Risk Management in Tax Engagements

John Raspante, CPA,MST, CDFA

NAPLIA

Copyright 2012

Important Disclaimers

- The content of this presentation and these slides is intended solely for general educational purposes, to give accounting/tax professionals a broad outline of the laws, legal concepts, and professional standards discussed herein.
- It is not intended for the purpose of providing specific legal, accounting, or other professional advice to any particular recipient for use in the recipient's practice or in advising the recipient's clients, or with respect to any particular jurisdiction.
- The author /presenter of said content (1) makes no representations, warranties, or guarantees as to its technical accuracy or compliance with any law (federal, state, or local) or professional standard; and, (2) assumes no responsibility to any recipient of the content to correct or update it for any reason, including changes in any law or professional standard.
- Recipients should not rely on the content of this presentation and these slides. Rather, before taking any action in connection with the laws, legal concepts, and professional standards discussed herein, recipients should consult the actual text of those provisions, and obtain specific legal and/or accounting advice.
- No warranties as to merchantability or fitness for a particular purpose are expressed or implied. Application and use of the laws, legal concepts, and professional standards discussed herein, and these slides, is solely the responsibility of the reader.

Copyright 2012

Objectives of Risk Management

- Gain Control:
  - Over risks in practice environment
  - Not to eliminate those risks
- Claims:
  - Prevent them
  - Make them more defensible

