carefully, arm yourself with knowledge, know your limitations, and be willing and able to say "no."

3. Are you taking the right steps to manage (and document) client expectations?

Effective communication is a key factor in any CPA-client relationship, and when you work to stay informed and in control of managing client expectations, you help to safeguard your firm. To that end,

good documentation is critical to successfully managing client expectations. Jurors (members of the public) generally consider CPAs to be experts in documentation, and falling short of that expectation may be viewed as negligent and perceived as falling below the standard of care.

Below are helpful documentation tips to get you through the remainder of tax season:

- **Engagement letters.** While engagement letters won't immunize you from lawsuits, they can be your first line of defense if a client makes a claim against you. Although you likely already have executed engagement letters in place with your tax clients, for those engagements that have had some engagement creep, memorialize the additional services by updating your engagement letter or obtaining a signed addendum clarifying the revised scope and limits.

  Numerous CAMICO engagement letter templates are available on the Members-Only Site's Engagement Letter Resource Center.

- **Always document significant meetings, communications and follow-up.** Follow up with written communications in circumstances including, but not limited to:
  - Change in engagement scope (may require a new engagement letter)
  - Negative information (e.g., tax return is already late, client's failure to timely provide information, client is facing an audit)
  - Judgment calls (e.g., aggressive tax positions taken by your predecessor)
  - Client agreement to take significant action
  - Conversations regarding transactions, extensions, or estimated tax payments

- **"Advise" clients of opportunities and "warn" clients about risks.** Consider obtaining a *tax representation letter* or stand-alone *certification letter* to mitigate high-risk scenarios such as the following:
  - If your firm is preparing amended income tax returns to reflect the ERC adjustments as required by the taxing authorities, and the firm is NOT responsible for assessing or opining on the client's eligibility for the ERC, CAMICO strongly recommends that in addition to having a signed engagement letter for such services, firms also insist the client sign a tax representation letter (this letter can be found on the Members-Only Site in the Tax Resource Center). This added defensive documentation will help protect the firm if clients later allege that the firm should have opined regarding eligibility for the credit, and/or if clients later allege the firm did not appropriately advise them of the potential risk given the extended statute of limitations afforded by the IRS for assessments without a corresponding extension for taxpayers to pursue refunds on the income tax returns.

  - For those clients with known extensive digital asset transactions, it may be prudent to have them sign a *tax representation letter* or a stand-alone *certification letter* at the conclusion of the engagement addressing cryptoasset implications (these letters can be found on the Members-Only Site in the Tax Resource Center). The additional defensive documentation provides evidence of the client's understanding and acceptance of their responsibilities regarding digital asset transactions and the limitations of the services your firm provided.

In addition to the above examples, there is a new area of potential risk associated with the Corporate Transparency Act (“CTA”). The CTA introduces a new and expansive reporting regime for entities deemed to be Reporting Companies to report *“beneficial owner”* information to the Financial Crimes Enforcement Network (“FinCEN”). CAMICO strongly recommends that CPA firms inform and advise their clients of the beneficial ownership reporting requirements under CTA. (Refer to CAMICO’s article in this IMPACT titled, “Corporate Transparency Act/Beneficial Ownership Information Reporting — Risk Management Considerations for CPA Firms”).

- **Written documentation should be factual, professional, and without personal commentary or unsubstantiated opinions.** Unprofessional and/or inappropriate comments can damage the integrity of documentation. Ask yourself whether your documentation would be helpful or harmful if presented at trial.

Additional Risk Management Tips

- **Fees, billings, and collections**
  The challenging economy has brought fee issues to the forefront as clients experiencing financial difficulties struggle to meet their financial commitments, including bills owed their CPAs. Good communication with non-paying clients is important, and may spur payment. At the very least, contemporaneously memorialized communications create a defensive documentation trail demonstrating that the client, by not responding to your communications, did not have a valid basis to claim your fees were not owed. When dissatisfied with work, clients normally respond to such communications by detailing their dissatisfaction.

  Fees, billings, and collection issues can and should be managed proactively. For additional information and resources on this topic, including sample collection letters, access CAMICO’s Engagement Letter Resource Center on the Members-Only Site.

- **Disengaging**
  Disengagement is an art form. Skillfully handled transitions can be mutually beneficial to firms and clients.

  However, care is needed when disengaging from engagements after they have begun. Disengaging too late and without sufficient cause may increase the likelihood a firm could face allegations of damages if the successor is unable to meet the deadline.

  Whether you decide to disengage a specific client, type of business, or area of practice, it is extremely important to terminate relationships professionally, formally, and in writing. At a minimum, your disengagement letter should always contain clear statements, a description of your work, and a list of any due dates or filings. When done effectively, disengagements are a good risk management tool for your firm and knowing how to do it skillfully and professionally will help you grow your practice and avoid potential liability exposure.

An article detailing disengaging best practices, *The Dos and Don'ts of Disengaging*, and illustrative CAMICO disengagement letters are available on the Members-Only Site within the Engagement Letter Resource Center.

- **Early reporting of potential claim situations**
  Promptly report potential claims, including potential errors or omissions, to CAMICO. Doing so protects your firm's full policy limits, and you may benefit from CAMICO's tax penalty abatement services, which provide expertise on abatement requests.

  CAMICO encourages early reporting by **reducing the deductible by 50%, up to $50,000**, for any potential claim that is reported before a claim is made. Further, if CAMICO determines that it is appropriate to retain counsel to assist with a potential claim, the related expenses preceding a claim will be absorbed by CAMICO and will not impact policy limits or be charged to the deductible.

  Subpoena and consultation services are included in these potential claim benefits. Early reporting helps our Claims Specialists achieve early, efficient, and effective resolutions, thereby mitigating the impact of errors and omissions.

CAMICO policyholders with questions regarding this article or other risk management topics should contact the Loss Prevention department at lp@camico.com, or call our advice hotline at 1.800.652.1772 and ask to speak with a Loss Prevention Specialist.

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