Client Screening and Acceptance

“I can’t believe this client is suing me. They were always slow to pay, and I had so much trouble getting the information I needed from them. It was never worth the aggravation. I should have gotten rid of them years ago. Where did I go wrong?”

Time after time, CAMICO claims specialists hear the same words when they first contact policyholders to discuss a new lawsuit. Difficult clients can develop grudges for various reasons. For example:

- They are not happy with the results of an engagement, even though there was nothing wrong with the services performed.
- They believe that the CPA rendered substandard services (especially when they are unhappy with the results).
- They don’t manage their own financial affairs well, subjecting them to problems for which they hold the CPA responsible.
- They are not financially responsible and will blame the CPA when their finances take a downturn.
- They owe so much money to the CPA that they believe asserting malpractice will help them avoid or reduce the amount they owe.

CAMICO has long recommended client screening as the first step in an effective loss control program. Client screening procedures are now standard practice in the accounting profession, and AICPA Practice Alert 2003-03, “Acceptance and Continuance of Clients and Engagements,” describes in detail the rationale and elements of such procedures.

CPA firms should evaluate all potential new clients and re-evaluate all current clients on a regular basis, at least annually. This enables the firm to better monitor clients, consider any changes that might affect the professional relationship, and avoid situations that could escalate into crises. Firms can also stipulate in their engagement letters that the engagement is not binding until client acceptance procedures have been completed. Three main considerations in the client acceptance process are:

1) **Is the engagement a good fit for the firm’s expertise?**

If the firm accepts an engagement for which it is not professionally staffed or qualified, it runs the risk of disappointing the client, or a third-party, and exposing itself to litigation and ethics violations. Due care demands that firms: a) are capable of performing the services required by the engagements they accept; and, b) are performing the services often enough to become proficient at them. CAMICO claims experience shows that firms “dabbling” in services outside of their areas of expertise are not practicing them often enough to become proficient. Services that represent less than 15 percent of a firm’s service concentration produce disproportionately high loss ratios.

Proficiency in any type of engagement includes the ability to identify risk stress points in the engagement. CPAs are expected to possess a thorough understanding of the client’s business and industry in order to identify those stress points.

Some CPAs make an annual habit of redefining and understanding the scope of their own practice, going as far as to write out a clear statement of what they can do and what they
cannot do. If they have clients who don’t fit into that scope, they disengage and refer the clients elsewhere. Establish a policy for what types of engagements your firm will avoid because of a lack of technical expertise.

2) Is the client the kind of client the firm would like to have?

Once you’ve established what type of work you perform best, ask yourself what type of clients you want. If you’re a new firm, you have the opportunity of selecting the clients you want. If you’ve been practicing for some time, there’s nothing to stop you from changing your clientele. Spend some time thinking about the question, “What kind of clients would I really like to have?”

A variety of factors need to be considered in answering this question, ranging from the client’s reputation and integrity to its commitment to appropriate accounting practices and to internal controls. CPAs should communicate with predecessor accountants and third parties to obtain as much information as possible about the client. Are the client’s expectations of CPAs reasonable? Does the client appropriately value CPAs’ services and advice? Background investigations are recommended for all significant engagements. When you have the information you need, explore ways to cultivate the kind of business you want.

Other important considerations will depend on the type of client or engagement in question. For some engagements, CPAs will need to consider potential or actual conflicts of interest, as well as whether the CPAs’ independence and objectivity are impaired in appearance or in fact, especially when considering services for attest clients. (See “A Synopsis of AICPA Ethics Interpretation 101-3” on page 3.)

3) Is the client financially viable?

The answer to this question is critical, especially in avoiding fee collection problems and disputes. Much of the information you need can be obtained by:

- interviewing the client and the client’s key personnel, banker, attorney, predecessor accountants and auditors;
- running a credit check;
- examining the past three years of financial statements;
- examining the past three years of tax returns; and
- examining prior CPA’s management letters.

Make a regular practice of interviewing the predecessor accountant, who can be an excellent source of information that many CPAs fail to utilize. Questions that prior accountants might answer include:

- Why did the client leave?
- Did the client pay bills on time? meet deadlines? keep good records?

Background Investigations

Background check should be considered for all significant engagements. Credit checks and public record checks are critical, but background checks are about more than the financial condition of the client. The questions the CPA firm should ask are:

- Why was our firm selected for this engagement?
- What was the source of the referral?
• What business is the client in?
  o Is the engagement within our firm’s areas of expertise? Is it risky?
  o Are the rewards of the engagement worth the risk?
• Will the engagement cause our firm any conflicts of interest (actual or potential)?
• Are the business and accounting records adequate and in order, or disorganized?
• Are the financial statements and tax returns for the past three years consistent?
• What is the client’s financial track record? (e.g., bankruptcies, business failures)
• What is the client’s level of financial sophistication? (especially the accounting staff’s)
• Is there a high staff turnover?
• Is a key partner or employee leaving?
• Is the client of a litigious nature, judging from our conversations with prior accountants and/or attorneys?
• Is the financial knowledge of the client acute?

Client screening should be done regardless of the nature of the services you are being asked to perform, preferably during the period between the client’s first contact with your office and the preparation and signing of the engagement letter (the “pre-engagement” period). Much of the information you’ll need can be asked at the client interview and verified later through other interviews. The more information you get, the better you’ll be able to assess the risk of the engagement or the client.

In a CPA partnership or professional corporation, it is a common practice for another partner or a client committee to review the client-screening information and to pass judgment on the acceptability of a new client.

There are high-risk clients and high-risk engagements. Some CPAs rank their clients according to how cooperative, knowledgeable, reasonable, difficult, or time-consuming they are. Engagements can be ranked as well by the complexity of the work. Generally, difficult clients with complex work pose the highest risk to the CPA firm.

**Disengaging**

Effective disengagements actually begin with the engagement letter, which should include language regarding the CPA’s right to stop work or disengage in the event the client does not meet the responsibilities set forth in the letter. If you encounter a problem during the engagement, an initial warning letter will serve to notify the client that the problem may result in a termination of the relationship. A final warning letter should also be sent before deciding to disengage.

If the firm does decide to disengage, terminate the relationship professionally and formally, in writing. At a minimum, the disengagement letter should always contain the following:

- a clear statement that you are disengaging and the effective date of the disengagement (e.g., “We must formally end our relationship with you as your accounting firm <effective immediately”>, or “as of [date]”);
- a description of any work that is in process or unfinished; and
- a statement of any due dates or filing deadlines that exist with regard to the work, whether finished, in process, or unfinished.
Review and edit the letter carefully to ensure that it is professional, objective, and rational. Don’t let it reflect personal feelings. Send the letter on a timely basis so that the client is not left with a deadline that cannot be reasonably met by going to another CPA. When done effectively, disengagement can leave your clients feeling that you have acted in their best interests.

Engagements that include audit, review, or compilation services require special attention. Such engagements are often used by clients for obtaining financing or satisfying loan covenants, and disengaging while in process can cause potentially negative effects.

Tax preparation engagements also require special attention. Ideally, the CPA firm should disengage after completing its work for the client. When the CPA disengages before completion, a successor CPA may be unable to finish by the deadline, causing missed opportunities or damage to the client’s business. CPAs should be aware of this exposure and should not wait until the last minute to disengage.

By heeding the warning signs that develop from the client-screening process, CPAs can avoid a lot of stress and save a lot of time, energy and money that may have otherwise been spent dealing with litigation and controlling damage to the firm’s reputation.

CAMICO guidance is always available by calling the advice line, 1.800.652.1772, or by e-mailing questions to lp@camico.com.