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American Institute of Certified Public Accountants. Professional Liability Insurance Plan
Committee

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ACCOUNTANT'S LIABILITY NEWSLETTER

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AICPA Professional Liability Insurance Plan

Number 15 • March/April 1989

DISTINCT FEATURES OF AICPA PROFESSIONAL LIABILITY PLAN

BY ROBERT M. PARKER
VICE PRESIDENT
ROLLINS BURDICK HUNTER
AICPA PLAN

When analyzing programs competing with the AICPA Plan, we often discover that distinct features of the AICPA Plan are lacking in other programs.

1. **Prior Acts Coverage** — The Plan can provide prior acts coverage back to the date of your first claims made policy as long as uninterrupted claims made coverage has been carried. Some companies provide prior acts going back only three years to when they were recently formed.
2. **Choice of Coverage Limits and Deductibles** — The Plan provides a choice of limits up to **\$5 million** together with several deductible options. Many companies only have one limit or deductible to offer.
3. **Innocent Insured Coverage** — This valuable protection affords coverage to those in the firm unaware that an employee or partner/shareholder committed fraud or other criminal misconduct. Some carriers think this coverage is inconsequential. If you were forced to defend yourself and hire your own attorneys, we doubt you would agree.**
4. **Automatic Surcharge** — The AICPA Plan's rating structure, based on a firm's revenues not staff size, does **not** have any automatic surcharges. Any surcharge that is applied is based on a review of the entire application.
5. **Consent to Settle** — Most programs provide for the insured's consent to settle a claim, but not all clauses read alike. Some policies seek legal fees back from insureds who

refuse to consent to a settlement.**

6. **Premium Financing** — As in 1988, the Plan will have premium financing **below prime rate** in 1989.

Any questions about the Plan should be directed to Rollins Burdick Hunter at 1-800/221-3023.

** Refer to your Crum and Forster Insurance Organization Companies' policy for actual terms. ■

YOUR PROFESSIONAL LIABILITY INSURANCE PLAN COMMITTEE

BY LEONARD A. DOPKINS
COMMITTEE MEMBER, AICPA PLAN

The AICPA Committee Handbook sets forth the objective for the Professional Liability Insurance Plan Committee as follows: "To assure the availability at reasonable rates of an insurance program available to local and regional firms which would assist them in defending against claims of negligence

Members of the Committee are sole practitioners, small local firms, large local firms and regional firms with several offices.

in their practice and to underwrite the costs of any recovery where such claims are found to be valid."

The Committee is made up of 9 members of the American Institute of Certified Public Accountants (including the Chairman). The Committee selection process for this group deliberately identifies a diversity of members in public practice (or retired from public practice) whose firms are of the size and character of the insureds in the program. Members of

LATE BREAKING NEWS

In a continuing effort to better serve the needs of the AICPA Plan insureds, Crum & Forster has raised the coverage limits to **\$5 million** as of January 1, 1989. For information, contact Rollins Burdick Hunter at 1-800-221-3023.

the Committee are sole practitioners, small local firms, large local firms, and regional firms with several offices. They are generally the managing partner of their firm.

These are CPA's who in their practice have coped with the problems of obtaining insurance at a reasonable cost with limits of coverage that make them comfortable. They have also

The Committee views its mission as that of a 'watch-dog' looking out for the interests of the approximately 10,000 firms insured in the program.

faced the problem of escalating premiums and, in some cases, the problem of defending against claims — be they with or without merit.

The Committee views its mission as that of a "watchdog" looking out for the interests of the approximately 10,000 firms insured in the program. The Committee meets at least quarterly with the broker, Rollins Burdick Hunter, and the underwriter, Crum & Forster. Our efforts are directed toward four areas. First, we constantly monitor the service of both the broker and the underwriter in the issue of policies, as well as their response to inquiries from member firms. To this end we receive statistical data as to the number of policies being currently issued, the delays in issuing certain policies, if any; surcharges over the standard premium rate and the reason therefore; etc. We have been very pleased with the improvements in

(Continued on page 6.)

