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LIABILITY

NEWSLETTER

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AICPA Professional Liability Insurance Plan

Number 17 • August/September • 1989

AICPA ACCOUNTANTS PROFESSIONAL LIABILITY PLAN: PREMIUM SURCHARGES — WHY THEY EXIST AND HOW THEY AFFECT YOUR PREMIUM

By Robert M. Parker,
Sr. Vice President
Michael J. Chovancak,
Ass't. Vice President
ROLLINS BURDICK HUNTER

Many accountants have asked us, when discussing their professional liability premium computation, whether they subsidize the premium for CPAs who engage in "more hazardous" types of practice than they do.

The AICPA Accountants Professional Liability Plan's premium scale does take into consideration the nature of the work performed by the individual firm and the individual firm's claim experience in an effort to assure all Plan Participants of an equitable

'Ultimately, a cost-benefit analysis must be done as to whether the revenues from a particular engagement outweigh the potential premium consequences from that engagement.'

premium. Those firms that perform engagements that have proven over time to be less risky and/or those firms that have had no claims reported receive a premium calculation commensurate with their individual risk. This is known in the Plan as the "standard rate."

Conversely, those firms that perform engagements that have been noted to produce a significant volume of claims (frequency) and/or high dollar value claims (severity) or those firms that have actually had claim activity may be subject to a premium surcharge over and above the standard rate. These surcharges may range in size from 5% to 50% of the standard rate, based on the amount of work in a particular type of accounting service and the number or severity of claims against the practice.

In an effort to keep member firms aware of these surcharges and plan their own risk management with respect to the types of engagements that they are willing to perform, the following list provides **some** of the reasons for which a surcharge **may** be levied on your firm's premium:

- Claims activity
- Lack of engagement letters on audits and reviews
- Audit engagements
- Financial institution audits
- S.E.C. engagements
- Business manager engagements
- Suits for fees
- Investment advise engagements

Ultimately, a cost-benefit analysis must be done as to whether the revenues from a particular engagement outweigh the potential premium consequences from that engagement.

In the event that your firm received a surcharge, the reason for the surcharge and the percent will be indicated in your quotation letter. Should you have any questions regarding how or if surcharges will affect your premium calculation and/or your insurance coverage, please contact your Account Representative at Rollins Burdick Hunter, 1-800/221-3023.

LITIGATION MANAGEMENT FOR ACCOUNTANTS LIABILITY CLAIMS

By G. Scott Williams
Staff Attorney
CRUM & FORSTER MANAGERS
CORP. (ILL.)

Over the course of time, Crum & Forster Managers Corporation has developed a national panel of

approved defense counsel who are authorized to perform work on behalf of the company and its insureds. These select counsel have been chosen after an extensive review process. While part of their selection relates to a positive track record and expertise in handling accountants' liability claims and litigation, attorneys must, additionally, exhibit demonstrated success in a courtroom.

Accountants professional liability litigation is an ever expanding arena. It is, thus, more important than ever before to be represented by an attorney who is intimately familiar with the litigation process, and capable of coordinating activity with Crum & Forster's team of claims specialists.

'It is more important than ever before to be represented by an attorney who is intimately familiar with the litigation process . . .'

The potential exposure faced by accountants in today's world, coupled with the upwardly spiraling cost of litigation, leaves no room for error.

From the very inception of a case assignment, approved counsel will work hand in hand with Crum & Forster's technical support staff, and the insured, to map out an effective and efficient litigation strategy. This strategy, agreed and documented throughout the life of a claim, involves several specific evaluations and reports. The first item which must be completed by counsel within 30 days of assignment, is the Initial Case Analysis. Counsel will review the claims file and investigation, as well as the pleadings and allegations against the

(Continued on page 4.)

This Newsletter is prepared by Rollins Burdick Hunter, administrator of the AICPA Professional Liability Insurance Plan as a service to the accounting profession to alert you to loss-prevention/risk management considerations in your accounting practice. It should not be regarded as a complete analysis applicable to your particular situation or used for decision making without first consulting your own firm's legal counsel. The Newsletter is furnished free to practice units insured under the AICPA Professional Liability Insurance Plan.

