

The Rules of Engagement



Martin Pollins outlines how having a formal letter of engagement in place can help you avoid getting sued.



Setting out your terms of business with your clients, with specific agreement on the work you do for them and the fees you charge, is the only sensible way in delivering professional services. To do anything else is professional suicide.

We can't complain if we get into trouble with our clients. After all, our professional bodies have been telling us for years that we must issue engagement letters. But for many busy practitioners, the whole business of issuing an engagement letter to clients is a bit of a nightmare. And when something goes wrong, not having an engagement letter is going to bring you problems and cost you a lot of money.

When I was in practice, I found the whole process of writing something down and agreeing it with the client to be a clumsy and time-consuming exercise. It often got in the

way of doing the work itself. There had to be an easier way, I thought. Although there were plenty of standard formats available that covered a few situations, all too often the particular client assignment didn't seem to fit those formats.

That's when I set out to create an engagement letter system (called Contract Manager) that would simplify the whole process, eliminate uncertainty with the client, and make it very easy to agree terms - including fees payable. It also had to be a management system that allowed me to find the original engagement letter and update it as and when required.

I came to the conclusion that what was needed was a very detailed "Terms of Business" letter that took into account all the risk management clauses we would all like to see. To this important letter, my idea was to append schedules for each category of work to be undertaken for the client.

Are Engagement Letters necessary?

In recent years, litigation against professional advisers has increased both in scale and frequency. Standard practice and indeed a requirement of many professional bodies, is for accountants to issue a formal letter of engagement defining their relationship with the client.

Statistics gathered by the AICPA Professional Liability Insurance Program in the USA provide dramatic evidence of the importance of engagement letters. More than two-thirds of professional liability claims in that Program arise from client allegations of professional lapses in tax practice and in approximately 25% of all claims made, the client alleged that the scope of the engagement went beyond the services which the accountant believed he or she had agreed to perform. The resulting claim then alleged that when performed, these disputed services were performed negligently. Alarming, a review of claims

maintained over several years for the AICPA Professional Liability Insurance Program shows that in over 40% of all claims, no engagement letter was issued at all.

Engagement letters are certainly necessary today as they form the basis of the contract between the accountant and client for the provision of professional services. Your engagement letter could become a crucial controlling factor in determining the responsibilities of both parties.

Fail to have an engagement letter system in your firm at your peril. The risk is just too great.

Engagement Letters help to avoid getting sued

After Enron, accountants everywhere are worrying about the potential of negligence claims and what the ultimate effect on their practice might be on increasing indemnity insurance premiums and an escalating level of claims.

As an accountant or tax advisor, your primary aim must always be to make sure that you don't get sued. Unless you have an up-to-date engagement letter in place, you could be in big trouble if there is a dispute over fees or the work you've done (or not done, as the case may be). Your engagement

letter ought to make it clear as to the scope of your responsibility and limitations on liability so that your first line of defence when a dispute arises is to show what was agreed at the start of the engagement – who does what and when.

One engagement letter is no longer enough – you should have separate engagement letters for each work assignment you take on for your client. You must update your engagement letters at least once a year and whenever the nature of your engagement changes.

... and if you do get sued

Engagement letters are a very effective loss-avoidance tool such that if problems arise in the client relationship, the engagement letter can provide essential evidence of the exact terms agreed, and may well head off an incipient legal action.

When accountants or tax advisors are sued, the first two questions they are asked are: (1) Do you have indemnity insurance? and (2) Do you have an engagement letter with the client that's suing you setting out what was agreed? The lack of either can make the defence against a professional indemnity claim all the more difficult.

Engagement letters help drive down the cost of indemnity insurance

Increasingly, insurers will look at your arrangements on the issue of engagement letters and take this into account when setting the level of your indemnity premiums.

Engagement Letters reduce the risk of fee disputes

Accountants should get used to using engagement letters for all new clients, new matters with existing clients and contingent fee matters. The likelihood of a fee dispute - leading to a possible later malpractice claim - can be substantially reduced if the key details of the fee arrangements are made clear at the outset and confirmed in writing.

Engagement Letters make good business sense

Whilst engagement letters are not a panacea for all disputes and disagreements, and they don't always protect accountants and tax advisors from litigation, they make good business sense:

- * They help prevent misunderstandings between the accountant and the client by describing, in writing, the mutual understanding of the terms and conditions of the engagement.
- * They eliminate any staff misunderstandings by providing those involved on the engagement with the specifics of the services to be rendered.
- * Enhanced client communications, such as regularly issued and updated engagement letters, help to avoid expectation gaps for services to be rendered. By re-emphasising both the value and the scope of services in advance, accountants can improve clients' overall satisfaction with professional services rendered. The satisfied customer is more likely to continue or expand a relationship with the accountant.
- * Engagement letters can also be an effective marketing tool for clients and prospects as the accountant can easily promote related accounting and other consulting services by mentioning them in his or her engagement letters.
- * Engagement letters reduce any potential legal liability by defining the responsibilities of both the accountant and the client.



Introducing Engagement Letters to Clients

Proper communication of your firm's risk management program is important. Although other accounting firms may have used engagement letters for years, introducing them in your practice may be new to many clients and will require some advance preparation.

It's important that you should explain to the client why an engagement letter is required. Make the explanation from the client's perspective to help build understanding of the change. Mention that your engagement letter:

- * Defines the services you are being engaged to perform;
- * Identifies engagement responsibilities of both your firm and the client;
- * Explains fees, billing, and payment terms; and
- * Assures the client that additional services will not be initiated without advance approval

You may wish to emphasise that engagement letters are required of all clients. Some accountants also mention "insurance requirements" when introducing engagement letters into a client relationship for the first time.

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