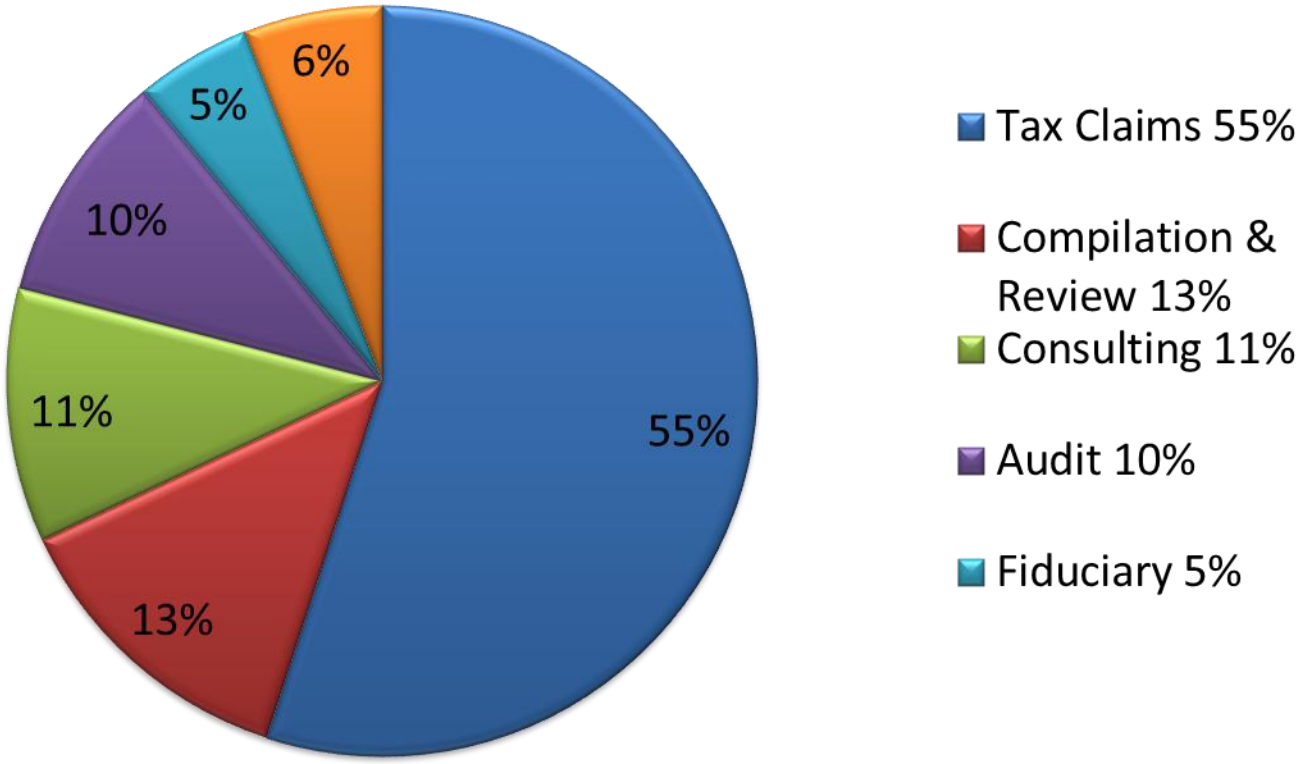
Copyright 2012

The Risk Environment

NAPLIA
Professional Liability Insurance

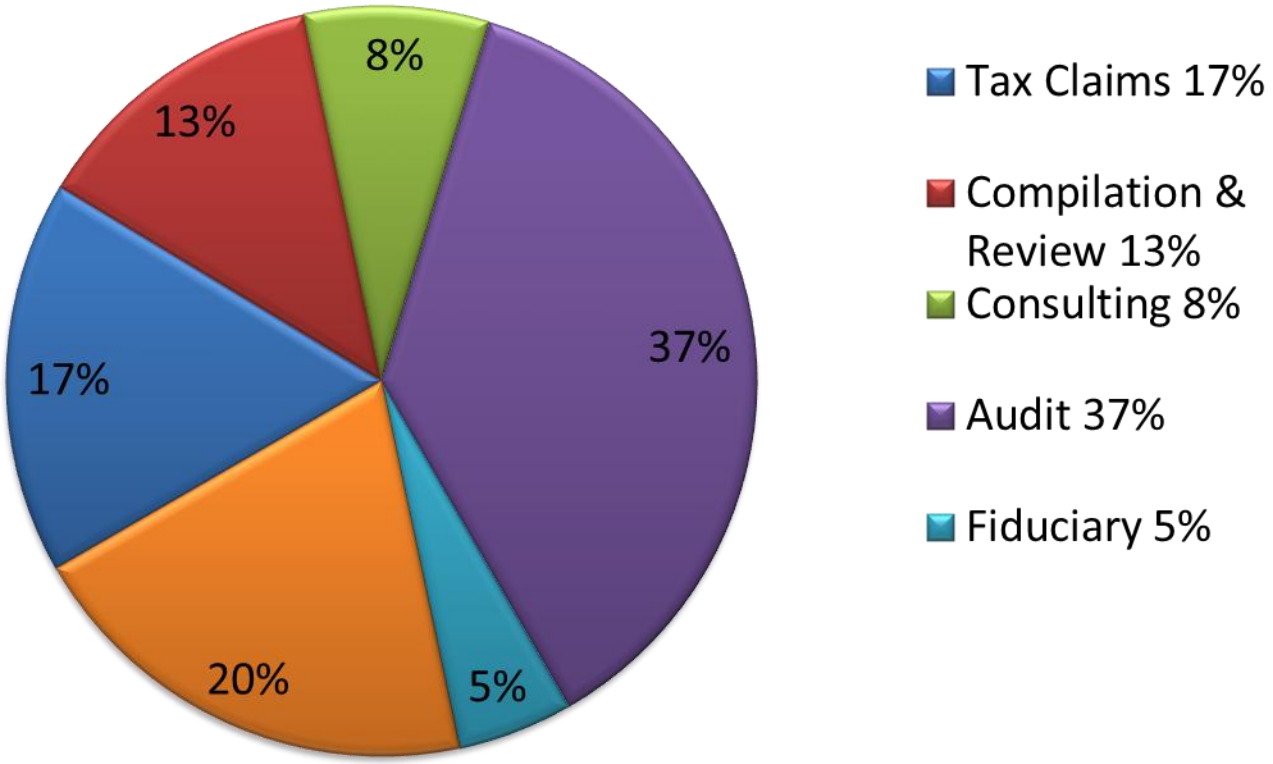
Copyright 2012

Percentage of Total Claims
(By Service)



Copyright 2012

Percentage of Total Dollar Losses
(By Service)



Copyright 2012

1040 exposures

- 1031 exchanges
- Matrimonial tax
- MRD
- Ethics / SSTSs / Circular 230
- Real Estate Professionals
- DOMA
- Willful Blindness
- NOLs