CLAIMS REPORTING

By Carolyn Finch
Claims Unit Supervisor
CRUM & FORSTER MANAGERS
CORP. (ILL.)

In our handling of claims against accountants, we speak to each insured. A consistent concern voiced by accountants is what type of circumstance should be reported to the insurance company as a claim. In the absence of a formal lawsuit, some accountants are unsure about when, or if, to report a circumstance which may give rise to a claim.

In recognition of this concern, this article will address guidelines you can use to assess what circumstances should be reported as a claim, or potential claims. Please note that these are guidelines, not all encompassing rules. If ever in doubt, please contact the Claims Department at Crum & Forster Managers Corporation (Ill.) for consultation.

Before discussing specific claim situations, let us review the basic premise of a professional liability claims made policy, i.e. the type policy in the AICPA plan. In the "Insuring Agreements," the insurance company agrees to accept a claim alleging negligence in completion of professional accounting services, provided the "... claim is first made against the insured ... during the

policy period and written notice of said claim is received by the Company during the policy period."

The claim must, then, (1) be related to professional accounting services, (2) be made against you as accountant, (3) be reported to the Insurance Company, and (4) reported during the policy term.

Additionally, Exclusion C is relevant to our understanding. That exclusion negates coverage for "... any claim ... if the insured at the effective date knew or could have reasonably foreseen that such act ... might be expected to be the basis of a claim or suit." Since the claim or notice of a potential claim triggers your reporting obligation during the same policy period, a quick rule-of-thumb is to let the insurance company know about it as soon as you do. Remember, if your client or a third party believes they have damages related to your services, whether you agree or not, you should report the circumstances.

Let's look at some common scenarios:

(A) If a client complains about services, but pays your fees and gives no indication of an intent to sue, should you report this incident?

This depends upon the nature of the complaint. The key question is, is the client likely to suffer or claim to have suffered any monetary loss? If so, the circumstances should be reported to the insurer.

(B) If a client refuses to pay your bill, but does not threaten to file suit, should you report this?

The question is, why is the client refusing to pay the bill? If there is any dissatisfaction from your services which the client believes cost him money, you should report the incident as a potential loss.

(C) What if the client refuses to pay the bill and expresses an intent to sue?

Clearly, under these circumstances, you have notice of a potential claim and you should notify your carrier immediately. This is so, regardless of the amount of damages alleged, or whether or not you feel you are correct in your position.

(D) What if the client files bankruptcy and there is no intent expressed to you to bring claim?

You should definitely report this as a potential claim to your carrier since the creditors of the bankrupt client could come back to you on any financial statement engagement asserting that the statements misled them into extending inventory or credit to the client.

(E) What if the client goes bankrupt and you hear some discussions of suing the accountants?

Again, you should unquestionably report this claim since it is likely that someone will bring suit to recover losses associated with your client.

(F) What if the FDIC or FSLIC closes an institution that you have audited?

While the answer to this question seems obvious by now, by all means, immediately report the incident.

The bottom-line is that you must promptly report to your insurer any and all circumstances likely to give rise to a claim. If no claim develops, you have lost nothing. If a claim develops immediately, or at any future date, you are protected up to the limits of liability that your policy provides at that time. Any time you have a question about how your coverage applies, do not hesitate to inquire. You have paid the premium for the coverage, the expertise, and service that goes with it, so get your money's worth.

FIRM CHANGES DEMAND POLICY REVIEW

By Kyle Nieman
Underwriting Manager
CRUM & FORSTER MANAGERS
CORP. (ILL.)

Changes in your accounting firm's structure may impact your Professional Liability Insurance coverage. In the June/July, 1988 issue of the Accountants Liability Newsletter, we explored the impact mergers have on a firm's coverage. Likewise, a partnership that breaks up to form multiple new partnerships has similar insurance issues that should be addressed before the break-up is effective.

