

CHAPTER 6

REJECTING OR WITHDRAWING FROM CLIENT ENGAGEMENTS

6.0 Introduction

Much has been written and discussed in risk management seminars regarding the importance and benefits of engagement letters. That written expression of the understanding between you and your client at the outset of your engagement assists in bringing your client's expectations into alignment with your own, and memorializing statements and agreements meant to protect you in the event the relationship breaks down. It is fair to say that engagement letters have gotten so much attention because the point in time when the client engagement forms is a critical point, containing great risk and opportunity. Far less has been written and discussed about the importance and benefits of the disengagement letter, and, for that matter, the disengagement process in general. Perhaps the lack of attention paid to disengagement issues reflects a view that the point of disengagement is not a critical point in the engagement. I do not share that view. Engagement termination presents great risk and opportunity. The purpose of this chapter is to help you understand that your exposure to liability in your practice can be profoundly affected by the way you conduct yourself at the end of engagements, and that you can take control of that exposure by including basic disengagement procedures in your overall risk management policies.

6.1 Knowing When To Reject And Withdraw From Engagements

If your client terminates your engagement, i.e., you get fired, you are thrust, involuntarily, into the disengagement process, and you should proceed to address any open issues concerning the engagement promptly, in the manner that will be discussed in later sections of this chapter. This section concerns itself with those instances when the business decision to end a client relationship rests entirely with you. One such instance is when you are confronted with a potential new client, and considering whether it is in your best interest to enter into a business relationship with this person or organization. There are also numerous events that may occur during the course of an existing engagement that should cause you to pause and consider whether to continue in a business relationship with your client. At each of these junctures, by making reasoned judgments about the risks and benefits of going forward, you greatly decrease the liability exposure of your accounting practice.

6.1.1 Prospective Client Engagements

It has been said that your best client is the one you don't accept. As cynical as that statement sounds, it contains more than a grain of truth. If you do not exercise good judgment in choosing your clients, you will needlessly subject yourself to engagements laden with problems, some of which will result in claims. You have enough to deal with in resolving unforeseen problems that arise during the course of engagements; you can ill-afford to burden yourself with problems that are quite apparent before you ever agree to accept a client or new engagement. Exercising good judgment in choosing your clients is a skill that you can develop over time, requiring, more than anything else, a commitment on your part to exercise restraint.

In order to have any hope of successfully screening potential clients, you must be prepared to say no, even in the face of a sizeable fee or other perceived benefit. You cannot effectively screen out undesirable clients or engagements if you feel compelled to accept every large-dollar fee that presents itself, or every referral from a particular source. If you can enter every interview of a potential client prepared to say no, if necessary, then you can critically assess each potential client in a way that will truly benefit your practice.

When considering a potential client (or potential new engagement from an existing client), you must be observant, and focused on several areas of inquiry, including, but certainly not limited to, the following:

1. What or who brought the prospective client to you?—red flag—the prospective client was referred by someone for whom you do not have great respect.
2. Why did the client leave the predecessor accountant?—red flag—the predecessor withdrew due to non-payment of fees or non-cooperation.
3. Is the subject matter of the engagement within your expertise?—red flag—you have no prior experience with the very specialized subject matter presented by the engagement.
4. Do you have the available resources to service the prospective client's needs?—red flag—time constraints or staffing needs would severely burden your practice.
5. What is the prospective client's reputation in the community?—

- red flag—the prospective client has a reputation of being dishonest, difficult and litigious.
6. How did the prospective client react to your discussion of fees, billing, and the need for a detailed engagement letter?—red flag—the prospective client is very fee conscious, seeks deep discounts and refuses to execute an engagement letter.
 7. How realistic are the prospective client’s expectations?—red flag—the prospective client expects greater services than you can provide for the proposed fee.
 8. Would you be comfortable working with this prospective client?—red flag—the prospective client is unusually arrogant, overbearing, condescending and otherwise difficult.
 9. What does your intuition tell you?—red flag—something you can’t articulate just doesn’t feel right or seems too good to be true.

Methodically and thoroughly utilizing a list such as this as part of your screening process will provide you with the information necessary to identify red flags, indicating foreseeable problems and incompatibility.

There is no fixed formula for weighing the information you obtain from the screening process. In some cases, a single red flag will be serious enough to warrant rejection of the proposed engagement. In other cases, you may note a number of red flags, but determine that there are enough mitigating factors to outweigh the perceived risk. The important thing is that you clearly understand the risk factors up front and undertake only those engagements with which you are comfortable. If, in light of the information you obtain, you trust your instincts and exercise common sense, you should eventually achieve a more desirable client base.