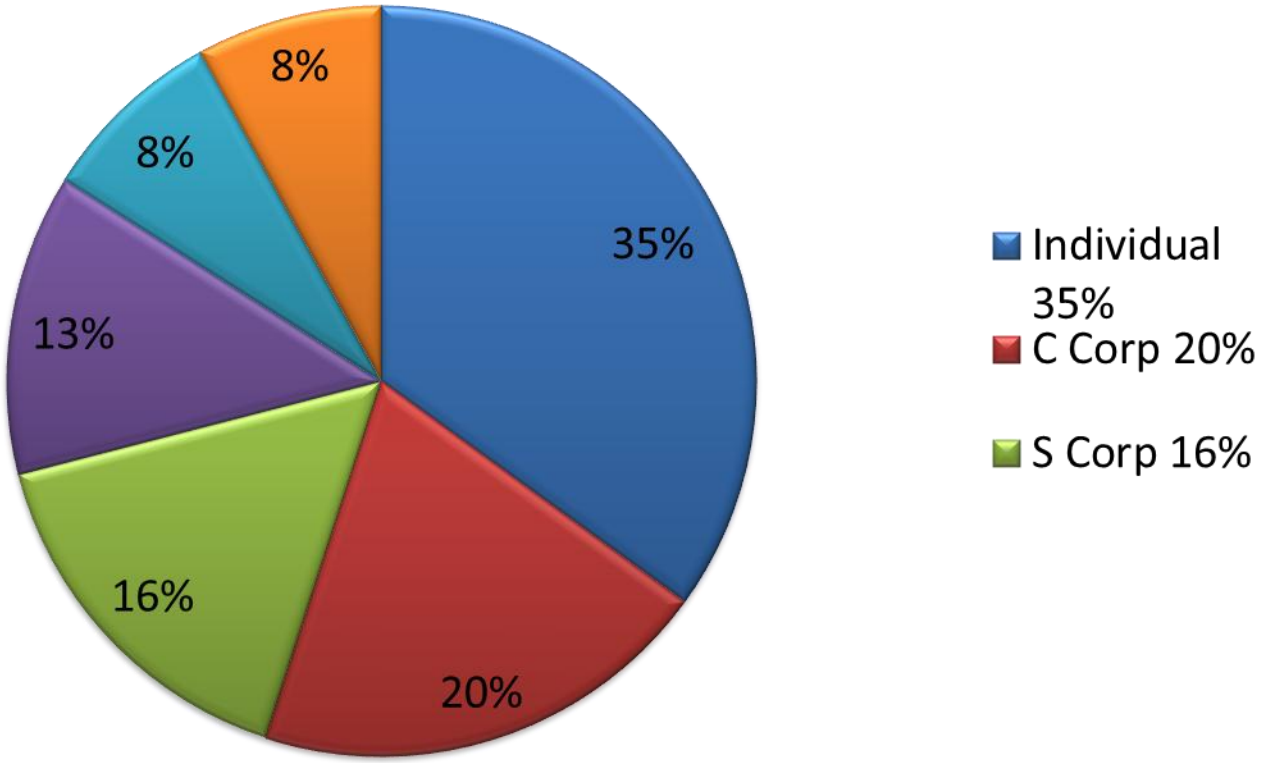
Copyright 2012

1040 Exposures (cont.)

- NJ Issues
- NYS issues
- Nexus audits
- Residency audits
- Conflicts of interest
- FBARs / Voluntary Disclosures
- CODI
- Request for Records