SCOPE OF COVERAGE IN AICPA PROFESSIONAL LIABILITY PLAN

BY ROBERT M. PARKER
VICE PRESIDENT
ROLLINS BURDICK HUNTER
AICPA PLAN

We are often requested to respond to inquiries by insureds on the scope of coverage in the AICPA Professional

Liability Plan ("the Plan") and would like to share some of the most often asked questions and our responses with you, the Plan membership at large. You need to refer to your policy, as the analysis which follows refers to certain policy provisions.

"At the outset, please understand

that these are general fact situations and responses. Each claim situation stands alone. Thus while you may know of a similar factual occurrence, a further specific fact can change the entire response. Note too, that it is the underwriter's claim department's responsibility to interpret specific policy provisions with actual claims documentation. We trust that the readers will appreciate this when considering the response which follows. In order to

(Continued on page 3.)

CLAIMS STATISTICS FOR TAX ENGAGEMENTS

The AICPA Professional Liability Insurance Plan Committee meets quarterly with Rollins Burdick Hunter, as broker/administrator, and the underwriters at Crum & Forster, to assess the health of the Plan and chart

its direction for the future.

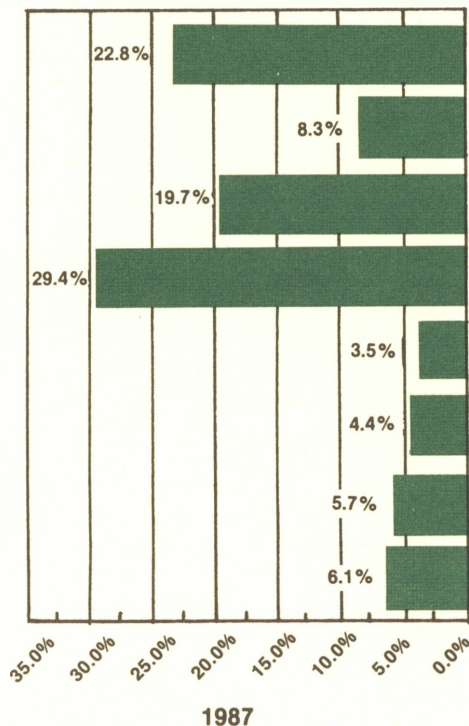
In that role, the Committee is constantly monitoring what causes insureds to have loss activity. In the last issue, tax engagements provided the greatest number of claims

(frequency 39%) and the highest dollar loss (severity 27.9%).

The following graphs show some of the most significant categories of tax engagement losses resulting from professional liability claims. ■

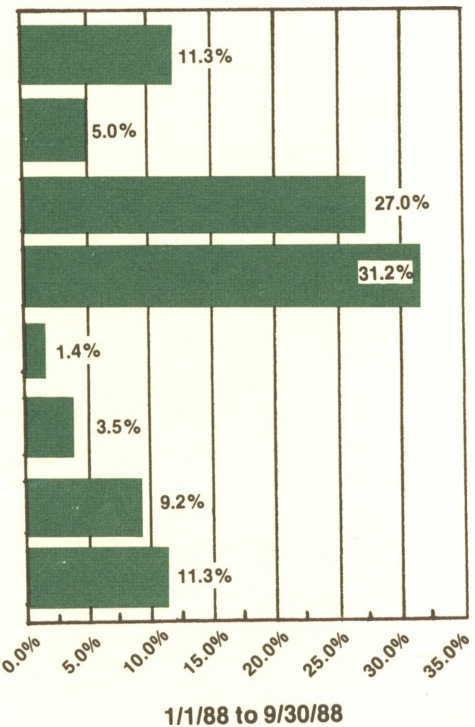
**AICPA — TAX ENGAGEMENT — SUB-CATEGORIES — CLAIMS COUNT
COMPARISON OF 1987 VS 1988
(First Three Quarters)**

CATEGORIES



NOTE: The above percentages relate to a claim count of 228.

- TIMELY FILING ERRORS
- ELECTION ERRORS
- ADVICE ERRORS
- OTHER ERRORS
- LIQUIDATION
- S CORP. ADVICE
- ESTATE TAX RETURNS
- OTHER TAX ADVICE



NOTE: The above percentages relate to a claim count of 141.

