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## Risk management : a CPA's toolkit for a changing environment

Anthony E. Davis

Marcia Gordon

Robert H. Spencer

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# RISK MANAGEMENT

A CPA's Toolkit for a Changing Environment

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**Anthony E. Davis, Esq.**  
**Marcia Gordon, CPA**  
**Robert H. Spencer, Ph.D.**

**AICPA**

RISK MANAGEMENT

DAVIS, GORDON AND SPENCER

AICPA

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**AICPA**

**Anthony E. Davis, Esq.**

**Marcia Gordon, CPA**

**Robert H. Spencer, Ph.D.**

This publication is adapted from *Risk Management: Survival Tools for Law Firms*, by Anthony E. Davis, © 1995 American Bar Association.

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# INTRODUCTION

## The Accounting Profession Today— Evolving Conservative Professionalism

The certified public accounting profession has changed a little since the first Certified Public Accountant's (CPA's) certificate was granted by the state of New York in 1896. What do you think those early accounting pioneers would say if they could look inside some of our public accounting firms today? First of all, we think they would be proud of the profession and of what it has become. We think they would be proud that today the designation CPA is one of the most trusted in the world. We think they would see honest, intelligent, highly respected men and women working side by side for the betterment of their clients and themselves.

Beyond all this, a double-edged sword looms on the horizon for accountants who are venturing into the new world of a multidisciplinary practice. We like the term *multidisciplinary*, it sounds so much better than *nontraditional services* which was what we called anything a CPA did that did not directly relate to balance sheet, tax forms, or audit reports. Multidisciplinary covers a number of emerging services, which CPAs are not only qualified in general to provide, but should excel at with continuing education and experience. We will discuss a few of these here, but not as a “how to,” and more as a “what you had better do!” In the past, accounting professionals were truly low risk.

Governed by time-tested and conservative guidelines and principles, most CPAs never spent much time considering the elements of risk and how vulnerable their practice might be to litigation. After all, if you messed up someone's taxes, you most likely had minimal exposure or loss for tax assessments levied against your client. There was more liability in the audit (attestation function) side of the business. For that, you followed approved guidelines and standards, kept careful records, and kept an even closer eye on the staff! CPAs must always be acutely aware that they are participants in an almost sacred trust. That trust is often twofold. First, to advise and guide the client on financial matters. Second, the CPA may be charged with protecting the good of the general public in the case of an audit or other attestation function. The CPA must be wise and therefore able to guide their client through mazes that they would rather not address on their own. It is beyond the scope of this publication to discuss specific aspects of the CPA Vision as it is being defined by the American Institute of Certified Public Accountants (AICPA). You can find endless amounts of information on that from your state society or from the AICPA at [www.aicpa.org](http://www.aicpa.org). As of the end of 2000, the AICPA boasted 330,000 members. As such, it is one of the largest professional organizations in the world. The AICPA is planning and shaping the future for its members by defining emerging areas and services where the CPA can expand its role and offer ever increasingly complex and needed services. In the process, the AICPA does not want any CPA to lose sight of those values that make CPAs the trusted advisers they are. The CPA Vision Statement states the following. CPAs are trusted professionals who enable people and organizations to shape their future. Combining insight with integrity, CPAs direct value by—

- Communicating the total picture with clarity and objectivity.
- Translating complex information into critical knowledge.
- Anticipating and creating opportunities.
- Designing pathways that transform into reality.

## ***Risk Management***

This is all nicely summed up into the Core Purpose of all CPAs, making sense of a changing and complex world. The CPA is guided, according to the Vision Statement, by certain Core Values. These include the following:

- Continuing education and lifelong learning
- Competence
- Integrity
- Attuned to broad business issues
- Objectivity

The CPA today is defined in the Vision Statement as offering the following Core Services:

- Assurance and Information Integrity
- Technology Services
- Management consulting and performance management
- Financial Planning
- International Services

To make all this happen the CPA must have core competencies, which are defined as the following:

- Communication and leadership skills
- Strategic and critical thinking skills
- Focus on the customer, client, and market
- Interpretation of converging information
- Technology adept

If all this sounds like a tall order, it is. The AICPA worked with CPAs, state accounting societies, and other groups to put together a plan it considers viable to accomplish the goals listed above. Here, our purpose is not to defend or oppose the Vision Statement of the Future CPA, but rather to focus on the potential risk associated with the new Core Services as well as the emerging services—as yet undefined—that will be offered by professional CPAs.

Stop and think for a moment—Which profession is considered the most conservative? It is accountancy. Worse, the label is sometimes misleading as well as negative. We all know the stereotypes—But how many of you proudly call yourselves bean counters and actually wear green eye shades or pocket protectors? Similarly, there are risks out there that many CPAs have never considered even though risk has never been perceived as a problem in the profession.

The young, “hip,” accountant today is a superman or superwoman of the business world—Able to leap tall buildings (and financial problems) at a single bound. They are faster than a speeding bullet (or new Pentium processor) at implementing state of the art technology solutions. As a result, one question that must be asked is, “Is every CPA able to perform on an equal level with all other CPAs?”

As CPAs begin venturing beyond those traditional services they are trained for in college, that is tax and audit, the potential for errors increases as well as the risk associated with failure. At a time when the largest CPA firms have spun consulting services out of the accounting practice, many CPAs are attempting to offer more of these, excuse the term, nontraditional services within the framework of their accounting practice.

This publication is about the less glamorous side of consulting services. It is about defining the exposure that firms take on when offering these new services, and what steps firms should take to perhaps minimize exposure and financial loss. In the process, we are not passing judgment in anyway on what services a firm should offer, our goal is simply to make CPAs aware and provide the tools necessary to determine whether the firm is ready to step out into this brave new world.

The bottom-line is that CPAs must begin learning to recognize risk and develop the proper methods to manage it.

## **IS THERE A RISK OF LOSING IT ALL?**

It has been estimated that about four thousand claims are currently brought every year against accounting firms in the United States<sup>1</sup>. The rising cost of professional liability insurance shows that the severity of these claims is also increasing. A newspaper article in the United Kingdom in the early 1990s put the total of outstanding and unresolved claims against accountants worldwide at \$40 billion<sup>2</sup>. Although these claims against the accounting profession began to surface relatively early in the twentieth century, they escalated rapidly in the late 1980s when the U.S. economy weakened, resulting in depressed earnings and real estate prices, increased business bankruptcies, and a sharp upswing in financial institution failures.

Although claims made against large national firms received widespread publicity, many more claims were made against smaller firms serving small, closely held companies. Many client firms sued their CPA firms to recover business losses, alleging improper or inadequate tax or consulting advice, financial statement errors, and failure to detect fraud or theft. Over time, business owners increasingly sued their professional advisers when things went wrong. Today, accounting malpractice claims run the gamut from tax return preparation errors, failure to detect an employee defalcation in a compilation engagement, and inappropriate investment advice to audit failure and improper technology advice.

## **WHY MANAGE RISK?**

Cumulatively, there are huge risks involved in providing accounting services. The dimension of these risks goes beyond the existence of claims and the sums paid out in settlement by the accounting profession and its insurers. Even if accounting firms successfully stave off liability (as sometimes happens), enormous costs result from defending against the claims and the lost productive time of partners and employees. These risks can indeed rise to the level of “losing it all,” as the bankruptcy of Laventhol and Horwath in 1990 plainly showed.

Furthermore, claims are by no means limited to the audit end of the practice. According to data compiled by Continental Casualty Company, a CNA insurance company and the underwriter of the AICPA Professional Liability Insurance Program, almost 60 percent of all claims against accounting firms arise from tax engagements. According to Goldwasser and Arnold<sup>3</sup>, tax service related claims encompass a wide variety of allegations, including the following:

<sup>1</sup> Goldwasser and Arnold. *Accountants' Liability*. PLI, 1999, 2000, p. 1-1.

<sup>2</sup> *Id.*, citing David Hellier & Roger Trapp, “Accountants Shiver as Cover Slips Away; A Legal Onslaught is Scaring Off Insurers,” *The Independent*, (UK), Aug. 1, 1993, at 5.

<sup>3</sup> *Op. cit.* note 1 above, at 1.3, p. 1-24.

## ***Risk Management***

- Failure to prepare all requisite returns
- Failure to cause the client to make timely tax elections
- Failure to advise clients of available methods for achieving legitimate tax savings
- Errors in the preparation of tax returns
- Failure properly to compute estimated tax payments

Thus, although such claims rarely rise to the same level of severity as audit related claims, the frequency of these tax claims makes them a serious source of risk for many in the accounting profession.

But the need to manage risk goes beyond the negative incentives to avoid claims and the loss of productive time (and the accompanying stress) that go hand-in-hand with claims. It is also about positive values: *servicing clients better* and *making the firm more profitable*. Good risk management policies, systems, and procedures focus on how to help firms achieve these positive ends, and, in the process, avoid or at least substantially reduce the threat or fact of claims. And, remember what every marketing executive and high-priced marketing consultant has told you a hundred times: The most effective client development is done with happy clients. Satisfied clients are clients who have been well served by the firm in the first place. So, putting in place the tools to ensure that every client, in every engagement, is pleased with the services rendered is the best recipe for financial success—and the best kind of risk management.

## **THE GROWTH OF ACCOUNTABILITY—AND WHO SHOULD BE RESPONSIBLE**

Smaller firms (under \$5 million in revenues) have experienced increased claims activity compared both to solo practitioners on the one hand and larger firms on the other. This is attributable, at least in part, to rapid growth with each partner operating largely independently, and with inadequate oversight and insufficient resources for the firm-wide training and quality control often found in larger firms. The problem is often exacerbated when firms expand into new practice areas in which the collective knowledge is insufficient for managing the practice in a way that is profitable and error-free.

Other factors were at work simultaneously with the growth of accounting firms and the increasing emphasis on specialization of practices in separate profit centers. Alongside the commercialization of the practice of accounting—in firms of all sizes—came an awareness of the business element of accounting, in all of its various guises, among the profession's clients and third parties who address or were affected by accountants.

It is important to note that the enormous increase both in the number and size of money claims against accountants and their firms includes but is by no means limited to the government's claims arising from the Savings and Loan crisis in the early 1990s. Other manifestations are to be found in the dramatic increase in allegations of conflicts of interest, in claims arising from the issuance of audit reports and other claims by nonclient third parties who allege injury at the hands of accountants with whom they had no direct connection, incidents of insider trading, and other recent additions to the more traditional kinds of malpractice claims.

It is notable that in this increasingly hostile environment, the professional liability insurers are not only increasing premiums, but also considering the possibility of rewriting policy language to exclude risks in which firms are not taking adequate (or at least some) steps towards risk



management. For instance, very broad language excluding coverage for claims arising from certain kinds of conflict of interest is already starting to appear in some policies, in reaction to the failure of firms to control new client and engagement acceptance procedures. Even the reinsurers, whose layers of coverage have been reached by the very large awards and settlements, are starting to pressure the underwriters of professional liability insurance to get serious about loss control for professionals.<sup>4</sup> Indeed, most insurers in this marketplace have staff and resources devoted to encouraging and recommending specific risk management policies and procedures to accountants. Some also take this function so far as to offer premium credits for undergoing and completing loss control training, or using such risk management tools as engagement letters. Additionally, the insurers have recognized the degree to which accountants have expanded the range of services that they offer, and have sought to underwrite based on firms' recognition of their practice strengths—and their avoidance of activities where they lack expertise.

Increasingly, insurers as well as firm managers and individual partners, even if they have not clearly articulated either the nature of the threats inherent in contemporary accounting practice, are, at last beginning to recognize the need to manage the practices of all of the individuals within accounting firms. Their response is intended to—

- Ensure practice consistent with professional regulations and standards.
- Maintain insurance coverage.
- Avoid both the massive money claims, with the seemingly inevitably ensuing settlements or judgments, and the more routine claims resulting from errors that, even though covered by insurance, result in substantial lost time and productivity, as well as damaged client relations.

Indeed, firms with multiple, even if individually relatively small claims arising from inadequate quality control procedures, may have a harder time obtaining insurance coverage at a reasonable price than those with a single very large claim. Risk management represents the process and the tools developed in order to meet these needs, in response to the external threats facing practicing accountants today. In all, you'll find this book and diskette a practical and informative resource tool for managing risks at your firm.

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<sup>4</sup> At the 1994 annual meeting of the Professional Liability Underwriters Society (PLUS) a considerable segment of the panel devoted to reinsurance issues focused on the need for effective risk management for professionals.



# **Part 1**

## **A Guide to Risk Management**



# Chapter 1

## What Is “Risk Management” (or “Loss Prevention”) Anyway?

It will help if we start with some simple definitions.

### **RISK**

For our present purpose, which is to introduce the subject generally, *risk* means any danger which, if not controlled, may lead to any consequence unintended by and actually or potentially harmful to an accounting firm or practitioner, including, at the extreme, professional discipline, malpractice, or other claims for money damages or allegations of wrongful conduct in the course of accounting practice which may cause financial or reputational harm.

One way of making the subject of risk concrete is to relate it to the deductible amount that is part of every professional liability insurance policy. If a firm’s policy sets a deductible level of, say, \$25 thousand per claim, then the simplest way that accountants in the firm can visualize the risk presented by each new client or matter for which a file is opened is that *it carries a potential price tag of \$25 thousand*. For many larger firms, the deductible levels are much higher, and are often payable before the insurer is required to contribute anything, including defense costs. In those firms, even if a client may be expected to yield very substantial fees, the actual out-of-pocket costs of defending a claim may actually not be greatly disproportionate to the anticipated billings. The first question that firms must ask, therefore, when opening each and every file, is whether the potential rewards anticipated from the new file are worth the potential *risk* of having to pay the cost of covering the deductible if a claim is made arising out of the representation. Of course, this method of evaluation focuses only on the financial costs implicated in defending claims, but this ignores the additional very real, if hidden, costs associated with claims, including time and billings lost from productive activities, damage to reputation, increased future costs of insurance, and so on. Furthermore, not all claims are settled within the limits of a firm’s insurance policy, as was demonstrated by a number of the larger savings and loan cases. Accordingly, recognition of the fact that every client and matter carry potential *costs*, as well as profit, gives substance to the meaning of risk in accounting practice.

### **RISK MANAGEMENT**

Risk management is the establishment of institutional (meaning, firm or practice-wide) policies, procedures or systems (sometimes referred to as risk management tools) designed to minimize risk within the firm and its practice. Ideally, every risk management tool should be able to perform *all* of the following:

- Establish uniform standards.
- Be capable of ready monitoring for compliance.
- Involve the minimum of intrusion and expense into normal operations or accounting practice consistent with maintaining the efficacy of the tool.

## **LOSS PREVENTION**

Loss prevention and loss control are the professional liability insurance industry's alternative terms for and are completely synonymous with *risk management*. If you reflect upon the history of the insurance industry, going back even to its roots in Lloyd's coffee parlor in London in the eighteenth century, a crucial element of underwriting has always been to seek to improve on the insurance risk by improving the safety of the product or service being insured. Initially, this meant the drive to improve shipbuilding and navigation techniques, since shipping commerce was the first industry to seek insurance. Subsequently, it has become a key element of all underwriting; hard hats for construction workers, seatbelts and airbags in automobiles are obvious specific examples of modern day risk-management tools either generated or at least strongly encouraged and supported by insurers.

What most accountants are unaware of is that risk management has arrived in service industries—and even other professions—in recent decades. Even in the accounting profession, risk management has been a fact of life for approximately fifteen years. Indeed, risk management is so well developed in the accounting profession that it involves not just the elements that are described and suggested in these materials, but often also mandatory external peer reviews—conducted by competitor firms—on a regular basis. This is important because it helps to correct the mistaken notion risk management is needed or effective only if a product (such as an architect's plans), or an intervention (such as a doctor's treatment) is involved.

Here are several examples of the importance and value of all forms of review, including existing internal and external peer review programs, in which managing the delivery of accounting services and in effective risk management cannot be overemphasized. The accounting profession lately has been battered by the Securities and Exchange Commission's (SEC's) increased public criticism of potential conflicts of interest. Partners and employees of an accounting firm committed numerous violations of the rules by investing in audit clients. The firm since has fired staff and partners and has spent millions of dollars in computer systems to detect and stop such conflicts. In another example, a client hired an accounting firm as his turnaround consultant. Shortly thereafter, his client filed for Chapter 11 bankruptcy law protection. The firm was eventually charged with fraud and giving incompetent advice in this Chapter 11 filing by the company's Chapter 7 bankruptcy trustee. In a negotiated settlement, the accounting firm's insurance company paid out a multimillion dollar settlement. The suit asserted that the accounting firm assigned "young and inexperienced" accountants from its restructuring consulting unit, who advised the client not to liquidate under Chapter 7, which they eventually did. An accounting firm was charged with audit negligence over several years and agreed to pay over 100 million dollars to settle claims that the firm failed to spot financial irregularities that led to the collapse of a conglomerate. Lawsuits that charge audit negligence are obviously quite common and frequently settled just to avoid the cost of extensive litigation.

A private investment company won an almost \$50 million jury verdict against an accounting firm by alleging that the firm’s audit of an acquisition candidate had overvalued the company’s inventory.

It is not only large firms that are sued for professional failures. While less publicized, even solo practitioners can find themselves in trouble for failing to follow appropriate practices.

### **Example 1: An Employee Defalcation**

Joe Daniels, CPA (not his real name), performed writeup and compilation work at a small but (initially) profitable construction company for many years. The principal of the client hated all aspects of the business bookkeeping and, over the years, increasingly delegated all such functions to a single, long-time, trusted employee. Joe got in the habit of treating this engagement as a profitable sinecure, accepting at face value the figures and information provided by the bookkeeper. Despite an obvious trend of falling profits over a number of years, Joe deferred to the principal by not raising problems unless the principal raised them first. When, after many years, Joe finally became suspicious and began to investigate why an originally profitable business was on the verge of bankruptcy, he discovered that over the previous decade the trusted bookkeeper has embezzled over \$1 million. When he reported this, instead of being grateful, the principal sued Joe for \$2.5 million—the \$1 million stolen plus additional damages for the loss of the business. The insurers settled for \$2 million, much less than they feared might have been awarded by a jury had the case gone to trial.

### **Example 2: A Client’s Fraud**

In another example involving a solo practitioner, John Able, CPA (also not his real name), had prepared tax returns for a pharmaceutical company for many years. The two owners of this modestly profitable enterprise decided that they had inadequate retirement savings, and embarked on a scheme to obtain a loan from a local bank ostensibly for expansion but actually for investment into their deferred savings accounts. In order to obtain the loan they prepared false financial statements, and then, on a regular visit to John’s office, took a batch of John’s letterhead when he and his secretary were distracted and then used the paper to present false statements to the bank. When the bank was subsequently audited, the loan was investigated, and the fraud was discovered. John was sued for \$11 million for conspiracy to defraud the bank. Even though John was ultimately successful in avoiding liability, proving that he was unaware of the fraud, the defense costs exceeded one hundred thousand dollars, and John lost hundreds of hours of billable time in preparing his defense.

### **The Risk Management Lessons From These Examples**

In both examples, lack of vigilance cost the accountants dearly. The next step, therefore, is to explore what kind of risk management structure in these firms and solo practices could have prevented these fiascos from occurring. To be successful, any such structure would necessarily have had to accomplish the following three functions.

1. Effectively evaluate risk at the time of new client and engagement acceptance.
2. Review the risks during the performance of the work, including appropriate management of the services.
3. Apply appropriate protective measures.

The following three aspects of risk management, taken from the overview presented later in this Chapter, are relevant to these examples:

1. New client and engagement acceptance policies and procedures
2. Team practice, peer review of partners, and supervision of associates subcategories of human resources management
3. Firm management (including risk management oversight)

### **New Client and Engagement Acceptance Policies and Procedures**

Accountants and their firms are most vulnerable to being injured by clients, and are also best equipped to avoid exposure when a client first seeks to engage the accountant. Clients, even apparently unimpeachable and highly desirable clients, can be source of threat as well as profit to their accountants. Aside from malpractice and other money claims, the developing law and practice relating to conflicts of interest and the meaning of the requirement of independence of auditors is testimony to that. Many sources of potential risk posed by clients, as well as appropriate controls to exclude or limit such risks, can be readily identified at or prior to the time of engagement.

In several of these examples, the key risk management procedures that could have prevented the losses involved better new client and engagement acceptance management. Client screening and, most important, well-crafted engagement letters clearly expressing (and limiting) the scope of the engagements, as well as a careful review of the work to see that it continuously conforms to the services promised, would have helped to limit the scope of the subsequent claims.

Consideration could (and should) have been given to at least the following issues:

1. Due diligence to ascertain the existence of an indicia that the client might be a “dangerous client” (The successor accounting firm must know whether and why the prior auditor had been terminated.)
2. The agreement of both firm and client as to the actual scope of services to be provided, including, in Joe’s example, a clear establishment of independence by the auditor or compiler, as the case may be, and an explanation leading to realistic understanding of those functions
3. The agreement of both firm and client as to the professional staff to be assigned to the engagement and, again, the requirement of independent oversight within the audit firm of the process
4. The ability of the client to pay the firm’s fees and expenses
5. The agreement of the client to execute a written engagement letter, in a form prepared and approved by the management of the firm, laying out these principles

In both John and Joe’s cases, careful engagement letters would have served both to limit what was expected to be done, as well as the accountant’s exposure in the event of a failure of the work product. Also, in John’s example, a letter might have been expressed to limit his liability to tax return preparation, thereby making it much simpler and speedier to establish his innocence. In Joe’s example, a letter would have provided the opportunity to review with the client’s principal the nature and scope of the engagement, and the limitations on the engagement with regard to the employees.



If it is truly intended for the new client review to be effective, the accounting firm’s management, independent of the introducing partner, should assess all new clients with respect to each of these categories. What would a thorough review of these issues by the two firms successively involved have revealed if undertaken when John and Joe were embarking on their engagements?

### **Team Practice and Peer Review of Partners**

The very words in the title of this section on peer review arouses fear and loathing in many accountants and many firms. It runs totally counter to the themes of individuality. Unfortunately, it cannot be ignored if all of the potential benefits of effective risk management are to be gained.

There are two reasons for implementing some level of peer review. First, it is the only way to be assured of maintaining a universally high standard of practice over time. Some firms have a history of retaining members of other firms to supervise their peer review programs, while many accountants prefer to limit peer review to internal oversight programs. AICPA and state CPA society peer review requirements mandate that other firms which are certified by the AICPA or state society to perform peer reviews do all peer reviews. This is a formal process with its own set of rules.

Second, however, even internal reviews, regularly undertaken, following clear guidelines that are understood and directed toward maintaining and improving service, are also a powerful tool for maintaining consistent levels of service to clients. This aspect of risk management has the potential for becoming a very positive marketing tool for firms in addressing current and potential new clients. Without reaching the level of faddishness denoted by Total Quality Management (TQM), this process can be presented to the outside world as part of a firm’s commitment to providing consistently high standards of work to its clients.

Although audits are necessarily conducted by groups of accountants, true team practice requires a formal system for ensuring that all client engagements are consistently *managed* on the basis of team input and review, rather than by individual partners. There are multiple benefits to be derived from the adoption of this approach to team practice. First, both the clients and the accounting firm benefit from the knowledge that the clients are receiving the best practices of the firm’s accountants. Second, there is a constant learning and training process at every level of the firm from the sharing of expertise that is inherent in team practice. Third, when errors occur—or when irregularities are discovered—they are likely to surface and be addressed early enough to prevent harm to either the client or the firm. Fourth, everyone—clients, the accounting firm, and the individual accountants on the team—benefits when individual accountants cease to be indispensable. Clients recognize the value of having a team to rely on; individuals get to learn to take advantage of being team members—including taking extended vacations; and the firm benefits from having happier clients and happier accountants! Finally, the whole process of continuous group oversight of matters in a team context helps to propel matters towards early and efficient completion.

A firm which has accepted the validity and the value of team practice, in conjunction with a regular peer review program, is one in which the failure to work with colleagues whose expertise is relevant (if not central) to serving a client is relatively unlikely to occur.

## **Firm Management and Risk Management Oversight**

In order for risk management practices to succeed, an essential prerequisite is that risk management must be accepted by everyone in a firm, from most powerful partner to lowliest clerk. A program which is recognized as being for the common good can operate as an effective brake on dangerous activities, including engagements that have the potential to harm the firm. An essential ingredient of effective risk management is the very public identification within accounting firms of the identity of the partners to whom compliance issues, as these issues are understood by the securities industry, and questions may be referred. In addition, the individual or team given that responsibility must be clearly seen to have the *authority* (and not merely the responsibility) for enforcing appropriate professional standards in the conduct of engagements. Every accounting firm needs a clearly expressed policy encouraging the early reporting of any variance from the standards and norms of practice that are being ignored in the handling of any engagement that, if not identified and appropriately responded to, will inevitably lead to malpractice, discipline, and public relations disasters. Only if such a designation and such supporting policies are in place and widely publicized and understood at every level in the firm, can the firm reap the important benefits of having a risk management partner. The early identification of problems allows for the remediation of any individual who may be ignoring or violating applicable policies, procedures, or standards; permits intervention to prevent harm to clients; prevents claims and professional discipline complaints. These benefits do not just happen, and will not happen in the absence of a clearly defined and well-publicized policy, backed up by a well-defined risk management structure within the firm.

## **THE MAIN ELEMENTS OF RISK MANAGEMENT FOR ACCOUNTANTS**

To understand what is involved in effective risk management, we must first try to define what constitutes good health in the context of accounting firm practice and management generally. In turn, this requires an understanding that risk management is about a continuous *process*.

The following are the three elements of the process of achieving effective risk management.

1. Identify risk management categories (encompassing both firm management and practice oversight categories).
2. Know what, if any, procedures or systems are already in place in each of the risk management categories.
3. Develop strategies to control risk categories or particular risks identified but not yet adequately managed.

The first element requires that we establish and define a framework of general if not universal application among accounting firms to be used in evaluating risks. The second element, particular to each firm willing to engage in appropriate self-examination, involves active inquiry and investigation to determine the nature and scope of existing risk management practices that are in place. The third element involves posing, for each risk identified during the investigation phase, the question, "What realistic risk management tool could be put in place which would effectively and efficiently control that risk?" For example, if a firm has concerns about the adequacy of its ability to catch conflicts of interest at the new client and engagement acceptance stage, the firm will need to review

both its management structure and the entire system of file opening and internal notification and checking for conflicts. Similarly, if a firm notes that a pattern of billing disputes with clients is developing, perhaps involving a particular practice group, it will need to review two aspects of its operations: its engagement letter practices and its billing policies and procedures. In each case, once the review is complete, the firm can add those procedures necessary to remedy any deficiencies or shortcomings that may have been disclosed or uncovered.

The biggest billing-related problem is that many firms are very diligent about billing clients for every quarter hour of time expended, but not so diligent about documenting the working papers about what services were rendered.

Most midsize and larger accounting firms use billing software packages that use service codes, much like physician practices. For these firms, the important issue is that the billing codes entered are accurate, and that the working papers be documented for any research or discussion performed that is being billed.

For smaller firms that do not use billing software, it is a matter of ensuring that the description of services rendered in the bill accurately reflects the services rendered. Indiscriminate use of terms like “audit,” “examine,” and “review” in billings can create significant problems in defending claims in which the scope of service is in dispute, and again, documenting the working papers appropriately is important.

This process and the list of the components of a comprehensive risk management system may be daunting when viewed as an apparently monolithic structure, in the form described below. It is therefore important to emphasize that, precisely because risk management is a process, it does not have to happen (and probably cannot happen) all at once. Both the investigation and implementation elements of the process can and should be done in discrete stages and over time. Establishment of effective risk management can best be viewed as a steady, continuous progress along a defined path, rather than the sudden and jarring imposition of particular (and painful) solutions. To use a medical analogy, risk management should be like taking vitamins, not undergoing major surgery. The second and third elements of the process are addressed in later chapters. However, it is worth noting here that the audit section of these materials is deliberately divided into separate questionnaires in order to make it entirely feasible and practical for firms to address specific risk management categories separately and according to their own schedule.

In order for a firm to decide which risk categories are most relevant to its particular needs and concerns, it will need first to consider the overall range of risk management issues. Then, in the context of the whole range of risk management categories, the process of evaluation can proceed on a selective basis. Therefore, we now turn to survey all of the basic risk management categories.

## **Identifying the Risk Management Categories**

### ***Accounting Firm Management Structure and the Firm Culture—The Leadership Component in the Control of Risk***

Effective management of individual elements of risk within the accounting profession can only occur within an overall management environment which meets the following two quintessential requirements.

1. *Authority.* The firm's management must have sufficient authority delegated by all partners to be able to control the practice of all of the individual members of the firm *without exception* (and regardless of seniority) where management perceives the need to impose such controls.
2. *Leadership.* The firm's management must recognize and accept the importance of effective risk management and must actively, continuously, and consistently communicate to all of the firm's personnel, from partners to receptionists, its commitment to implement risk management throughout the firm.

