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SPOTLIGHT

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Don't let scope creep lead you out of bounds

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Almost every sport uses a defined boundary. The playing area, whether it is a football field, basketball court, or baseball diamond, is clearly defined and understood by all athletes who play the game. It is pretty easy to ascertain whether you are in or out of bounds. It's not so simple in the accounting world. Consider these examples:

- A large accounting firm had to resign from an audit engagement because a permissible nonaudit service was found to have deviated from its intended scope, causing the auditor's independence to be impaired. The client then brought a claim against the CPA firm to recover fees previously paid to the CPA firm and additional fees incurred to select and hire a new auditor.

- Every year, a small CPA firm made adjusting journal entries, reconciled bank accounts, and performed other activities to "clean up" a client's financial records to prepare the tax return. When the client discovered that one of its employees had embezzled funds, the client sued the CPA firm, alleging the CPA should have detected the theft because of its involvement with the client's books and records.

- A wealthy individual tax client of a midsize CPA firm sold his business, which resulted in negative tax consequences. The client alleged that the firm failed to give him proper tax advice regarding the sale and brought a claim against the firm. The CPA firm indicated the engagement was for tax return preparation services only, as documented in the engagement letter. However, it acknowledged discussing the sale as a courtesy to the client.

Whether it is termed scope creep or engagement creep, it can be challenging to stay within the boundaries of an agreed-upon scope when delivering client services.

WHAT'S THE BIG DEAL?

Professional liability concerns

A significant number of claims asserted against CPA firms in the AICPA Professional Liability Insurance Program include allegations related to a disputed engagement scope. Even if a scope dispute is not expressly alleged, defending a claim can be challenging if the firm's activities were not in line with the scope described in the engagement letter (if an engagement letter even existed). Often, the scope of service is inadvertently expanded by a well-intentioned CPA trying to deliver good client service. Perhaps the client asked the CPA to "quickly look into something" or wanted to "bounce something off" the CPA. Or, during the performance of services, the CPA realized that additional services, such as bank reconciliation cleanup or the preparation of an additional state tax return, were needed. Acting upon these good intentions may place additional obligations on the CPA, which may be challenged by a plaintiff attorney in the event of a professional liability claim.

Financial concerns

Often a CPA completes an engagement, reviews the client's unbilled fee balance, and wonders how the balance got so high. It is likely that additional work was performed in an effort to deliver superior service. The CPA profession has established a great service culture. However, this culture can become a double-edged sword and should not be to the financial detriment of the CPA firm. Time is money. If not managed appropriately, supplemental activities outside the original engagement's scope may not only increase professional liability risk, but also may result in write-offs if the client refuses to pay for the additional work.

Other "costs" firms often overlook when dealing with scope disputes include lost time spent debating with the client, the aggravation caused by these misunderstandings, and potential reputational damage that may be caused by an unhappy client. These costs exist even if a claim is not asserted.

RISK MANAGEMENT TIPS

To help stay in bounds, consider the following tips:

- **Be mindful of whom you let play in your league.** Perform proper client acceptance procedures. Take on only those clients that are a fit with the firm. Be sure to evaluate all potential new clients, including those who seek the firm's services or come from an acquired firm or practice.

- **Have a game plan.** Use an engagement letter for all services. The scope section of an engagement letter is critical when a professional liability claim arises. Scope of work should be clear, and the boundaries of the service to be performed should be well-defined. Clarify any limitations of the services. Identify aspects that will not be included, if appropriate. Include a statement indicating that if additional services are needed, written client approval will be required, and additional fees will be charged.

- **Ensure everyone understands the rules.** Communicate the scope to all client service team members, particularly those who perform services on-site at the client's location, to ensure everyone knows the boundaries of the services. Consider providing a refresher to teams on long-term engagements. Clarify client understanding of what is included in the scope of services. Strengthening these communications will help mitigate the risk of unintended scope creep.

- **Stick to the game plan.** Deliver services in accordance with the scope outlined in the engagement letter, and document work performed in engagement workpapers. Well-documented workpapers provide evidence of services delivered and assist in the defense of claims related to scope disputes. In addition, billing records, particularly the narrative included on client invoices, should align with the services described in the engagement letter. Consider attaching a copy of the engagement letter to invoices.

- **Adjust the game plan, if needed.** Circumstances may change, additional work may be needed to proceed, or the CPA may identify additional service opportunities. All of these items require the CPA firm to pause and consider a new course of action. Work with the client to adjust the engagement scope. Document the revised scope and fee impact in a communication with the client. Depending on the extent of the revision, the client communication could be a simple email, an engagement letter amendment, or a new engagement letter.

- **Know when to make cuts.** A client who consistently asks for "quick favors," balks at engagement letters or additional fees, or pushes the boundaries of the engagement's scope might be taking advantage of the firm's commitment to client service. Not only does this type of client increase the firm's professional liability risk, it is likely to result in poor realization for the firm. Consider cutting this client from the firm's roster.

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