Scope of Coverage

(Continued from page 2.)

establish some common ground for understanding, some assumptions or definitions are provided in these responses where we thought it would be helpful to discuss certain words

... it is the underwriter's claim department's responsibility to interpret specific policy provisions with actual claims documentation.

with varying interpretations, such as "participation," "assisting" or "selection."

1. "Investment Consulting" — Is covered for financial planning where generic investments are identified and/or recommended. You should note that Exclusion (J) of the policy excludes advice with respect to "specific securities."
2. "Participation in buy-sell agreements between shareholders of client entities" — If "participation" is defined as providing accounting advice of financial terms of the buy-sell agreements, this activity is covered. If however, the accountant is a participant in the entity or the buy-sell agreements, no coverage is provided.
3. "Negotiating the terms for selling or acquiring an interest in a client's business" — Coverage is provided if the accountant is acting at the direction of the client and a contingent fee or commission is **not** received. This response ties in to the policy's Exclusion (I) which excludes from coverage activities prohibited by the AICPA's rules of conduct.
4. "Preparing financial forecasts for purchasing stock in the client's corporation" — Coverage is provided.
5. "Introducing clients to people who sell investment products" — No coverage is provided if the accountant has a financial interest in or received a fee from the sale of the investment product.
6. "Assisting clients in attracting investors into new partnership" — Coverage is provided if "assisting" is defined as the preparation of financial forecasts,

projections and financial statements. The accountant should not solicit investors, as Exclusion (J) would apply. The preparation of financials alone, however, does not equal solicitation.

7. "Jointly making an investment with a client when the firm has invited the client to participate" — Coverage is **not** provided for such activities, as there could be lack of independence.
8. "Computer equipment selection and installation" — Coverage is provided when "selection" is defined as advising the client as to the merits of computer equipment. Recommending specific equipment for purchase is covered provided the accountant does not receive remuneration or financial advantage other than fee for advice.
9. "RICO Claims" — A Civil RICO claim, of course, involves allegations of serious misconduct, i.e. a "pattern

of racketeering." Please see Policy Exclusions (D), (E) and (F) for a more detailed explanation.

Of utmost concern in a RICO claim is Exclusion (D), whereby coverage does not apply "to any claim arising out of any dishonest, fraudulent, criminal or malicious act or omission of the Insured." There would be no coverage under Exclusion (D), after there has been an **adjudication** that an insured did, in fact, violate the Civil RICO statute. Until that adjudication, however, the policy would provide a defense, providing there are other covered acts alleged. Defense costs, as you are all probably aware, can be astronomical. As such, the fact that the policy would provide a defense is a significant "coverage" aspect of the AICPA Plan.

In addition, there is coverage under

(Continued on page 4.)

CLAIM REPORT

DO CAREFUL RESEARCH BEFORE GIVING ADVICE

The following claims are abstracted from claims filed with the program. A common thread present in both claims is a failure to carefully research authoritative tax literature **before** giving advice. Anyone can make mistakes; but to give advice in a highly technical area without doing the necessary research is asking for trouble.

1. The insured was engaged to help his client design a pension plan. Erroneous advice from the accountant led to the IRS disallowing the plan and an assessment for taxes, penalties and interest. The CPA believes that penalties and interest will be at least \$100,000 in addition to a tax assessment of \$100,000, for a total claim of \$200,000 plus defense costs.
2. The client receives large distributions from both a pension plan and a profit sharing plan funded by his employer. The CPA gave erroneous advice about the treatment of these distributions. The CPA admits that IRS Code

and Regulations were not checked. The CPA states that had he consulted the Code, he believes that the error would not have occurred. The CPA is therefore liable for the tax deficiency, interest and penalty.

There is a lesson to be learned here. With the frequency of changes in our income tax laws and with the ever changing regulations, every practitioner must always be careful when furnishing advice. It is best to take the time to research the problem and document your file with the appropriate references to authoritative tax literature before giving advice.