The absence of these components in a firm's structure or culture spells the most fundamental danger for a serious attack of external money claims against the firm. Similarly, the publicity attendant upon the recent firings of partners at a national CPA firm over the failure to abide by insider trading and investment policies demonstrates the damage that can be done to a firm's reputation if it has failed to adopt an adequate risk management structure that applies throughout the firm, from the top down.

### ***Assignment of Risk Management Responsibilities***

Separate and distinct from the fundamental requirement that firms recognize the need for an effective management structure alert to its risk management responsibilities is the actual assignment of the task of overseeing the risk management functions. In order to move from the philosophical and cultural recognition of the importance of risk management to its effective introduction throughout the organization, the firm must delegate, in a coherent and centralized way, the ongoing duties to monitor and control the individual categories of risk identified as concerns within the firm. This process of moving from the theoretical to the practical requires that some identifiable partner (or committee) be given the responsibility and the authority to fulfill the day-to-day functions of managing the practice for the avoidance of risk.

When a firm has reached the point of recognizing the need for and the delegation of the risk management function, it must next turn to assessing the ways in which the separate categories of practice risks are relevant to its membership structure, culture, and practice areas. What follows is a list of the headings of the principal classes and categories of risk that firms need to manage in today's hostile environment. It is not comprehensive in that new risks arising out of the accounting profession are demonstrated all too frequently. However, it does categorize most of the problems that have faced firms in the twenty or so years since liability to clients, third parties, and regulators became regular and serious matters of concern.

### **The Practice Oversight Categories**

What follows here is an outline of the main categories of risk management evaluation and of the principal areas of review within each category. The purpose of this outline is to demonstrate the scope of the risk management function within accounting firms, and the necessary reach of any survey that seeks to measure the level of a firm's adoption of risk management principles. Next to the heading of each category is a reference to the related questionnaire in Part 2, "Quality/In Control (QUIC) Survey for CPA Firms Questionnaires," of these materials which, together with the corresponding answer and analysis sheets in Part 3, "Quality/In Control (QUIC) Survey for CPA Firms Answer and Analysis Sheets," explores each subject area in greater depth. These materials are referred

to collectively as Quality/In Control (QUIC) Surveys, and are designed to offer a specific solution to firms interested in or committed to improving their risk management. As explained above, the references to the questionnaires should not be taken as an indication that every risk management topic is of equal concern to every accounting firm, or that firms must address every topic at once in order to practice appropriate risk management. Firms will choose the segments relevant to their own particular needs.

The categories are a framework for evaluating risk management but are not exhaustive. For instance, one can add categories relating to specific practice areas or categories having to do with particular activities which accountants often undertake. Nevertheless, this outline at least sets us on the road of understanding what it is that risk management encompasses.

### **Identifying What Risk Management Is Already in Place**

The following two elements are involved in determining which components of risk management are actually in place within a firm, and these elements are often in conflict:

1. *What the firm’s management thinks* is in place, based on policy manuals and procedures, firm culture, specific directives, and so on
2. *What the people practicing within the firm actually do* on a day-to-day basis, including partners, employed accountants, and nonprofessional support staff.

These two elements are often so distinct and dissimilar that descriptions of the two elements actually seem to describe totally different institutions. To give the simplest of examples, a managing partner of a firm was considering her firm’s policy of maintaining (and periodically reviewing) a supposedly complete chronological file of all correspondence leaving the firm on its letterhead. Although there are excellent reasons for such a system, including current review of the work product of partners as well as other professionals, and maintaining backup copies of materials, these policies can only be met if the procedures are followed. The managing partner in question noted that a recent check had belatedly revealed that only half of the firm’s professionals were contributing to the chronological file. In itself, this was not surprising; what was startling was the reason—which was not venal. It turned out that the half who were served by secretaries who had been with the firm since the policy had been established, four years earlier, were all religiously following the system; but almost all of the professionals whose secretaries had joined subsequently were not—because no one had told incoming secretaries about the procedure! Now this is not, in the scale of things, a weighty lapse. But it illustrates neatly the problem of the bifurcation of theory and practice, even if an effort is being made to practice good risk management.

This example demonstrates that having a beautifully crafted firm or office policy manual is, by itself, meaningless, if it is being ignored at the points where its observance may be important, if not essential to the firm’s well-being (or to its very existence). There must be a system or procedure for checking—at regular and quite frequent intervals—the extent to which the troops on the ground—both the accountants and the support staff—know and actually follow those policies and procedures management believes to be in place. Otherwise, sooner or later the procedures and systems will fail.

Professional liability insurers try to compel at least elements of this verification process with the increasingly detailed questionnaires that comprise their application forms. However,

the attention given to these by firm management is often perfunctory at best, and the opportunity for an effective review of management practices is lost for another year. Without continuous monitoring from the perspectives of both management and the staff, even adequate risk management policies may well be useless. Furthermore, the yearlong gap between insurance applications may be too long to delay this process of reviewing what is in place with respect to at least some of the risk management categories. For instance, it may be advisable to check that new client and engagement acceptance procedures are being followed every month, and this can often be accomplished quite simply in conjunction with the issuance of prebilling information. To await the insurance application process, which might not even ask a question that would require the relevant review in any event, might be more than enough time both for a breakdown in the risk management system to occur as well as for circumstances to develop which will lead to a claim.

Chapters 2, “Defining Risk for Traditional Accounting Services,” 3, “Multidisciplinary and Assurance Services,” and 4, “Managing Risk,” explain the role of the accounting firm self-assessment in enabling firms to take control of this process of determining what risk management is in place and where the gaps are. Then a firm interested in actually performing a self-assessment will have all of the background necessary to proceed to the questionnaires in Part 2. Finally, after completing each questionnaire, there is a corresponding answer and analysis sheet (usually referred to as crib sheets) in Part 3 that explains—question by question—what each answer means in terms of the state of the firm’s risk management.

### **Developing Adequate Risk Management**

Assuming now that the appropriate recognition has been given by the firm’s management to the need to adopt effective risk management strategies, and assuming, also, that a survey has therefore been done to verify what systems are already in place, then the firm must turn to the development and implementation of new policies and procedures. As it was expressed by one firm’s risk management partner (whose very title demonstrates that firm’s awareness of the importance of this function), “the standard reaction is ‘Don’t bother me; I’m not your problem; go bother Joe down the hall—he had the last claim.’” Furthermore, accountants, some of whom are still accustomed to billing by the hour, resent bitterly (and understandably) any new procedure that wastes billable time on apparently non-income-productive activities, and fight the adoption of any such procedures as bitterly as they feel that resentment.

Accordingly, as far as practicably possible, risk management controls should be self-executing. Self-executing means both that the control works as an automatic alert, and that if the automatic control fails, the activity being controlled cannot proceed until there is compliance with the control procedure. A simple example is a billing system in which a firm’s accounting department puts in place a procedure whereby, every time it responds to a request for prebilling data, it also sends a copy to either an administrator or management partner, in addition to the person requesting the billing information. In this way, there is both a review and a trigger for inquiry by a third party at the beginning of the billing process, well before a bill is issued. Many kinds of similar control are possible within the billing process and at various stages; the particular procedures will vary both with the sophistication of the firm’s time recording and billing systems, and with the firm’s

perception of the need to control the process. That this kind of control is important must be clear at least to the firm that was recently allowed to proceed with a suit against one of its professionals who had solicited a client to pay him individually in return for a limitation of the firm’s bill. Had the control been in place the professional would have known that as soon as the billing process began his attempt to redirect payment would have been detected. Like almost every such control, therefore, while it may be possible to circumvent a control temporarily—in this instance, by writing the improper letter to the client—by making ultimate detection certain (or at least very likely), the procedure will hopefully deter breaches, or at least actually lead to their prompt detection.

Another example of self-executing risk management procedures is found in many new client and engagement acceptance systems. These should operate so that no time can be recorded on a client matter unless (and until) *all* mandated conflicts checking, engagement letter, and assignment of staff decisions and processes have been completed. In this way, the incentive on the partner and staff is to comply—quickly and efficiently—with the systems. The roadblocks do not involve human interference with the particular practice group unless the new client and engagement acceptance process throws up any of the problems which it is precisely intended to identify, in which case it can be resolved before it becomes a crisis. Again, such procedures do not ensure either that there will be compliance or, therefore, that lapses leading to potential claims will never occur. At least, however, they remove from the process any possible incentive to deviate from the system, and so make compliance much more probable.

Some procedures or controls are, by their nature, only partially self-executing. A simple example may be found in the sensible risk management control in place in many firms in the form of a policy that formal reports require the signature of two partners (thereby ensuring oversight of documents likely to be asserted as a basis for liability against the firm). Here, the policy only works if the accountant who is asked to prepare such a letter initially complies with the policy by showing a draft to the appropriate partner or committee. Even here, however, there may be room for some additional control to make more probable that such compliance will occur. For instance, in most cases, the likely (or possible) need for such a letter will be apparent from the time the matter is opened. Accordingly, if all new client and engagement acceptance forms require that such a possibility be identified, and are automatically passed to the oversight committee or partner in order that the appropriate entity or person can assume its or his role from the outset, presumably before the urge to subvert the policy arises, breaches are less likely to occur.

It is precisely because not all procedures can be self-executing or fully self-executing that peer review is an important part of a comprehensive risk management system. If accountants know that their files are subject to regular review, they are again likely to be deterred from breaching these controls and procedures.

The element of self-execution within at least some of the procedures and controls adopted by a firm as part of its risk management program necessarily signifies a second element which is equally crucial to the program’s success—that *no one* is “above the law.” No matter how senior or venerated, or how large the billings of a partner or practice group, *everyone* is subject to the same procedures. Of course, some are going to succeed better than others in finding ways, after disclosure and discussion with management, around particular problems. But no one should be able to make special arrangements without disclosure and approval. Unless the risk management system can accommodate that requirement, it is, by

definition, inadequate (and likely to fail in the very situations most dangerous to the firm's well-being).

Following the chapters describing the risk management self-assessment process, Chapter 5, "The Role of Accounting Firm Assessments Generally—and Self-Assessments Particularly," returns to the subject of the development of risk management tools that will work in the varied cultures of American accounting firms. The goal is the development of strategies that will enable the implementation of the findings of a self-assessment in a way that can readily be seen to be constructive, positive, efficient, and as sensitive as possible to the need to minimize time-consuming and burdensome administrative chores, as well as establishing effective risk management controls. First, however, it is important to consider in greater depth the first element of risk management, the identification of risk in each firm's practice; Chapters 2, 3, and 4 address the *why*, *what*, and *how* of accounting firm self-assessments.



## Chapter 2

# Defining Risk for Traditional Accounting Services

The purpose of this and the next two chapters is to provide insight into the liability risks associated with the practice of accounting and to emphasize the importance of risk management within all levels of the firm. Becoming embroiled in a professional liability claim is certainly an action all firms want to avoid . . . and for good reason. In the words of Charles Dickens, written in 1853—

Becoming involved in a lawsuit is like being ground to bits in a slow mill; it's being roasted at a slow fire; it's being stung to death by a single bee; it's being drowned by drops; it's going mad by grains.

Risk associated with the traditional accounting services tends to focus on several specific areas. This Chapter will address these common legal pitfalls for accounting firms. Although the type of services provided may affect these specific areas, each has tremendous impact on attestation engagements, compilation and writeup services, and tax preparation and planning. CPAs who offer attestation services are particularly vulnerable to lawsuits because they play an indispensable role in a majority of financial transactions and often are considered “lucrative” targets. In fact, more lawsuits against CPAs have been filed during the last sixteen years than in the entire history of the profession.<sup>1</sup>

The following are the five common legal pitfalls that will be discussed in this Chapter:

1. Lack of appropriate professional skills
2. Practicing in unfamiliar areas
3. Lack of proper hiring and supervising of staff
4. Poor documentation
5. Failure to detect fraud or defalcation

When discussing risk in traditional accounting services, it is a good idea to readdress what we mean by risk. For our present purposes, *risk* is any danger which, if not controlled, may lead to any consequence unintended by and actually or potentially harmful to an accounting firm or practitioner, including, at the extreme, professional discipline, malpractice, or other claims for money damages, or allegations of wrongful conduct in the course of accounting practice which may cause financial or reputational harm.

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<sup>1</sup> Paul Geoghan, “Stay out of Court,” *Journal of Accountancy*, September 1998.

Risk can also be identified as both internal and external. Internal risk is inherent to the practitioner or the accounting firm. Employment, staffing, and training issues are examples of internal risks facing accounting firms. Basically, those risks are more closely within the firm's span of control. External risk exists outside the parameters of the accounting firm, its partners, staff and employees and include clients, third-party users of the firm's work product, tax, bankruptcy, environmental or other law or legislative changes, and economic trends.

### **REDUCING RISK RELATED TO LACK OF APPROPRIATE PROFESSIONAL SKILLS**

The accounting profession is a vast and expanding world. And it certainly has been, especially recently, a changing profession. Standards, procedures, and pronouncements are issued regularly and frequently. The Financial Accounting Standards Board (FASB) and Governmental Accounting Standards Board (GASB) issue new accounting standards yearly. In addition, the Auditing Standards Board (ASB) frequently issues new or revised auditing standards. The Internal Revenue Service's (IRS's) sweeping code changes and its complexity have become legendary. Federal and state tax laws change constantly.

Regarding financial statement engagements, many claims are made against accounting professionals for failure to detect or disclose departures from generally accepted accounting principles (GAAP) and failure to comply with generally accepted auditing standards (GAAS) and Statements on Standards for Accounting and Review Services (SSARS). Accounting practitioners must make a conscientious and dedicated effort to maintain professional acumen in order to effectively practice in today's ever-changing environment and with the future's anticipated fast pace.

Tax claims continue to be the most prevalent claims against the accounting professional. Failure to recognize changes in the tax law and how it relates to a client's business can, unfortunately, turn reasonable and sound tax advice into a potential liability claim. With this in mind, attention to current federal, state, local, or international tax implications cannot be overemphasized. Practitioners performing tax planning engagements are required to perform and complete stringent tax law research. The practitioner must be aware of not only the current tax law, but also any proposed legislation that could be enacted that will affect implementation of the plan. With the ever-changing tax laws and legislative actions, all firms must have access to a tax research library.

CPAs may want to consider issuing a general warning statement such as the following with all tax advice and planning engagements.

This tax advice represents our best professional opinion based upon the factual representations that you made to this firm and the tax law existing on this date. We cannot guarantee this result because of the uncertainty inherent in future legislative changes, court rulings and IRS interpretations of the tax laws. IRS positions are subject to retroactive change, which could affect tax positions previously taken by you. Slight changes in the facts may alter the result. Opinions of courts often conflict, and judicial thought is subject to change.

Special attention should be given to preparing and training staff members for the tax season. This should be an ongoing process, including the following, versus a once-a-year activity. In addition to being trained in new tax laws, staff members need to be familiar with internal procedures and performance standards.

- Conduct short, informal sessions focused on specific areas to help keep staff members up-to-date on tax law changes and important areas of internal control.
- Encourage questions and foster an accepting attitude to cite specific areas of difficulty, confusion or problems.

Many firms hire temporary, part-time, or new personnel prior to tax season, or hire per diem help during tax season, which means special training sessions are required to ensure consistency and compliance with procedures. Sessions should also be provided to provide instruction regarding the firm's tax preparation policies and quality control procedures. Additional guidance and close supervision will be necessary to ensure that the work of these personnel will not result in potential liability problems for the firm. One of the keys to preventing claims during tax season is the careful, thorough review of tax returns, related schedules and elections before they are released to clients. Certainly staff must be supervised, but review of the work product is critical.

All tax practitioners should be familiar with the AICPA's Statements on Standards for Tax Services. Effective October 2000, these standards apply to all tax practice, not just practice before the IRS. Additionally, plaintiffs' attorneys will certainly use these statements, and the formerly entitled Statements on Responsibilities in Tax Practice (SRTPs), and refer to them during a tax liability claim. The current Standards are the following:

- SSTS No. 1, *Tax Return Positions*
- SSTS No. 2, *Answers to Questions on Returns*
- SSTS No. 3, *Certain Procedural Aspects of Preparing Returns*
- SSTS No. 4, *Use of Estimates*
- SSTS No. 5, *Departure From a Position Previously Concluded in an Administrative Proceeding or Court Decision*
- SSTS No. 6, *Knowledge of Error: Return Preparation*
- SSTS No. 7, *Knowledge of Error: Administrative Proceedings*
- SSTS No. 8, *Form and Content of Advice to Taxpayers*

It is critical that CPAs maintain current training in the specific technical areas and industries they serve. Firms need to provide training aligned with staff members' areas of practice and knowledge level. Partners also need to remain current in their professional development and areas of expertise. Continuing education is critical at all levels within the firm.

Fortunately, there is a wealth of educational material available to firms and practitioners. The AICPA, state CPA societies, and many other vendors provide materials and assistance on a myriad of practitioner issues. Nevertheless, the vast amount of material and the complexity of its content call for an astute and dedicated learner. The more educated and experienced your personnel, the better chance a firm has to practice safely from a professional liability standpoint, and perhaps even more importantly, your clients will be better served.

It is recommended that accounting firms develop and follow in-house performance standards. Professional standards for traditional accounting engagements are broad. Because of this and the ever-changing environment in which you practice, firms should consider developing their own standards for these engagements and implement controls to ensure compliance. Standards should include engagement acceptance, following minimum procedures, form and checklist completion, supervision of engagement personnel and review of working papers, financial statements, tax returns, and all reports.

### **REDUCING RISK RELATED TO PRACTICING IN UNFAMILIAR AREAS**

The accounting professional who practices in unfamiliar areas is running, not walking, in a minefield. Failure to fully understand GAAS, GAAP, IRS Code sections, or Treasury Department Circular No. 230 and realize their implications to the engagement at hand is a relatively common basis for many liability claims against accountants. It is often a very difficult allegation to overcome when questioned about your prior experience, education, and expertise in the unfamiliar area of practice; or when asked to disclose specific educational training sessions taken by engagement team members to obtain additional knowledge in an unusual or complex area.

It is important to remember that traditional accounting engagements are ensconced in a changing environment. Industry, economic, regulatory, and technological forces may create a vastly different engagement from year to year. Industry specific pitfalls abound. Additional important considerations to consider are industry trends, tax treatment, reporting policies, financial statement disclosure, accounting methods unique to the business or industry, credit policies, related parties, and financial relationships. There is no room for complacency in a well-managed accounting firm with a strong risk management culture.

The failure to apply proper audit procedures to an industry with a specialized audit guide is frequently alleged by the plaintiff's attorney as an audit deficiency. Knowledge of the client's industry, business transactions, forms of accounting records, stated qualifications of personnel, accounting basis for presentation, and form and content of financial statements is required for non-audit engagements by SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100). Specific industry guides, published by the AICPA, are useful tools and should be included in your firm's library. All staff personnel assigned to the engagement should be made aware of the industry guide available and required to read it.

Ensure that all staff personnel assigned to the engagement are knowledgeable about industry-specific methods, applications, and transactions. Encourage them to seek out experienced firm members, AICPA industry guides, if applicable; or additional information, if questions arise. Let them know that it is imperative that questions be addressed and resolved in an appropriate and timely manner. Staff members must bring issues, concerns, or errors to the attention of engagement supervisors or managers. Not asking for clarification may cause confusion—or it may cause a lawsuit.

Should you decide to enter into an engagement in an area or field of practice in which you are not knowledgeable and experienced, you must enter with caution. Ensure that all areas of the engagement that are unfamiliar to you or unusual are documented and researched.

Seek the assistance of a CPA or appropriate professional or expert with the required technical experience. Consider a joint venture on new engagements or perhaps hiring a CPA to provide review services or oversight assistance during the engagement. Talk to your partners and colleagues; they may be familiar with a CPA that practices in the particular field you are seeking. Contacting the AICPA, your state CPA society office or local universities may also be useful in your search. State society chapters and discussion groups are also excellent sources to locate the appropriate professional to assist with new or unfamiliar engagements or industries. It should be noted that firms should verify that professionals hired to assist the firm in engagements are covered by professional liability insurance. Once an engagement is accepted, the firm must take steps to acquire the necessary expertise. If necessary, the firm should hire the appropriate level of expertise required to successfully complete the engagement.

Additionally, if a firm accepts an engagement to perform services that the firm does not have prior experience in performing, this should be discussed and disclosed to the client, both orally and in writing, before engagement work commences. Although the firm can obtain the necessary resources to perform the engagement competently, the client needs to be aware of the conditions and accept them as a term of the engagement.

Unfamiliar areas of tax are almost a common occurrence. However, performing a complicated tax engagement without the requisite tax knowledge, expertise, and diligent research will very likely result not only in erroneous tax law interpretation but a potential liability claim against the firm. As previously stated, all firms must have access to a tax research library. Research should be required in (1) all areas or situations where a practitioner or firm does not know the answer and (2) areas that are addressed infrequently by the firm. This is necessary to ensure that advice given reflects current judicial interpretation of the tax laws.

Practicing in unfamiliar areas of accounting, tax, or consulting is always risky and generally should be avoided. However, this is not always feasible. The well-managed firms will take time to analyze the risks involved and develop an engagement plan to manage risk during the performance of a successful engagement.

Attention also needs to be given to potential independence issues that may arise when expanding services to clients. *The Statement on Standards for Consulting Services* must be carefully reviewed and followed. Independence is required when providing attestation services for a client (Section 101.5 of the AICPA Professional Standards). Independence would be impaired when providing consulting services which involve specifically managing clients' staff or making final decisions impacting the clients' business. It is important that all consulting staff (who may not be CPAs) are aware of potential independence issues and are familiar with applicable standards and guidelines.

## **REDUCING RISK RELATED TO LACK OF PROPER HIRING AND SUPERVISING OF STAFF**

The AICPA PCPS 2000 Member Survey asked PCPS members to identify what will be the most pressing problem three years from now, the number one issue was staffing. MAP members have expressed views that the staffing crisis will continue to grow in importance and is so significant that it may threaten the continuing viability of some firms. Indeed, many CPAs cite staffing issues as an on-going concern.

Here are the top five practice management issues for the past five years, according to the annual MAP Committee poll of PCPS members<sup>2</sup>:

- ***2000 Top Five MAP Issues.*** Out of 278 participants, the following turned out to be the Top Five MAP issues:
  1. Finding, hiring and retaining staff
  2. Keeping up with technology
  3. Fee pressures and pricing of services
  4. Succession planning and identifying and developing future owners and funding partner retirement
  5. Marketing and practice growth
- ***1999 Top Five MAP Issues.*** Out of more than 350 participants, the following were the Top Five MAP issues:
  1. Finding, hiring and retaining staff
  2. Marketing/practice growth
  3. Keeping up with technology
  4. Delivering high quality service
  5. Succession planning/future owners and partner retirement
- ***1998 Top Five MAP Issues.*** Out of 138 participants, the following were the Top Five MAP issues:
  1. Finding and retaining quality staff
  2. Marketing and practice growth
  3. Determining and meeting client needs and expectations/delivering high-quality services
  4. Capitalizing on consulting opportunities
  5. Keeping up with technology
- ***1997 Top Five MAP Issues.*** Out of 180 participants, the following were the Top Five MAP issues:
  1. Finding, hiring and retaining staff
  2. Keeping up with technology
  3. Capitalizing on consulting opportunities
  4. Marketing
  5. New service development
- ***1996 Top Five MAP Issues.*** Out of fifteen participants, namely, the MAP Committee only, the following were the Top Five MAP issues:
  1. Finding, hiring and retaining staff
  2. Identifying and developing niche markets
  3. Technology
  4. Responding to change in the profession
  5. Capitalizing on opportunities in consulting

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<sup>2</sup> "Top Five MAP Issues," *The Practicing CPA*, December 2000, page 5.

Because of the strong economy and past hiring cutbacks at larger firms, CPAs report there is a smaller pool of people looking for work, especially in the three-to-five year experience range. They go on to say that those seeking work do not have the kind of experience they seek or are unwilling to take on some of the demands of a career in public accounting.<sup>3</sup>

It is plain to see that finding, hiring, and retaining staff is of utmost importance to CPA firms today, as it has been for the past few years, and is anticipated to be the main concern for several years. Hiring good people was never easy . . . and it's not getting any easier. Experienced staff members are an accounting firm's number one safeguard against liability claims. Proper training and supervisory review at all levels are among the first steps a well-managed CPA firm can take to reduce its risk to potential liability problems. Experienced personnel usually command a higher salary, and they are worth it! They bring competitive advantages to client service and satisfaction, as well as lessening the potential liability threat. The importance of qualified staff members is further asserted with the first standard of field work, which requires that the work be properly planned, and assistants, if any, are properly supervised.

Lack of proper staffing and supervision is very often identified and alleged by plaintiff's attorneys when prosecuting a claim against the accounting professional. Almost all attestation engagement claims will include an allegation of inadequate or inappropriate staffing. Adequate supervision and careful review of work product is essential to maintaining a strong culture of risk management within the well-managed firm. Supervisory review of personnel and work product is an extremely important internal control for the accounting firm and must not be taken lightly

It is recommended that the firm take steps to create an office policy to address potential liability issues. The person closest to a suspected error is often not the most reliable or accurate in assessing the error's potential effects or repercussions. A timely, objective assessment is needed to address the potential error or liability issue and to resolve the matter in an appropriate and expeditious manner. A firm policy should be communicated to ensure that suspected errors and potential liability issues are identified and communicated to an appointed person or to the engagement supervisor or manager. Some firms find that appointing a particular person for this role works best. In addition to being technically qualified, this should be a person with whom staff members are comfortable discussing difficult or sensitive issues. It is important that the firm creates, and continues to foster, an environment that provides for the success of this office policy. Trust, confidentiality, and timely resolution are major features of a good policy.

### **How to Avoid Hiring Pitfalls**

The employer-employee relationship is becoming an increasingly litigious one. The careful firm will begin the process of limiting its exposure right at the beginning, with the hiring process. Consulting with competent counsel on employment law issues, especially with respect to performing background checks on prospective employees, is recommended.

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<sup>3</sup> Anita Dennis, "A Good Hire is Hard to Find," *Journal of Accountancy*, October 1998, page 89.

### **How to Avoid Legal Liability in the Hiring Process<sup>4</sup>**

Application forms are especially useful because the applicant provides the information for the employer's use. An application form should include the following:

- A provision that requires the applicant to declare that his or her answers are true, correct, and materially complete
- A declaration or certification that allows the employer to take the steps to ascertain the truth of any statement in the application
- A declaration that the applicant understands that any false or incomplete answers may constitute a reason for termination of the hiring process or grounds to terminate any possible employment in the future
- A release permitting the employer to give references without liability

Conducting face-to-face interviews is a good idea, especially when the interview process mirrors the written application. Things that the employer should not ask about, though, include the following:

- Religion
- Age
- Race
- Military status (The employer may, however, ask about relevant job training in the military.)
- National origin (The employer may, however, ask whether the applicant is authorized to work in the United States and whether the applicant can prove that status upon employment.)
- Familial status (The employer may, however, ask about the applicant's availability to perform specific tasks and to travel.)
- Disability other than questions that are tailored closely to actual job duties and activities
- Arrest and conviction record (Generally, the employer may not ask about arrests that do not result in convictions.)

### **Reference and Background Checks**

After completing interviews and making a hiring decision, the next step is to perform a thorough reference and background check. With the difficulties many firms are experiencing in hiring qualified candidates, some firms may be tempted to skip over this very necessary step in the hiring process. A number of states have recently passed privacy laws that may affect this process. If you do not have in-house resources, or if your own resources fail to obtain sufficient information to make a definite hiring decision, consider retaining the services of a professional. Fees for professional reference checks range from about \$75 to scan the background of support- or staff-level personnel to about \$500 for a detailed report pertaining to management and partner-level candidates. Additionally, there are a number of resources on the Internet that can assist in background checks, which are

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<sup>4</sup> Copyright 1998 by The American Law Institute. Reprinted with the permission of *The Practical Lawyer*. Subscription rates \$45/year, \$9.75/single issue. This article appeared in the October 1998 issue of *The Practical Lawyer*.



generally inexpensive, easily accessible, and easy to use. The following are some companies that do reference checks:<sup>5</sup>

- Corporate Investigations, Inc.  
1700 No. Highland Road  
Pittsburgh, PA 15241  
(412) 429-2400
- Fidelifacts  
50 Broadway  
New York, NY 10004  
(212) 425-1520
- Robert Half International, Inc  
*How to Check References When References are Hard to Check*  
For a free copy of this 17-page booklet, contact your local Robert Half/Accountemps or call (800) 854-7091.