6.1.2 Existing Client Engagements

Even good client-intake decisions, however, can result in engagements from which you should eventually withdraw. Your engagement may be trouble-free, but circumstances may arise that require withdrawal. On the other hand, your relationship with your client may deteriorate to an unmanageable level. When your engagement reaches such a point of no return, failure to withdraw can expose you to serious liability and impose a burden on your resources that can cause material harm to your practice. It is, therefore, necessary to be prepared to withdraw from any engagement, and understand the factors that may make withdrawal necessary.

Although the possible reasons for withdrawal are unlimited, the following is a list of the reasons you are most likely to encounter in your practice:

1. You are leaving your practice due to retirement, illness or relocation;
2. Issues have arisen in your engagement that are beyond your expertise;
3. The demands of your engagement require more resources than you possess;
4. Your client has failed or refused to pay your fees;
5. Your client has failed or refused to cooperate or communicate with you;
6. Your client has failed or refused to follow your recommendations or implement your adjustments;
7. Your client is accusing you of malpractice;
8. You have developed a conflict of interest; or
9. Your client is engaged in illegal, immoral or unethical conduct.

In some of the above cases, you may have no choice but to withdraw from your engagement, and your client will likely understand the need, as in the case of retirement, illness, relocation, lack of expertise, lack of resources and conflict of interest. In other cases, however, withdrawal may be a judgment call on your part, and your decision to withdraw may invoke a hostile reaction from your client. In such cases, you should confront your client with the problem and seek resolution short of withdrawal (when you have been accused of malpractice, however, you should immediately report the incident to your professional liability insurer).

It is important, in deciding whether to withdraw from an engagement, not to allow the process to continue for a prolonged period of time. Problem engagements do not tend to improve over time, unless you and your client have addressed the problems and are using the time to work through them constructively. Once you have identified a problem, such as nonpayment of fees, you should bring it to your client's attention immediately. In doing so, you are likely to learn the reason for the nonpayment: e.g., cash shortage or dissatisfaction with services. You can

then work to resolve the problem before allowing your outstanding fee to increase much further. If you cannot resolve the problem, you should act quickly to terminate your services and exit the engagement. Problems such as non-cooperation and non-communication should be handled similarly.

When your client accuses you of malpractice during the course of your engagement, you should seriously consider withdrawal. Even if your client retreats from the accusation during subsequent discussions and wants you to continue on, it will be impossible to completely erase the incident from your memory, and, chances are, the lingering knowledge that your client has made such a threat in the past will always burden your engagement. You may find yourself rendering services at no charge, discounting invoices and making concessions to your client's position that you would not have made but for the past accusation. In most cases, once the accusation is made, the relationship has materially changed. Any time that your relationship with your client undergoes a material change, you should terminate the former engagement and, if both parties are willing, enter into a new engagement agreement. The most prudent course would be to require your client to agree, as part of a new engagement letter or in a separate document, to release you from any and all liability for services rendered in the past, as a condition of performing any future services. If your client won't release you, don't continue the relationship. Why would you want to expend your resources servicing a client that is planning to sue you?

Difficulties can arise when you feel compelled to withdraw at a time when a deadline is imminent. This scenario can be encountered in a variety of engagements, such as a compliance audit or a tax return preparation engagement, when your client fails to cooperate or supply necessary documents prior to the filing deadline. When facing this dilemma, you should confront your client with the nature and consequences of its conduct, and make every reasonable effort (and document those efforts) to resolve the matter without compromising your ethical standards. In many cases, the urgency can be eliminated by obtaining an extension of the applicable deadline, or enlisting the services of a mutually-respected neutral to mediate the issue. Thereafter, you can make your withdrawal decision in an atmosphere of relative calm. In those cases where the problem persists, and the deadline cannot be extended, and if the problem is such that withdrawal is the only appropriate option, you should seek assistance to guide you through the withdrawal process. Your professional liability insurer is a good place to start. Because many difficult withdrawals rise to the level of pre-claim incidents that are reportable events under your policy, your insurer may wish to appoint legal counsel to advise you.

6.2 Documenting The Rejection Or Withdrawal

When you decide not to accept a new engagement or to withdraw from an existing engagement, it is critically important to send your client a short letter announcing or confirming your decision, and bringing closure to any open issues of which you are aware. Similarly, when your client initiates the termination, you should send a confirming letter to your client bringing closure to open issues. You should even consider sending a letter of non-engagement when you have had a casual conversation with someone during which you offered your thoughts on certain technical accounting or tax issues. You could use such a non-engagement letter to invite the person with whom you had the informal discussion to continue the dialog as part of a more formal business relationship.

The purpose of all of the correspondence noted above is to make a record of the non-existence of, or break in, a relationship and your efforts to communicate significant matters to your client or prospective client before closing your file. The exercise of sending a non-engagement or disengagement letter takes little time or effort, and serves as a valuable tool in building principles of risk management into your practice.