The area of pension and profit sharing plans has become increasingly complex in recent years. Likewise, numerous other areas of tax practice which used to be simple and easily dealt with, have become more complicated. Take the time to make sure that the advice you are giving is correct under the circumstances and supported by the tax literature. ■



QUESTIONS AND ANSWERS

BY KYLE NIEMAN
UNDERWRITING MANAGER
CRUM AND FORSTER MANAGERS
CORP. (ILL.)

Every week hundreds of phone calls are received from policyholders questioning whether or not certain situations will impact their coverage. We provide the following questions for your review in the event that your firm faces a similar situation.

- Q. We are merging with another firm. What must we do to make sure we are covered and that we do not lose any coverage?
- A. As discussed in the June/July 1988 Newsletter, contact the program administrator Rollins Burdick Hunter well in advance of the merger date. A merger

All part-time employees who have worked more than 20 days during the last fiscal year should be included in your staff size count.

may represent a significant change to your firm, necessitating the completion of an application reflecting the information on the new firm. To preserve continuous coverage for your firm, request coverage that will protect the new firm going forward and also the predecessor firms that have merged.

- Q. We have been asked to act as an authorized distributor for a software manufacturer. What effect does this have on our coverage?
- A. The sale of computer hardware and/or software is not covered by your Accountants Professional Liability policy.
- Q. We have never performed audits before. We now have the opportunity to do so. What do we need to report?

- A. Any changes in the services your firm provides must be indicated on your next renewal application. Be careful not to accept an engagement that your firm is not qualified to perform.
- Q. We have established a separate entity to handle our financial planning. Will this entity be covered by our policy?
- A. The entity is not covered unless named on the policy.
- Q. What are the qualifications to obtain prior acts coverage?
- A. Prior acts coverage may be purchased by qualified firms with previous claims-made coverage. This coverage may be retroactive

- to the beginning of uninterrupted claims made coverage.
- Q. We hire help during the tax season. Should we report these staff members on our application and are they covered by the policy?
- A. On your next renewal application, all part-time employees who have worked more than 20 days during the last fiscal year should be included in your staff size count. Refer to the definition of insured in your policy to confirm that employees while acting in the scope of their duties for the Named Insured are covered under the policy. ■

AICPA ACCOUNTANTS PROFESSIONAL LIABILITY INSURANCE • NEW APPLICATION FORMAT

MIKE CHOVANCAK
ASSISTANT VICE PRESIDENT,
ROLLINS BURDICK HUNTER

The AICPA Accountants Professional Liability Plan recently began using a revised application format for both renewal and new insureds.

The new application is designed to develop a more complete yet concise description of the particular firm — providing the firm with an easier format to complete and the underwriters with a more accurate understanding of the firm. Many of the questions have been re-worded to be more direct and to the point, while related questions have been sequenced into a more logical order.

The new application is designed to develop a more complete yet concise description of the particular firm.

Based upon recent statistics, approximately 31% of all applications received by the Plan are delayed because of requests for additional information. It is important to remember that the application is not only used for underwriting analysis, but actually becomes a part of the final policy, and as such each question must contain a full response.

The following application questions have been noted to produce a higher than normal volume of requests for additional information:

QUESTION 9: Indicate the number of staff within your firm in the appropriate categories below.

- A. proprietors, partners, owners and officers:
- B. CPAs, excluding those listed in A above:

(Continued on page 5.)

Scope of Coverage

(Continued from page 3.)

the policy known as "innocent partners coverage." ** It can be found in the policy, following the Exclusions, and states that: "Subparagraph (D), (E) and (F) do not invalidate this insurance to any Insured who did not act with knowledge or consent in the matter to which the Exclusion applies." In this context, there is coverage, for example, if both an individual from a firm and the firm itself are named in a lawsuit, so long as the other members of the firm (partners, shareholders, employees) were innocent as respects the fraud or criminal activity at issue in the RICO claim.

Perhaps the foregoing article has raised additional questions in the reader's mind. We would be pleased to discuss inquiries with you. Contact Rollins Burdick Hunter at 1-800/221-3023.

** Refer to your Crum & Forster insurance organization policy for actual language. ■

New Application Format

(Continued from page 4.)