## REDUCING RISK RELATED TO POOR DOCUMENTATION

The email messages on your screen, the memo on your desk, engagement correspondence—these are examples of documentation that could come back to haunt you. Proper documentation of client files is certainly the cornerstone of a good risk management program. Documentation includes both paper and electronic application of the client acceptance form or process, the engagement letter, other communication with the client, working papers, spreadsheets, reports, and memos to the file documenting conversations or meetings with the client, third parties, or other professionals involved in the engagement process. Good documentation is vital to not only successful claim resolution, but can be extremely valuable in avoiding a claim situation or resolving an issue of conflict with clients, partners, or staff members.

Although engagement letters are not required by professional standards, they are strongly encouraged in professional literature. Statement on Auditing Standards (SAS) No. 83, *Establishing an Understanding With the Client* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), requires an auditor to establish an understanding with the client that includes the objectives of the engagement, the responsibilities of management and the auditor, and any limitations of the engagement. The statement also requires the auditor to document his or her understanding with the client in the working papers, preferably through a written communication with the client. SSARS 7 states that the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. In addition, Appendixes B and C of SSARS 7 contain an illustrative engagement letter for a compilation and review engagement.

Engagement letters establish the legal framework for a working relationship with your client and should be viewed as the contract with your client. This letter may be the single most important instrument to a successful engagement. The engagement letter memorializes the agreement between the CPA and client, and provides an opportunity to

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<sup>5</sup> Jayne E. Osborne and Roy C. Thornton, "How to Manage Your Accounting Practice." New York: Harcourt Brace Professional Publishing, 1999, page 8.39.

discuss the scope of the engagement, the nature of services to be provided, and the fee structure involved. Careful engagement letter writing and review should be a part of every firm's risk management program. See additional engagement letter discussion in Chapter 4, "Managing Risk."

Unprofessional or inappropriate documentation of client files can "fuel the fire" when discovered by plaintiffs' attorneys who are always looking for evidence that will support their client's position or discredit the opposing side's witnesses. An accounting firm's working papers are subject to discovery and may be examined very closely for discrepancies, review notes that have not been adequately cleared, incomplete areas, and certainly any inappropriate comments. Computerized data, such as engagement spreadsheets, notes, and memos will be required to be produced if considered potentially relevant to the litigation. Some states have passed rules of civil procedure to define the word *documents* to include "all retrievable information in computer storage." If detected, rest assured that they would not go away quickly, or inexpensively.

In *Easley, McCaleb & Associates, Inc. v. Perry, No E-2663 (GA. Super. Ct. July 13, 1994)*, the Superior Court ruled that deleted files on a defendant's computer hard drive are discoverable, and the plaintiff's expert must be allowed to retrieve all recoverable files.

According to David L. Schultz, CPA, ABV, a partner with Schultz, Chapel & Co., LLP in Fort Myers, Florida, and a member of the Committee on Litigation and Valuation Services, "The trend in litigation is that more attorneys are requesting all forms of communications and records that exist in practitioners' files—often to the surprise of the practitioners, who do not recall storing the files. The best system for avoiding problems in this area is to exercise extreme care in drafting all file memoranda and communications."

According to an Ernst & Young LLP poll of 400 executives attending the American Management Association's Human Resources Conference, 36 percent said they use email more frequently than any other communication tool. By comparison, only 26 percent of respondents cited the telephone, followed by 15 percent who said they prefer face-to-face meetings. Another study shows that daily floods of email are leaving 60 percent of executives, managers, and professionals feeling overwhelmed. According to the survey conducted by the Institute of the Future and sponsored by Pitney Bowes, individuals may send and receive up to 190 messages a day.<sup>6</sup> It's important to carefully select the method of communication and consider its impact on the receiver.

### **REDUCING RISK RELATED TO FAILURE TO DETECT FRAUD OR THEFT**

Fraud is the number one liability concern that an accounting firm faces! If client management commits fraud, the accounting firm is at serious risk. In addition, it is common for clients to seek recovery of damages from accounting firms if the accountant fails to detect a theft committed by an owner or employee of the client business.

The single employee who commits a theft is probably a more common risk than widespread fraud committed by management. The failure to uncover thefts is a common allegation against accountants not only in audit engagements, but also in compilation and write-up services. For compilation and write-up services, the risk is usually associated with

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<sup>6</sup> Jon A. Booker and Susan Coomer Galbreath, *The CPA Journal*, December 1998, page 59.

the smaller client, since they often have weaker internal controls, especially in the area of segregation of duties. In an embezzlement, the aggregate amount of money whose disappearance would not be noticeable or have a detrimental impact to a large company can be devastating to the smaller company. The loss due to a theft of money or other assets by an owner or employee can be quite material to the small company and therefore, exposes the accountant to a very serious liability problem. It should be noted that sometimes embezzlers start out by stealing small amounts occasionally and then in increasing frequency over a three to six year period as they become bolder. Often the amounts stolen aren't material to a company's financial statements in a single year but are significant over the entire period of the theft.

Although no court has ruled that an accounting firm performing a compilation must actively search for evidence of a defalcation, most courts will hold an accountant liable for a defalcation if the accountant ignores obvious problems or detects problems but fails to inform the appropriate parties. Also, the firm should not place undue trust in management representation.

When discussing fraud concerns in an audit engagement, several professional standards need to be identified. SAS No. 1, as amended by SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), states the following.

The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.

Additionally, SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317), notes the following.

Whether an act is, in fact, illegal is a determination this is normally beyond the auditor's professional competence...the determination as to whether a particular act is illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

As a practical matter, by the time a court of law decides whether or not a fraud or theft occurred, it is probably too late for the auditor. The client, shareholders, creditors, or other third parties usually have expectations that the independent auditor should have discovered the fraud or theft. Jury behavior studies also indicate their high reliance on auditor examinations to uncover fraud or theft.

These are high and perhaps unrealistic expectations. Nevertheless, it is advantageous to ensure that all staff members are reminded about the importance of professional skepticism, know the signs pointing to fraud or theft, and ask pertinent questions when the situation warrants. Often, the reasons why accountants disregard evidence of possible errors, irregularities, or illegal acts have to do with budget constraints, lack of time, and client pressure. Any attempt by the client to rush or control audit work should be addressed with extreme caution. Failure to confirm or disaffirm evidence of material misstatements is a major cause of audit failure. Therefore, all evidence of irregularities must be fully investigated. Do not dismiss suspicions of wrongdoing because of client pressure. Additionally, you may need the aid of legal counsel or other expertise if suspicions relate to illegal acts.

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<sup>7</sup> *Accountants' Legal Liability Guide*, San Diego: HBJ Miller Accounting Publications, Inc., 1990, page 4.28.

The following are suggested audit risk assessment criteria.

1. *Management characteristics.* The following may be indications of fraud or defalcations.
  - A single person dominates management's operating and financing decisions.
  - Management's attitude toward financial reporting is unduly aggressive.
  - Management (particularly senior accounting personnel) turnover is high.
  - Management places undue emphasis on meeting earnings projections.
  - Management's reputation in the business community is poor.
  - There are reservations about the competency of fiscal management.
  - Management resists the issuance of a detailed management letter.
  - There are artificially imposed excessive separations of duty.
2. *Operating and industry characteristics.* The following may be indications of fraud or defalcations.
  - The profitability of the entity relative to its industry is inadequate or inconsistent.
  - The sensitivity of operating results to economic factors (inflation, interest rates, unemployment, and so on) is high.
  - The rate of change in entity's industry is rapid.
  - The direction of change in the entity's industry is declining with many business failures.
  - Organization is decentralized without adequate monitoring.
  - Internal or external matters that raise substantial doubt about the entity's ability to continue as a going concern are present.
  - The company has experienced severe losses over an extended period of time.
3. *Engagement characteristics.* The following may be indications of fraud or defalcations.
  - Many contentious or difficult issues are present.
  - Significant difficult-to-audit transactions or balances are present.
  - Significant and unusual related-party transactions are present.
  - The nature, cause, or the amount of known and likely misstatement detected in the audit of prior period's financial statements is significant.
  - A new client has no prior audit history or sufficient information is not available from the predecessor auditor.
  - The audit fee has been negotiated to an unreasonable amount.
  - The audit fee has been so low that inexperienced staff is being used in inappropriate areas.

Some of the more common reasons why financial statement fraud is committed are to—

- Receive performance-related bonuses.
- Meet business goals and objectives.
- Obtain high purchase price for acquisitions.
- Increase value of company stock.
- Dispel negative market perceptions.
- Obtain financing or to obtain more favorable financing terms.
- Demonstrate compliance with loan covenants.
- Demonstrate increased earnings per share or partnership profits (and thereby increasing dividends or distribution payouts).

Professional skepticism cannot be overemphasized. Findings of irregularities, illegal acts or errors must be well documented and carefully communicated to the client's audit committee, or to the highest level of management with equivalent oversight of the financial reporting process, which is typically the board of directors.

This Chapter highlighted areas of liability risks associated with traditional accounting services, with the intent of emphasizing the need for risk management at all levels within the firm. The importance of risk management throughout the firm will be further discussed in the following chapters and the upcoming QUIC surveys.



# Chapter 3

## Multidisciplinary and Assurance Services

The introduction of Assurance Services has expanded the vision for the accounting profession, and indeed expanded the types of services being performed by many CPA firms and practitioners. Many firms have already adopted some of these services, and others are exploring the addition of these engagements into their current repertoire of services. This Chapter will discuss potential liability concerns and the impact these services may have on the management of the accounting firm.

The Special Committee on Assurance Services (SCAS) was formed by the AICPA with the following objective.<sup>1</sup>

To analyze and report on the current state and future of the Audit/Assurance function and the trends shaping the Audit/Assurance environment, focusing on the current and changing needs of users of decision-making information and other stakeholders in the Audit/Assurance process and how best to improve the related services provided to those parties. The committee shall consider whether the definition of the Audit/Assurance functions should be modified or supplemented and whether the profession needs an additional set of concepts. In formulating recommendations for improvement and ideas for implementation the Committee shall balance practicality, vision, and the need for change which the study reveals and shall take a long view (example, five to ten years or longer) (1995/96 AICPA Committee Handbook)

The SCAS has defined Assurance Services as follows.

Assurance Services are independent professional services that improve the quality of information, or its context, for decision makers.

In this definitional context, assurance services denote that the service itself will be of value to the user. Although in some instances a final report will be the important or most valued outcome, the SCAS took an open-ended approach to the concept of assurance services, rather than focusing on the goal of report issuance.

The SCAS stated the importance of independence with the following statement.

Independence has been, and will continue to be the foundation of the assurance function.

It should be noted that there are no independence standards unique to assurance services. The verbiage used in the SCAS report can be paraphrased to indicate that the independent accountant should be unbiased regarding the information derived from the assurance services engagement. Most impairment of independence results from direct or indirect

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<sup>1</sup> The final report of the Special Committee on Assurance Services can be found at <http://www.AICPA.org>.

financial interests in the information which is the subject of the engagement. It may also result if a CPA is involved in performing management functions, which may be interpreted as a financial interest or a “mental” interest in the results of the engagement.

In referring to professional services in the definition, the SCAS indicates the need to apply professional judgment to the services and to conform to Rule 201 of the AICPA Code of Professional Conduct. Rule 201 requires accountants to comply with the following standards for all engagements:

- Professional competence
- Due professional care
- Planning and supervision
- Sufficient relevant data

The SCAS defines quality as encompassing both reliability and relevance. The decision maker’s needs are the key determinant in defining the quality of information. The decision makers should be viewed as the customers, with the emphasis on serving their needs, even when the decision maker is not the client. As a general rule, these engagements will involve three parties. The assurer provides assurance that assists one party in making a decision involving the accountability or oversight of the other. In contrast to consulting services, which are designed for an outcome and intended to assist a client in directly improving a condition, assurance services focus on providing decision makers with information necessary to make the best decision.

It should be noted that not all assurance services are attest-level services under the AICPA *Professional Standards*. How the particular service is structured has a direct impact on whether it is a consulting service, attest service, or assurance service, which falls under general professional standards. See the discussion under performance measurement services and elder care for additional consideration.

Of course, the accounting firm should not render services in which its practitioners are not technically proficient. The scope of services offered not only varies with the needs of the client, but also should be limited to the level of the accountant’s professional knowledge and skills. Additionally, each client should have an engagement letter, carefully developed and modified for each client.

The AICPA and several state societies provide CPE courses and conferences along with other materials to educate members and other accounting professionals in assurance services. Furthermore, the AICPA has developed practice aids and handbooks for assurance services. The AICPA’s Web site or your state CPA society’s Web site can provide additional information on course and conference selection and availability of materials.

## **BUSINESS PERFORMANCE MEASUREMENT**

Business performance measurement is the identification of critical success factors that lead to measures that can be tracked over time to assess progress made in achieving predetermined goals. It is sometimes referred to as strategic performance measurement and provides additional, useful information to decisions makers about an organization’s accomplishments of its goals and objectives. Although business performance measurement



gained prominence in the 1990s as an effective management tool, the current definition has been expanded to include many types of financial measures as well as various nonfinancial measures.

Since business performance measurement is not a periodic activity, but rather an ongoing process, CPAs can provide valuable assistance in the integration of performance measurement with the client's other information systems.

The SCAS described a number of services under the umbrella of performance measures. Depending on how these services are structured, they may be consulting services or attest services, and some may be assurance services, which fall under general professional standards. The SCAS also indicated that assurance on performance measurement services could be provided under current professional standards. The identified services include—

- Assessing the reliability of information being reported from the entity's performance measurement system for a pre-existing system.
- Assessing the relevance of the performance measures, which the organization has already developed.
- Identifying relevant performance measures.
- Assisting in the design and implementation of a performance measurement system.
- Assisting and advising the organization on improving its performance measurement system and its actual results.

Assurance on Business Performance Measurement is often viewed in the following seven steps or phases.

1. Management support
2. Assessing current systems
3. Identifying critical success actions
4. Developing performance measures
5. New system implementation
6. Evaluation of the new performance measurement system
7. Acceptance of the system

Although these assurance services continue to evolve, some considerations should be carefully reviewed by the accounting firm involved in providing business performance measurement services. Some of these considerations include the following:

- Staff knowledge of client and expertise in client's business and industry
- Client acceptance, upper management buy-in, and evaluation of prior planning efforts
- Development and communication of an effective engagement letter that clearly describes duties, responsibilities, timing, and other factors inherent within the scope of the engagement

Since these engagements often involve a planning and project team, communication becomes critical regarding the project plan, expectations, and assigned responsibilities. Effective and frequent communication and documentation is essential for a successful engagement and to avoid potential liability risk.

## **ELDERCARE**

ElderCare services capitalize on the CPA's reputation for independence, objectivity, and integrity. The SCAS describes the nature of ElderCare services as follows.

ElderCare is a service designed to provide assurance to family members that care goals are achieved for elderly family members no longer able to be totally independent. The service will rely on the expertise of other professionals with the CPA serving as the coordinator and assurer of quality of services based on criteria and goals set by the customer. The purpose of the service is to provide assurance in a professional, independent and objective manner to third parties (children, family members or other concerned parties) that the needs of the elderly person to whom they are attached are being met.

It is recognized that the concept of ElderCare will involve several different types of CPA services, including one or more of the following: (1) consulting services, (2) direct service provision, and (3) assurance services. Independence issues could result if an accountant is providing direct services to a particular elderly person while concurrently providing assurance services to other parties regarding that same elderly person.

### **Consulting Services**

The consulting services portion of ElderCare positions the CPA as the focal point to assist family members in identifying the standard of care needed and expected for care of the elderly person. This could involve providing listings of services and options available within the community or the establishment of (1) goals for assistance, (2) customized delivery plan, along with the type of providers required to accomplish the identified care goals, and (3) expectations of required level of performance from each care provider, including criteria identification to be used to measure performance.

Within the consulting portion, several areas of service pose potential liability risk to the accounting firm. ElderCare is a specialized and wide area of service. Each plan must be tailored to the individual and their circumstances. Adequate planning, understanding, and communication regarding the established goals, and the tailoring of the plan become extremely important to the success of the engagement. Additionally, the expectation of the required level of performance for each service provider needs to be well understood and once again tailored to the specific engagement. Communication and documentation are pivotal risk concerns during the ElderCare engagement as the CPA will be directing and working with numerous external professionals. The risk is heightened when working with multidisciplinary professionals that may be quite outside the current realm of the CPA's practice.

Selecting caregivers is an important part in the care of the elderly. Since established criteria does not exist to measure the effectiveness of caregivers (home health agencies, nursing and sitting services, housekeeping services), CPAs must be extremely cautious when discussing or making recommendations regarding caregivers. Additionally, CPAs must proceed with caution when involved in communicating the expectations of required level of performance to service providers. Since it is extremely important that providers have a very clear understanding of the expectations, it is best if this is accomplished with formal, written agreements between the provider and responsible family members. Firms may need to seek legal or healthcare expertise to assist in this documentation.

### **Direct Service Provision**

At times, the CPA is engaged to take a more active role in the management of elderly care, and perform accounting and supervisory tasks that would usually be performed by the elder or a family member. In these situations, the accountant is acting in the place of the client, for example, ensuring that income due the elder is received and properly deposited, monitoring of investments, review of invoices and payment of bills, including those for care providers, and arranging necessary transportation for doctor visits and household matters.

Once again, the CPA providing ElderCare services may be influencing or directing the activities of a multidisciplinary team, which may include geriatric care providers, elder law attorneys, insurance agents, stockbrokers, physicians, trust officers, and financial planners.

The type and level of direct services provided will certainly vary according to the scope of the ElderCare engagement. When expanding the direct services offered to care for the elder, the CPA must proceed carefully and take appropriate steps to ensure that communication is thorough, understood, and properly documented. This is especially true when identifying the scope of service and CPA responsibility in the area of investment monitoring. The firm is exposed to an extremely high risk situation if it expands its service or accepts responsibility beyond receiving reports, recording the necessary information for tax and accounting purposes, and ensuring that investments are being handled in accordance with instructions from the client. This should be carefully avoided by defining the scope and limitations of this service in the engagement letter, and by ensuring clear communication and documentation of responsibility and accountability for investment monitoring.

### **Assurance Services**

Assurance services describe the analytical services that are somewhat related to the attest function that CPAs are familiar with and already provide. The difference, however, is that these ElderCare services reflect the assurance of services, not historical financial statement reporting.

Assurance services provided may include reviewing financial transactions, inspecting logs, diaries and other evidence (including direct observation) to ensure that agreed-upon performance criteria are met, investigating and providing information to responsible parties and reporting findings to the client or other concerned family members.

Caution is necessary in the performance of ElderCare services. CPAs must demonstrate that all appropriate and acceptable professional standards are being followed. Additionally, firms should consider several concerns associated with ElderCare services and potential liability issues. These concerns include, but are not limited to the following:

- Sufficient staffing levels within the firm with the necessary expertise, including crisis management and knowledge of the aging process (both normal and abnormal); insurance and long-term care; Medicare, Medicaid (and the criminal penalties that can be applied); and wills, trusts, and advance directives
- Potential disputes involving client, family members, care providers, and other professionals concerning objectives, level of care and financial matters

## ***Risk Management***

- Issues of trust, the skepticism of family members about CPA intentions, suspicions of undue influence to acquire part of the estate, and the theft of assets
- Potential of utilizing or associating with unqualified, unprofessional, or fraudulent “professionals,” care providers, or family members
- Required licensing of multidisciplinary team members
- The firm’s professional liability insurance policy and coverage concerns
- Adequate liability insurance policy of multidisciplinary team members
- Current and appropriate licensing of selected multidisciplinary team members

Last, it is highly recommended that firms develop a system of quality control that encompasses all ElderCare services and not just those that fall under the guidelines of the Statements on Standards for Attestation Engagements (SSAEs), Statements on Standards for Accounting and Review Services (SSARSs), and Statements on Auditing Standards (SASs). By having an overall system of quality control in place, you increase the likelihood that your services will be competently delivered. This will also increase the likelihood that your ElderCare practice will be successful, and it may reduce the level of risk exposure.

## **RISK ASSESSMENT**

Risk assessment assurance services build upon skills utilized in traditional services and can be provided to a CPA’s existing clients. The SCAS felt these services could be offered now by CPAs with the appropriate skills and resources. Assurance on risk assessment provides useful information to decision makers about an organization’s ability to identify and manage its risk. Measurement criteria for this service will be engagement-specific. The SCAS highlighted three types of assurance services that CPAs can offer to help clients identify and manage risks. The services are the following:

- Identification and assessment of potential overall risks faced by an entity
- Independent assessment of risks identified by an entity
- Evaluation of an entity’s system for identifying and limiting risk

Risk assessment involves determining the likelihood of an adverse event as well as its potential impact on an entity. Risks are generally classified as (1) environmental, (2) business process or asset risks, and (3) information risk. In general, the risk assessment process includes the following:

- The establishment of objectives (operations, financial reporting, and compliance) and systems to track achievement of objectives
- Risk identification, both internal and external
- Risk analysis, involving the following:
  - The likelihood of occurrence of the risk
  - An estimate of the potential impact of the risk
  - Identification of activities or controls which could lessen the likelihood of occurrence of the risk or mitigate its potential impact
- Risk management and monitoring

Careful and thorough understanding and agreement with the client regarding the scope of the risk assessment engagement is critical. Identify the intended users of this service at the client and formalize the process for reporting findings, including the provision of reports. Managing client expectations or perceptions will be one of the keys to a successful project. Reports are usually one of the valuable tools provided to the client during these engagements, and therefore must be carefully crafted and thoroughly reviewed.

## **WEBTRUST SERVICES**

The anonymity of electronic commerce (e-commerce) makes it crucial that people know with whom they are doing business. Without this assurance, the authenticity of the transaction may be questioned, fraud might occur, and payments for certain transactions might be lost or diverted. The potential for fraud, dispute, and other business risks in this new environment obviously is much greater.

The growth of e-commerce requires the reduction or elimination of the barriers that companies normally employ to bar unauthorized outside access to critical company information and resources. Literally hundreds of persons outside of the company may be able to authorize or influence changes in production levels, shipments of goods, and funds transfers. The promise of e-commerce is best fulfilled through the relatively unrestricted flow of information and decentralization of authority. The new system of commerce requires new concepts of control, authorization, confidentiality, and anonymity.

WebTrust is an examination-level attestation engagement provided by specially licensed public accounting firms. The WebTrust practitioner “audits” the online business to verify compliance with Principles and Criteria. The Principles and Criteria address matters such as privacy, security, availability, confidentiality, consumer redress for complaints, and business practices. The American Institute of Certified Public Accountants (AICPA) and the Canadian Institute of Chartered Accountants (CICA) have developed the WebTrust Principles and Criteria jointly. In the United States, the WebTrust engagement is performed in accordance with AT Section, *Attestation Engagements* (AICPA, *Professional Standards*, vol. 1, AT sec. 100), requirements.

CPAs can provide a valuable service by helping to address the risks and promoting the integrity and security of electronic transactions, electronic documents, and the supporting systems. The CPA would provide assurance to e-commerce participants that the e-commerce service providers and the tools and systems in use are functioning in accordance with the WebTrust principles. This would be similar to today’s attest engagement regarding management’s assertions that its internal control structure conforms to accepted standards.

The AICPA offers the new and approved WebTrust 3.0 family of services to provide best practices and eBusiness solutions for Business-to-Consumer and Business-to-Business Electronic Commerce, for Service Providers, and for Certification Authorities through practitioners.

### **WebTrust On-line Privacy Program**

Consumer fears have spawned intense interest among business, governmental agencies, and watch dog groups in the United States and elsewhere. The WebTrust On-line Privacy program offers assurance for business managers and consumers alike as to how personal information is stored and shared in today’s business.

### **WebTrust Security**

Consistently, security is rated among the top concerns of business customers and online shoppers alike. WebTrust practitioners can evaluate the site's security measures from all angles, including access, disaster recovery, and security policies, procedures, and controls and report on the web site's security and provide assurance to users.

### **WebTrust Business Practices/Transaction Integrity**

For many seasoned Internet shoppers, worries about doing business with an anonymous company online present a barrier because dot coms have sometimes come up short in delivering on promises for important matters such as shipping and complaints. WebTrust Business Practices/Transaction Integrity services are designed to allay these consumers' fears.

### **WebTrust Availability**

Many service providers, business-to-business, and business-to-consumer sites are finding that customers and prospective customers are worried about access. A global business exchange that positions itself as an international clearinghouse stakes its reputation on being available for business as promised. WebTrust Availability service is designed to allay customer concerns and giving assurance that the site will be there as promised.

### **WebTrust<sup>SM</sup> Consumer Protection**

On-line shoppers consistently cite privacy and failed delivery promises as impediments to future purchases. The WebTrust Consumer Protection service uses best practices internationally recognized standards, and a rigorous verification process, to identify areas of potential trouble and provide the road map for quality service.

The AICPA WebTrust program educates CPAs to provide Web-based assurance services to clients. Detailed information on the program can be found at [www.aicpa.org](http://www.aicpa.org).

### **SysTrust<sup>TM</sup> Services**

In their search to provide better service to their customers while reducing costs, companies seek help from the outside and are quickly moving to acquiring services from third-party providers, partnerships, and other types of joint ventures. The choice of a third-party whose systems are not reliable can have a significant impact on business. Some recent examples from the business world are telling in this regard. Company A, a confectionery company, was unable to deliver product in time for the Halloween candy season due to information processing systems problems. The disruption in delivery led to considerable revenue losses incurred by their distributors and retail outlets that carried their products.

Company A is not the only one to suffer losses due to unreliable information processing systems. An online auction site, a day trading site, and a foreign stock exchange all have incurred losses due to information processing system failures. The failures led to larger problems with customers, service providers, and investors. The stock value of these companies reportedly dropped as investors' confidence in the companies suffered once knowledge of the information processing problems became known.

In order to answer the increasing concerns with regard to the unreliable systems, the Canadian Institute of Chartered Accountants (CICA) and American Institute of Certified Public Accountants (AICPA) developed a service of certification called “SysTrust”, intended for CA or the CPA to report on the reliability of a system. The development of this service is part of a broader future vision to supply real-time assurance on informational databases and systems.

SysTrust is an assurance service developed by the Assurance Services Executive Committee (ASEC) of the AICPA and the Assurance Services Development Board (ASDB) of the CICA to be provided by public accountants. It is designed to increase the comfort of management, customers, and business partners with the systems that support a business or a particular activity. Users of this service are shareholders, creditors, bankers, business partners, and third-party users who outsource functions to other entities, stakeholders, and anyone who in some way relies on the continued availability, integrity, security, and maintainability of a system. Unreliable systems experience frequent system failures and crashes that deny internal and external users access to essential services; failure to prevent unauthorized access to the system, making it vulnerable to viruses, hackers, and loss of data confidentiality; loss of data integrity, including corrupted, incomplete and fictitious data; and serious maintenance problems resulting in unintended negative side-effects. The SysTrust service helps differentiate entities from their competitors because entities that undergo the rigors of a SysTrust engagement will presumably be better service providers who are attuned to the risks posed by their environment and equipped with the controls that address those risks.

To earn an unqualified SysTrust opinion, a system must meet all of the SysTrust principles and criteria. The complete list of principles and criteria is available on the AICPA Web site, as are examples of qualified and unqualified SysTrust reports. For more detailed information on the SysTrust Principles and Criteria, visit [www.aicpa.org](http://www.aicpa.org).

Although both the WebTrust and SysTrust assurance services provide a much-needed product for clients of CPA firms today, the public accounting firm must be very cognizant that these are highly advanced services and require the firm to invest in additional training and testing of its staff. As discussed in Chapter 4, “Managing Risk,” the importance of system security and information privacy will continue to drive the demand for these types of services. If CPAs do not provide these types of services, someone else will.





# Chapter 4

## Managing Risk

“No Pain, No Gain” should only be applied in the gym—not in business! However, since most of us believe that the greatest gains come from areas of greatest risk, we must strive to minimize risk and therefore economic loss. Notice that we did not say *eliminate* risk. The objective of this Chapter is to isolate and focus on specific areas within a public accounting practice in which experience tells us the greatest risk exists and there is high exposure to financial loss. Although the examples that follow are based on consulting services offered in a multidisciplinary practice, you should consider that the guidance and recommendations apply to each and every service, each and every time you offer them.