An effective non-engagement or disengagement letter has certain basic characteristics. First, it should be sent as soon as possible after your client terminates your engagement or after you make your decision not to go forward. A delay in confirming or acknowledging your client's decision to terminate your engagement can result in confusion if your client later decides to deny that the termination occurred. A delay in making a decision on rejecting a new matter or in notifying a client of a decision to reject a new matter provides fertile ground for your client to allege that it believed you had accepted the engagement, and was prejudiced by your delay. A timely letter will go a long way toward eliminating such claims.

An effective letter is also brief, and written with simple, clear and unambiguous language that will be easy for your client or the prospective client to understand. The point of rejection or disengagement is not the time to engage in a lengthy argument for your side of a dispute, or to resort to accounting terms of art to make a point. The time for all of that may come later. At the time of rejecting or terminating an engagement, you should be trying to convey basic information that sets forth your view of what has occurred, and announces how you intend to conduct yourself in light of the changed circumstances. Anything else will serve only to clutter the letter and divert your client or the prospective client's attention from the central points.

Your letter should be carefully addressed and sent by certified mail (or some other form of delivery that provides a written receipt). After all, if you are going to take

the time to write a good, clear letter, you ought to obtain some proof that your client or the prospective client received it. You should not use fax or email, even though those media can provide confirmation. The law is slow to change, and a certified letter is a method that has stood the test of time in the courts. Don't take the risk of testing something new when your practice is at stake.

Addressing your letter requires thought in many cases. If your client or the prospective client is an individual, address the letter to that person, but be sure to use the address that you have been instructed to use, that you have regularly used, or that you are confident will be effective. If you represent more than one person, jointly or collectively, your letter should be addressed to all of them (or you should send the same letter to each of them, showing the others as being copied). If your client or the prospective client is a business organization like a corporation, partnership or trust, your letter should be addressed to the person or group of persons who have been designated as your contacts. In most cases, the addressee should be the person or persons who signed your engagement letter, such as a member or members of a board of directors or audit committee. If your client's business has multiple locations, be sure to identify the best location for reaching your contact.

When drafting your letter, begin by stating the purpose of your letter: to give formal notice of rejection or termination of an engagement or engagements. Next, you should state the effective date of rejection or termination: e.g., as of the date of your letter. Failure to do so can lead to speculation on the part of your client or the prospective client, and mistaken assumptions that you are going to continue your services until some future point in time: the end of the month, quarter or year; the end of the audit; until a successor is located; until financing is obtained, etc. By drawing a bright line of rejection or termination, you reduce the chance of misinterpretation. And, once you have rejected or terminated an engagement, do not begin or continue to render services, even minor ones, unless you first create an appropriate engagement letter. If you say you're stopping, then mean what you say, and stop completely. Any other course of action will only lead to confusion.

You should also be sure to state precisely which services you will not be, or no longer be, rendering. This, of course, is not an issue when you are only doing an audit or only preparing a tax return. It is quite important, however, when your engagement entails a number of services, such as bookkeeping, compilation, tax and consulting. If you are no longer going to render any further services, you should state precisely that.

Although it is optional, your letter will have more context and be more understandable if, at or near the beginning of your letter, you explain the reason for rejection or withdrawal (not necessary, of course, when your client has terminated the engagement). I do not recommend going into great detail with your explana-

tion. A phrase, or one or two sentences, generally will suffice. Oftentimes the reason for your withdrawal is that your client has acted improperly, making your job impossible or extremely difficult. You may be quite upset or emotional at the time you are writing the letter. Be careful in choosing your words, and leave all of the emotion out of it. You can be general or specific, but make every effort not to be unnecessarily offensive or accusatory with your words. Thus, when withdrawing from an engagement because your client has insisted that you take a position that is improper, you might simply state that you regret that you cannot continue in the engagement because of irreconcilable differences of opinion regarding the matters of disclosure in the course of the audit. Anything more specific is not necessary and risks being inflammatory, to no end. You should, however, be sure to document your file as to the specific problems you encountered and the detailed reasons for your withdrawal. You should also follow any legal or professional requirements for reporting client misconduct or criminal behavior.

The balance of your letter should be forward-looking. Specifically, you should inform your client or the prospective of any deadlines that are approaching, and recommend that your client or the prospective client retain another professional to provide the necessary services to meet those deadlines. You should offer to cooperate with any successor, as discussed more fully below. Including such a discussion of upcoming deadlines, although helpful to your client or the prospective client, is primarily meant as a protective measure for you. By making a record of your instructions, your client or the prospective client cannot, after a deadline is missed, effectively claim ignorance and blame you for the problem.