Through the AICPA Plan both routine and complicated scenarios are handled on a regular basis requiring the cooperation of all parties involved. Firms that split-up to form separate new firms should assess liabilities and

make sure each party is responsible for their share of the exposure. An example would be a dissolution of a firm out of which two or more new firms may be formed. The new firms will need to secure coverage not only for their activities going forward, but also make provisions for prior activities as well. Each case wherein a firm breaks up presents unique facts that must be evaluated to determine the Professional Liability needs of all parties involved. It is thus important that you contact Rollins Burdick Hunter well in advance of a dissolution or change in your firm to review your options for securing coverage.

Regardless of the reasons behind a reorganization, it is crucial that all parties cooperate in working with Rollins Burdick Hunter to identify your insurance needs.

ESTABLISHING ADEQUATE PROFESSIONAL LIABILITY INSURANCE LIMITS

By Kyle Nieman
Underwriting Manager
CRUM & FORSTER MANAGERS
CORP. (ILL.)

What limit of Professional Liability insurance should your firm carry?

Many firms only address this question the first time that they buy Professional Liability insurance and do not reconsider the limits as a part of their yearly renewal process. Professional Liability insurance coverage should be a top priority in your firm. A review of your firm's insurance needs should

'Take a look at the scope of services you are providing to see if the limits you are carrying are adequate.'

become a routine exercise at the time you are completing your renewal application, well in advance of your policy expiration date.

Chances are, your firm is not the same as it was when you first started your practice. As your firm and your client base change, consideration should be given to the limit of liability your firm carries. It is important to recognize that different accounting services may result in different exposures to your firm. Take a look at the scope of the services you are providing to see if the limits you are carrying are adequate.

For instance, one of an accounting firm's clients had grown rapidly in the last couple of years. The accounting firm provided audited financial statements for the client, a contractor and issued an unqualified opinion without verifying the collectability of accounts receivable. The contractor filed for bankruptcy, causing one of the bondholders for the contractor to make a settlement payment on performance of over \$1,000,000. The bondholder subsequently filed suit against the accounting firm for damages in excess of \$1,000,000 alleging that they relied on the firm's financial statements. Due to the increasing size and complexity of the accounting firm's clients, this loss was much larger than ever anticipated. This accounting firm of five individuals only carried a professional liability insurance policy with a limit of \$250,000. (The limit had been the same for several years as consideration was not given to the exposures provided by a changing practice).

Additionally, there are features in Professional Liability Insurance policies that should be considered when determining what is an adequate limit to carry. First, a limit of liability applies to damages paid to settle a claim and also legal expenses. A claims-made policy provides you with a defense and will pay for expenses incurred in defending a claim against your firm. This means that expenses paid in defending a claim reduce the limit of liability and the amount of funds available for paid damages. For the period of 01/01/83 through 12/31/88, 34 cents of every dollar paid through the AICPA Plan went towards legal expenses incurred in defending plan insureds. Thus, not only should the largest loss expected be one measure of the limit of liability but expenses incurred in defense must also be anticipated.

Also keep in mind that the limit of liability applies to each claim and aggregate. In the event a single or multiple claims deplete the limit of liability, there is no coverage for other claims that may arise during that policy year. We recommend that you plan

your insurance and anticipate your firm's needs well in advance of need. Limit increases are not offered mid-term so make sure your limit is adequate prior to renewing your policy.

In today's legal environment, with loss potential and legal cost increasing, it is important each year for you to anticipate coverage needed for the

'... not only should the largest loss expected be one measure of the limit of liability, but expenses incurred in defense must also be anticipated.'

coming term. We hope you are not surprised by a claim, but if you are we hope you have selected adequate limits of liability. Please call RBH for advice on your protection.

CLAIM REPORT

By Terry Hothem
MILLER, WAGNER & CO.
PLIP Committee Member

The following claims are abstracted from actual claims filed in the program. Even though many claims appear to have questionable merit, once filed, they become costly. Many times a little more care and business judgment can avoid practitioners being put in a position of being forced to defend unnecessary suits. The best defense against any suit is quality work. Considerable CARE and good DOCUMENTATION are key ingredients to performing quality work.

Hopefully, the following abstracts will help remind you of the kinds of situations any of us could get into.