- *The Engagement Process.* We will first examine the engagement process, and then discuss how to focus on the engagement process to minimize risk. From the creation of the engagement letter through the management of the execution phase of an engagement, we will examine potential areas of risk.
- *Policy and Procedures.* Written policy and procedures provide a methodology for documenting what staff should do (policy), when, and how (procedures). Many firms have policy manuals in place for traditional activities such as tax return processing and the audit process. However, we find that the sudden and rapid advancements of technology have left many firms severely lacking, and therefore exposed to risk. There are some policies, which are absolutely necessary today, such as a firm privacy policy and an Acceptable Use Policy for how staff should use the firm’s technology resources.
- *Contingency Planning.* Contingency Planning, or Disaster Recovery Planning and Business Continuity Planning, has long been considered a necessary evil. Contingency Planning today is absolutely necessary. The dependence on technology has changed many of the inherent methods for backup and recovery should “the lights go out”. Today, if the lights go out, what can you do without a computer? The answer—Not much! Having the right plan can also minimize revenue loss and protect your firm from unexpected failures. The risk of a failed computer is very real. It is not a matter of *if*, but simply a matter of *when*. Here, we will discuss the tools you need to evaluate your business contingency plan and minimize the loss attributable to systems’ failure.
- *Security.* Technology has changed the business environment so rapidly that many business professionals have lost control of valuable, confidential property. From the Internet to Information Leak, we will look at what you should know to minimize the threat to your firm’s loss of intellectual property.
- *Privacy.* With all the legislation going through Congress, privacy will be the hottest topic this year. How are you to protect your client’s private and often confidential information? Is your firm taking part in activity that uses client information in ways that were not intended when it was collected? What is your risk of violating your client’s trust and exposing your firm to liability?

## **THE ENGAGEMENT PROCESS: POTENTIAL AREAS OF RISK**

Why do good engagements go bad? The experts tell us (that would be the litigation attorneys) that the following are the four primary reasons that engagements fail:

1. Lack of understanding of the client's expectations
2. Failure to manage the process
3. Lack of adequate resources
4. Failure to begin with the end in mind

Let's take a closer look at each of these reasons why an engagement goes bad and determine how you can avoid these in your engagements.

### **Lack of Understanding of the Client's Expectations**

Seems like a simple statement. Yet, failure to provide what the client actually expected may be number one on the list, and way in front, of all other reasons for failure.

Misunderstanding as to the client's expectations often occurs because we approach the engagement incorrectly. The primary focus is too often to get that signed engagement letter, turn it over to staff, and then move on to the next hot client.

Consider, instead, approaching the engagement as a two-step process. The first engagement should be an assessment to define client's requirements and to document needs. This first engagement should provide multiple alternatives to satisfy these needs. Once complete, the assessment is then refined with the help of the client, and a second engagement is developed to implement the chosen solution. This two-step approach is far superior to the older approach of having a couple of meetings, writing a general scope engagement letter, and jumping into the engagement.

Many times, there are huge differences between what both the client and the firm thought the project would be like when the assessment engagement letter was signed and what the final services turned out to be. This is because, during the discovery phase of the assessment, the firm is at ground level and it is possible to see more clearly why things are done the way they are, find out who the real decision makers are, and determine whether the client has the resources and desire to see the project through to a successful completion. This assessment phase is the right time to determine whether you are compatible with the client, and to learn as much about the client's needs as possible.

### **Failure to Manage the Process**

No one wants to admit they are doing a poor job of managing client engagements. However, sometimes, as a result of stress or overcommitment, firms fail to take the time to make sure they are doing what they should be. What they should be doing is what is defined in the scope of the engagement. If, during this initial work phase, additional needs are defined, the engagement must be modified, in writing, with the client signing off on their agreement to the modifications or extensions defined. *Failure to do this leads not only to lost revenues, but also misunderstandings between the firm and the client.*

One often-heard comment from a partner-in-charge, or the manager of the engagement, is that he did not have time to properly conduct oversight during the engagement. Or, he

says that there is not enough time built into the engagement to bill “management” time. Finally, the argument comes down to the cost of the engagement being trimmed to the point where there is not enough billable time planned to properly manage the engagement. All of these “excuses” are purely myth! When it comes to truly managing a consulting engagement, “oversight” is a perfectly legitimate function.

Management responsibility can only be delegated so far. Thinking of an engagement as a project, your first responsibility when developing the implementation plan is to divide the project into small manageable tasks. As a manager, you must track each task closely throughout the life of the engagement. This does not mean micromanaging or second-guessing the assigned staff. It means having an appropriate number of briefing sessions on a regular basis, either documenting project progress yourself or requiring your managers or supervisors to provide you regular Memorandums for File, which become part of the working paper file. You might also consider forwarding these to the client, asking them to file the documents in their folders after reviewing them and to contact you if there are any points they wish to discuss. The documentation should be factual and concise. Saying as much as possible in as few words as possible should be an art you finely hone. A well-documented engagement is a successful engagement and the lack of documentation leads to failure. If you discipline yourself to document, you will be extremely pleased with the results, and so will your clients.

Another important management element is your visibility to the client. To manage well, you must be visible to the client, as well as to your staff during all phases of the engagement. This presence should be physical with periodic visits to determine whether the client is satisfied with the progress, and to reinforce with staff that you are actively managing the engagement. For example, if the engagement is a technology project, it might include something as mundane as having cabling run at your client’s site. Obviously, you do not need to be on-site for the duration of this phase, and I would imagine that professional staff is not actually running cable and crimping connectors. In most cases you will either recommend a reliable third-party vendor, or your firm may elect to subcontract this service as part of complete turnkey services. This opens you to even more responsibility in the oversight and performance of laborers on the job. In either case, you know enough to tell whether the people responsible are doing a good job. Are they staying out of the client’s way? Are quality materials being used? Simply dropping by and having a presence is appreciated by your client, as well as your staff, and helps to avoid problems later.

As mentioned earlier, oversight is a part of the project implementation process and is billable and worthwhile to your client. You must include time in your engagement for briefing meetings, documentation, and client visits. However, keep in mind that the most important meeting of all is at the end of the engagement. Always make sure that your project team is debriefed at the end of an engagement, asking tough questions and learning how they could do the next engagement better. Remember hindsight is always 20-20. Although some clients will not take the time to debrief you, the really good ones, the long-term relationships you wish to cultivate, are impressed by your openness and desire to do better. They know this will mean savings to them in future engagements. All staff should understand that the purpose of the debriefing is not to assign blame, but to learn. Debriefing meetings are a great time to recognize staff for all the things they did right and also to say, “Let’s do that again!”

### **Lack of Resources**

Many engagements fail because adequate resources were not allocated to the project. If you do not understand the technical requirements of an engagement, make sure someone involved does, and can thoroughly explain options to you. Having the right tools makes the difference. To have a successful consulting practice, you must provide your people with the resources to complete projects, both in a timely manner and with “best practices” techniques. For instance, in a technology consulting practice, this means setting up a “clean room” with test servers, workstations, software, and a library where staff can model solutions, test concepts, and troubleshoot problems without being under the client’s watchful eye. A technology consulting practice can be very profitable. But no one ever said it would be inexpensive to get into. There are critical minimal skills you will have to have on staff such as software knowledge, network operating system setup and administration skills. Other skills can be considered for outsourcing to third parties. This happens when you are unable to afford or do not have enough specific work to justify such resources on a full-time basis.

If you know you will be using third parties to participate in engagements, create these relationships early—*before* you need them. Many firms make the mistake of taking on services they are not prepared to provide directly with the assumption they can contract these services out to “just anyone.” This creates sufficient risk to the firm that you must consider this approach carefully. Although the task may be delegated to others, the responsibility never is! This is true, for the most part, whether you perform the services, or recommend a third party and your client engages them. The only thing your client will remember is that you made the recommendation. The decision to provide services by a third party should be limited to repeat business or demand for specific services which are inappropriate for your firm to offer, such as installing computer cabling. You should identify vendors you want to associate with and check them out carefully in advance. This may mean checking references and visits to their office to see first-hand what type of business they maintain. In some cases, firms have been known to request a copy of the company’s financials so they could determine whether the company had a sound financial standing and not in danger of going out of business, thus leaving the firm in a lurch. You cannot really disassociate yourself from all responsibility for third-party services. You can simply tell the client that you do not offer these services, and let them find someone on their own. If you recommend someone to the client, you ultimately take responsibility and you will receive some share of the blame if the vendor does not perform well. Meet personally with your potential third parties and make sure they understand the CPA model. This includes engagement letters, working papers, meeting time lines, billing, and so forth. You should not wait until you have a signed engagement letter in hand to look for resources. Such actions often lead to failure and exposure to the risk of liability. If you find you don’t have the commitment to resources (skills, time, or staff), then walk away from the engagement or refer it to someone else you trust, and ask the client to remember you the next time.

### **Failure to Begin With the End in Mind**

Risk is created and engagements fail because, as Stephen Covey so aptly puts it, you did not begin with the end in mind. Engagements fail and risk liability is created because of the three primary reasons discussed above. This illustrates that you probably did not give the

engagement enough planning to begin with. You were concentrating so hard on getting the signed engagement letter that you did not think about your destination at the end.

Finally, termination of the engagement is as an important phase of the engagement process as getting the engagement signed and doing the work. As you are planning your engagement letter, you should think about where you plan to be the day you sit with your client and say “This completes this engagement, now what may we do for you next?” No surprises make for happy clients and successful engagements. The best way to plan for your engagement is to break it into small manageable tasks. Each task is a deliverable. Each deliverable is a billable event. This makes for a great formula for success.

The next step is to take each task and flow them into a project management package such as Microsoft—Project®. Using these tools, create timelines and present these to your clients. The client should sign off that they understand and accept each schedule. Good documentation includes Gant charts, Program Evaluation and Review Technique (PERT) diagrams, and calendars. When it comes to minimizing your exposure and risk, it is critical that the client can see you have carefully planned your approach, and they know what to expect and when. In the real world, we know that “stuff happens,” and when it does, you should immediately update the project and present your client and staff with the new information. To minimize your risk, don’t even think of beginning the engagement without a clear understanding of all the deliverables, how you are going to create them, and by what date.

After you have accomplished this detailed planning for the project, and before taking any engagement proposal to your client, put yourself in their shoes and ask yourself these questions.

- Am I qualified to provide my client this service?
- Will this bring tangible value to my client when I am done?
- What would I be willing to pay for this service? (This a much better question than “How much will my client pay for this service?”)

There are many things that make consulting beneficial to your firm, but number one is profit. If you can’t make a profit, don’t do it. If you can’t create repeat clients, don’t do it. If you are not having fun, don’t do it! With all this said, talk with your consulting staff and consider your firm’s current approach to consulting. Is it up to your firm’s standards? Did you or your staff cut corners for the sake of time? Would you be embarrassed to turn the files over to your client or a competitor if they were asked for? Today, consulting services are not subject to the same scrutiny as traditional tax and audit services, but increasingly they will be. As public accounting firms move further into the multidisciplinary services arena, attention to professional guidance, such as the *Statement on Standards for Consulting Services* (AICPA, *Professional Standards*, vol. 2, CS sec. 100), must be carefully reviewed and followed. To manage the entire process more effectively, we recommend dividing engagements into distinct phases or steps. There are many books written on the subject and the number of phases, tasks, and recommended approach varies, so it is best to review several of these on your own and find the process that fits you best. To understand these processes, consider the following as a good example of the phased approach.

### **Phase I—Discovery**

If you think about the last engagement you had that was, let us say, not as successful as you would have liked, did the problems start at the beginning of the engagement? To be a successful consultant, you must have a well-defined engagement process. Many of your engagements will be with clients for whom you have not provided services before. Find out as much as you can about the client before you write the engagement letter! Answer each of the following before you even begin developing the engagement letter.

- Who is the client?
- Do you have a conflict of interest?
- Are you talking to the right people?
- Is management really committed to the project?
- Are you sure you understand what the client is asking for, and are you qualified to provide the services?

### **Phase II—Engagement**

If you are ready to engage the client, the next step is developing the engagement letter. The engagement letter is a contract for services to be rendered and must be taken seriously. The engagement letter is one of the first items entered into the court record when the client sues you for failure to perform. The typical consulting engagement letter defines the scope of services that the firm is agreeing to provide and the client is agreeing to pay for. Your client signs off that the services you have described are what they want done, and they agree to pay you as defined in the letter. If an engagement fails because you did not perform as promised in the scope of services defined in the engagement letter (and many failed consulting engagements can be traced back to the engagement letter), it will most likely be deemed the firm's fault! Since the greatest risks are with larger, and often more technical, engagements, courts attempt to review the engagement letter (since it is a contract for services) with an eye toward completeness and ease of understanding. Making your engagement letter too verbose, or too simple, in that the description leaves too much to interpretation, will create doubt in the minds of the courts and could go against you in the end.

### **Phase III—Analysis**

This phase is another big point of failure in the consulting process. The signed engagement is your signal to begin. However, your next step is to gather as much information as you can about the project. Interview, read, analyze, review everything, and then review your engagement letter again and determine whether you can still provide the services promised. If the answer to any of the following questions is *no*, or "I don't know," then you need to return to the client with engagement letter in hand and request that the scope be redefined based on your discovery work.

- Is the pricing still right?
- Is the scope of the engagement unchanged?
- Do you fully understand what needs to be done?
- Are you ready to map out a solution?

This is why we recommend, when possible, that there be two engagements—one for discovery and defining the project and another for the services to be provided.

This is the solution planning stage where all the meetings, feedback, and analysis are resolved into a plan of action. A detailed action plan is developed and assignments are made. If your engagement is to end with the written plan, then the document needs to be presented to the client in a form in which they can then take action themselves. If the analysis is part of the larger engagement, then the findings must be presented and signed off on by the client prior to the execution of the next phase.

#### **Phase IV—Implementation**

If the engagement is for you to perform specific services, then Phase IV is where you put your written plan into action. Make sure you do not lose control at this critical stage of the engagement. Often, you will be asked to work with client staff in the implementation process and give direction to person(s) who are not under your supervision. Bottom line is—You can't do this! Be sure you know where the role of the consultant begins and ends, versus the role of the manager. Consultants create solutions and plans; they influence change, but are not directly involved in the change process. Managers implement change and are directly involved in the process. Make sure you do not mix the roles of consultant and manager in the eyes of your client. These need to be separate engagements and are managed differently. There is further reason to be careful where you draw the line with a client. If your firm provides attestation services for your client, you must remain independent. See Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 1, ET sec. 101.5). Therefore, you cannot provide consulting services in which you specifically manage clients' staff or make the final decisions that would affect your clients' business. The client must be the decision maker. Your consulting staff (who may not be CPAs) may not be aware of the fine line that constitutes independence. It is your responsibility to have them review the standards and ensure they understand them.

From time to time, your engagement will require you to provide specific services inside the client's offices and utilizing the client's staff, and are in fact assuming the role of manager. Since the staff does not work for you, assigning tasks, deadlines, and reviewing the product produced becomes very sensitive. Your staff assigned to the engagement must understand their limits and how they interact with the client's staff. This often-stressful situation can be intensified if the staff of the client do not agree with what client management is doing or does not support you in the project. This can easily happen when you are performing a technology engagement that will result in new accounting applications, a change in how the company does business, such as implementing an e-commerce system for instance, or any situation in which the client's staff believes their position or livelihood may be adversely affected. If the client's staff is not supportive of the project, they can do, or not do, many things to sidetrack or sabotage your engagement. In the end, you will suffer the potential liability. Therefore, with engagements that include the client working closely with your staff, the potential risk to you increases significantly. And these sensitive issues must be addressed.

### **Phase V—Termination**

This is the last phase of an engagement and, quite possibly, the most critical to the engagement process. This is also the most difficult phase for consultants to execute properly. Every engagement should have and must have a set defined conclusion. Termination is the defined end to an engagement. This does not mean you cannot enter into additional engagements for services with the client. In fact, all of us want to have a long-term relationship with our clients. However, the client must know when you expect to complete the engagement, and this is your goal throughout the engagement. Let the client know when you are done. Schedule a meeting, then—present a document that illustrates the objectives of the engagement, services you have provided, and the conclusion. This document recaps the delivery of services as agreed upon and should also cite successes or problems as appropriate. If, from the client’s viewpoint, the engagement is ending on a less than satisfactory note, be careful not to minimize issues and problems at the conclusion of the engagement. In all cases, it may be important to maintain evidence of the date the engagement was concluded and even a sign-off by the client in order to defend against any claims beyond the statute of limitations. Cases have arisen months and years after an engagement is concluded. Given staff turnover, the history of engagements is often lost. A written document in the file recapping the engagement and the exit briefing may be strategically important. There is also another “upside” to the exit briefing when an engagement is completed. Internally, this is a great time to share with staff what the firm did right, and what the firm could have done a little better. The exit briefing is also a great time to offer the client additional services!

### **THE ENGAGEMENT LETTER: WHERE IT ALL BEGINS**

The engagement letter may be the single most important instrument to a successful consulting engagement. A key to most traditional accounting services, the engagement letter is often overlooked in the consulting arena. A proper and thorough engagement letter can make the difference in the final success of a project.

The consulting engagement is not precisely an engagement for *agreed-upon procedures*—technically speaking, that is, since under the CPA *Professional Standards*, an agreed-upon procedures engagement is governed by the attest standards. However, the principles behind the process of defining the scope of the engagement and services to be provided do apply. The client being made aware of the services to be provided and the compensation to be paid for those services seems to apply as well. We might also argue that the other principles such as avoiding conflict of interest, standing by professional standards, quality of service, and responsibility to the client should all apply as well.

The following is a traditional engagement letter, which has been in use over fifteen years, with explanations for each section. This is intended to be an example only for discussion of potential risk areas. There are a number of sources from which to obtain sample consulting engagement letters. Also, laws differ by state, as well by country if you do international consulting, so ensure that you have counsel review your standard letters and your approach. If the engagement is large enough or complex enough, you may want counsel to review it prior to execution. We do recommend that your firm select one or a few standard engagement forms and stay with those unless there are extenuating circumstances. Standardizing ensures that everyone follows the prescribed and approved procedures and, once again, limits your risk of exposure and economic loss.



As we go through this letter, we will review specific wording in each paragraph. Always remember that this letter, once signed, is a form of contract, and is, therefore, binding on you and your firm. Also, remember that there should never be such a thing as accidental wording. There should be no such thing as filler either. Every word in the letter should be there for a purpose, and every word should be scrutinized accordingly.

Dear:

This is an open letter *[It is a matter of personal preference to always make the initial engagement letter open so that additional work may be done under the same engagement, with written addendums such as (electronic mail) emails and memorandums filed with the original signed letter. The client does not have to sign each individual engagement. However, don't use this to avoid future engagement letters. For all engagements that represent significant time or investment (more than two hours for instance) or liability, a separate engagement letter should be sent. Depending on the type of services you offer, you might consider issuing a new engagement yearly to establish a statute of limitation date, should liability issues arise.]* of engagement between *[Name of Client]*, hereinafter referred to as Client, and *[Firm name]*. Under the scope of this engagement, *[Firm name]* will conduct the following services. *[You may choose to make the opening paragraph a little more personal, but we do not recommend it. Keep the agreement formal; after all, it is a contract.]* The scope of this engagement shall be as follows:

*[Describe each task that is to be performed, or product to be delivered, under this engagement. Although you want to be specific, this is not the place for too much detail. You are describing an objective or product here, not how the product will be created or delivered. If the engagement is very complex, attach detailed specifications to the engagement letter.]*

Upon completion, you will be presented with a comprehensive report, as well as specific findings and recommendations for action. A preliminary report will be provided during our exit briefing with a comprehensive written report to follow within ten working days. *[Always let the client know what to expect at the end of the engagement, or each deliverable within the engagement.]*

*[Here, you should provide your timetable for executing this engagement.]*

Our fees for services under the scope of this engagement will be \$*[amount]* plus expenses. The Client may request additional services at our standard hourly rate as applicable. *[More detail here as needed. Be specific as to expectations and costs. Don't try to hide the cost, and don't minimize what you believe the expenses will be.]*

All fee estimates are based on experience, an assumption of adequacy of needed resources, internal controls, and the degree of assistance of your staff. Should any situation arise that will materially increase this estimate, we will advise you immediately. All services not included in the scope of this engagement are, of course, on a fee basis with a minimum billing of one-quarter hour as described below. *[This is an important paragraph. Often, the client promises to provide services or resources that do not materialize, or turn out to be inadequate. When this happens, confront the client immediately and provide estimates as to additional fees incurred due to failure on their part to meet their responsibilities. At this point, the client will either find the necessary resources or agree to the additional cost. Liability occurs, or consulting profits are often lost not just because services are not provided or deadlines are not achieved when the client did not meet their responsibility, but because the firm failed to call the client when the problem became known.]*

*[Note the one-quarter hour billing increment. This is also a critical issue. If you get a phone call at the office while you were working on another project, what is your lost time? The call may have only taken five minutes, but what did the interruption cost you? Again, we want to stress the importance of letting your client know how you bill early in the process.]*

### Right of Withdrawal

*[This is a most unusual paragraph, and if you choose to not use it, that is fine. Some users rarely invoke this paragraph because it is in the letter to begin with. Still, it lets the client know that you are serious, and a professional. Because consulting engagements are so fluid, it is important to have a back door from which to exit if the relationship turns sour. This does not mean you bail on the client, but sometimes management changes or other forces affect your ability to complete an engagement.]* You, the Client, may withdraw from this engagement at any time, without cause, should you desire to do so. We do request that you notify us in writing of your decision to withdraw. We also reserve the right to withdraw from this engagement at any time, should we feel that the mutual objectives of this engagement cannot be reached, or if we believe that we cannot properly serve your request for support. Should either party withdraw from this engagement, all fees and expenses incurred to date will be billed and due payable. We have designed this engagement so that it could be done in phases, with each phase being a product in itself. This allows the Client to continue to assess the value of the engagement as it proceeds.

### Fees and Payment

Fees for our services are computed at our standard rates, plus expenses, and are based on the time our service requires. Our current fees for these services range from \$[amount] to \$[amount] per hour. Fees quoted are often based on a composite of the rates of those individuals assigned to the engagement. As with all professional services, actual fees may vary slightly. *[For fixed fee engagements, you will obviously need to restructure this paragraph. We caution, however, on how you negotiate pricing with a client once you deliver an engagement letter. As you have already defined the services to be provided and expenses to be incurred, you have also quoted a fee to provide these services. If you do negotiate a different fee, or change the scope of this engagement, it is recommended that you prepare an engagement letter that reflects the new conditions for the client to sign and void the original document.]*

*Again, a point of contention and liability often arises over the price quoted and what was billed in conjunction with the services provided. It is important that the Client fully understands your fees, how and when they will be billed, and the services they will receive for the amounts paid.]* If the scope of the engagement changes so those fees would be higher than anticipated, we would provide the Client with new estimates for approval immediately. *[Stick to this and your life will be much less stressful. The concept here is not that far from that of the proverbial Change Order! And, if you have ever built a home, you have dealt with the Change Order request. Builders do this to ensure they collect for any cost due to customer changes, and for good reason. Clients will often attempt to throw in little extras that were not part of the agreement, hoping they will get the additional services for free. When this happens, you should advise the client immediately that something has occurred to change the scope of the engagement, define any additional cost, and obtain written approval to proceed. If the approval is given orally, write it up as a Memorandum for File and send a copy to the client for their files. Finally, make sure that all the staff assigned to the engagement know the parameters and what to do if the Client requests additional services, or does not meet agreed up deadlines.]*

Acknowledgment and Acceptance

Please indicate your approval of the terms of this engagement by signing where indicated below. Should you have additional questions, please do not hesitate to contact us.

Very truly yours,

[Name]

[Firm]

*[It is not a good idea to start an engagement without a signed engagement letter. Remember that it is a contract; so make sure the person signing the engagement letter is authorized to bind the client to the terms of the engagement.]*

Accepted by: \_\_\_\_\_

Print name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

This concludes our discussion of the engagement letter process. No matter what you think of the above sample, you must review each and every form letter, contract, or correspondence in your firm and consider each word, sentence, and paragraph to determine whether the words have value, whether they should be there, and whether you are committed to what those words say. If you are not, you may be saying something you are not prepared to defend in a court of law or to an unhappy client.

**POLICIES AND PROCEDURES**

On a regular basis, we read of employers who are sued because employees created a hostile workplace, displayed materials inappropriate to the workplace, or made inappropriate advances to fellow workers via email or company-sponsored bulletin boards. Combine the casual atmosphere of Internet communications with the substantial electronic paper trail that exists, and it's easy to see why the use of *e-evidence* has skyrocketed within the following kinds of litigation:

- Discrimination
- Harassment
- Offensive
- Inappropriate Materials

Our objective in this section is to discuss those areas in which you are creating risk as a result of your own failure to manage technology, which contributes to the liabilities described above. You create risk for your firm as well as potentially for your client if you fail to apprise them of their exposure to risk; you suffer economic loss if your people are not using the technology you provide them for acceptable purposes. All of this happens if you fail to document, or you fail to require your client to document, or you fail to provide your client with the proper documentation to minimize their potential exposure to economic loss, thereby minimizing risk!

## **Discrimination**

Discrimination occurs more often in the workplace than most people realize. Often, we consider discrimination to pertain only to racial or sex discrimination, but this is far from true. Granted, most cases today that we read about do focus on these areas, such as the following.

- A Federal court in New York allowed a class action discrimination suit based on racist emails. The defendant was a large Wall Street brokerage firm and the plaintiffs were seeking \$60 million in damages; see *Owens and Hutton v. Morgan Stanley & Co., Inc.* (96 Civ 9747).
- Female warehouse employees alleged that a hostile work environment was created in part by inappropriate email. Plaintiffs ask for \$60 million in damages, and the case was settled out of court; see *Harley v. McCoach*, 928 F. Supp. 533 (E.D. Pa. 1996).

At the forefront of both of these cases was the use of the companies' email system. Managers today are not prepared to understand the effect that mismanaged email can have on the business.

Technology can also create another form of discrimination. An employee sued a large Midwestern company because the company had begun posting all internal position openings on the company's Intranet, a form of electronic bulletin board in this case. The employee believed that he did not have equal opportunity to apply because he did not use a computer in his job and was not provided open access to the information. In the end, the company had to pay damages, change the way openings were announced internally, and ensure that computers are accessible to all staff.

## **Harassment**

Harassment is not something that any professional would allow to happen in a professional office. However, today's executives are poorly equipped to combat and possibly unaware of a new form of harassment that results from the technology. The following are examples.

- International Microcomputer Software paid a former employee \$105,000 after she received sexually harassing messages on the firm's electronic bulletin board, even though the company reported the incident to authorities and launched an internal investigation. (Staff Writer, CNET News.com. April 14, 1999.)
- Chevron settled a sexual harassment lawsuit for \$2.2 million over email postings such as: "25 reasons why beer is better than women." (Jerry Adler, *Newsweek*, "When E-mail Bites Back," November 23, 1998.)

Without a written policy in place against such behavior, and a method to monitor that they do not occur, management is vulnerable to suits such as these.

## **Offensive**

Offensive content is not as hard to determine as some might argue. The number of cases pertaining to offensive content has risen dramatically over the past few years. The cause for this may be a general lack of understanding, but this excuse will most likely not hold up in court.

- The *New York Times* dismissed twenty-three employees at an administrative center for violating the company's email policy regarding "offensive or disruptive messages, including photographs, graphics and audio materials." (Staff writer, *New York Times*, December 1, 1999.)
- The Xerox Corp. fired approximately forty people for viewing pornographic sites at work. (Richard Mullins, *Rochester Democrat and Chronicle*, October 7, 1999.)
- At least six employees of the U.S. Navy Naval Supply Systems Command (NAVSUP) have been or are expected to be suspended for circulating "inappropriate, adult humor material" in emails. Another five hundred were reported disciplined. (Staff writer, *The Sentinel*, December 4, 1999.)

### **Inappropriate Materials**

Material deemed inappropriate to the workplace is not brought into the workplace and certainly not displayed or sent to anyone else whether they consent to it or not. Here are a few notable cases from the past few years.

- The Justice Department's antitrust lawsuit against Microsoft Inc. is based in large part on internal email messages about efforts to insert a bug into Microsoft products to disable competitors' products. (John R. Wilke, *Wall Street Journal*, August 27, 1998.)
- The defense contractor Raytheon sued twenty-one John Doe employees for posting company confidential information on the Internet. Two workers have since been identified and have elected to resign. (Staff Writer, CNET News.com. April 6, 1999, 1:30 p.m. PT.)
- The restaurant chain Shoney's is demanding that Yahoo reveal the identity of one hundred people who posted confidential information concerning restaurant closings and an alleged pending bankruptcy filing on message boards. (Staff Writer, CNET News.com. April 12, 1999, 5:00 a.m. PT.)

Over the past few years, it has not been unusual for consultants to be called upon in situations where employees were found to be using their company's computers for purposes "deemed inappropriate to the workplace." In one instance, the offending party claimed that the material on her machine was nothing more than a couple of risqué cartoons (it was much more), and that, at the worst case, she should only receive a slap on the hand and maybe the loss of a few days' pay. Management believed otherwise, saying that someone in her position of responsibility (head of personnel) should have known better. They sought a termination, an action that will go to a board of review and possibly a courtroom.

