

High Risk Clients

Not all clients are created equal when it comes to malpractice risk. Be careful when agreeing to perform accounting services for them. Here are examples of risky clients:

1. *Co-ops* – (such as oil, gas, or farmers' co-ops) - Co-op organizations of this type are considered high risk because placing a value on the inventory of a co-op is difficult and prices fluctuate dramatically. Accountants who serve these co-ops have difficulty measuring clients' inventories and establishing the worth of these businesses. Additionally, because co-ops are comprised of many individual members, the potential number of potential plaintiffs can also be large.

2. *Factoring companies* – These types of companies establish national currencies for imports and exports and also represent a high risk for accountants. If an accountant makes a mistake working with a factoring company, the consequences can be significant.

3. *Contractors* – The construction industry can be extremely volatile. Contractors have a higher-than-average percentage of business bankruptcies. Therefore, the risk for an accountant who works with contractors is potentially high.

4. *High-profile entertainment clients* – These clients represent a high risk for accountants because they are often very wealthy and typically do not manage their own funds. Accountants who serve these clients face significant risks due to these factors.

5. *Public companies* – These clients are typically large companies, and they represent high risk because third parties such as investors and shareholders rely on the clients' financial stability. Accountants face significant risks regarding both their clients and third parties who may rely on the accountant's analysis.

6. *Financial institutions* – New trends in claims involving fraud have developed out of the 2008 financial crisis. The most common are Ponzi schemes. Accounting firms with financial institutions as clients could face allegations for failure to detect Ponzi scheme-related activities, which can result in class action lawsuits filed by investors and shareholders. The high-profile Ponzi schemes of Bernard L. Madoff and Robert Allen Stanford are two notable examples.

7. *Foreign entities* – Accounting firms face a substantial risk when they provide services to clients who are located in foreign countries. Accounting firms should have effective quality controls in place. Firms should also adhere to quality auditing standards, implement sound risk management programs, and engage in active regulatory oversight. This oversight reinforces the assurance of high-quality accounting and auditing standards. Preparation of financial statements should be in accordance with U.S. Generally Accepted Accounting Principles (US GAAP) or with another body of accounting standards, such as those promulgated by the International Accounting Standards Committee (IASC).

High Risk Clients

8. *Chinese Reverse Merger clients (CRM)* – This occurs when shareholders of a private company located in China purchase shares of a public “shell” company listed on a US Stock Exchange. If the public company is already registered with the SEC, the private Chinese company does not have to go through the regulatory process, and the Chinese private company becomes a public US company. The Public Company Accounting Oversight Board (PCAOB) has raised concerns that US registered accounting firms have not followed PCAOB standards when conducting audits of companies outside the US. The SEC issued an Investor Bulletin* in June 2011 cautioning investors to beware of certain reverse mergers.

* This SEC Bulletin appears in Exhibit A, which can be found here: <https://www.sec.gov/investor/alerts/reversemergers.pdf>

These sample engagement letters, checklists, and practice and consent forms are for illustrative purposes only. We recommend you use these letters and forms only after you have consulted with your attorney. Since your practice may be different than those described in the sample letters and forms, we recommend that you modify them to suit your individual practice needs. Use of these sample letters and forms is not intended to constitute a binding contract, does not constitute legal advice, and does not satisfy your obligation to do thorough research. © Gilsbar Specialty Insurance Services, L.L.C. and Date.