



## PROFESSIONAL LIABILITY SPOTLIGHT

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# Unintended Consequences of Professional Referrals

By Sarah Beckett Ference, CPA

Regardless of the digitization and virtualization of how business is conducted and how people connect, a fundamental truism for all CPA firms is that relationships matter. Client service, respect, and trust are hallmarks of the profession, so it's no surprise that when a client asks for assistance and advice, the gut instinct is to help. Indeed, the views of a CPA are held in such high regard that clients ask for the CPA's recommendations to other professionals, such as attorneys, financial planners, insurance agents, valuation experts, and more. A CPA may also be asked for referrals when a client seeks to fill an open position within its organization.

However, professional referrals may expose the CPA to potential liability for negligence. The CPA's referral to another professional is perceived as an endorsement of that individual's capabilities. If the recommended professional reveals himself or herself to be incompetent or a fraudster, the CPA may be blamed for the client's loss or, at the very least, suffer damage to the client relationship. Consider the following:

A client asked his CPA for a recommendation to fill an open assistant controller position. A partner at the firm recommended one of the firm's senior associates whose performance did not meet the firm's requirements for advancement. The partner thought that the employee might perform better in a different environment. Attempting to kill two birds with one stone, she praised the senior associate's potential in a subsequent conversation with the client. The client acted on the partner's advice and hired the firm's employee. The partner's praise soon proved false when the senior associate failed to file the client's payroll tax returns and to remit payroll taxes. The client was assessed significant penalties as a result and brought suit against the partner and the firm, asserting the partner had misrepresented the senior associate's qualifications, indicating they would not have hired him but for her glowing recommendation.

During discovery, internal firm emails from the partner and others revealed their true thoughts about the senior associate's performance, questioning how he was able to pass the CPA Exam, noting that his workpapers were unintelligible and lacked a grasp of basic common sense, and lamenting his inability to meet deadlines. In addition, the client's recollection of the conversation about the senior associate differed from that of the partner. The CPA firm ultimately settled with the client for a small amount but lost the overall client relationship and the significant fees that went with it.

Of course, the easiest way to avoid being blamed for the actions of someone else is to decline to provide a client with any referrals.

However, this approach is not particularly practical nor is it in the spirit of good client service. Instead, follow these tips to help mitigate the risk of a claim alleging a negligent referral.

### DO SOME DUE DILIGENCE

A client will likely expect a CPA to have some basis for recommendations made. Therefore, conduct a limited investigation of a professional's background, training, experience, reputation, professional credentials, and/or licensing before making the referral. The depth of the investigation should be reasonable given the circumstance. What is considered "reasonable" varies with the CPA's familiarity with the recommended professional's field. More will be expected with respect to financial professions such as financial planners or other CPAs. Less will be expected when the referral relates to unrelated professions such as attorneys or architects. In many cases, simply verifying that the other professional has an appropriate license, conducting a simple internet search to identify complaints or negative news, and gaining a high-level understanding of the quality of their work may suffice.

### PROVIDE OPTIONS

When asked for a referral, provide choices from which to select rather than recommending only one option. This protocol helps the firm minimize its potential risk. Providing multiple options, and doing so in alphabetical order, also helps ensure the firm is not implicitly endorsing the qualifications of one professional over all others.

In addition, provide referrals to individual service providers rather than to the entities for which they work.

### SET EXPECTATIONS

Include a disclaimer that clarifies the nature of the referral and articulates the responsibilities (or lack thereof) of the client and the CPA. A disclaimer is a valuable tool in communicating to the client both the basis of the referral and that the accountant will not be supervising the work of the recommended party. Such a disclaimer may be worded as follows:

You have requested that we provide you with a referral to other professional advisers to assist you with your professional needs. This provision clarifies the nature and limitations of the referrals of other professionals we are making to you. We have conducted a reasonable inquiry into whether the professionals are licensed but have undertaken no further investigation,

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including review of work products or inquiries, regarding the quality of the services provided by referred professionals. We will not supervise or monitor a referred professional's performance of services for you in any manner. We assume no responsibility for a referred professional's work product. You are responsible for evaluating, selecting, and retaining any professional and determining whether their services will meet your needs. You acknowledge that there is always a risk that a referred professional will act negligently or fraudulently and agree to hold us harmless in that event.

## PUT IT IN WRITING

Even the sharpest of minds can have fuzzy memories when disputes arise. To help avoid differences in recollections, provide referrals to other professionals in writing. In addition to being a handy solution to the fuzzy memory problem, providing documented referrals allows for the inclusion of the disclaimer language described above.

For efficiency, consider prepopulated referral sheets by profession similar to what a pediatrician might provide to his or her patients for referrals to pediatric therapists, dentists, optometrists, and other specialties. Be sure to regularly review each professional's qualifications to ensure their inclusion on any list you may provide remains appropriate.

## ANYTHING ELSE?

The "Commissions and Referral Fees Rule" (ET §1.520.001) of the AICPA *Code of Professional Conduct* provides guidance to members regarding commissions or referral fees received for the referral of products and services to clients. The rule prohibits the receipt of commissions when the referral is made to a client for which specific attest services are delivered.

If the CPA receives a permitted referral fee from the referred professional or a commission, it must be disclosed to the client in writing. Finally, be sure to consider how the receipt of any commission or referral fee might be perceived in the event of a future claim.

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**Sarah Beckett Ference, CPA**, is a risk control director at CNA. For more information about this article, contact [specialtyriskcontrol@cna.com](mailto:specialtyriskcontrol@cna.com).

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