1. TAXES: TAX ADVICE AND ALTERNATIVE MINIMUM TAXES — A CPA was asked to estimate the tax liability of a substantial transaction and the tax savings considering an option of a charitable contribution. The advice

given failed to consider alternative minimum taxes of approximately \$350,000. This problem is a common one where the CPA is asked "what if" questions. The lesson to be learned here is, which answers, done without proper care or recalculations, can lead to costly improper advice.

2. PRACTICE MANAGEMENT: FILING SUITS TO COLLECT FEES — A CPA firm filed suit against a former client to collect amounts owed on work performed. In response to the fee suit, the client initiated a counter-suit alleging negligence in the performance of specific tax services. The problem of receivable collections and decisions regarding fee disputes must be very carefully considered. Overall business judgment often dictates an uncollectible account is the best alternative in settling fee disputes. It is also important to note that premium surcharges are sometimes assessed for firms which actively sue for collection of fees.

Litigation Management

(Continued from page 1.)

insured. Defenses, proposed discovery, and the answer to the litigation are discussed in detail.

The second item in the litigation process involves an Agreed Litigation Plan between the insured and the Crum & Forster technician. The Litigation Plan specifically identifies the issues and documents, what information remains outstanding, as well as anticipated defense costs. A detailed budget is established by defense counsel and an action plan agreed. Very importantly, the primary objective is to see that an aggressive and positive defense is conducted for the insured. While cost control is important, that objective is secondary to the support of the insured and his practice.

‘ . . . the primary objective is to see that an aggressive and positive defense is conducted for the insured.’

The assignment of a case to an approved counsel, who is familiar with and willing to abide by strict procedural requirements, minimizes the potential for missed steps during the critical first stages of a claim. Additionally, the process maximizes the opportunity for a successful resolution of the claim, whether it be by

settlement or ultimate trial. Crum & Forster's approved counsel are mindful of the significant burdens which

‘The success of this team approach . . . has resulted in significantly lower loss exposure to insureds.’

litigation places upon an accounting professional's time. The defense of each claim is handled in a manner which is as unobtrusive to the accountant and his business practices as possible.

The success of this team approach

which coordinates and defines the activities of approved counsel, claim staff and insureds, has resulted in significantly lower loss exposures to insureds. While our Litigation Management Program has been in place for many months, further refinements are occurring which we believe will further expedite and control the litigation process. We have determined, additionally, that insureds are the best gauge of our litigation control efforts. If you note areas wherein the investigation and defense can be expedited, please feel free to notify your claims technician or their supervisor.

THE OFTEN OVERLOOKED SIGNATURE PAGE

The last **Account's Liability Newsletter** issue featured an article by Mike Chovancak, Assistant Vice President of Rollins Burdick Hunter on the new format being utilized on the AICPA professional liability insurance applications.

In the article, Mr. Chovancak stressed the importance surrounding the accurate completion of the application, as it actually becomes a part of the insurance policy. Often overlooked, but crucial, is the signature page, found on the last page of the application. This section should be signed and dated by **all** partners and principals of the firm. Many times, however, the application is received without the required signatures and in

some instances not signed at all.

The importance of having all partners' and principals' signatures is two-fold. First, as mentioned earlier, the application actually becomes a part of the insurance policy. Therefore, if all signatures are not present, the insurance policy itself is incomplete. Second, by having all partners and principals sign the application, each will have the opportunity to review the application for accuracy of the information being provided.

By asking questions up front, you can help prevent the application from coming back for further questions, and therefore prevent delays in the application process. Consequently, should you have any questions while completing the application, please feel free to contact the Account Representatives at Rollins Burdick Hunter at their toll-free number 1-800-221-3023.

AICPA PROFESSIONAL LIABILITY INSURANCE PLAN COMMITTEE

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Newsletter Editor: Barbara J. Frantz

AICPA Professional Liability Insurance Plan Committee
c/o Newsletter Editor
Barbara J. Frantz
Rollins Burdick Hunter
123 North Wacker Drive
Chicago, IL 60606
Phone: 312-701-4083

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