

## Engagement and Disengagement Letter Essentials

By Suzanne M. Holl

Engagement and disengagement letters are two of the fundamental building blocks of effective CPA risk management. Along with client screening and ongoing documentation practices, engagement and disengagement letters are crucial for addressing the high expectations that clients and the public have for CPAs. These expectations affect the way that CPAs are perceived in the world of professional liability, where CPAs are judged by jurors, judges and arbitrators who generally have a limited understanding about what CPAs do in their profession.

Judgments and verdicts rendered in liability disputes create what are sometimes referred to as jury or claims standards, which have almost always been higher than the standards the profession has established for itself. CPAs who pay proper attention to their professional liability exposures gear their risk management techniques not only to what the profession expects of them, but also to what the public expects of them.

### Engagement Letters

CPAs must reach an understanding with the client about the engagement, and that understanding should be put in writing with an engagement letter. Engagement letters help CPA firms improve communication with clients, document engagements more effectively, and protect the firm from litigation. Letters should be as detailed as possible in describing the nature and extent of the services that the firm is being retained to perform, as well as the services that the firm is *not* being retained to perform.

Similarly, engagement letters should be as detailed as possible regarding the client's responsibilities and obligations that will facilitate the engagement (e.g., providing necessary documents and accurate information in a timely manner).

The following guidelines of do's and don'ts are provided to assist you in writing effective engagement letters.

#### Engagement letters should:

- State the purpose of the engagement.
- Define the scope and limits of the engagement (specifically what the firm *will* and *won't* do).
- Specify known negative conditions or adverse situations.
- Note client instructions, responsibilities, deliverables and dates.
- Note reliance on facts provided by the client.
- Outline terms of fee collections and the consequences of late payment.
- Include a stop-work clause. (Enforce the clause to prevent unpaid fees from building up to the point where the firm wants to sue for them, or the firm is in financial distress.)
- Indicate the firm's record retention policy.
- Include third-party service provider language, if applicable.

- Confirm client's acknowledgement to the terms of the agreement and request client's signature.

**Additional considerations:**

- Include language regarding the client's responsibility for the adequacy of internal control.
- If applicable, explain limitations regarding financial statement distribution.
- Include alternative dispute resolution language (i.e., mediation for all disputes, and an arbitration clause for fee disputes only).
- Evaluate the appropriateness and efficacy of including limitation of liability clauses.

**Engagement letters should *not* include:**

- Marketing information. Defer promotional information and other forms of marketing to other documents. The engagement letter should be viewed as a contract and composed accordingly. It is not the place to convince a client that your firm is the answer to all their problems. An engagement letter limits your services, rather than selling your services. Wording such as, "We are particularly suited for this type of work" may be appropriate for a proposal letter, but not for an engagement letter.
- All-encompassing language. An engagement letter should not contain all-encompassing language. Because an engagement letter limits the scope of your firm's work, avoid superlatives and absolutes. For example, use words such as "notice, examine, follow, observe, study, investigate, test, watch and comment on." However, avoid words and terms such as "all, every, analysis, any, absolute, complete, confirm, judge, determine, totally, thorough, validate and verify."
- Legal jargon or ambiguity. Make the engagement letter easy for the client to understand. Don't use abbreviations or words only a CPA would understand. Any ambiguity in the engagement letter will most likely be decided in the client's favor in a court of law, so keep the language simple and clear.

**Additional areas to consider:**

- Limit the use of unilateral language to lower-risk engagements (signed engagement letters are always the strongest "first line of defense").
- Avoid evergreen letters – update letters annually to reflect changes in the scope of the engagement.
- Avoid usurious interest charges. Instead, assess a "late fee" for unpaid balances.

### **General engagement letter tips:**

- Every engagement letter should include the full or exact name of the client, entity type, specific state names and tax years for tax engagements, and purpose of engagement.
- Review the letter with the client and get agreement regarding the terms and conditions before beginning the work.
- Update engagement letters at least once per year.
- Update engagement letters whenever engagements change.

The best way to improve client communications and manage risk is to use a detailed engagement letter that the client understands and signs. A well-documented engagement, and a strong defense, begin with an effective engagement letter.

### **Disengagement Letters**

Most CPAs—even those highly skilled at client screening—will periodically encounter situations and client relationships that call for disengaging. While the subject of disengaging is typically thought of as (at best) unpleasant, disengaging can be a practice management tool that increases firm profitability and creates a better situation for both the CPA and the client.

Proper client disengagement procedures should be used to avoid causing a loss for the client. When you decide to disengage, you should seek to 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.

It is often essential to provide ample lead time before a client's deadlines to better protect the firm from a claim or from being forced to provide some crucial services before disengaging.

Review and edit your disengagement letter carefully to ensure that it is professional, objective, and rational. Situations that provoke disengagements are often emotionally charged. Don't let your letter reflect your personal feelings. Your client needn't feel antagonized in any way. When done effectively, disengagement can leave your client feeling that you have acted in the best interests of both parties.

Disengagement is an important practice management tool, and knowing how to do it skillfully and professionally will serve to help you expand your practice and avoid liability. Any time you need advice about a client situation or a disengagement letter, call your risk advisor.

Effective communication is a key factor in any CPA-client relationship. When the firm stays informed and in control, it is better protected. In the end, good risk management is good practice management and will help the firm enhance its clientele and avoid liability.

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