It is very clear that obscenity and pornography absolutely cannot be tolerated in the workplace. Aside from any personal reasons that may exist, it is against the law. With the emergence of e-evidence, the plaintiff's ability to subpoena email messages and the history of sites a person visits, the ability to prove a case is significantly easier. Again, a business that does not have appropriate written policies in place and a method to monitor employees has little chance of defending themselves in court.

The best way to truly protect the best interest of your firm, and minimize risk, is to place the proper written policies in place. Although there is no single right policy statement, we have researched a number of examples and compiled a sample that seems to cover the

territory. As always, this is only a sample, and we suggest you seek the advice of counsel before implementing your own version.

### **The Acceptable Use Policy**

The Acceptable Use Policy defines the acceptable use of automated data processing equipment, software, and communications as provided by your company. Everyone in the company must be expected to follow the written policy without exception. The policy should be both in writing, and perhaps placed on the company Intranet for easy access.

From the earliest time, there have been policies on the use and distribution of passwords and confidential information. When the first personal computers entered corporate America, management responded with Personal Computer Use policies. Then along came email, and a few leading firms developed Electronic Mail Policies. Today, all these have been merged into one comprehensive document known as the Acceptable Use Policy. To provide guidance, and also define how inappropriate use creates risk for your firm, consider the following.

With the availability of information on the Internet today, the temptation to copy this information and use it for personal gain is almost overwhelming. Music is distributed freely via a number of on-line music sites. Many of these sites act as peer-to-peer exchanges where people can share music they have copied from CDs. If you knowingly, or unknowingly, allow employees to use your firm's computers to copy and distribute copyrighted material, music, text, or images, you are liable and responsible! The first step is to explain to your employees that such activities will not be tolerated. The next step is to have a statement, such as the following, in your Acceptable Use Policy to reinforce the point.

Users will not violate copyright laws and their fair use provisions through inappropriate reproduction and/or distribution of music, movies, computer software, copyrighted text, images, and so on.

Computer hackers are very smart people; you do not think they would always use their own computers at home to hack into unauthorized sites, do you? No, they will come in early, work through lunch, and stay late. They could be using your computer resources and Internet access to gain entry into sites they are not authorized to visit. Many offenders tell judges that they only visited pornographic sites during lunch and did not force their views on anyone in the office. The idea being, of course, that they did what they did on their own time and not the employers and did not intend to offend anyone. Sorry, this does not fly either!

Users shall not use company computers or network facilities to gain unauthorized access to any computer systems. Using programs intended to gain access to unauthorized systems for any reason or purpose is strictly prohibited.

This is a great time to introduce the concept of *information leak*, a new term for a high-tech economy. Actually, the idea is not new at all, just the vehicles for making it happen. Remember in the early 1980s when managers became concerned that employees would copy confidential or private information onto floppy disks and take them when they left the company? Ah, we wish for the good old days. Today, the number one cause of information leak is handheld devices and inappropriate use of the Internet.

Handheld devices include such devices as the popular Palm, or WinCE operating system devices. We consider handheld devices today to be where the first microcomputers were twenty years ago. Many on your staff are bringing small, convenient, and powerful tools into the workplace without the authorization or approval of management. A simple software application is loaded on the user's workstation and a docking station for the handheld is attached. Within a few moments, the user can synchronize the handheld device with your corporate personal information management system. In moments, your entire client database, contact information, manuals, and nearly any piece of information on your network can be transferred to these deceptively small, but powerful devices.

Now, before you panic, we are not saying that this technology is not beneficial to your organization. They can make your people more productive, save time, and increase productivity. Yet, these same tools are routinely removed from your offices and carried about. They are lost in airports and left laying on tables at meetings. Without proper guidance, in the form of written policies and procedures, you are leaving yourself exposed to risk. The private and confidential information of your company is on those devices. So, until you develop these policies and determine how these devices can best serve your company, add the following to your Acceptable Use Policy.

Users shall not connect unauthorized equipment to company equipment—including but not limited to handheld devices, docking stations, hubs, routers, printers, or other equipment connected to the company's network directly or via remote attachment.

Many network administrators and managers feel comfortable with their system security, but consider this. The firm's practice management and accounting software has all been password protected, so only users who are authorized may access information via the applications. What many people fail to realize is that although the application may be locked, the database file structure may be wide open. With all operating systems today, file access rights must be declared according to user and user group specifically. Failure to do this may make the files accessible by anyone. When mainframes ruled the day, only a select few even knew how to access data files, much less open them up and extract the information. Today, children have enough understanding of computers to open and view files. Many of your staff, fresh out of college, has all the skills necessary to search for, open, and view data that is not properly secured. Although a written policy itself will not prevent unauthorized intrusion into data files, the threat may go a long way to stopping the simply curious.

Users shall not make unauthorized attempts to circumvent data protection schemes or uncover security loopholes. This includes creating and/or running programs that are designed to identify security loopholes and/or decrypt intentionally secure data.

Business owners must take the loading and running of unauthorized software very seriously. First, unauthorized files may carry computer viruses that jeopardize the safety of your computer and stored data. Second, in today's litigious environment, unhappy employees or terminated employees are quick to turn your company into one of several entities that monitor the illegal use of software. Firms today must have a solid written policy that the firm will only load and use licensed, legal software, and that—

## ***Risk Management***

Users will not violate terms of applicable software licensing agreements or copyright laws.

Users will not knowingly or carelessly run or install on any computer system or network, or give to another user a program intended to damage or to place excessive load on a computer system or network. This includes but is not limited to programs known as computer viruses, Trojan Horses, and worms.

Users will use company resources solely to conduct company business. Use of company resources for commercial activity, such as creating products or services for sale is strictly prohibited.

Finally, to minimize exposure to the risks we discussed above relating to email and inappropriate use of the firm's technology, we suggest the following items be added to your Acceptable Use Policy as well.

Users will not use email to harass or threaten others, or to send materials that could be deemed inappropriate, derogatory, prejudicial, or offensive. This includes sending repeated, unwanted email to another user.

Users will not use email on company-owned, company-sponsored or company-provided hardware or services to transmit any information, text, or images that could be deemed inappropriate, derogatory, prejudicial, or offensive.

Users will not initiate, propagate, or perpetuate electronic chain letters.

Users will not send mass mailings that are not directly associated with or in the performance of the routine course of duties or assignments. This includes multiple mailings to newsgroups, mailing lists, or individuals, for example, "spamming," "flooding," or "bombing."

Users will not forge the identity of a user or machine in an electronic communication.

Users will not transmit or reproduce materials that are slanderous or defamatory in nature, or that otherwise violate existing laws, regulations, policies, or which are considered to generally be inappropriate in a workplace.

Users will not display images or text that could be considered obscene, lewd, or sexually explicit or harassing in a public computer facility or location that can be in view of others.

Users will not attempt to monitor or tamper with another user's electronic communications, or read, copy, change, or delete another user's files or software without the explicit agreement of that user.

The list above defines each of the specific areas of concern a company usually encounters. The following takes these concerns and places them in an appropriate text for a policy statement. Again, you should review your policies carefully, and have them reviewed by legal counsel to ensure that the wording and enforceability are appropriate to your geographic area.

The following sample policy will give you some guidance in the development of your own.



**Acceptable Use Policy for Sample Company**

Sample Company encourages the sharing of information, comprehensive access to local and national facilities to create and disseminate information, and the free expression of ideas. General-access facilities and infrastructure are provided to further these purposes. There is an obligation on the part of those using these facilities and services to respect the intellectual and access rights of others—locally, nationally, and internationally.

Computing resources and facilities of Sample Company are the property of the company and shall be used for legitimate activity related to the performance of the duties and responsibilities of the users only, administrative, public service, or approved contract purposes. Supervisors may, at their discretion, allow personal use by the employee of these resources that does not interfere with the institution or with the employee's ability to carry out company business. Individuals who disregard elements of this policy will be subject to appropriate disciplinary and/or legal action by Sample Company. Use of company computing facilities for personal or commercial use is not authorized. Use of company computing facilities for educational purposes must be consistent with other training educational programs. The use of company computing facilities for higher education degree-seeking or certification programs may only be done with the specific written approval of the appropriate supervisor.

Individuals and noncompany organizations using the company's facilities to gain access to noncompany facilities must be cognizant of and observe the acceptable use policies of the company at all times.

Failure to observe these policies will result in the immediate disconnection or loss of use privileges, as well as possible disciplinary action or termination at the discretion of the offending party's supervisor or department head based on the nature and severity of the offense.

Unauthorized viewing or use of another person's computer files, programs, or data is prohibited. All users should also be aware that all programs and all files are deemed to be the property of the company, unless the individual has a written agreement signed by an appropriate representative or officer of the company. Federal or state law may require disclosure of individual computer files that are deemed public records under the state public records statute. State and federal law may prohibit the disclosure of certain records as well.

Entry into a system, including the network system, by individuals not specifically authorized (by group or personally), or attempts to circumvent the protective mechanisms of any system, are prohibited. Deliberate attempts to degrade system performance or capability, or attempts to damage the systems, software, or intellectual property of others are prohibited.

The electronic mail system shall not be used for the "broadcasting" of unsolicited mail or for sending chain letters, and the communication system shall not be used for the sending of material that reasonably would be considered obscene, offensive, or threatening by the recipient or another viewer of the material.

The company reserves the right to monitor and record the usage of all facilities and equipment, and all software which is the property of the company by ownership, lease, rent, sponsorship, or subsidy, if it has reason to believe that activities are taking place that are contrary to this policy or state or federal law or regulation, and

as necessary to evaluate and maintain system efficiency. The company has the right to use information gained in this way in disciplinary or criminal proceedings.

The Federal Copyright Act nearly always protects commercial software. Use of company facilities or equipment for the purpose of copying computer software that does not contain specific permission to copy (some licenses do allow the making of one copy for backup) is prohibited. The unauthorized publishing of copyrighted material on a company server is prohibited, and users are responsible for the consequences of such unauthorized use.

An individual's access to computer resources may be suspended immediately upon the discovery of a violation of this policy.

This policy contains the company's complete acceptable use policy and replaces any pre-existing policy issued before [Month, Day, Year]. For questions about this policy, contact [Name and Contact Information Here].

Failure to comply with any of the above policies may result in termination of your network services, disciplinary action, and/or criminal prosecution. The company reserves the right to terminate any company network connection without notice if it is determined that any of the above policies are being violated.

## **CONTINGENCY PLANNING**

Management today must be keenly aware of how technology has affected the fragility of our work environment. Imagine for a moment that your computer, your network, all your servers just went down. What will you do next? You have a staff of one hundred, all with an average billing rate of, let's say, one hundred dollars per hour, just to make the math easy. How long can you stand losing ten thousand dollars every hour? Perhaps this scenario is a bit overdramatic, but then again, maybe not. In most business environments today, we are so dependent on technology that the loss of our systems for any extended period of time could be catastrophic. There have been reports of companies who never recovered from a major loss due to catastrophic failure. This failure may have been caused by simple mechanical failure or a force of nature like a hurricane or tornado, or a simple brownout or planned blackout.

For many years, disaster recovery was only necessary to combat such events as natural disasters like fire, hurricane, tornadoes, and so forth. Since those early days, Disaster Recovery has evolved to encompass principles of Business Continuity Planning, and Business Continuity Planning has expanded to encompass Contingency Planning. (For this discussion, we will use the common term *Disaster Recovery* to also include Business Continuity Planning and Contingency Planning.)

The drawback to each of the terms is that they often limit what constitutes a disaster. Most managers think of disasters in terms of catastrophic failure. Catastrophic failures occur due to natural disasters, acts of war, or criminal actions. In this discussion, we will maintain that there are at least four levels of disasters and that there are risks of loss at each level. Although disasters cannot be prevented, they can be minimized and significant savings realized. Picture that it is April 15 and a large, mean, and very important client is due in an hour to pick up his return. Having your printer fail may be minor disaster—but it could be a major calamity for you at that moment! Also consider that any failure of equipment or limitations placed on your ability to work can affect your ability to meet commitments or perform services, therefore, creating risk and potential loss of revenue.

Again, management's focus has always been on preventing or minimizing the possibility of large-scale failures. Today, our experience indicates that the cumulative loss from small technology failures, called Level 1 failures, are actually greater than for a single Level 4 failure, a catastrophic failure. In this section, we will discuss the four levels of failure and how to minimize your risk or exposure to failure.

### **Level 1 Failures**

- A Level 1 disaster can be remedied in less than four hours.
- A Level 1 disaster has a minimum economic impact.
- A Level 1 disaster is defined as having a very limited impact.

An example of a Level 1 failure might be a printer that is out of toner, a network interface card or network connection that fails, maybe even a software applications that fails because security was not assigned. Consider a single or a group of workstations that are down because of a power supply or hub that is not working.

All of these can be remedied fairly quickly. All of these happen in your office every day and you don't even think about them. But wait—that's the problem! You don't even think about them. Now would be a good time to consider your staff's hourly rates, or hourly cost and then multiply the cost of Level 1 failures over a year. If you think the number could be a large one, you are correct. But, you ask, "How can I avoid a network card failing, or a printer running out of toner?" By planning and managing, that is how. An act as simple as deploying a Help Desk in your organization to record and track all incidents can go a long way to reduce or minimize such failures and while you may not be able to eliminate all failures, a small fortune can be saved by minimizing their effect.

Products like Track-It from Blue Ocean Software, [www.blueocean.com](http://www.blueocean.com), is one such solution. Priced under \$500 for a single user copy and under \$1000 for multi-users (special pricing for Enterprise needs), Help Desk software like Track-It can be used to inventory all hardware and software by workstation. By tracking all problem calls, the system can alert your technology staff of a pending problem and take a positive corrective action. Help Desk software can also eliminate a common support problem of technology staff trying and retrying the same procedures to no effect, because they did not know that other staff had already tried the solution and it had not worked. For smaller firms without technical staff, or the financial resources for Help Desk software, consider using off-the-shelf generic software to help you manage your technology. Simple Access forms and database tables can be created to track problem calls and resolutions as well as maintain hardware and software inventory information. If you are not an Access user, consider doing the same thing with an Excel spreadsheet. The important thing is to log and track problems to identify a pattern of problems and take remedial action minimizing economic loss.

Other preventive actions include a policy to replace toner cartridges in all printers every so many months. For instance, a firm policy to replace toner in all tax department laser printers every three weeks (the actual time will depend on the number of users, volume, and experience) and not waiting for a call to come that the printer is not working. In the end, your staff's time is far more valuable than the cost of a toner cartridge, and it only takes a few minutes of nonproductive staff time to generate a loss.

### **Level 2 Failures**

- Level 2 failures can be remedied in less than twenty-four hours.
- Level 2 failures have an economic impact, but are generally not considered significant.
- A Level 2 failure is defined as affecting a larger group of users or network segments.

An example of a Level 2 failure might be a CSU/DSU or network server that brings down all users in a department, or perhaps a truck that runs into the phone pole in front of the office, taking down the branch communications to the main office.

Again, there is no way to prevent a Level 2 failure from occurring; the skill is minimizing the effect. What will your staff do when a Level 2 failure occurs? Will inventory items be lost? Will errors occur that could result in a lawsuit or loss of a client down the road? The effects of Level 2 failures are minimized by having tested the Business Continuity Plans that are in writing, and meant to instruct staff as to what they should do, who to call, and what actions to take if the press shows up! Written plans are necessary, but testing them is even more important.

### **Level 3 Failures**

- Level 3 failures can be remedied in less than seventy-two hours.
- Level 3 failures have an economic impact and are generally those conditions defined in the Risk Assessment process.
- A Level 3 failure is defined as a point of failure that affects a significant number of mission critical users.

When a Level 3 failure is declared, the business must determine whether it is necessary to implement the organization's Disaster Recovery Plan. Level 3 failures can escalate to Level 4 quickly. Note the defined period of time for level 3 failures is identified as less than seventy-two hours, or three business days. Beyond this, we find that the risk of loss increases dramatically. When a business suffers a failure of this length of time, they typically fall back to some type of manual system. These systems weaken and fail rapidly beyond three days as staff becomes hurried, or lax, in recording information or maintaining that information for later entry when the computer system returns. Some businesses could not even afford to be down this long. Imagine a public accounting firm that loses its computers on March 9; just before corporate returns are due to be filed!

### **Level 4 Failures**

- Level 4 failures exist when the organization experiences a catastrophic failure.
- Level 4 failures have a significant economic impact and must be defined in the Risk Assessment process.
- When a Level 4 failure is declared, the organization activates its Disaster Recovery Team and executes the Business Continuity Plan.

The objective of the Disaster Recovery Plan is to allow you to continue to operate during a disaster, even if at a diminished level. Your goal is to be self-sufficient to the lowest level possible. Catastrophic failures are typically brought on by natural disasters such as hurricanes, tornadoes, or fire. These types of occurrences are expected in many parts of the

country and planning for them is absolutely necessary. The attitude of *when* and not *if* is very helpful in preparing for Level 4 failures. Level 4 failures assume the activation of your Disaster Recovery Plan and the need to acquire equipment, software, and relocation to an alternate site. Note that Level 4 disasters are declared when you anticipate being down for longer than seventy-two hours. You may have a bad storm come through that takes your systems down, but if you can be back up and running in less than seventy-two hours, then the disaster may only be categorized as a level 2 or 3.

### **If You Fail to Plan, You Plan to Fail**

Planning for the emergency response in the aftermath of a disaster is a complex task. Preparation for, response to, and recovery from a disaster affecting the functions of the organization requires the cooperative efforts of many support organizations in partnership with the functional areas supporting the “business” of your company. The Disaster Recovery Plan is a formal document that records the objective of the overall plan. Who is responsible? How will the recovery take place? Involvement and commitment to the process begins in the boardroom, not the back room. From the highest level of the organization, there must be a commitment. Like all good projects, the planning process begins in committee. There are three well-defined groups as follows:

- Contingency Management Steering Committee (CMSC)
- Emergency Response Teams (ERT)
- Functional Area Recovery Management (FARM) Teams

The CMSC is the highest-level committee and is composed of senior management. Although the CMSC ultimately supports and approves the plan, the development and execution of the plan is most often delegated to the ERT. The ERT is chaired by the Managing Partner, President, or CEO, and is composed of senior management to include the head of Information Technology (you pick the title) and the Comptroller. The ERT either develops the Plan or assigns responsibility and approves the end product. The FARM Teams are assigned to specific areas and are responsible for executing the plan and coordinating with the ERT. For example, in a financial Institution, there could be a Teller FARM and Loan FARM at each branch, an accounting FARM, and so forth. In a manufacturing environment, you might have Shop FARM, a Warehouse FARM, Supply FARM, and so forth. In a large CPA firm, you might have a FARM for each office or by department. In a small office, a FARM is not needed.

The CMSC authorizes and supports the plan by providing resources. The ERT develops and manages the Plan and the FARM executes the Plan. There are a number of teams that are created to execute the Plan, and we will discuss these in more detail later. Keep in mind that the number of teams and their responsibilities will vary with the size of the organization. But no matter what size your organization, there are certain basic functions that must be included.

Remember, the goal here is to minimize your risk. Therefore, your plan must identify the critical functions of your organization and the resources required to support them. The plan must provide guidelines for ensuring that needed personnel and resources are available for both disaster preparation and response, and that the proper steps will be carried out to permit the timely restoration of services.

The Business Continuity Plan specifies the responsibilities of the ERT, whose mission it is to establish organization-level procedures to ensure the continuity of business functions. In the event of a disaster affecting any of the functional areas, the ERT serves as liaison between the functional area(s) affected and other organizations providing major services. These services include the support provided by security, personnel, and public information dissemination on behalf of the company.

On a periodic basis, no less than annually, the ERT must ensure that the plan undergoes a formal review to confirm the incorporation of all changes since the prior examination. The ERT will initiate a complete review of the Plan, which could result in major revisions to the plan document. These revisions will be distributed to all authorized personnel, who exchange their old plans for the newly revised plans.

Testing the plan is an essential element of preparedness. Partial tests of individual components and recovery plans of specific FARM Teams should be carried out on a regular basis. A comprehensive exercise of the continuity capabilities and support by the designated recovery facilities should be performed on an annual basis. Under the overall direction of the ERT, support is provided to assist a functional area's recovery by ERTs. These teams, described below, work in conjunction with the FARM of the area affected by the problem condition to restore services and provide assistance at the operation level.

In many cases, the organizations comprising these support teams have as their normal responsibility the provision of these support services. This support is generally documented in a Standard Operating Procedures (SOP) Manual for the organization. The Business Continuity Plan is an adjunct to that documentation and highlights the interfaces between the organization level service and the individual FARM Team operations requirements. In cases in which the documentation in this Plan and the organization's documents differ, the organization's documentation has precedence. Here are a few of the Teams that may be critical to rapid recovery.

- *Damage Assessment/Salvage Team.* Headed by the General Manager, Firm Administrator, Managing Partner, or in some cases the President or CEO, and activated during the initial stage of an emergency, the team reports directly to the ERT, evaluates the initial status of the damaged functional area, and estimates both the time to reoccupy the facility and the salvage value of the remaining equipment. This team draws members from functional areas, as well as finance and information systems as well as appropriate support suppliers/vendors. Following the assessment of damage, the team is responsible for salvaging equipment, data and supplies following a disaster; identifying which resources remain; and determining their future utilization in rebuilding the data center and recovery from the disaster. The members of the Damage Assessment Team become the Salvage Team.
- *Transportation Team.* A temporary ERT headed jointly by the Manager for Computer Operations, which could also be a network administrator or senior operator, is responsible for transporting resources personnel, equipment, and materials to back-up sites (*hot sites*) as necessary. This team draws members from two organizations: Information Systems personnel who normally operate the shuttle bus and other personnel who are responsible for transporting heavy equipment. The second group could be outsourced services provided by a local moving company.

- **Public Information Team.** This is the interface with the media, the general public and staff who are not directly participating in the recovery process. An Administrator, the Human Resource/Personnel Officer or a team from both areas may handle this. The organization must carefully prepare a plan defining what information is to be provided and who is authorized to represent the company.
- **Telecommunications Team.** Headed by the Director of the Information Systems, this team is responsible for establishing voice and data communications between the affected site and the remainder of the organization.
- **Other Teams.** These may include Insurance, Security, Accounting, and Personnel.

### **Responding to a Disaster**

There are six required responses to a disaster, or to a problem that could evolve into a disaster. Each of these points must be addressed in the Business Continuity Plan.

1. Identify a point of failure and determine a disaster condition.
2. Notify the persons responsible for recovery.
3. Declare an emergency and initiate the Contingency Plan.
4. Activate the designated hot site (if the failure level is appropriate).
5. Disseminate information.
6. Provide support services to aid recovery.

Your next step is to lay out the format of your plan developed on the six points listed above. The following assumes that you have already documented all critical systems, network components, and software needed to run your business' mission-critical processes. You should also have listed all vendor and supplier contacts and the items you receive from them so that additional stock may be ordered in an emergency.

The disaster recovery strategy explained below pertains specifically to a disaster that disables the main data center. This functional area provides computer and major network support to core applications. Especially at risk are the critical applications, those designated as Level IV systems. The Business Continuity Plan provides for recovering the capacity to support these critical applications within seventy-two hours. Summarizing the provisions of the Plan, subsections below explain the context in which the organization's Contingency Plan operates. The Contingency Plan complements the strategies for restoring the data processing capabilities normally provided by the Data Processing (or Information Technology) Department. The Disaster Recovery Phases are described as follows.

#### ***Emergency Declaration Phase***

The emergency phase begins with the initial response to a disaster; this is the identification of a *Point of Failure*. During this phase, the existing emergency plans and procedures direct efforts to protect life and property, the primary goal of initial response. Security over the area is established as local support services such as the police and fire departments are enlisted through existing mechanisms. The chairperson of the ERT is alerted and begins to monitor the situation.

If the emergency situation appears to affect the main data center (or other critical facility or service), either through damage to the technology infrastructure or support facilities, or if access to the facility is prohibited, the ERT chairperson will closely monitor the event, notifying ERT personnel as required assisting in damage assessment. Once access to the facility is permitted, an assessment of the damage is made to determine the estimated length of the outage. If access to the facility is precluded, then the estimate includes the time until the effect of the disaster on the facility can be evaluated.

If the estimated outage is less than seventy-two hours, recovery will be initiated under normal operational recovery procedures. If the outage is estimated to be longer than seventy-two hours, then the chairperson activates the ERT, and the Business Continuity Plan is officially activated. The recovery process then moves into the back-up phase. Under some conditions, it is advisable to notify the ERT that a disaster has occurred even if the event is expected to last less than seventy-two hours. The ERT remains active until recovery is complete to ensure that the organization will be ready in the event the situation changes.

### ***Alternate Site Activation Phase***

Normally, the Alternate Site Activation phase begins with outages enduring longer than seventy-two hours, or when management deems that the emergency warrants activating the back-up processing site. In the initial stage of this phase, the goal is to resume processing critical applications. Processing may resume either at the main data center or at a designated hot site, depending on the results of the assessment of damage to equipment and the physical structure of the building.

In the Alternate Site Activation phase, the initial hot site must support critical applications for whatever time frame is necessary to recreate a permanent site. During this period, processing of these systems resumes, possibly in a degraded mode, up to the capacity of the hot site. If the damaged area requires a longer period of reconstruction, then the second stage of this phase commences. During the second stage, a shell facility (a pre-engineered temporary processing facility) is assembled and placed in a designated area.

A hot site provides equipment capable of processing your applications and supporting communications as defined in the contract agreement. When a Hot Site is activated, the assumption is that you will be required to provide no or minimal physical equipment. You will be expected to provide programs and data, and in some cases, an operator, although many hot site providers will provide one or more operators at an additional cost leaving your staff to concentrate on getting your site back on-line. A shell facility normally comes equipped with power and communications "stubs" for you to connect to. Shell facilities assume you are providing all necessary hardware, software and staff. Shell facilities tend to be for much longer time frames beyond a week or two.

### ***Recovery Phase***

The time required for recovery of the functional area and the eventual restoration of normal processing depends on the damage caused by the disaster. The time frame for recovery can vary from several days to several months. In either case, the recovery process begins immediately after the disaster and takes place in parallel with back-up operations at the designated hot site. The primary goal is to restore normal operations as soon as



possible. The definition of *normal* might be relative to what you can afford. Many businesses may be able to perform at a diminished level and still meet mission critical objectives. Some time should be spent on this point as operating at full, or normal levels might be much more expensive, or might result in additional costs that are not really justified.

The Recovery Phase incorporates all steps necessary to bring mission-critical functions back up to a service level. This could mean restoring operating systems procedures, applications and data (data bases) and validating all information as current before beginning. Part of the planning and procedure documentation for this Phase includes documenting the time required from the moment that a disaster is declared and that the Coordinator activates the alternate processing site until the system is operational. To determine what is really needed in a reduced capacity, you should categorize all software and processes under the following categories and then concentrate on where your greatest weaknesses are.

**Category I—Critical Functions.** These are must have functions such as manufacturing, order entry, environmental control, and such. Without these systems, you shut down.

**Category II—Essential Functions.** It is sometimes difficult to determine the difference between critical and essential. However, essential functions might be defined as inventory control, shipping, customer address and phone numbers, and so on. You could do business without them for a short time, but the impact would be significant.

**Category III—Necessary Functions.** These are functions such as accounting, financial reporting, accounts payable, and payroll. (Granted, payroll might be critical!) are considered as necessary, but again, you could get by for a short period of time.

**Category IV—Desirable Functions.** This would most likely be everything else from spreadsheets to word processing.

The final sections of your plan should describe the FARM Teams, the people who manage the recovery process, and their responsibilities. This will differ drastically by company. Don't forget a section on Disaster Recovery Procedures that include building evacuation and what to do in case of medical emergency, fire, hurricane, tornado, and so forth. In this section, there are specific action items and who is responsible.

The losses resulting for computer downtime will only increase in the future unless business learns to plan for and manage such failures. The power outages of early 2001 along the west coast may only be the beginning of such power outages nationally that could result in systems failures. The above documentation may seem like a lot of useless paperwork and testing, but unless business learns a lesson from the past and prepares for contingencies, the risk of failures will only increase.

## SECURITY

Security and Privacy are becoming more important in the operation of your business than ever. By the time you finish reading this Chapter, a computer hacker will have found a new way to break into an information system, and put a company's intellectual property and proprietary business information at risk. Talk about a risk factor!! With the increased

corporate Internet activity we are experiencing today, corporate America is putting their information at greater risk than ever. Whether using the Internet to convey information between corporate sites, conducting business on the Internet, or using email, all these activities increase the potential that a business will be *hacked*.