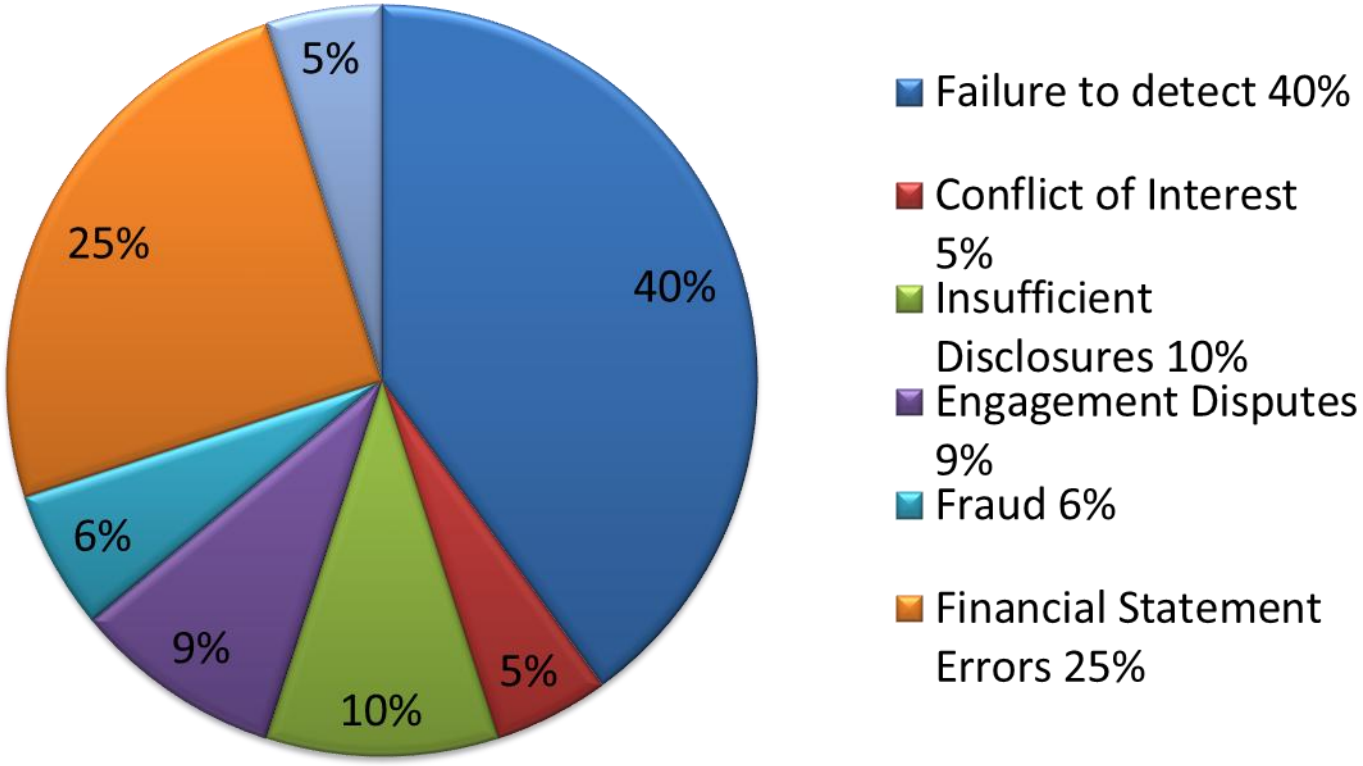
Copyright 2012

Percentage of Tax Claims
(By Type of Client)



Copyright 2012

Percentage of Audit Claims
(By Source of Claim)



Copyright 2012

Defending Claims: The Basics

NAPLIA
Professional Liability Insurance

www.naplia.com

Copyright 2012

Statutes of Limitation
(Varies By State)

- Malpractice limitation period
- Discovery rule
- Action
- Reliance
- Injury

Copyright 2012

Principal Exposures

- Exposure to clients:
  - Civil suits for damages
  - Complaints to State Board
- Exposure to third parties:
  - Civil suits for reliance damages
  - Government investigations

Copyright 2012

Theories of Liability

- Negligence
  - Errors
  - Omissions
- Violation of professional ethics
  - Conflict of interest
  - Breach of confidentiality
  - Withholding client documents
- Breach of contract
  - Fee dispute
  - Failure to render agreed services
- Violation of consumer protection statute
  - Breach of fiduciary duty
  - Fraud
  - Other egregious behavior

Copyright 2012

Negligence
(Elements of Claims)

- Client must prove:
  - Liability—Existence of negligence
    - Duty—Standard of care
    - Breach of duty
  - Damages
    - Actual harm suffered by client
  - Causation
    - Sufficient connection between negligence and harm
- Failure to prove any one element will defeat claim