You should use your letter as an opportunity to remind your client of the obligation to pay in full any of your outstanding invoices for professional fees and expenses. Many a client will assume that your termination of an engagement constitutes waiver of outstanding invoices. You can dispel that assumption with a short sentence or two, worded simply and matter-of-factly. In doing so, you will be making a record that may assist you in the future, and that may also, in some cases, result in payment.

Finally, as a matter of policy, you should include in your letter a statement identifying any documents in your possession that constitute original records of your client or the prospective client, and setting forth a procedure for disposing of them. One method is to offer to return those records, and invite your client or the prospective client's instructions (for pick-up or delivery). Another method is to package the original records along with your disengagement letter, or under separate cover, and send them to your client or the prospective client. You could also simply include in your letter a statement that the records will be maintained in your file, available for retrieval upon reasonable notice. If you take the latter approach, you should educate your client or the prospective client as to your file retention policy insofar as it will impact such original records.

6.3 Cooperating With Your Client Or A Successor Accountant After Disengagement

After disengagement has occurred, you should be prepared to cooperate with a successor accountant retained by your client. Responding to requests by successors for engagement information is a topic discussed at greater length in Chapter Five of this book. For purposes of this chapter, however, you should keep in mind that such requests are a natural outgrowth of disengagement, and how you respond may have a real impact on your exposure to claims and threatened claims by former clients.

In brief, you are bound by the standards of your profession to provide basic cooperation to your successor. If your client has paid your fee in full, and if there is no pending, threatened or perceived risk of litigation with your client, most accountants will permit the successor to have access to all of the workpapers as a matter of professional courtesy. On the other hand, if your fee remains unpaid, in whole or in part, and/or litigation has commenced or is foreseeable, many accountants will restrict their cooperation, at least in the context of attest services, to providing the successor access to only those workpapers that will support opening balances. It is advisable to consult local legal counsel and/or your state society to determine whether any statutes or regulations in your state bear on the issue of cooperation with successors.

Regardless of the approach you take, be sure to obtain the written authorization of your client before releasing to a successor any documents or other information obtained or prepared in connection with your client's engagement.

6.4 Sample Disengagement Letter

The following letter contains sample language that you may use as a guide in documenting withdrawal from your own client relationships. This sample language relates to an engagement that included write-up, compilation and tax preparation services for a closely-held corporate client and its three principals. In this instance, withdrawal became necessary due to infighting among the shareholders and lack of cooperation:

[Date]

BY CERTIFIED MAIL/RETURN-RECEIPT REQUESTED

Board of Directors

[Corporate Name]

[Corporate Address]

RE: Termination of Professional Services

Dear Board Members:

I am writing to give you formal notice that as of the date of this letter, the Firm will cease to render any professional services to the Corporation or its individual shareholders, including but not limited to bookkeeping, accounting and tax-related services. I regret that disengagement has become necessary, but conflicts within the Corporation's management and our inability to obtain cooperation from the Corporation on critical engagement issues have led to our decision.

We are not aware of any impending tax or financial reporting deadlines that the Corporation must meet. The shareholders, however, are on extension relative to their federal and state income tax returns. Those returns must be filed by [Date]. We urge that the shareholders promptly retain successor tax professionals in order to meet those filing deadlines.

We are currently in possession of the Corporation's original general ledger, cash journals, and schedules of aged accounts receivable and fixed asset depreciation. We will forward those original documents to you promptly under separate cover. We do not possess any other original documents of the Corporation or the shareholders.

I wish to call your attention to the Corporation's outstanding account with this Firm for past services rendered in the amount of \$5,500.00, which is currently past due. Termination of future services does not discharge the Corporation's obligation to make full payment of that past due balance. I would appreciate your prompt attention to bringing closure to that account.

If you wish this Firm to provide a successor accounting or tax professional with information concerning the Corporation and/or its shareholders, please provide me with a letter informing me of the precise information you wish us to produce. Upon receipt of your written request, we will, at a minimum, follow the standards of our profession in cooperating with successor professionals. Please be advised that if the Corporation has paid this Firm's fees in full, we will also consider those aspects of your request that exceed the minimum requirements of our professional standards.

Thank you, and please contact me with any questions you may have.

Very truly yours

[Engagement Partner]

cc: Individual Shareholders

6.5 Conclusion

As discussed above, decisions whether to reject or terminate engagements, and the manner in which rejection or termination is accomplished and documented, are important events in your practice. Effective risk management requires a commitment to screening out undesirable prospective clients, identifying factors warranting withdrawal from existing engagements, and proceeding with withdrawal in a careful manner aimed at minimizing liability exposure to you and your practice. This chapter has outlined the basic framework for understanding disengagement and related issues, and the tools necessary to implement protections within your practice.