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Considerations for accountants when returning client files and best practices to avoid a malpractice lawsuit.

The termination of services, a seemingly benign event, can be the prelude to a claim for professional negligence. The New Jersey State Board of Accountancy's Rules of Professional Conduct, embodied in the New Jersey Administrative Code at N.J.A.C. 13:29-3.1 to 19, set forth the parameters that govern an accountant's duties and obligations to clients in response to a request for a return of the "client's" records. See N.J.A.C. 13:29-3.16.

In situations where clients end the professional relationship with their accountant, it is natural for one to focus their attention on the topic of most immediate concern—"have I been fully paid, and will I be paid." While attention to accounts-receivable is an appropriate business and file transfer consideration, the main focus of attention must be risk management with full consideration of the State Board's Rules of Professional Conduct as part of the task of collecting the client's file and preparing documents to be produced or returned to the client. If ignored or intentionally disregarded, instead of receiving an envelope with a check for fees, a CPA could wind up receiving an envelope delivered by a process server which begins: "The plaintiff, named above, has filed a lawsuit against you"

N.J.A.C. 13:29-3.16—or the "Records Rule"—mandates that an accountant or the accounting firm owe a duty to a current or former client to furnish certain documents and papers "upon request made within a reasonable time after original issuance of the document in question" The documents the accountant is required to provide/return include: 1) copies of tax returns; 2) any reports or documents issued by the accountant to or for the client; 3) records which the accountant removed from the client's premises or received for the client; and 4) the accountant's work papers, to the extent they include "records which would ordinarily constitute part of the client's books and records, and are not otherwise available to the client." Id. The obligation to return documents is qualified to allow an accountant to make and retain copies of documents that form the basis for work done by the accountant, i.e., when the documents also form part of the accountant's work papers—and it is advisable to retain copies of the materials that are returned to a client, a task made significantly less burdensome where most firms electronically scan almost all paper intake.

Turning back to the topic of attention when one first receives a notice of termination of services—fees—it is critical to know that an accountant must honor the obligation to return or provide a client record irrespective of whether the client has an outstanding balance for fees owed. An accountant is prohibited from withholding client records hostage to fees. In fact, such a circumstance can implicate the AICPA's Code of Professional Conduct and the ethical requirements of ET Section 501.02, Acts Discreditable, Interpretation 501-1, "Response to Requests by Clients for Records."

As most accountants are aware, as referenced in the New Jersey Records Rule and ET 501, the crucial aspect of producing or returning documents to a client, for risk management and Rule compliance purposes, is differentiating between the "client" file/documents and the accountant's work product. An accountant's work papers (to the extent they don't constitute part of the client's books and records or are otherwise available to the client) are the accountant's property and are not strictly subject to the disclosure requirements addressed here. By way of simple example, a CPA generally is not barred from withholding an audit report if fees are owed for that specific work product. (ET 501-1 provides guidance in addressing production issues with its definitions of "client," "client-provided records," "member-prepared records," "member's work product" and "member's working papers.")

The event of a request for the return of a client's file can become the basis for a claim of professional negligence, i.e., the accountant's failure or delay in returning documents to the client resulted in the imposition of penalties and interest by the Internal Revenue Service or the Division of Taxation, as well as additional accounting and legal fees. Frequently, allegations of this type arise from situations where an accountant fails to follow the guidance of the Records Rule and refuses to return, or delays in returning, documents until the client's bill is paid or settled. However, that scenario more often than not generates a notice of claim or ethics grievance. Plaintiffs will argue that, because they were deprived of necessary financial or tax records, they—or the successor accountant—were unable to prepare and submit tax returns in a timely fashion. The resulting penalties and interest for the failure to file or the failure to pay taxes form the basis

for the claim for damages. Further, where a client's prior accounting is not pristine and where the failure to timely file/pay results in an audit, a former client's claim for damages can easily skyrocket into the stratosphere, despite the fact that the present accountant was not engaged during those periods.

Despite the risks attendant to the return of records, there are few cases addressing this type of claims. As a result, accountants and attorneys must rely on the Records Rule and ET 501-1 and the guidelines which these authorities provide. Some suggested best practices in this context include:

- *Maintain Electronic Files:* Where possible, implement a cost effective electronic record system for retention of client files and records. Electronic files avoid the paper chase of locating physical files—some of which may be in storage—incurring time to confirm completeness and the costs of copying and/or later scanning potentially thousands of documents.
- *Cooperate (even though it may be painful):* Focus on the Records Rule and its guidance on how to respond and how to avoid impermissible actions. Terminations are unwelcome and sometimes rancorous. However, don't let emotion be your guide. Don't give in to temptation and refuse to cooperate with the request and, equally important, do not delay such that filing or payment deadlines applicable to the client are missed. Avoid the "smoking gun" ransom email or letter—"you'll get your file when I get paid." As discussed, there is no surer path to the steps to the courthouse than to adversely impact a client's ability to fulfill their obligations under the tax code.
- *Speed:* Timely respond to a request for a client file or documents. Frequently, a quick response can calm client anger about the basis for the termination and can also form the basis for a strong defense to a future claim where the former client is assessed penalties or interest because of their failure to timely file returns or pay taxes.
- *Internal Communication:* Upon receipt of a request for documents, instruct your staff to direct all communications to the supervising accountant and review procedures to diligently begin gathering the documents required to be disclosed.
- *Document Your Actions:* Memorialize internal instructions to staff and communications with the former client addressing the request for records. Acknowledge in writing that the request was received and that the request will be addressed as timely as feasible. Document your compliance with the obligation owed the former client, as these crucial facts may become significant to a future defense of a claim. Lastly, document your transmission of information to the former client and document their receipt of any information that you provide. Where practical, you can utilize electronic tools to assist your compliance, i.e., secure file-sharing websites or electronic transmission provides a platform to track and confirm the exchange of information. Avoid making the production or return of the file difficult and costly for the former client. That tactic will only backfire.

Every accountant or CPA will be faced with termination by a client. Whether a cordial separation or not, the key to responding to these situations is to remain mindful of your professional ethical obligations and to comply with the guidance provided by the Records Rule and ET 501-1. Following some best practice suggestions can help avoid a contentious client breakup, lost time, lost billing, ethics implications, the expense of deductibles and the prospect of damages at the end of a costly litigation.

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