- C. all other full-time employees:
- D. all part-time employees who have worked more than 20 days during the last fiscal year.

CLARIFICATION: "Staff Total" should be the total of sub-questions A. thru D. inclusive.

QUESTION 10: Is Applicant, or any partner, stockholder, or principal licensed as a lawyer, insurance agent or broker, real estate agent or broker, or registered as an investment advisor? If "Yes," please provide name and professional license, as well as professional liability insurer and policy liability limits.

CLARIFICATION: Services performed as a lawyer, insurance agent or broker or registered

investment advisor are not covered under your Accountants Professional Liability Policy. Do not include income derived from these activities in question 12.

QUESTION 11: Is any partner, stockholder or principal engaged in any business other than public accounting practice on either a part-time or full-time basis? If "Yes," explain activity and include hours per week and income.

CLARIFICATION: Activities other than accounting are **not** covered under your policy. Do not include income derived from these activities in question 12.

QUESTION 14D.: Management Advisory Services: (Management Advisory Services includes investment advice. Please attach explanation of Management Activities.)

CLARIFICATION: A **thorough explanation** of management activities needs to be provided.

QUESTION 15: Provide number of Audit Engagements conducted within the last fiscal year in the following categories: Manufacturing, Retailing, Financial Institutions, Brokerage, Construction, Government, Non-Profit Organizations, Other (Please Specify).

CLARIFICATION: Requests **numbers**, not percentage.

QUESTION 21: Within the past 5 years, has your firm performed any professional services for any client in which any partner, principal or shareholder or any relative of a

Many of the questions have been reworded to be more direct and to the point, while related questions have been sequenced into a more logical order.

partner, principal or shareholder owns an equity or financial interest or serves as an officer, director, trustee or partner? If "Yes," give full particulars, including the relationship of the aforementioned person(s) to your firm, the name of the client, the percentage of equity or financial interest held by the aforementioned person in the client's business, the capacity (officer, director, trustee or partner) in which the person(s) serves, the type of engagement performed by your firm and the amount of fees generated from the client during the fiscal year.

CLARIFICATION: Please read (and re-read) this question carefully. Basically, this question ties into Exclusion K of the policy and identifies accounting services provided by the insured to related entities — related for insurance by ownership interest and/or principals of the insured serving in like capacities in the client's business.

Again, it is extremely important to thoroughly respond to this question as this work may be excluded from coverage and fees would then be subtracted from "Gross Billings."

The application **must** be signed by all owners, partners, or principals.

Finally, as you are preparing the application, please feel free to contact the Plan Administrator (Rollins Burdick Hunter) at 800/221-3023 for assistance.

AICPA PROFESSIONAL LIABILITY INSURANCE APPLICATION

Underwritten by
Crum and Forster Insurance Organizations
A XEROX Financial Services Company

Administered by
ROLLINS BURDICK HUNTER
4870 Street Road, Torrance, PA 19069-0005
CALL TOLL FREE 800-221-3023

This is an application for a "Claims Made" policy. The policy applies only to claims first made against the insured during the policy period. The limit of liability available to pay damages or settlements shall be reduced by amounts incurred as "Claim Expenses." If a policy is issued, this application will attach to and become part of the policy; therefore, it is important that all questions are answered accurately.

INSTRUCTIONS

- Please read carefully all statements and questions on this application.
- Answer all questions, if the answer is none, state "none."
- If space is insufficient to answer questions fully, use separate sheets of paper.
- Application must be signed and dated by all owners, partners or principals.

COVERAGE SELECTION

1. Desired limit of liability:
 \$ 250,000/5 250,000
 \$ 500,000/5 500,000
 \$ 1,000,000/5 1,000,000
 \$ 2,000,000/5 2,000,000
 \$ 3,000,000/5 3,000,000

Desired deductible, per claim:
 \$ 1,000
 \$ 3,000
 \$ 5,000
 \$ 7,000
 \$ 10,000
 \$
 Other _____

*Limit and deductible subject to minimums and maximums depending on staff size.