*Hacked* is a simple term for the intrusion of an individual or individuals into your automated systems for the purpose of doing harm. The U.S. Department of Justice has had their first convicted juvenile hacker who had to serve time. The sixteen-year-old pleaded guilty to hacking crimes and served six months in a detention facility for his offenses. Going by the name *cOmrade*, the young hacker made his way into a military computer network used by the U.S. Defense Threat Reduction Agency (DTRA). *cOmrade* also managed to gain unauthorized access to a server located in Dulles, Virginia, and installed “backdoor” access to the server. The backdoor program collected more than 3,300 messages. In addition, the hacker found a way to discover at least nineteen user names and passwords of department employees’ computer accounts. He also retrieved and downloaded proprietary software from NASA worth around \$1.7 million. NASA uses the software to support the International Space Station’s physical environment. Computer systems at NASA were forcibly put out of business for twenty-one days in July of 1999 in order to address the security breaches. If this happens to the Department of Justice and NASA, what is happening to your systems?

Security of networks from intrusion has become the number one objective of today’s network administrator. It is possible to protect information systems and associated business assets. But to do so requires an understanding of the state of the hacking, and the art, if you will, of breaking into and accessing data. Hackers use a wide variety of readily available tools and techniques to infiltrate information systems. The simplest and earliest hacks were accomplished by stealing or guessing user passwords to gain access to company systems. Today’s hackers have much more sophisticated tools and an extensive network of like-minded individuals who share information, usually via the Internet, about the vulnerabilities they discover and how to exploit them. These people take advantage of seemingly trivial or unrelated weaknesses in operating systems, networks, and application programs, linking them with other weaknesses in other areas, to infiltrate what was thought to be the best protection. Hackers often discover weaknesses in operating systems and application software programs by reverse engineering the code. Literally, they take the code apart and determine which instructions do what. If backdoors (meaning program code that allows entry that bypasses the system’s usual security) are left available by system programmers, they can be discovered by this process. Sometimes programmers have legitimate code, meant to be used for the benefit of the user, but hackers can use this same code to gain illicit entry. Code weaknesses are inherent in even the most carefully written and tested software, especially off-the-shelf software.

Merely applying patches to off-the-shelf software and systems or trusting firewalls (the electronic wall separating a company’s computer network from the outside world) is not the answer. Reliance on these devices alone can provide a false sense of security, potentially giving hackers access into your system. Most people, even technologists, do not realize that even firewalls become obsolete over time, unless they are diligently maintained to resist evolving hacker techniques.

The key to protecting your business is to recognize that the tools and techniques for hacking are constantly changing. Protection depends on understanding what hackers look

for and how they use it to serve their ends. Understanding these techniques gives companies a better feel for how to protect their assets, and how to make sure their business stays securely operational. Securing your system today is but the very first step in real protection. Keeping your system's protection current is essential to operating any information processor into the future. Keeping up with hacker technology means constant study. Professional hacker-trackers constantly monitor public or "open-source" channels, including hacker chat rooms, software, and hardware manufacturer's updates, Web sites dedicated to security, security company product advances, and so on.

So how secure are your systems today? In the CSI/FBI 1999 Annual Report (which is something most of you are not expected to read), 57 percent of respondents with an Internet connection reported attacks from the outside, a 20 percent increase over the previous year. Numbers were not available—as of the writing of this book, but it is certain to be up substantially considering the rash of Denial of Service attacks that occurred during the year. First, understand that all the hackers are *not* outside your company. (After all, these folks have day jobs!) Most illegal system intrusions begin with employees breaking into company files, systems, and networks. It is necessary for a firm to include security policies and enforce them. To determine whether your systems are secure, it may be worthwhile to hire a professional to conduct what is commonly referred to as conduct Penetration Testing.

A number of you most likely use password protection on your confidential and private Word and Excel documents. So you probably feel pretty good that your confidential information is safe from prying eyes! Well, a visit to [www.lostpassword.com](http://www.lostpassword.com) may just shock you a little.

Access Data ([www.accessdata.com](http://www.accessdata.com)) is a U.S. commercial company that has a number of off-the-shelf applications for data security, including the Forensic Toolkit (FTK). As computer crimes continue to increase, both in occurrence and severity, FTK provides law enforcement and corporate security personnel technology to fight this battle. The Forensic Toolkit is a new tool for computer crimes investigators that assist them in tracking possible hackers and determining if an intrusion has occurred.

Finally, [www.crack.com](http://www.crack.com), will provide you your passport to the underworld of hacking and cracking. (Note, crackers simply break in for the thrill of it and have no harmful intention, other than that they are breaking the law, while hackers enter with the intent to steal or do harm.) Most public accounting firm partners are truly amazed how open to intrusion their systems are, and the potential losses that can result. Many do not realize that they may have already been hacked. If you are an Auditor in public practice, the threat of hackers to your client, and your obligation to make them aware of the threat, is very real. For more information on security and intrusion protection, visit [www.symantec.com](http://www.symantec.com), and Steve Gibson's web site at [www.grc.com](http://www.grc.com).

With the speed of change we experience in the Internet, some of the sites noted above may be gone by the time you read this book, but fear not, many more will spring up to take their place. To find information on your own, simply use the Search feature of your browser and use keywords such as "Hack", "Passwords", and "Security" to find sites of your own. In any case, you have a solid understanding now of how easily your network may be intruded upon as well as actions to take to minimize the risk of someone intruding upon your system and taking information.

The Security Audit has become a hotly sought service. There are several reputable companies that offer the service. However, do not expect these services to be inexpensive. Penetration Testing, one type of security service, attempts to penetrate into your network from outside your firewall or point-of-entry. Security Audit testing and reporting can run from \$12,000 and up depending on the level of testing you feel is appropriate. The downside to having a Security Audit conducted is that the findings are only valid at that exact moment. Someone could turn off your firewall the moment the examiners leave and your system would not be secure. Some businesses such as banks elect to have continuous testing which is a combination of automated software and human interaction to continuously test their systems' vulnerability to attack.

Finally, it is very important to have written policies internally as well. There are far more recorded occurrences of employees and others being involved in unauthorized removal of client information. The common term for this is Information Leak, which sounds simple enough but you can expect the violations of systems security to increase and occurrences of information theft to continue to increase, and you are responsible for taking action to prevent this. To determine whether your systems have exposure either internally or from external sources you might consider having a security audit conducted by a reputable technical firm. Financial Institutions have begun requiring annual security audits of their systems and this practice will expand into other business sectors rapidly over the next decade.

## **PRIVACY**

The convergence of the Internet, electronic communications, and commerce has created a heightened state of concern over personal, and often private, information. In 1999, 2000, and 2001, the Congress of the United States took decisive steps to protect individual's private information, as well as how you may utilize your clients' information once collected. You may consider this to be beyond the realm of an accounting practice, but think again. The most significant, and best-publicized act was the 1999 Gramm-Leach-Bliley Financial Modernization Act. Although this act primarily focuses on the banking community, it has far-reaching implications for other industries as well. Because of acts such as this, the AICPA is attempting to determine how much CPAs must be aware of and responsible for reviewing during the audit process. For instance, as a result of the Gramm-Leach-Bliley Act, the Federal Trade Commission issued regulations directly affecting tax practitioners and other practitioners providing services to individuals. The Securities and Exchange Commission (SEC) has also come out with its own guidance on privacy disclosures for investment advisers registered with the SEC. Any firm involved in financial planning, or providing financial consulting services, should be aware of these and act accordingly.

There are several facets to the personal privacy issue. First, there is the well-publicized collection of information at a web site. This collection could be information keyed into an on-line form and sold for private gain. The information keyed in for the purpose of purchasing a product falls into this category, as does the invasion of privacy by placing cookies on a user's system without their knowledge, or collecting specific information about a user through the use of intrusive software, again without the user's knowledge. New laws being passed by Congress are clear in regard to limiting the use of information for a purpose not agreed to by the individual supplying the data.

Today, common sites collect information on a premise generally known as Opt-out. In simplistic terms, this means that at the bottom of a form, after the user has entered all content, there will be a small disclosure statement asking the user to check a small box if they do not wish their information to be shared with anyone else. If this box is not checked, and there are other but similar methods of acknowledgment, which barely satisfy existing privacy laws, the assumption is that permission is given. It is expected that Congress will change this to require sites to ask individuals to Opt-in. That is, private information may not be used for any purpose, implied or explicit, without the express permission of the individual. Even if Congress does not pass such legislation soon, users themselves are beginning to turn away from entering confidential information without some guarantees of privacy, and if users will not complete purchase forms, they cannot become customers and e-commerce will die a quick and painful death.

The second reason that privacy will continue to be an issue is the maturing of a technique commonly referred to as data mining. *Data mining* exploits an existing database, correlating data elements to create new information. Data mining is not new; the introduction of these techniques began with analysis of large mainframe databases. Today, there are several off-the-shelf software applications to assist in this process. With the emergence of open database compliant (ODBC) software, the underlying data is much easier to get to. To understand how data mining works, consider this scenario.

You are a business or financial consulting partner in a public accounting practice. There are several services you could provide for your clients, such as financial planning, estate planning, portfolio management, trust work, and so forth. Yet, you only have a few ways to market these services. Send out mailers to clients and anyone else you can buy a mailing list on, visit club meetings and “greet and meet,” maybe even give a talk or two. And, you can encourage your partners to refer clients to you. Sound familiar? All the actions above are time-tested, and to some degree, produce results. But how many people do you need to qualify to come up with the ones that need and can afford your services?

Now consider another approach. As you review your client listing, you think that a number of them qualify for your services, but how do you know for sure? CPAs know more about their clients than many of the clients know about themselves. The information lies in the most obvious place—the clients’ tax files. Think of the information entered for a tax return. How much money they have, their portfolio information, age, address, net worth, even information as to their broker, lawyer, and banker. It is all there. Using tools that exist today, the tax and other databases can be mined. That is, a specific data field can be selected and extracted (*exported*) from the tax processing application database and placed (*imported*) into a database you can sort and analyze for your own purpose. The AICPA *Code of Professional Conduct* makes it clear that activities such as selling client confidential information is not acceptable internal use of client data. In some cases, this is an internal decision. In others, we will see guidance emerging from the profession as to what is appropriate and what is not. The best advice for now may be: If in doubt—don’t do it! For more detail of the extent of privacy regulation, visit <http://www.ots.treas.gov/rules.html> and review how stringent regulation is becoming for financial institutions.

Every public accounting firm must have a published privacy statement. It is important to publish the privacy statement on your web site. And your Internet privacy statement should be the same as your practice privacy statement. A few helpful hints are the following.

- Provide easy access for your Privacy Statement.
- Ensure a review by legal counsel for *defensibility*.
- Ensure that your staff knows your policy and that it is followed!
- Be clear on what to tell your clients.

Your clients should know the following.

- You understand the importance of protecting the privacy of your customers/clients.
- You take seriously the importance of safeguarding customer/client information and are committed to their privacy.
- Your staff must be committed to personal privacy.
- Your organization makes every effort to collect, retain, and use customer information only as it pertains to your ability to serve that customer/client.
- You limit employee access to personally identifiable information to those with a need to know.
- Your employees understand the importance of customer/client privacy and follow the company guidelines.

Your firm must never disclose client personal or account information to unaffiliated third parties, except for the purpose of transferring information to reputable agencies; or when the information is provided to help complete a client initiated transaction (meaning, filing an electronic return, or vouching for a client's financial position when requested to do so by the client).

The following sample privacy statement is to provide you guidance only in understanding the type of information needed in your statement. You should consult with legal counsel before posting your privacy policy on the Internet or distributing to your clients.

### **Sample Privacy Statement**

Sample Firm understands the importance of protecting the privacy of our clients and others who visit our Web site. We consider any personal information you may supply to us to be personal and confidential, and we are committed to using this information solely for the purpose of providing you with superior service and convenient access to the right products and services.

We take our commitment to safeguarding client information seriously, which is why we have adopted the following principles.

- Sample Firm makes every effort to collect, retain, and use client information only where we believe it is useful (and as allowed by law) in administering Sample Firm business and to provide products, services, and other opportunities to our clients.
- Sample Firm limits employee access to personally identifiable information to those with a business reason for knowing such information. Sample Firm stresses the importance of confidentiality and client privacy in the education of its employees. Sample Firm also takes appropriate disciplinary measures to enforce employee privacy responsibilities.

- Sample Firm does not disclose our clients' personal or account information to unaffiliated third parties, except for the transferring of information to reputable credit reporting agencies; or when the information is provided to help complete a client-initiated transaction; the client requested the release of the information; or the disclosure is required or allowed by law.
- Sample Firm maintains appropriate security standards and procedures regarding unauthorized access to client information.
- If Sample Firm provides personally identifiable information to a third party, we insist that the third party adhere to similar privacy principles that provide for keeping such information confidential.

### **Conclusion**

This train never stops. We have consolidated several areas of potential risk into the topics above and provided direction and solutions to address each. However, with the state of technology today, we must be reminded that this is a moving target. Staff will continually need to be trained on the latest virus protection and security software. Management must review policies on an annual basis and test that the procedures truly work. Strive to ensure that staff is aware that you are aware and that they understand the dangers that threaten the firm every day.

Risk is always with us. But your planning and preparedness can help minimize it as much as possible.





# Chapter 5

## The Role of Accounting Firm Assessments Generally—and Self-Assessments Particularly

### THE FUNDAMENTAL PURPOSE—THE PROPHYLACTIC SELF-ASSESSMENT

The following quotation from Demosthenes, for which we are indebted to Professor Langevoort,<sup>1</sup> precisely encapsulates the argument for using self-assessments as an essential ingredient of modern risk management.

Nothing is easier than self-deceit.  
For what each man wishes, that he also believes to be true.<sup>2</sup>

This quotation highlights two aspects of the problem that the accounting profession faces today. As described in Chapter 1, “What Is ‘Risk Management’ (or ‘Loss Prevention’) Anyway?” despite the incidence of massive money awards against accounting firms, many CPAs still view their firms as insulated from experiencing malpractice claims because they “know their clients.” On the other hand, even among those prepared to accept in principle the need to face the risks, there are some who believe that risk management consists of handing out policy manuals describing the risks of accounting practice and recommending appropriate procedures. Thus, it is possible to pay lip service to the need for risk management, without ever really coming to grips with the actual dangers confronting each firm, and each practitioner, on a daily basis.

For those prepared to turn their backs on self-deceit and to face the realities of practice in the new and hostile climate, the *only* solution—as an essential first step—is to confront directly the risks involved in their own firm's practice, and to evaluate the existing policies and procedures already in place to control or manage against those risks. Without that initial analysis, it is impossible to determine either what changes or additional tools are appropriate, or how to implement them most effectively. Similarly, the best available texts on risk management, or the clearest policy manuals, cannot constitute risk management if they are circulated in a vacuum of ignorance. Furthermore, it is undeniable that even the best texts (and most manuals) lie on shelves (or in closets) and gather dust. A self-assessment, on the other hand, *forces* a firm to deal with risk management; by its nature, it compels involvement.

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<sup>1</sup> Langevoort, “Where Were The Lawyers? A Behavioral Inquiry Into Lawyers’ Responsibility For Clients’ Fraud,” 46 Vand. L. Rev. 75 (1993).

<sup>2</sup> *Ibid.*, p. 95, quoting Demosthenes, Third Olynthiac, sec. 19.

It is also important to note that the self-assessment process, to be of greatest value, must be viewed as an ongoing process, rather than a once-in-a-lifetime event. Although this may sound revolutionary, it is not; the major international accounting firms *all* perform at least some level of risk management self-assessment as a matter of regular routine. Thus, they may carry out internal self-assessment on specific practice areas annually. These may involve, for instance, reviews of files to check for compliance with relevant policies and procedures. On a less frequent, but still regular basis they may call in outside assessors to perform independent assessments to confirm both that their policies and procedures meet industry standards and that they are actually conforming to their own requirements. In the rest of the accounting profession context, similar principles should apply. For instance, different aspects of peer review may be implemented at periodic intervals which balance the need to maintain this type of oversight with the need to minimize disruption to practice. Similarly, in firms beginning the risk management process, the different categories of risk may be examined at convenient intervals which balance the same needs, rather than in one, potentially disruptive, fell swoop. At the very least, and for the same reason, the different risk categories discussed in Chapter 1 can be examined in series, rather than all at once. Thereafter, at whatever intervals are deemed appropriate by each firm to assure that adherence to risk management systems is ongoing, the different categories can (and should) be reexamined.

### **ADDITIONAL USES FOR ACCOUNTING FIRM SELF-ASSESSMENTS**

The risk management self-assessment has significant utilities in circumstances extending beyond firms that have independently recognized the need to develop effective risk management, or to test and improve the tools already in place. The four most common additional uses for self-assessment are the following:

1. To develop or improve firm-wide management structures in firms with offices in multiple locations
2. As a “due diligence” tool in evaluating prospective merger candidates or firms, from other firms
3. As a foundation for the introduction of Total Quality Management (TQM)
4. In response to claims

### **MULTI-OFFICE ACCOUNTING FIRM MANAGEMENT**

CPA firms with multiple offices or branches, whether within close geographic range or in various states across the country, have a heightened need for self-assessment tools. Multiple office firms face additional risk management concerns due to the difficulty of ensuring the consistency of risk management practices within or among the various multiple offices or branches. Basic issues like new client acceptance and work product review procedures are made vastly more complex, but also the problems of maintaining a uniform level of competence, and imposing *any* central management are greatly increased. For firms with these structures, the self-assessment ought to be a regular tool to help ensure adherence to basic firm management requirements, as well as risk management policies. If firms confront the potential (or, in some cases, the recent experience) of significant claims (and awards) being made against them arising from the activities of an office perhaps

thousands of miles from the headquarters office, there is no alternative to the use of self-assessments on an ongoing basis. Otherwise, any meaningful effort aimed at central governance, including risk management, cannot be maintained.

### **Self-Assessments as Due Diligence Tools**

One of the most obvious facets of accounting firm growth (and demise) in the past fifteen years has been the trend toward mergers and acquisitions. The difficulties of assessing potential merger candidates' practices before the acquisition, and of actually assimilating the two firms afterwards are enormous. Oddly, accountants are sometimes rather cavalier in how they undertake these transactions; these same accountants would be alarmed if their own clients conducted commercial dealings in such a manner. The very idea of applying techniques to assure due diligence in transactions among accounting firms is often limited to consideration of "the numbers," with inadequate concern about other important aspects of the transactions, such as the compatibility of practice specialties, personnel, and clients. Anecdotally, at least, as a direct result of this abdication of normal caution, a number of accounting firms have suffered significant claims and losses, following their acquisition of or merger with other firms or practice groups. This may never be entirely preventable, but the parallel step—the kind that firms would insist on for their clients—are available in the form of risk management self-assessments.

Such due-diligence assessments would encompass those elements of risk management deemed most critical to the practices of both firms involved in the merger discussions. For instance, it is becoming common for firms to review each other's new client and engagement checking mechanisms as an essential prerequisite to mergers today. Similarly, for the reasons discussed in Chapters 1 and 2, "Defining Risk for Traditional Accounting Services," it would be difficult to deny the importance of a review of each other's billing practices and systems, or perhaps their special practice areas, before agreeing to a merger, if avoidance of potential embarrassments later is an important criteria to either firm.

Not only will due diligence self-assessments disclose potential dangers in the forms of inadequate client intake control, or ineffective calendar management, but they will also reveal basic firm culture issues, including, in particular, the degree to which the need for risk management (or *any* management) is accepted by the merger candidate or practice group being studied. A firm's willingness—or unwillingness—to undertake a self-assessment may also speak volumes as to the degree to which it has already addressed the specific risk management issues of concern to the acquiring or other merger partner firm. As always, if deals are prevented by the application of the self-assessment process, the great likelihood is that they would have been *bad* deals for the acquiring firm.

### **Self-Assessments and TQM**

Much has been promised by the advocates of TQM in recent years, and the accounting profession has not escaped the attention of the management pundits advocating this new approach to the delivery of accounting services. What is clear from a review of even the briefest and most introductory of materials about TQM is that it advocates a change of attitude within the organization toward the ultimate client, and the way in which services are delivered to the client. There is no doubt that any approach which seeks to create systematic improvement in the overall level of service being rendered to clients is positive

and should be encouraged. However, to the extent that TQM focuses principally on the delivery of services to clients, and does not address the internal controls within a firm, its adoption may mask, not resolve potentially serious risks within a firm's practice. What is also often left unclear by advocates of TQM is how it is possible to create worthwhile changes without first evaluating what is in place—and what does, or does not work. To use a cliché that is very appropriate to this situation, *"If it ain't broke, don't fix it."* Often, a risk management self-assessment will show that much about the way a firm is run is effective and works well, for the firm and its clients. It is important to recognize that self-assessment can prevent *unnecessary* tinkering, and promote change only in the areas in which there actually is an identified problem. The two approaches are by no means antithetical; however, risk management, and particularly the self-assessment process to determine what is in place, ought to be viewed as a necessary prerequisite to the adoption of TQM techniques. Thus, the implementation of TQM may well be one aspect of the changes in firm management which will appropriately follow from or be adopted in tandem with the introduction of effective risk management.

### **Claims Response**

It is notable that the accounting profession is probably among the last areas of liability underwriting to undergo the discipline of thorough and meaningful risk analysis; clearly, however, this can be delayed no longer. Professional liability insurers are starting to recognize the usefulness of assessments as a mechanism to identify causes of recent occurrences, and as a basis for development of control tools to prevent future claims and losses. This is, of course, at least partly an effort to close the barn door after the horse has bolted. Nevertheless, it is a real, and increasingly common phenomenon for insurers to request risk management assessments after a history or pattern of claims has begun to develop, either as a condition of renewal or as an element in the process of establishing an appropriate renewal premium. Although both the profession and the insurance industry are not yet at the point of making assessments an automatic response to claims, this moment may arrive. Insurers have traditionally adopted a variety of new approaches to dealing with firms with significant claims or loss histories. These include the obvious increased premiums (which can be selective as well as across the board), and increased deductibles (*loss retentions*, as they are called by insurers). It is increasingly common for insurers today to add to this armory the use of policy terms and conditions which effectively impose risk management techniques. Within this context, the assessment, as a significant tool in the process of determining what insurance coverage is appropriate for particular firms—and at what price level—appears to be gaining ground among underwriters as an important consideration for insurers as a component of their efforts to reduce underwriting risks.

## **WHY SELF-ASSESSMENTS?**

### **The Goals of an Accounting Firm Self-Assessment**

Parts 2, "Quality/In Control (QUIC) Survey for CPA Firms Questionnaires," and 3, "Quality/In Control (QUIC) Survey for CPA Firms Answer and Analysis Sheets," of this book, constitute a tool designed to demystify the risks, to resolve the dilemmas, and to provide a structure for the analysis and control of the risk elements in accounting practice.

Although these materials can also be used as an externally supervised assessment process, QUIC Surveys have been designed as a *self-assessment* kit. By using the QUIC self-assessment materials, firms can, in their own time and under their own control, accomplish the following.

- Evaluate, in a structured and coherent framework, the state of risk management already in place.
- Determine the nature and scope of changes to existing policies and procedures needed to create a better “comfort level” that the firm is sensibly controlling the risks inherent in its practice.
- Make the necessary changes in a manner, and on a timetable consistent with the firm’s individual management style and dynamic (sometimes called a firm’s culture) or even, in appropriate circumstances, as a prelude to changing the prevailing culture.
- Justify recognition from the firm’s professional liability insurers of the firm’s control over its practice, with a view to qualifying for premium savings in the years to come (or at least to avoid a rate increase).

### **The Advantages of the “Do-It-Yourself” Approach**

It is notable that the pressure for increased control over how accountants practice can be felt from many sources external to accounting firms. The SEC, IRS, and other governmental regulators continue to propose, recommend, or implement changes or restrictions that affect the practice of accountancy. And the judiciary and legislators are reviewing and tightening the relevant codes and rules governing professional conduct.

The issue of firm culture is pertinent here. Some firms pride themselves on being very decentralized and democratic, with a bare minimum of authority being delegated to managers for any purpose. In this type of culture, problems within and conflicts among practice groups, are at least more likely to be out in the open than in a firm which has accepted the need to delegate some management functions, despite ignoring risk management in that delegation process. At the other extreme there are firms, often those founded by a single, very powerful leader (or a small group of accountants who founded the firm), where the founder(s) have retained a tight hold over every aspect of the management of the firm. What is clear is that whatever the model, or style of firm culture that prevails within an accounting firm, that culture will be a crucial element in any risk management self-assessment process. Initially, the management group within the culture must be convinced of the need for and the benefits to be derived from the self-assessment and risk management. Equally important, the acceptance of that premise may also denote willingness to make appropriate changes in the culture in order for those very benefits to be realized, and for the good of the firm over the long term.

A firm’s culture is also likely to have a direct effect on the choice between conducting an internal self-assessment and employing a third party to perform, or at least direct the assessment. In those firms in which the organizational structure and strength to manage the process internally are present, a self-assessment is likely to be both more effective and more acceptable among the firms’ members. Only in firms in which, for whatever reason, the culture does not include an accepted central organization capable of performing an assessment whose results are themselves likely to be accepted by the firm’s membership, or

where the need to replace or reconstitute central management is a driving influence in undertaking the assessment, is outside direction or input likely to be needed.

The reasons for undertaking a *self*-assessment, rather than hiring an outside consultant to do it, principally have to do with *control*. By choosing to use only internal resources, a firm gains at least the following benefits of complete control over the following:

- The existence and contents of the findings of the assessment process
- The timing of the assessment
- The costs, both in terms of time spent, and savings of the cost of hiring outsiders
- The use to which findings are put, and the degree and timing of any implementation program

### ***Control Over the Contents—and Disclosure of Assessment Findings***

By encouraging self-assessments voluntarily, firms may well avoid more intrusive methods that insurance companies may stipulate, especially if the accountants insurance market hardens once again and insurance rates begin to escalate. Additionally, by undertaking self-assessments now, the firm retains much greater freedom as to whether to reveal anything regarding its results or what to reveal.

### ***Control Over Timing***

As should already be apparent from the survey in Chapter 1 of the range of issues to be explored in a full-scale risk management self-assessment, to undertake the entire process at one time may involve the participation of a significant number of partners. Although the time commitment of each individual may not be great (as described in detail in Chapter 7, “How to Conduct a Self-Assessment”), a comprehensive self-assessment may engender significant discontent if it involves too much disruption at any one point in time. One of the advantages of doing-it-yourself is that the firm can spread the process out and select both the elements undertaken and the timing of the process so as to minimize the disruption and maximize the benefits. Although outside consultants may be able to accommodate some delay in the process, traditionally they have undertaken assessments the way an army general marches his army—continuously, once commenced, and, above all, relentlessly. To some degree, it is obviously more cost effective (from the consultant’s point of view) to do it once, from start to finish. However, this can have the effect of seriously undermining support for the process within a firm, and therefore wasting some of the good will needed for useful implementation of findings later.

### ***Control Over Costs***

This is an obvious corollary of controlling the time commitment involved in the process. Some firms may wish or feel compelled by circumstances, such as significant claims or losses, to “get it over with quickly.” Nevertheless, many will prefer to take the process more slowly, and in stages, thereby spreading the “lost” billable hours over a longer period. Similarly, a firm that is comfortable that it has the capacity and will to oversee the process internally can save the significant sums which outside consultants will charge for supervising a self-assessment.

***Control Over the Implementation Process***

Although a firm is obviously free to reject the findings of an apparently objective outside consultant, there is much greater freedom of movement and room for compromise if the process has been entirely internal. Again, the greatest contrast is between assessments undertaken voluntarily and those propelled by outside forces. If outsiders are involved, particularly if the impetus for the self-assessment came from a firm's insurers, the likelihood is that they will insist on a role in determining what use is to be made of assessment findings. The benefits of maintaining internal control are obvious. The only outsider may be a consultant selected by the firm for his sensitivity to the fine points of firms' individualized cultures. Even so, the politics of achieving even highly desirable changes may sometimes be absent when most needed. Change often can be accomplished more effectively from within than through the efforts of such outsiders.





# Chapter 6

## What Is a Self-Assessment?

The self-assessment is a powerful diagnostic tool designed to assess the state of an accounting firm's preparedness to deal with the types of risk likely to be encountered in the day-to-day practice of its individual accountants. Like an X-ray, it will create a picture at a specific moment in time, but a picture of clarity sufficient to enable rational determinations as to the current strength of the patient and the appropriate course of treatment. The medical analogy is strong because, like a doctor deciding on what areas of the anatomy to check—and whether a group of X-rays will suffice or whether a CAT scan or MRI for more detailed and penetrating pictures is required—a firm can decide upon the degree of thoroughness and penetration it wishes to undertake in its self-assessment. The self-assessment is structured so that the following three independent sets of decisions must be made which determine the scope of the survey.

