

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

considering. Because the CPA did not have experience with this type of investment, she advised the client to consult with his own financial adviser, but she did not document the ...

Jun. 15, 2016



CPAs are often considered a client's trusted business adviser. As such, a CPA may be asked to "look over" an investment a client is considering or the CPA may receive a client's monthly investment account statements in connection with tax and/or bookkeeping services. Seems innocent enough, right?

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

“Please Review This Investment”

A client asked his CPA for her opinion regarding an investment they were considering. Because the CPA did not have experience with this type of investment, she advised the client to consult with his own financial adviser, but she did not document the conversation.

The client made the investment, and the CPA prepared the client's tax returns. While preparing the tax returns, the CPA contacted the client with questions regarding the investment but again did not put anything in writing.

A subsequent IRS audit determined that the investment was an impermissible tax shelter and assessed the client substantial penalties and interest. The client sued the CPA, seeking recovery of lost investment returns, penalties, interest, and attorneys' fees. The client alleged the CPA provided negligent investment and tax advice, and made errors in preparing the tax returns. The claim investigation revealed that there was no written communication with the client regarding conversations that took place before the investment. There also was no documentation of the investment-related questions the CPA posed to the client in connection with preparing the tax returns. While there were several contributing factors to the case, the lack of documentation, such as an engagement letter, to support the CPA's version of the events made the claim difficult to defend. As a result, the claim was settled.

What about a long-term client asking you to evaluate a potential investment in a closely held business or real estate venture? In one situation, the CPA presumed the client was seeking advice regarding the tax consequences associated with the structure of the investment and provided related advice. However, the advice was not documented, nor was an engagement letter defining the scope of services issued. Later, the client lost his entire investment. He then sued the CPA, alleging the CPA

failed to warn him of the risks associated with the investment. Due to the lack of

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

CPAs—and the widow transferred all of her investments to the broker. Periodically, the CPA, the client, and the broker met to discuss the widow's investment portfolio. The CPA also received monthly brokerage statements in order to prepare the tax returns.

Over the next several years, there were few distributions to the widow, and the assets declined significantly in value. The widow sued both the broker and the CPA, alleging that the broker “churned” her account to generate commissions and claiming the CPA was negligent in providing investment advice, recommending the broker, and failing to supervise the broker's activity.

The investigation revealed that the broker did, in fact, “churn” the account. Engagement letters issued by the CPA did not address the scope of advisory services, but rather indicated that tax compliance and limited planning services would be provided. The broker did not have errors and omissions insurance and had limited assets. As a result, the widow vigorously pursued her claim against the CPA.

“Do You Know Someone?”

In the above example, the CPA was closely involved in the client's affairs. However, CPAs do not have to be that involved to get in trouble. A client asked their “trusted advisor” for a referral to an investment advisor. The CPA had several clients realizing large, sustained returns from investing with a certain investment company and made a referral to that advisor.

Unfortunately, the investment advisor was operating a Ponzi scheme, and the client lost most of his retirement assets. As a result, the client sued the CPA for the lost investment and projected earnings on the investment. The client alleged that the CPA made a negligent referral and failed to supervise the activities of the investment advisor.

While the CPA claimed his involvement was limited to making the referral and

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

clients' funds. Now operating in a new state, the advisor stole money from the CPA's client. When the CPA's client discovered the theft, the CPA was sued for providing a negligent referral. While the CPA's involvement was limited, lack of proper licensing of the advisor was problematic for the defense.

“Keep an Eye on My Advisor”

The CPA firm had a new and growing client. While an engagement letter was obtained for the initial services provided, personal and business tax compliance, new engagement letters were not obtained when services were expanded, including when the client asked the firm to work with his financial advisor and monitor investment activity. Later, it was discovered that the financial advisor stole a significant amount of money from the client.

The client filed suit against the CPA firm for negligence, breach of contract, negligent misrepresentation, gross negligence, and fraud. The CPA firm's defenses included comparative negligence, the client failed to oversee his advisor. Unfortunately, even though the engagement letter stated the CPA firm was not responsible for detecting theft or fraud, the additional services provided, including oversight of the advisor, proved problematic. As a result, a settlement was reached.

Risk Management Recommendations

As these cases demonstrate, many practitioners, especially those who provide “only” tax services, fail to recognize the risks associated with providing advice related to client investments. Below are items a CPA may wish to consider in order to avoid a misunderstanding regarding the scope of services to be provided:

- **Engagement letters.** Engagement letters issued for tax compliance services should

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

- depending on the engagement:*
- ***Decline to provide investment advisory services.*** Without additional training, CPAs are typically not qualified to provide specific investment advice regarding the suitability of specific investments for clients. Additionally, investment advisers are subject to state and federal regulations. CPAs with appropriate qualifications should consult the resources available to members of the AICPA Personal Financial Planning Section, including the Statement on Standards in Personal Financial Planning Services.
 - ***Brokerage statements.*** CPAs do not customarily receive original investment account statements or have access to online information regarding client investments. CPA's should ask themselves "what is the purpose of obtaining the statements?" To the extent it may be necessary to obtain these statements to provide requested services, consider obtaining duplicate account statements or securing "read only" access to online account information. Access should be limited to only the information needed to perform the engaged services.
 - ***Discussions with client brokers and investment advisers.*** If possible, obtain required information directly from the client. When required, CPAs may seek to limit such discussions with third parties to obtaining only information necessary to provide tax advice to the client.
 - ***Referrals.*** When providing clients with a professional adviser referral, a CPA should provide at least three options, advise the client to conduct due diligence on the advisers, and disclaim, in writing, any responsibility for selecting or supervising the adviser or monitoring investment results. Before providing referrals to investment advisers, the CPA should verify that the advisers are licensed and in good standing and advise the client to do likewise.

CPAs often are solicited for advice regarding potential investments. A CPA should refrain from providing specific investment advice unless he or she has been adequately trained and licensed to serve as an investment adviser. Establishing a

clear understanding with the client regarding the scope of services to be provided

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

firm. Deb provides risk control consulting services for CPA firms in the AICPA program. She participates in the development and delivery of risk management training and education products including the live risk management seminar and self-study programs.

Accounting • Advisory • Auditing • Financial Planning • Financial Reporting

CPA Practice Advisor is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors.

© 2024 Firmworks, LLC. All rights reserved