*Includes claim expenses

INSURED INFORMATION

2. Name of Applicant's Firm: _____ State _____ Co. _____ County _____ Business Phone _____

3. Principal business address: _____ State _____ City _____

4. Year Applicant's practice was established: _____

5. Professional Associations: AICPA State CPA Society

6. Has the Applicant's name changed in the past five years or has Applicant merged with or acquired another firm? If "Yes," list all predecessor/constituents.
 Firm Names: _____

7. Briefly describe the Applicant's program for professional development and continuing professional education of the professional staff (including the area of concentration).
 Dates: _____

8. Within the past 3 years, has the applicant had a quality review under the sponsorship of the AICPA, a State Society, or any other professional association?
 If "Yes," please provide the dates and descriptions of the last two quality reviews below.
 Yes No

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ALL QUESTIONS MUST BE FULLY ANSWERED

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The application must be signed by all owners, partners, or principals

Your Professional liability plan

(Continued from page 1.)

processing of applications and the prompt policy issue.

Furthermore, we are constantly reviewing new professional services being offered by our members with a view toward insuring that the coverage being offered by the policy forms is appropriate. There is a task force on the Committee which meets independently with the broker and the underwriter and is constantly evaluating language in the policy coverage and the exclusions with a view toward providing the best and most complete coverage for our members.

Extensive statistical information on claim experience is furnished to the Committee by Crum & Forster Managers Corp. Over the years significant improvements have been made in the claim information reports so as to furnish the Committee (as well as the underwriter) with the largest body of statistical information on the nature, frequency, and severity of claims from the various areas of professional services. In addition, at each quarterly meeting, the Committee reviews all larger claims in great detail having received in advance a narrative report giving all the facts in each case.

With input from the Committee the underwriter has continually refined and improved their financial reporting on premium revenues, claim losses and expenses of this program. As a result, your Committee can track trends both favorable and unfavorable; the Committee can evaluate the policy

limits being offered and can relate that to the reinsurance being purchased; and finally and very importantly, each year the Committee must approve the rate that will be charged to our insureds for the succeeding year. As you know, the Committee has already announced that there will be no

change in the rate for 1989 over that of 1988. Your Committee is continuously evaluating the professional liability insurance product being offered to our members as to cost, coverage and service levels in order to provide the best available program. ■

ACCOUNTANTS MALPRACTICE COURSE PRESENTED BY PEPPERDINE UNIVERSITY OF LAW AND THE CAMBRIDGE INSTITUTE

A two-day course was recently held in both Newport Beach, California and Washington D.C. to examine the challenge facing both the accountant as well as attorneys representing accountants in accountant malpractice suits.

The Course was led by several prominent attorneys and accountants who have been initially involved and well versed in litigation as respects accountants malpractice. This panel of experts discussed, in great detail, the peculiar/unique facets of accountants malpractice suits and the individual valuable experiences in this field.

The course curriculum addressed such topics as:

- Background of accountants malpractice and factors leading to escalation of the frequency and severity of claims.
- Regulatory structure that the accountant is faced with in performing his/her duties.
- Sources of claims — clients and non-clients.
- Various liabilities that the accountant is subject to, including common law liability, Federal Securities Laws, etc.
- Avoiding auditing failures.
- Accountant's opinion.
- Malpractice defenses.
- Insurance developments for accountant's malpractice.

The specific rights and responsibilities of the accountant were illustrated to disclose high risk areas of vulnerability for the accountant and how one can attempt to insulate oneself from potential liability suits.

The class also was limited and provided a ready atmosphere to engage in thorough question and answer sessions. To obtain information for dates and sites of future courses, please contact The Cambridge Institute at 1964 Gallows Road, Vienna, Virginia 22180-3861 (703/893-8500).

The AICPA also sponsors outstanding seminars such as:

Surviving Litigation: How to avoid or defend a malpractice suit. 14 presentations of this seminar are scheduled throughout the country. For more information, contact the AICPA Continuing Professional Information hotline 1-800-247-7269. ■

AICPA PROFESSIONAL LIABILITY INSURANCE PLAN COMMITTEE

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The contents of this newsletter do not represent an official position of the AICPA Professional Liability Insurance Plan Committee.