Copyright 2012

Standard of Care—Duty

- Reasonableness standard
- What would the reasonably prudent accountant have done under similar circumstances?
- Objective standard—Expert testimony needed
- Compliance with professional standards does not insulate the firm from liability

Copyright 2012

Managing Risk—During Engagement
("Failure-to-Detect" Claims)

- At the client-selection stage
  - Clients with healthy organizations
  - Document—Engagement letter
- At the planning stage
  - Be observant, inquisitive
  - Focus on internal controls
  - Document—Forms, checklists, memos
- During performance stage
  - Be thorough, objective, skeptical
  - Confront clients when needed
  - Document—Work papers, correspondence
- At conclusion
  - Document—Management letters

Copyright 2012

Defending the Claim
(Failure-to-Detect Embezzlement)

- Limited scope of engagement
- Reasonableness:
  - Compliance with professional standards

Copyright 2012

Exposure to Third Parties

NAPLIA
Professional Liability Insurance

Copyright 2012

Theories of Liability

- Negligent misrepresentation
  - Errors
  - Omissions
- Violation of professional ethics
  - Conflict of interest
- Violation of statutes/regulations
  - Fraud

Copyright 2012

Negligent Misrepresentation (Elements of Claims)

- Third party must prove that you:
  - Made false statement of fact
  - Had no reasonable basis to believe it to be true
  - Intended to induce third party to rely on it
- Third party must prove that it:
  - Believed statement and reasonable relied on it
  - Suffered harm flowing from that reliance
- Failure to prove any one element will defeat the claim
- Third party must also have standing to bring claim

Copyright 2012

Standard of Care

- Reasonableness:
  - After exercising reasonable prudence
  - Would another accountant
  - Under similar circumstances
  - Believe statement to be true?
- Objective standard
  - Expert testimony usually required

Copyright 2012

Negligent Misrepresentation
(Most Common Complaint)

- Failure to detect:
  - Errors
  - Fraud
  - Illegal acts
  - Internal control issues:
    - Significant deficiencies
    - Material weaknesses
- Resulting in material misstatements

Copyright 2012

Managing Risk—During Engagement
(Failure-to-Detect Claims)

- At the client-selection stage
  - Clients with integrity
  - Firm has sufficient expertise
  - Document—Engagement letter
- At the planning stage
  - Be thorough, objective, skeptical
  - Document—Forms, checklists, memos
- During performance stage
  - Be thorough, objective, skeptical
  - Confront clients when needed
  - Document—Work papers, correspondence
- At conclusion
  - Additional layer of review
  - Document—Management letters

Copyright 2012

Defending the Claim
(Negligent Misrepresentation)

- Limited scope of engagement
- Compliance with professional standards
- Proportionate responsibility
  - Demonstrating plaintiff's fault
    - Unreasonable reliance
    - Lack of due diligence
- No causation
  - Plaintiff's harm caused by other factors
- Plaintiff's lack of standing

Copyright 2012

Standing to Bring Claim
(Three Doctrines)

- Privity
  - Most restrictive to third parties
  - Need agreement/close contact with accountant
  - Old majority—No longer
- Restatement
  - Middle ground
  - Plaintiff—member of class expected to rely
  - Majority rule—Trend is in this direction
- Foreseeability
  - Least restrictive to third parties
  - Plaintiff must only be foreseeable user of work product
  - Minority rule—Once very popular
  - Only MS and WI appear to still follow this doctrine

Copyright 2012

Other tax exposures

- Sales and use tax
- Estates and trusts
- 990s
- Payroll tax returns
- Domiciles
- 5500s
- Corporate taxes
- Transfer Pricing

Copyright 2012

1040-Series Returns
(Rev. Proc 2008-35)

- Separate written document
- Paper consent
- Electronic consent
- Mandatory statements in the consent
- Affirmative consent
- Signature
- Incomplete consents
- Multiple disclosures/uses within single consent
- Disclosure of entire return
- Adequate data protection safeguard

Copyright 2012

Thank you

John F. Raspante,CPA

732-216-7552 JohnR@naplia.com

508-656-1300

NAPLIA
Professional Liability Insurance

Copyright 2012