1. *Which questionnaires will be utilized.* This determines which aspects of risk management within the firm will be examined.
2. *Which accountants and staff members will participate in the assessment process by receiving and responding to the questionnaires, and participate in the follow-up process.* This determines the degree of thoroughness and reliability of the results to be obtained.
3. *The timing of the process.* This balances the need to obtain the desired results with the degree of disruption of normal practice and management routines which the survey may entail.

The Quality/In Control (QUIC) Survey self-assessment materials have been designed to give maximum flexibility to firms in making these three levels of decision when embarking on a risk management self-assessment. On the one hand, a firm may wish to do a very specific, narrow focus survey, to determine, for instance, how well its new client and engagement acceptance and screening procedures are working within a particular practice group or within a particular satellite office. In that event, the firm will utilize only "Questionnaire 3—New Client and Engagement Acceptance," and distribute the questionnaire only to a cross-section of the practice group or office to be evaluated. At the other extreme, a firm may decide that it needs to undertake a complete self-examination, and therefore set about the process of conducting a full scale self-assessment using all of the questionnaires and conducting the survey over a very large proportion of its personnel covering every practice group and every office. Every intermediate use of the materials is possible, and the decisions made as to the scope of self-assessment will depend on each firm's perception of the risks which it faces and its degree of preparedness (or lack of preparedness) to control those risks. Equally, as already described in Chapter 5, "The Role of Accounting Firm Assessments Generally—and Self-Assessments Particularly," the materials can be used, in whole or in part, within particular offices, or as a due diligence tool in evaluating potential merger or acquisition partners.

## **WHAT IS INVOLVED IN ADMINISTERING AN ACCOUNTING FIRM SELF-ASSESSMENT?**

Chapter 7, “How to Conduct a Self-Assessment,” spells out the detailed instructions and guidelines for administering a self-assessment of whatever depth and concentration has been selected. In brief, the process involved is the following series of sequential steps:

- The decision as to the scope of the self-assessment.
- The selection of the person from senior management who will oversee and supervise the self-assessment
- The selection of the accountants and staff members who will participate (by completing the questionnaires and joining in the follow-up review sessions)
- The distribution and completion of the questionnaires and the collation of the responses
- The conduct of review sessions, including (in the case of a QUIC self-assessment) distribution and discussion of the answer and analysis sheets in Part 3, “Quality/In Control (QUIC) Survey for CPA Firms Answer and Analysis Sheets”
- The preparation of a report to the firm’s management (or, in some firms, to the entire firm) detailing the findings and conclusions yielded by the assessment
- The decision by management as to what steps to take to implement additional risk management within the firm, and how to introduce the relevant policies, procedures, or systems

Because the materials are in separate segments, and each firm has the power to make its own decisions as to the scope and timing of the self-assessment, the process is completely flexible, and entirely within the control of those firms which decide to undertake a self-assessment.

## **WHAT CAN A SELF-ASSESSMENT ACCOMPLISH?**

### **Evaluate Practice Risks**

The fundamental prerequisite for satisfying the concerns of partners and managers of accounting firms about the level of risk within their collective practices, and for establishing the appropriate insurance premium structure for an accounting firm, is to undertake a thorough survey of the status quo. The first function of a self-assessment like a QUIC Survey is to take a snapshot of all of the risk elements in a firm’s practice at a moment in time, and of all of the policies and procedures in place at that moment. Without that snapshot, meaningful decision making as to what additional risk management is appropriate, and how to implement it, is impossible. With that picture, the nature of the exposure and at least the direction and general outline of the remedial steps will be apparent.

### **Evaluate Insurance Coverage**

Part of the picture obtained from a comprehensive self-assessment is the recent history of claims and complaints. The review will encompass billing disputes as well as more traditional malpractice claims and grievance complaints. Billing disputes are a breeding ground for claims, even if in the past these have been resolved, and examining them is part

of the analysis that will enhance the quality of the snapshot when it comes to making recommendations.

There are several other elements of professional liability insurance coverage that should be regularly reviewed. These include not only the current coverage and premium status, but also the terms of the policy itself. It is also essential to understand reporting requirements and the disclaimer rights (of the insurer), as well as the scope of coverage and exclusions. Finally, it is important to have in place clear policies and procedures for addressing potential claims as soon as these arise, in order to minimize the scope of the problems and optimize the firm's response. The issues here include conduct of internal investigations, avoidance of creation of damaging documentation—as well as of the destruction of records, and the assignment of responsibility of dealing with aggrieved clients, third parties, and the media. Unless all of these issues have all been thoroughly reviewed with the broker or underwriter in the recent past, this is an important function included in the QUICS self-assessment process.

### **Develop Risk Management Programs**

The end product of a complete self-assessment is an analysis of the current status of risk management and loss prevention within a firm and the identification both of the areas needing new or revised policies and procedures, and suggestions for the scope of any such changes in approach. Neither the questionnaires comprising the QUIC Survey, nor the answer and analysis sheets accompanying each questionnaire are an end in themselves; rather, they are intended to create a self-defined route map for the unique risk management needs of each firm. By undertaking a self-assessment, the firm retains complete control both over the development and use of the information which is generated, and the scope and timetable of any changes which it decides to adopt. In addition, the firm always retains the freedom to retain the services of outside consultants to assist either in identifying risk management problems or in finding acceptable solutions for implementing needed change.

### **When Not to Do-It-Yourself**

There are certainly some situations when a self-assessment is *not* appropriate, even when the impetus for improved risk management does not stem from outside pressure—such as in the insurance or discipline contexts, or if the assessment is being used as a due diligence tool. (See Chapter 5.) First, if the partner or management executive who would normally be responsible to do the work involved cannot spare the time or be spared from other commitments to undertake the task, an outsider will have to be brought in. Second, in some circumstances the very reasons prompting the self-assessment are such that only an outsider can bring sufficient objectivity to the task for ultimate findings to be acceptable or, sometimes, even credible to the whole firm. These circumstances may be cultural, as previously discussed, or there may be internal disagreements over management issues, or external requirements such as a recent claims history giving rise to insurance renewal concerns. Finally, some accountants, faced with the two competing clichés of “Doctor, heal thyself!”, or “A lawyer who represents himself has a fool for a client,” prefer to follow the latter. Sometimes, the objectivity of an outsider will help the process along both in terms of getting the job done efficiently, and also so as to ensure that the end product, in the shape of findings and a report, is well balanced. A variant on all of these scenarios is the appointment on a permanent basis of an outside ethics consultant, with this self-assessment

oversight task being but a part of her or his responsibilities. This option is discussed at greater length in Chapter 7.

Absent these kinds of special circumstances, however, there is no reason, in principle, why firms cannot effectively undertake the process of reviewing and improving their risk management from within, beginning with an effective self-assessment. Chapter 7 explains how to go about this task using the QUIC Survey questionnaires and crib sheets.

# Chapter 7

## How to Conduct a Self-Assessment

### THE SELF-ASSESSMENT PROCESS

There are six phases involved in conducting a risk management self-assessment. These phases will be discussed in detail in this Chapter. These phases are the following.

- *Phase 1*—Select the partner or administrator who will supervise and conduct the self-assessment.
- *Phase 2*—Decide the following.
  - Determine whether the self-assessment is to be comprehensive, or, if not, which segments of the self-assessment are to be undertaken.
  - Determine the timing of the self-assessment and follow-up.
- *Phase 3*—Distribute and complete the questionnaires.
- *Phase 4*—Review the completed questionnaires, including distribution of the respective answer and analysis sheets to the following:
  - The supervising partner or administrator
  - Each person who completed a questionnaire
- *Phase 5*—Prepare an internal report, including both a summary of findings and recommendations for consideration by firm management.
- *Phase 6*—Consider and implement the report.

### PHASE 1—SELECTION OF THE PARTNER OR ADMINISTRATOR WHO WILL CONDUCT THE ASSESSMENT

The first element in the process is the appointment of a partner or administrator to oversee the self-assessment. If the firm already has a partner designated as responsible for risk management, or for ethics issues, or at least for professional liability insurance matters, it makes sense to give this person the responsibility for the self-assessment. This partner presumably already has some familiarity if not detailed knowledge of the issues raised by and reviewed in the self-assessment process, which makes it easier, meaning, a shorter learning curve, to assimilate and ultimately communicate the information derived from the self-assessment. Even if there is no such identifiable partner within the firm, the fact that the firm's management has decided to embark on the self-assessment indicates at least that there is recognition of a need to address the subject. It is only a short step to appoint a partner to this task who is intended—if the results of the self-assessment indeed indicate the need (as they are likely to do)—to thereafter become the person responsible for all aspects of the firm's risk management program. Furthermore, *ex officio*, this partner or administrator should either be a member of the senior management team in the firm or should report directly to senior management.

The discussion in the Introduction and in Chapter 1, “What Is ‘Risk Management’ (or ‘Loss Prevention’) Anyway?” clarifies the problems that arise if the risk management function is inadequately performed (or not performed at all). It is vital that the right person is selected to oversee this task. Unless the person responsible is committed to the idea that risk management is important, and has an interest in accounting practice management generally and risk management particularly, not only will the job be done inadequately, but the worst possible message will be given to everyone in the firm—both by the fact of the inappropriate selection and because of the way the task will be performed. It is essential, therefore, for the firm’s leadership to address this appointment seriously. As discussed earlier, the commitment of management is essential if any risk management is to be effective, and this appointment is a vital step in *communicating* that sense of importance to the rest of the firm. At the time the appointment is made, this sense of the significance being ascribed to the risk management function, and to the self-assessment process which is about to be undertaken, can be underscored either at a firm meeting or, at least, by the circulation throughout the firm (to support staff as well as all professionals) of a memorandum introducing both the appointment and the functions to be performed by the appointee. The following model may illustrate what might be said in such a memorandum.

MEMORANDUM

DATE : January 1, 20XX  
TO : ALL PROFESSIONALS AND ALL SUPPORT STAFF  
FROM : THE MANAGEMENT COMMITTEE/MANAGING PARTNER  
SUBJECT : APPOINTMENT OF JANE JONES AS FIRM RISK MANAGEMENT PARTNER

We are pleased to announce the appointment of Jane Jones as our firm’s risk management partner, effective today.

Maintaining a uniform standard of excellence in serving our clients does not happen by accident, or in a vacuum; it requires the constant commitment of each of us to perform the tasks assigned according to the highest standards of the profession. In the prevailing climate of increased regulation of accountants, from both within the profession and outside, and the all-too-frequent occurrence of claims against other firms aspiring to similar standards, we have concluded that the time has come to recognize the need to oversee our own practice from within. Our appointment of Jane Jones demonstrates our commitment, and our determination to take appropriate steps to ensure our own observance of relevant standards at all times, and to avoid as far as possible the threat of claims against the firm.

Her functions will include the following:

1. Oversight of all risk management within the firm, including the following:
  - a. New client and engagement issues (including supervision of conflicts checking, and compliance with standard engagement terms)
  - b. Billing systems and controls
  - c. Internal and external Peer review and practice oversight
  - d. Professional Liability Insurance coverage, and claims handling

2. Acting as the firm's risk management partner, available to all professional and support staff at all times both for advice on issues involving professional standards, as well as in the event of concerns that appropriate professional regulations, ethics and firm procedures are not being followed in any matter involving either clients or staff of the firm

In addition, and as a first step in the process of assuring all of us that we are adequately prepared to meet all of the demands of our professional responsibilities, we have asked Jane Jones to supervise the conduct of an internal self-assessment to review all of our risk management policies and procedures. She will shortly be contacting a cross-section of the firm—both professionals and support staff—with a detailed description of what will be involved in this survey.

We wish to stress to everyone in the firm—from senior partners to messengers—that we regard the risk management function as vital and central to our continued well-being and success as a firm. Our appointment of Jane Jones to be responsible for this aspect of the firm's management recognizes our confidence that she can ensure that all of us accept the importance of practicing within the parameters not only of the relevant professional regulations and ethics but also of appropriate internal policies and procedures. We urge everyone to work with Jane Jones in fulfilling these responsibilities.

There is an alternative to such an internal appointment, for firms that find themselves unable to identify a partner with the right skills, interests, or availability to perform the task, but which also do not wish to relinquish these functions (either during the self-assessment or thereafter) to a complete outsider, and that is to select and appoint, on a permanent basis, an outside ethics consultant. There is no reason why such a consultant cannot also take on the mantle of responsibility for oversight of the self-assessment process if a firm has chosen this approach to meeting its risk management needs. However, it should be noted that this may still leave a gap in terms of actually establishing control, for risk management purposes, over the senior members of a firm choosing this approach, and this issue will have to be addressed as part of the process of reviewing the results of "Questionnaire 1—The Firm Leadership and Management Structure." Suitably modified to account for the fact of the appointment of an outsider, and to delineate the availability of and means by which the appointee may be contacted, the memorandum set out above may also be used to announce this appointment. However, if such an outside appointment is being made, there may be additional benefits—most obviously actually to meet the individual—to be gained, from introducing the individual in person at an appropriate meeting or meetings.

## PHASE 2—THE DECISIONS AS TO SCOPE AND TIMING

Set out in Chapter 1 is a detailed list which comprehensively charts the issues investigated within each risk category which may be surveyed in a Quality in Control Survey (QUICS) self-assessment. Shown next to the heading of each risk category is the number of the questionnaire which corresponds to that category.

### The Scope of the Self-Assessment

In many instances, the reason that the self-assessment is being conducted, as discussed in Chapter 5, "The Role of Accounting Firm Assessments Generally—and Self-Assessments Particularly," will largely determine whether the self-assessment is to be comprehensive, or

focused on one or more of the specific risk categories. In firms that are approaching the process out of a recognition of the need to get a handle on risk management generally, but without having previously identified any specific concerns, consideration of the list and description of risk management categories in Chapter 1 should assist the firm's leadership in making the decision as to either proceed with a comprehensive self-assessment, using all of the questionnaires, or possibly identify with some certainty which specific areas of the firm's activities indicate a pressing need to be studied or those that are already well controlled and not in need of investigation.

There is or should be one absolute rule at least as to all first-time self-assessment. The following two segments of the self-assessment are or ought to be *essential* to every self-assessment, and are necessary prerequisites of any and all other segments:

1. "Questionnaire 1—The Firm Leadership and Management Structure"
2. "Questionnaire 2—The Risk Management Structure"

Together, these two elements of the process provide the crucial foundation for the rest of the risk management process. As has been stressed throughout these introductory chapters, risk management can only be effective if and to the extent that management is committed to the process, and has recognized and has taken the steps necessary to cover all of the basic elements of the firm's practice that are sources of risk. Accordingly, these first segments are designed to test two matters, the degree to which management has *recognized* all of the potential sources of risk within the firm's practice, and the degree to which management believes it has *responded* to the need to manage those risks. These segments together provide the answer to the fundamental question: What risk management policies and procedures does management *think* are in place in the firm in all of the risk categories? The remaining questionnaires then explore each risk category separately in detail and in depth. As we have seen, a necessary prerequisite to effective risk management is to have in place an appropriate and centralized risk management structure, within the firm's overall management system, or at least initiating this process of creating such a structure by appointing a partner (or permanent outside consultant) as discussed in this Chapter in connection with "Phase 1—Selection of the Partner or Administrator Who Will Conduct the Assessment." Accordingly, a firm must be *very* sure of the adequacy of its existing arrangements in these two areas before deciding to ignore these aspects of QUICS and dive right into one or more of the substantive risk category questionnaires. On the other hand, firms may accept the need to undertake these preliminary elements of the self-assessment and then find, in reviewing the results (which is discussed in this Chapter in the sections entitled "Phase 4—Distribution of Answer and Analysis Sheets and Conducting Review Sessions" and "Phase 5—"Preparation of a Report"), that their overall management, or their risk management oversight structures are inadequate to their needs. If this happens, the corresponding answer and analysis materials, which correspond to the questionnaires, will help point the way in remedying the identified deficiencies. How best to go about the implementation of these and other changes prompted by the assessment process is discussed in this Chapter in the section entitled "Phase 6—Consideration and Implementation of the Report."

The following descriptions of the subject matter of each questionnaire, and the people within the firm who should be asked to respond to each if they were administered, taken in conjunction with the detailed description in Chapter 1 of the risk management category to which each relates, may assist in reaching a decision as to which segments should be undertaken—or omitted.



### **Questionnaire 1—The Firm Leadership and Management Structure**

The first task in the QUICS process is to ascertain the current risk management structure as viewed by the firm's executive management group. An essential element of the analysis of the review at the end of the process is to compare management's view of the situation and the actual state of affairs as found in the rest of the firm. Accordingly, this questionnaire assembles and organizes information regarding risk management within the firm's existing management structure. In turn, this information creates a benchmark for the analysis of existing risk management for purposes of comparison, during the review process, with the models suggested in the answer and analysis sheets.

Accordingly, the questionnaire should be separately completed by all partners who have a senior executive or management role within the firm, including, as relevant (and applying the particular titles and designations used in each firm) individual managing partners, the members of management or executive committees, as well as any other partners who are expected to assume management positions in the immediate or near future.

### **Questionnaire 2—The Risk Management Structure**

This questionnaire assembles and organizes information regarding the detail of the firm's existing risk management policies and procedures and highlights any missing or inadequately controlled areas in all of the risk management categories. Again, this establishes part of the benchmark necessary for comparison, during the review process, with the models suggested in the answer and analysis sheets.

This questionnaire should therefore be completed by all partners with *any* risk management functions, including responsibility for new client and engagement acceptance, billing, accounts, human resources, professional liability insurance (coverage and claims), office systems involving calendar control, and disaster recovery, as well as partners designated as compliance partners or advisers within the firm. When in doubt, again review the list of risk management categories set out in Chapter 1; partners with executive responsibility in *any* of the areas discussed—including membership of relevant oversight committees—should *all* complete this questionnaire.

As discussed above, undertaking the self-assessment function encompassed in these first two questionnaires normally constitutes a discrete and necessary prerequisite for the use of the questionnaires in the substantive risk categories, which are described next.

### **Questionnaire 3—New Client and Engagement Acceptance**

This questionnaire assembles the information regarding the firm's new client and engagement policies and procedures within all of the aspects reviewed in this risk management category in Chapter 2, "Defining Risk for Traditional Accounting Services." Again, during the review process, the results are compared to the models suggested in the corresponding answer and analysis sheet.

All partners with any involvement in any aspect of new clients or engagements, including conflicts checking, procedures for issuing client or file numbers, assignment of matters to partners and associates, the development and use of engagement letters, and the other issues described in this category, should complete this questionnaire. In addition, all managerial level support staff involved in any aspect of the client and engagement process,

including running the conflicts checking system and file opening procedures, should be asked to respond to the questionnaire.

### **Questionnaire 4—The Engagement Management**

This questionnaire helps the firm focus on the formal issues of creating a contract with the client for services in the form of an engagement letter that does not open the firm to litigation, and in fact is structured so that the firm will have a high probability of a successful engagement. Managing the engagement begins with creating the engagement letter and then following through with the engagement until complete. This questionnaire will help you ask the tough questions to make your firm more responsive.

This questionnaire should be completed by the managing partner or other partner(s) or principal(s) of the firm who currently has or have the greatest share of responsibility for oversight of engagement management. However, since there may be several persons in the practice who may have equal and significant responsibilities in the engagement process, this questionnaire and the associated answer and analysis sheet should be reviewed carefully by each of them. It is also recommended that this information be shared with tier two or lower staff, as it may provide insight to them as to the responsibilities of the firm, as well as themselves, to their clients in the conduct of an engagement. As with the other questionnaires, you should complete it to the detail you feel appropriate and then compare your partners' and staffs' answers to the recommendations found in the section on answers. The real benefits will, of course, come from the actions you take from there.

### **Questionnaire 5—Contingency Planning for Technology Failures**

Based on the premise that “Those who fail to plan, plan to fail,” this questionnaire will help you determine whether your firm has a business contingency plan that would help sustain the firm in the event of a true disaster. More than that, this questionnaire will help you address other safety and soundness issues and determine the areas of your firm in which you have financial exposure. This questionnaire should be completed by the managing partner or other partner(s) of the firm who currently has or have the greatest share of responsibility for contingency planning.

### **Questionnaire 6—Human Resources Management**

This questionnaire assembles information regarding the firm's existing policies and procedures in the areas of human resource management, including internal peer and practice review, oversight of the professional staff, lateral partner and merged or acquired practice controls, and training. As in each of the questionnaires, the information gathered creates a basis for comparison with the models discussed in the corresponding answer and analysis sheet.

This questionnaire should be completed by all partners and managerial level support staff with any involvement in employee hiring and dismissal (both professional and support staff), including those responsible for the oversight of lateral hiring and mergers, and the acquisition of other firms or group practices. In addition, all those involved in the review process of partners and all professionals in the firm, as well as all those involved in any substance abuse oversight program operated by the firm, should complete this questionnaire.

### **Questionnaire 7—Professional Staff**

This questionnaire differs from the others that correspond to particular substantive risk categories. Instead, it parallels the first “Questionnaire 1—The Firm Leadership and Management Structure Questionnaire,” and “Questionnaire 2—The Risk Management Structure”) but from a different perspective, namely, that of the professionals and staff who have no management function, but rather who are expected to act in accordance with the policies and procedures identified by management in the first two questionnaires. Thus, this questionnaire has the following two vital functions:

1. To test which of the policies and procedures that management has identified as being in place across the gamut of the risk management categories and that are, in fact, either known to or operated by the professionals and staff on a day-to-day basis
2. To identify problems encountered in performing as required by those policies and procedures that are recognized and in operation

In short, this questionnaire is a “reality test” of all of the other questionnaires.

Accordingly, the intent is that this questionnaire be completed by a genuine cross-section of the firm’s professional staff—every practice group and every level of seniority. The only restriction is that no one who responds to *any* of the other questionnaires is eligible to respond to this one.

### **Questionnaire 8—Client Relationship Management, Handling Problems and Claims**

The purpose of this questionnaire is to assemble information regarding the firm’s existing policies and procedures for managing client relationships. The twofold purpose is to ensure that problems will be avoided, but also to address and respond to professional issues, such as cases involving actual, potential, or threatened court and regulatory sanctions, and actual, potential or threatened malpractice (or other civil) claims.

This questionnaire should be answered by the firm’s practice group leaders, counsel, as well as the partner(s) responsible for any aspect of dealings with the firm’s professional liability insurers or brokers (coverage as well as claims), and any partners and management level support staff charged with responsibility for any aspect of advertising, public or media relations, or marketing.

### **Questionnaire 9—Disaster Recovery and Business Continuity**

This questionnaire gathers information relating to the firm’s planning and preparedness to address a variety of possible disasters such as fire, building closure, or the sudden death of key partners, which would render all or part of the firm’s practice or business functions inoperable.

All partners responsible for any aspect of the day-to-day administration of the firm, including the purchase and leasing of office equipment and support services, computer and information systems, office space, the supervision of support staff, and the office manager(s) should respond to this questionnaire. In addition, selected members of staff—both professional and support—at every level of seniority, should also be asked to respond, in order to determine the degree to which people in the firm are informed of whatever policies and procedures exist.

## **Timing the Self-Assessment Process**

There are two issues of timing which need to be examined. First, the duration of the self-assessment process as a whole, from the distribution of the first announcement to implementation of changes adopted during the review process needs to be considered. Second, the frequency of repetition of all or parts of the self-assessment must be examined.

## **Duration of a Self-Assessment**

There is no single optimum time frame for conducting a risk management self-assessment. Precisely because it is a *self*-assessment, the duration of the process is entirely within the control of the firm undertaking the survey. There are, however, some alternative strategies that the firm can choose from in controlling the duration of the process. The choice will depend in each instance on the balancing of two competing considerations: haste to complete the process and minimization of disruption to day-to-day practice and routine. By and large, the faster the pace of the self-assessment, the greater the short-term interruption of routine. On the other hand, the total amount of time taken by the process will not vary greatly; the issue will be how long a period over which to spread the process and any resulting disruption. The one relatively constant feature of the process is that each questionnaire has been designed so that it should not require more than one hour—two at the outside—to complete, plus perhaps one additional hour to gather supporting or relevant internal firm documentation to be considered alongside the responses to the questionnaires.

At one extreme, therefore, will be firms that choose to undertake the self-assessment in an intensive manner. This involves totally stopping and breaking from routine in order to conduct the entire process—probably in four stages, perhaps in a series of short firm retreats spaced as little as a week apart. Taking this approach, the first session, lasting not more than a day, would be used to introduce the process, and then both to circulate and complete the questionnaires. Some people would have multiple questionnaires to complete, such as senior administrative staff with responsibilities for aspects of new client and engagement management oversight of billing systems, and, perhaps, of calendar control and time management. Others would have only one or none to complete, if only a cross-section will be completing “Questionnaire 7—The Professional Staff.” Consequently, this day should be structured so that those with only one (or no) questionnaire to complete will participate in other activities, such as an internally led continuing professional education (CPE) program on a specific risk management topic. The interval between this first session and the second would be used by the partner or outside consultant in charge of the self-assessment to collate the responses, and to identify the main issues raised by the responses which require discussion and review at the second session that will follow this interlude.

The second session would be used to conduct the review sessions described in this Chapter in the section entitled Phase 4 and would itself be followed by an interlude used for the preparation of the report, as discussed in the section entitled Phase 5.

Next, a third session would be conducted for the firm’s management alone, to consider the report, and to decide the degree to which it wishes to implement the report’s recommendations.

Finally, the fourth session would convene the entire firm to review the self-assessment, the report, and management's decisions as to implementation. The actual length of the sessions and of the intervals, will depend on the scope of the self-assessment, the size of the firm, and the number of respondents involved in completing questionnaires. Even a mid-sized firm that chooses this intensive approach should be able to complete the whole process in between four and eight weeks, depending, again, on the scope of the self-assessment and the intensity of work between sessions to prepare for the next phase.

At the other extreme will be firms that prefer to break the process up into much smaller segments, perhaps holding a series of meetings before commencing the process. Then, having decided on both the scope of the self-assessment and the distribution list for the relevant questionnaires, the questionnaires are simply sent them out with a covering memorandum requesting that they be completed and returned by a stated deadline. If the entire process is conducted in this fashion, thus allowing participants to structure their involvement within the constraints of their individual schedules, the self-assessment—particularly if it is comprehensive—is likely to drag out for at least several more weeks than the intensive approach discussed above. Indeed, if a firm were to choose to undertake a comprehensive self-assessment, but to do so in stages, completing, reviewing, and reporting on each questionnaire separately, the process could quite appropriately last for eighteen months by allowing two months for each segment. Nevertheless, there is no reason why the self-assessment of the firm taking a slower approach should be any less effective in the long run; the choice is simply another example of how firm cultures can and do affect management decisions, without any particular positive or negative values necessarily following from the choice of approach to this timing issue. Both the tortoise and the hare will arrive at the same finishing line in the end.

### **Repeating the Assessment Process**

To firms considering their first risk management self-assessment, it may seem premature to discuss the timing of follow-up assessments. However, the subject is inescapable. This is because risk management is a continuous, ongoing process, and self-assessment is a snapshot in time. It is vital that, periodically, those responsible for risk management assure themselves and the firm's senior management, that they are succeeding in their efforts. Some elements of this review process, such as the introduction of an internal peer review program, may be institutionalized as an ongoing undertaking. Others require monitoring, at least occasionally. For instance, the only way to be sure that new client and engagement policies and procedures are being implemented as nearly uniformly and universally as possible is to check; and the simplest method of checking is to conduct a follow-up assessment, albeit perhaps of limited scope. This aspect of risk management ought to be an automatic task for the partner or outside consultant assigned to oversee the firm's risk management program. The timing of such limited follow-up self-assessments may appropriately vary depending on a variety of factors, including the size of the firm, the appearance of problems, the turnover of staff, and the differing risk categories of concern or relevance to a firm's practice. As a very simple rule of thumb, however, there is no risk category which, having once been surveyed, should not be subject to some checking on an annual basis. For instance, in the area of new clients and engagements, such a review might involve a random check of a small number of files to ensure, for instance, that appropriate engagement letters are in the files, with the relevant client countersignatures. Similarly, a firm that establishes a risk management program should consider conducting at least some

elements of a true assessment, as defined here, within every three to five years. Even firms which have vigorous risk management should be concerned that things may be too comfortable, and that problems may go unnoticed (or be deliberately ignored), unless at least partial assessments are conducted within reasonable intervals, subject to variations in the length of the intervals based on the same variables outlined above in discussing the initial decisions regarding the scope and timing of first time self-assessments.

### **PHASE 3—DISTRIBUTION AND COMPLETION OF QUESTIONNAIRES**

Having selected which elements of the survey to undertake, copies of the relevant questionnaire(s) should be distributed to the appropriate partners or other staff, either with an accompanying memorandum described below, or following a firm meeting at which the same information is conveyed. In addition to the explanation of the appropriate distribution for each questionnaire in connection with Phase 2, each of the questionnaires begins with its own introduction, including further descriptive material indicating the partners and staff who should be asked to complete them. By way of example, the introduction to “Questionnaire 3—New Client and Engagement Acceptance,” follows.

#### **QUALITY/ IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS**

##### **QUESTIONNAIRE 3—NEW CLIENT AND ENGAGEMENT ACCEPTANCE**

1. This questionnaire has been developed with the following two purposes in mind:
  - a. To assemble and organize the information regarding the firm’s existing new client and engagement acceptance policies and procedures
  - b. To give the firm’s management an opportunity to develop an initial, benchmark view of its new client and engagement acceptance policies and procedures, for purposes of comparison with the answer and analysis sheet
2. This questionnaire should be completed by the managing partner or other partner of the firm who currently has the greatest share of responsibility for oversight of the new client and engagement acceptance process.
3. The following steps should be taken in answering the survey.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A* (not applicable).
  - b. The firm may decide to alter the answers, as follows.
    - i. If the firm later decides either to prepare or supplement its formal policy statement concerning new client and engagement policies and procedures, and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to the questions, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures in more detail should be attached.
4. If the questionnaire has been completed, turn to the answer and analysis sheet. By comparing your firm’s responses to the material set out in the answer and analysis sheets, you will determine the extent to which your current policies and procedures succeed or fail in providing secure and effective risk management oversight in the area of new client and engagement acceptance, and the particular aspects that may benefit from additional attention or restructuring.

Prior to receiving a questionnaire, each person who will be asked to respond should also either hear from the firm's senior management at a meeting of the kind described in this Chapter or, at a minimum, receive a memorandum explaining the following:

- *Why* the questionnaire is being circulated, both in general and, if relevant, to each recipient;
- *To what use* the information will be put
- Containing any appropriate additional instructions, a *deadline* for completion and return of the questionnaire

The memorandum (or meeting) should also explain that the completion should not take more than an hour (two at the most), and possibly only a few minutes. In addition, assuming that this comports with the firm's culture, each recipient should be informed that after completion, he or she will receive the answer and analysis sheet(s) relating to the questionnaire(s) he or she has completed, and that he or she will be included in a review session during which the implications of the questions, and the recipient's responses will be discussed.

By way of preview, and to demonstrate the straightforward nature of the questionnaires (including the simple *yes, no, or NA* format), the following is the first page of Questionnaire 3—The New Client and Engagement Acceptance,” the “Introduction” to which is set out above).

**A. CLIENT ACCEPTANCE—GENERAL**

	YES	NO	N/A
1. Does the firm have a standard prospective or actual new client form?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Is it possible for the firm to accept a client without completion of the standard new client form?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Is there a partner or committee responsible for oversight of client acceptance?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Is the partner or committee available to review new clients on a daily basis?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Does the partner or committee have the authority to reject proposed new clients and engagements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. In the event of a disagreement with the introducing partner, does any partner or committee have authority to reject a new client?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Does the firm solicit business by entering “beauty contests” sponsored by prospective clients?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

(continued)

**A. CLIENT ACCEPTANCE—GENERAL** *(continued)*

	YES	NO	N/A
8. a. Does the firm have written policies and procedures to review the potential for independence violations or conflicts of interest before participating in such solicitation?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Was the policy statement last circulated			
i. Within the last three months	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Three to six months ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. Seven to twelve months ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iv. More than one year ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Hopefully, it will be apparent from this excerpt (which is typical) that the questionnaires are straightforward, and easy to complete.

Apart from “Questionnaire 7—The Professional Staff,” the questionnaires are not intended to be answered anonymously. The central idea is that those *responsible* for given aspects of risk management answer “on the record.” Different considerations may apply to this questionnaire, since this is intended to be a check on the accuracy of the perceptions of those with actual responsibilities against those *without* such responsibilities, and since those responding may feel inhibited from responding with complete candor if they have any fear of reprisals of any kind because their identities may be revealed. Accordingly, whether it is necessary or appropriate for this particular questionnaire to be answered anonymously, or whether that should be optional, is a matter for each firm’s management to decide. The determination should be made when the cover memorandum is formulated, or when preparing for the preliminary meeting to introduce the self-assessment, and should be made in the light of the firm’s culture and of the circumstances surrounding the decision to conduct the self-assessment.

**PHASE 4—DISTRIBUTION OF ANSWER AND ANALYSIS SHEETS AND CONDUCTING REVIEW SESSIONS**

The answer and analysis sheet corresponding to the questionnaire should be distributed to each person as he or she returns his or her completed questionnaire, even before the person supervising the self-assessment has reviewed the responses. This serves the purpose of immediately giving the participants in the self-assessment process an understanding of the significance of the material under study. In addition to whatever specific and substantive information is developed from their answers, each participant will thereby also gain an increased sense of the significance of the risk management process to the firm’s well-being.

Again by way of example, the following is the Introduction to and the answers and analysis to the questions in “Questionnaire 3—New Client and Engagement Acceptance” excerpted above, taken from the corresponding answer and analysis sheet.



**QUALITY/IN (QUIC) CONTROL SURVEY FOR ACCOUNTING FIRMS  
QUESTIONNAIRE 3—NEW CLIENT AND ENGAGEMENT ACCEPTANCE  
ANSWER AND ANALYSIS SHEET**

**I. FUNCTION**

This questionnaire is designed to explore the following:

- The scope of the firm's existing new client and engagement acceptance policies and procedures, and the degree to which they are implemented
- The extent to which the existing policies and procedures effectively control the risks associated with or which can arise from the new client and engagement acceptance process

This answer and analysis sheet (otherwise known as the "Crib Sheet"), to be most useful, should not be read or reviewed by anyone until all those asked to respond to the "New Client and Engagement Acceptance Questionnaire" have completed the process of responding to the questionnaire. Then an initial, twofold review can begin. First, each individual should consider his or her responses in the light of this Crib Sheet. Second, everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the current state of the firm's management structure for the control of the new client and engagement acceptance process. Once there is agreement as to what is in place, and how the process is operating, the question of what gaps or problems exist, and what can be done to close them can be addressed, consistent with the inevitable tensions between the firm's management culture and the dangers inherent in doing nothing.

A third level of comparison will also assist, namely comparison of the responses to this questionnaire with the responses to the separate questionnaires, "Questionnaire 1—Firm Leadership and Management Structure," and "Questionnaire 2—Risk Management Structure." To the extent that the responses of the firm's senior management and its risk managers do not agree with the views of the partner(s) and administrators actually charged with the day-to-day oversight of the new client and engagement acceptance process, the firm will also have to address what adjustments in the actual system are necessary, appropriate, and realistically possible to bring perception closer to reality.

For many firms, the answers yielded by this review process will either reassure or enable those firms to decide upon and to implement any needed changes to their new client and engagement acceptance policies and procedures. For some, on the other hand, the answers yielded by this review may create dilemmas or the potential for internal conflict of a kind that will lead the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at the strategies and tactics to implement needed changes. In that event, help is available from a number of sources. First, many of the professional liability insurers have staff that are knowledgeable and available to give guidance in many areas. Second, the author of this QUICS process is available to consult and provide assistance and guidance, as no doubt, are other independent consultants.

**II. SCOPE**

This Crib Sheet, and its companions relating to the other QUICS questionnaires, are designed to raise issues and provoke self-examination within the firm. The central purpose of the questions, and of this Crib Sheet, is to help determine whether a

comprehensive system of new client and engagement acceptance is in place and appropriately overseen to control the risks that are inevitable if new clients and engagements are inadequately screened, reviewed, and controlled. Thus, the answers and analysis contained in this Crib Sheet are intended to perform the following two functions.

- Provide explanations and definitions of the key *problems* and risks that the underlying questionnaire is intended to uncover in the context of a particular firm.
- Generally review the accounting and legal liability issues that may arise if the management of these issues falls short of adequate.

It is not the intention of the authors that the Crib Sheets constitute a complete analysis of the new client and engagement acceptance process. Rather, it is our purpose to help firms to determine whether they have systems, policies, and effective procedures in place that enable them, internally, to supervise the process so as to be able to anticipate, and to control the various new client and engagement acceptance problems and issues as and when they may arise, but before they become threatening. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of its practice.

### **III. STRUCTURE**

The Crib Sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the Crib Sheet provides three levels of guidance. First, the significance of the question is reviewed, meaning, “Why are we asking you this?” Second, the broad implications of each response (*yes, no, or N/A*) are discussed. Third, there is an explanation of the level of importance of addressing the gaps uncovered in policies or procedures.

### **ANSWERS AND ANALYSIS**

#### **A. CLIENT ACCEPTANCE—GENERAL**

1. It is *essential* that every firm have a highly detailed new client and engagement acceptance questionnaire or form. Accordingly, any *no* or *N/A* answer immediately and automatically triggers loud alarm bells. Without an appropriate form, no meaningful control of the new client and engagement acceptance process is possible. In addition, the lack of such a form is likely to lead to billing and collection problems.

The new client form should encompass *at least* the following matters:

- Name and address of the client
- Names of all officers and directors of a corporate entity
- Names of all related, subsidiary, associated, or parent entities of the client
- Intended billing arrangements
- The identity of partners and others involved in introducing the new client
- A description of the following: the nature and scope of the engagement; any limitations agreed to with the client on the terms of the engagement; and the specific areas of expertise likely to be required

- If a prior accounting firm was utilized by the client, a detailed explanation for the reasons underlying the change; *and* confirmation that the prospective client has given permission to call upon prior accountant
- Any special circumstances concerning the client that should be disclosed to the partners or committee responsible for new client acceptance prior to accepting the engagement
  2. Assuming that the firm does have an appropriate new client and engagement acceptance form, its mere existence is of no value *unless its use is required in all circumstances and without exception*. The best way to ensure that this is the case is to structure each of the file opening, time recording, and billing systems in such a way that they cannot be operated *in any way* until *each* of the following two conditions have been met.
    - a. The standard form has been *fully* completed, and signed by a partner
    - b. The form has been reviewed and approved as discussed below at items 3, 4, 5, and 6.
  3. Assuming that the firm has both an appropriate new client and engagement acceptance form and both of the controls described in item 2 above, the system is still of no value *unless there is fully independent oversight and control of the new client/engagement acceptance decisions*. This applies to all firms with more than one principal or partner. The key element here is *objectivity*. The essential requirement is that the partner and committee have the final authority to determine if, or on what conditions, the engagement should be accepted by the firm. The introducing partner should have no veto or right to circumvent this decision-making process under any circumstances. The future financial well-being of the firm and of every individual partner may depend on this. At least arguably, several of the recent major claims against and settlements by accounting firms result, at root, from their failure to control the new client and engagement acceptance process—whether the result of inadequate checks on the entity or its management, inadequate “smell testing,” or inadequate staffing for accounting issues. If the firm takes on clients for the short-term billings believed available, without reviewing all of the matters listed at item 1 above, sooner or later a claim will arise that could have been avoided or protected against.

Although some firms have reservations about this kind of strictly enforced, objective review, partly justified on the ground that it is intrusive upon the prospective client, we suggest that such misgivings are ill founded. On the contrary, desirable clients to whom the process is carefully explained should be *reassured* by the thoroughness of the process, which they will rightly see as being for their own protection, as well as for the benefit of the firm and its existing clients.

4. Again, as to all firms with more than one partner or principal, unless the answer to this question is *yes*, the firm cannot adequately respond to the needs of potential new clients, unless the rules discussed in items 1, 2, and 3 above are going to get “bent.” Accordingly, *no* or *N/A* answers should constitute another alarm bell that the system may not be adequate to protect against inappropriate engagements.
5. For the reasons set out in the prior responses, it will be clear that even objectivity within a thorough review process will ultimately provide no protection unless the reviewing partner or committee has the *authority* to make decisions binding upon the introducing partner, not responsibility without authority. The issue here is to counterbalance the obvious and

- usually appropriate and commendable impulse to accept all potential new clients against the necessary level of caution and care needed to avoid accepting engagements that carry unacceptable levels of risk.
6. The purpose is to indicate that an “appeals” process may be appropriate in some firms, but that whatever consideration is given to the introducing partner’s views and wishes, the firm, not the introducing partner *must* make the final decision in each case.
  7. The significance of “beauty contests” within the general category of client development is that they may pose dangers in the realm of client conflicts. Since meetings held with potential clients for such purposes may involve the disclosure of confidential or sensitive information, it is important to look closely before entering “beauty contests.” It is because of these potential dangers that a *yes* answer requires careful attention to items 8 and 9.
  8. The following also apply.
    - a. If the answer to item 7 was *yes*, it is important that the firm have clearly defined policies and review procedures in place to address, identify, and avoid the potential dangers described. Accordingly, a *no* or *N/A* here exposes a potential gap in the new client and engagement acceptance system.
    - b. If the appropriate policy and procedure exists, is it known to and understood by the partners? This question addresses the issue of how to communicate with individual firm members in situations in which actual controls are hard to devise. Whereas the system of file opening, time recording, and billing can have internal controls effectively embedded in them, it is harder to control an activity that partners are supposed to be engaged upon when they are not doing client work, namely client development. Accordingly, it is suggested that, absent other ways of actually controlling these activities, there should be regular and *frequent* circulation of this policy and the reasons for its existence. It is suggested this information must be circulated at least once a year; any intervals longer than one year may be inadequate.

As with the extract from the underlying questionnaire to which this material corresponds, this extract is representative of the content and layout of all of the answer and analysis sheets.

In addition to distributing the answer and analysis sheets, it is important to hold a formal review session. All of the respondents to each questionnaire should meet to compare notes, as this will help in the process of verifying individuals’ conclusions, and in developing a consensus within the firm of what if anything can and should be done in the way of changing or developing new policies and procedures. It will also help cement the process, begun at the inception of the self-assessment, of emphasizing both the importance of risk management generally to the future well being of the firm and the fact that everyone in the firm has continuing responsibilities within the process.

### PHASE 5—PREPARATION OF A REPORT

The QUICS self-assessment process is intended to be more than a training exercise. The responses of the participants to the questionnaires, and the reaction of the respondents to the materials at the review sessions, should be reviewed and considered by the person in charge of the self-assessment process. In this way, all areas covered in individual

questionnaires are compared, so as to ascertain both those elements of risk management that are agreed by all, as well as those for which there are differing perceptions. In addition, “Questionnaire 7—Professional Staff,” should be carefully reviewed in order to verify the comments and conclusions of those responding to the other questionnaires. All of these responses should then be gathered, in the form of a report to senior management, which should include whatever consensus exists for needed changes in policies and procedures, and the suggested means of their implementation.

There is a structure that is appropriate for this report. Under a separate subheading for each risk management category surveyed and questionnaire distributed and completed, the report should address the following:

- The perception of current risk management policies and procedures held by firm management
- The perception of current risk management policies and procedures held by those accountable or responsible for their development and implementation
- The actual level of awareness and perception, as well as adherence, to the policies and procedures by partners and professional staff
- The consensus (if any), and the risk management partner’s own recommendations regarding the need to add or to change existing policies and procedures under each heading

It is suggested that any recommendations be separated into the following categories:

- Management changes needed
- Policies needed or requiring change or supplementation
- Procedures needed or requiring supplementation
  - Form documents needed, including suggested models
  - Implementation suggestions, including analysis as to the extent to which the firm can or should proceed internally, or will need outside input and assistance

## **PHASE 6—CONSIDERATION AND IMPLEMENTATION OF THE REPORT**

The self-assessment process should conclude—and the new era of organized risk management should commence—when the management of the firm meets to review the findings and conclusions reached during the self-assessment. Some firms will have the satisfaction of discovering that they are well governed and managed in all relevant respects, and need make no changes. Others may find that, although the survey demonstrated some areas where the responses raise concerns about the firm’s policies or procedures, the firm is unable or unwilling to make changes. Nevertheless, at least their decisions will be made intelligently, and not by default. In those firms in which the process demonstrates a consensus in favor of needed changes, it is imperative—for the reasons discussed throughout these introductory chapters—that these be made not just with the concurrence, but with the active support of senior management. For risk management to work effectively in any area, it must be applied across the board, in the sense of “equality before the law.” Accordingly, management must support, and be seen to support, not just the process but any changes resulting from it. Firms that do proceed in this way will hopefully find not only that their internal operations run more smoothly, but that they derive positive benefits

in the added respect of their clients and potential clients, in the control and prevention of claims, and the reduction or at least control of insurance costs.

Most firms, having progressed through items 1 through 5, will have the ability to implement the changes in a manner consistent with the firm's existing culture and governance structure. For some firms, the needed changes may raise difficult questions relating to their management structure and their culture generally. In those firms, the changes suggested by the self-assessment may be hindered in their adoption by internal politics, and difficulties may be encountered in obtaining the requisite consensus for making those underlying reforms to the firm's existing culture. For firms finding themselves in this predicament, even if they conducted the survey as a self-assessment, it is often helpful at this juncture to consult outside experts who can act as both counselors and mediators, and who can also "take the heat" of finding an acceptable solution to the problems which have been identified. The goal of the QUICS process is to strengthen firms, not to create divisions within them. Chapter 6, "What Is a Self-Assessment?" discusses this and other aspects of the implementation process in more detail.

# Chapter 8

## Follow-Up and Implementation

### INTERNALLY OR EXTERNALLY DIRECTED REFORMS

Although the risk management survey is an essential prerequisite for the establishment and maintenance of an effective risk management system, it is the beginning, not the end of the process. The first question confronting a firm that has completed what is, after all, a thorough diagnostic workup, is how to go about the process of turning the information generated, particularly the insights into the shortcomings of existing policies and procedures, into useful, acceptable, and workable reforms. The second question, following on the heels of the first, is the same one that arose at the start of the self-assessment process—Should the firm do-it-itself, or hire an outside consultant to oversee the implementation process? Here, however, it is quite possible that the answer may be different, because the considerations, pressures, and the benefits of each approach are different.

The question of control—over information, cost and timing—may be less significant at this stage. Now the issue is less a matter of divulging firm secrets than seeking defined management expertise in developing specific solutions to meet identified problems. On the other side of this same issue is the important consideration of whether there are, within the firm, the necessary skills to develop the specific tools appropriate to the particular needs. Firms are almost always well aware of who, within the various practice groups, are the effective rainmakers and the strongest practitioners. Much more problematic is identifying those who are skilled and interested in taking a management and leadership role in the administration of the firm (as opposed to heading up a practice area). Often, even if individuals with the capacity to perform these functions have already emerged, there is real conflict both in the mind of the individual and among the other partners as to whether the best use of individual talents is management, as opposed to active revenue generation through practice. It is for this reason that a number of firms have moved to copy the practice of other large business enterprises, namely, hiring the equivalent of a chief executive to perform this function. Although it is clear that there is no single correct model of accounting firm governance, risk management principles, as discussed here, strongly indicate the need for a structure that is centralized to an extent sufficient to overcome the cottage-industry system, but also humble and flexible enough to recognize and accept the principle of equality before the law. Only with this balance will risk management take effective root. To the extent that firms have not already established a culture in which governance with these attributes exists, this may itself be an indication that outside help should be sought at this stage to help in making appropriate and positive changes to the firm's culture. Since having in place a management structure ready, willing, and able to practice and, when necessary, enforce risk management practices is the first element of

effective risk management, firms that come to perceive this to be a problem at any stage of the self-assessment process may, as suggested in Chapter 6, “What Is a Self-Assessment?” do well to look for outside help in developing a governance structure that will work for the future as the first step in implementing the findings of their risk management self-assessment.

The question of firm culture and politics may play an even more important role at this juncture than in deciding who should conduct the self-assessment in the first place. Firms with very strong central authority structures may react very differently to the prospect of outside practice management consultants than firms that are more collegial and democratic in organization. Even within the category of firms with strong central management, the reactions of a strong individual founding and managing partner (or group of founding senior partners) may be very different from a strong management committee that is elected and therefore more accustomed to consensus-building within the firm. In both cases, the real challenge is to find the approach that will most easily lead to the adoption of effective risk management solutions which can carry the endorsement of the firm’s management. Firms will have to address all of the variables that go into these cultural problems in deciding for themselves whether they have both the ability, the personnel resources, and the will to make the necessary changes from within or whether outside help is essential to accomplish the desired results.

### **THE ELEMENTS OF EFFECTIVE IMPLEMENTATION**

As anyone familiar with medicine knows, even if there is a full and accurate diagnosis, selecting effective treatment may be as much art as science. Drugs have side effects, both known and sometimes surprising, and some patients may actually be allergic to what would otherwise be a standard treatment. So it is with risk management in accounting firms. Policies designed to rein in lone-wolf partners in one area of a firm may have unanticipated and unpleasant consequences in entirely different practice areas. Procedures established to create uniform systems—perhaps billing, or docket control—may cause a political firestorm from a segment of the firm not previously identified as threatened by such changes.

There are many examples of this phenomenon of unintended consequences within accounting firms. For instance, the story is told (probably not apocryphally) of a large and prominent firm in New York where the management committee had decided to install a new computer network, one of the principal reasons for which was to establish an improved calendar and docket control system. Unfortunately, whether because of governance problems going back to cottage-industry issues, or simply (as the partner concerned loudly avowed) because of the cost of the proposed system, the head of the firm’s litigation practice went out one weekend with his pick-up truck and purchased, delivered to the office, and installed on the desks of everyone in his practice group, a set of basic, stand-alone personal computers that were compatible with each other (although not networked), but incompatible with both the hardware or software selected for installation by the firm’s management.

Other unintended consequences of changes in management systems can be even more dramatic and potentially destructive. At the extreme, risk management systems imposed in ways for any reason perceived as threatening may yield departures from the firm of otherwise valued partners or whole practice groups.



Precisely because the appropriate responses to assessment findings are so closely tied to the particular culture of each firm, all that is possible in these materials is to set out the common denominators of all *successful* implementation strategies. It will be up to each firm, alone or with its outside consultant, to strive to find solutions which conform to these basic parameters. Successful risk management tools necessarily meet most if not all of the following criteria.

- They must be as simple.
- They must be user-friendly.
- They must be self-executing.
- They must not add to firm expenses.
- They must have the unequivocal support of the firm's leadership.

### **Simplicity**

Risk management tools must be as simple as possible. Although new procedures may involve changes to the firm's operating manual, complicated and lengthy policy statements are to be avoided; they are boring, and are likely to be ignored. If complexity is unavoidable, for instance when new computer hardware (or software) is a component of improved scheduling (or new billing systems), the changes need to be introduced in two phases in order, as far as possible, to *make* the complex solution practicable. First, the reasons for and the anticipated benefits of the changes needs to be explained to everyone concerned. Second, adequate training must be given to *everyone* who will need to use the system, and training will also have to be integrated into the orientation of new hires. By way of contrast, in the same example, the rule of simplicity would not be met and would be violated by the mere circulation of a computer manual to the people required to use the complex new system.

### **User-Friendly**

Risk management is intended, as one of its benefits, to improve the overall quality of the services which firms provide to their clients. Accordingly, risk management procedures which are time-consuming or appear to impede the ability of fee-generating professionals to do their billable work, are not likely to be perceived as improvements. Thus, if a firm determines that it needs to improve its monitoring of billing or expense recording, in order to avoid billing disputes with clients, or embarrassments of the kind recently reported among the Big Five, the new systems should as far as possible be automated and integrated within the computer system, or should be independently monitored by support staff rather than fee earning partners.

Some forms of risk management are regarded by accountants as inherently unfriendly. The most obvious example of this is peer review. Even here, however, the principle of user-friendly procedures can apply. There is all the difference in the world between peer review which is structured or operated as a hostile, big-brother-is-watching-and-reviewing-your-files, as is reputedly the case in some of the accounting firms, and a program which, on an ongoing basis, requires partners to work in teams with colleagues on a certain number of cases each year, where support as well as mutual evaluation, is an integral component. Evaluation remains an important element of effective peer review, but, like any criticism, it

can be constructive or destructive. In introducing peer review of any kind, firms should ensure that the emphasis is on the positive attributes of the program, and on its goal, the maintenance of standards of service to clients. Similarly, in establishing other human resources risk management policies and procedures, such as those designed to avoid discrimination or misconduct in the workplace, or to identify partners or staff suffering from alcohol or drug abuse problems, programs that emphasize the protective or helping nature of the policies or procedures are likely to make them simultaneously less threatening and more effective. This issue of presentation is thus a part of making risk management user-friendly, even if the subject matter is apparently or necessarily intrusive. Similarly, if a risk management procedure is inherently burdensome on fee-earning partners or staff, such as an improved and more complex new client and engagement acceptance review process, it will be easier to gain acceptance if it is made clear that the system selected is *less* burdensome and intrusive, and easier for individuals to operate, than alternative systems that were considered and rejected.

### **Self-Executing**

Ideally, effective risk management tools should operate in such a way that the system in question will not work any other way. For instance, if it is determined after the self-assessment that the firm's new client procedures need revamping, perhaps to improve conflict checking and avoidance, the new system should operate so that no time can be billed to clients without the issuance of billing codes, and that these are tightly controlled by support staff so that the prerequisite checks must be made *before* the client is accepted into the billing system. This would include, for instance, making sure that temporary or personal billing codes cannot be used to subvert the new requirements. In this way, the system compels its users, primarily the partners, to adapt to and use the new tool, which will, it is hoped, quickly become second nature. Similarly, if potential conflicts are identified, the new system should operate like an automatic alarm, thereby alerting management to the existence of policy issues needing to be addressed, and avoiding decision making by the interested partner. Again, for example, no client or matter number for billing or time recording purposes should be possible until the relevant independent approval has been obtained.

### **No Additional Expense**

Unless inherent to the prevention of specific losses, to the greatest extent possible risk management tools should be structured so as not to add to firm expenses. Sometimes it will be of the essence of the problem identified that a cost will be involved in solving it. For instance, arranging off-site storage of backup computer records as part of disaster recovery preparations will inevitably involve some expense, but the decision to take such precautionary steps will obviously follow from an assessment of the liabilities, and the operational problems which would arise if a disaster were to occur without implementing basic preventive steps.

There is a more subtle danger involved in relation to the expense of implementing risk management procedures, namely, that the firm's support staff will be overburdened by additional procedures. Ultimately, the size and cost of supporting the firm's activities will thus rise, albeit apparently indirectly. This will require careful evaluation and, as with everything else to do with risk management, will come down to a cost-benefit analysis—an

assessment of the comparative benefit to be gained from making each suggested risk management change measured against the actual and potential costs of making the changes. In this analysis, costs include both any direct out-of-pocket expenses associated with the change, as well as any indirect (but nonetheless real) costs, such as disruption to accountants' practices, loss of billable time, or even, at the extreme and as discussed earlier, the departure of accountants. The firm will therefore need to decide, with each risk management tool individually, and with the cumulative package, what risks it can live with without prophylactic steps, what tools will add to the firm's service to its clients, and what risks it must protect against despite whatever costs are inherent in obtaining that security.

### **Management Commitment**

As has been stressed throughout these introductory chapters, the support, and commitment of a firm's management is an essential prerequisite and a nonnegotiable and nonwaivable component of effective risk management. It is absolutely essential for the effectiveness of individual risk management mechanisms and for the successful implementation of a regime of risk management, that the firm's leadership be *seen to be committed* to the program. This commitment must specifically, and publicly include acceptance of the need and of the will to enforcing compliance at *every* level, including within the ranks of senior management and powerful partners. Unless the principle of equality before the law is unequivocally a part of the process, risk management will, sooner or later, fail. If policies and procedures are to be followed only when it suits the partners, and not when the difficult issues actually arise, then by definition the process has already failed. It is precisely to prevent situations like undertaking conflicting client representations, or deliberate overbilling of clients, that risk management is imposed. To work, there must be *no exceptions*. That is what leadership and true management of any organization is ultimately about. To go back to the cottage-industry model with which we began in Chapter 1, "What Is 'Risk Management' (or 'Loss Prevention') Anyway?" the fundamental question facing firms which are considering the utility of risk management is whether they are willing to move past that structure. Are they willing to accept—for the good of the whole (and therefore, ultimately, for the good of the parts)—the controls and, sometimes, the restrictions inherent in effective risk management? Only in firms where management accepts that basic premise is there any hope that the rest of its membership and its staff, will go along.

Accordingly, a suggested first step in implementing those recommendations of the self-assessment report accepted by a firm's management will be for management to *communicate* its decisions and its support. The model memorandum in Chapter 7, "How to Conduct a Self-Assessment," which might be used to introduce the appointment of a partner (or outside consultant) to oversee risk management, and the self-assessment process, can be dusted off and revised to form the basis for this renewed expression of commitment to the implementation process.

### **TIMING THE IMPLEMENTATION OF RISK MANAGEMENT**

As with the timing of the self-assessment process, so again with the implementation of changes prompted by a self-assessment, the timing of the introduction of changes is entirely within the control of the firm seeking to make the changes. The choice will depend in each instance on the balancing of the following three, sometimes competing considerations:

1. Haste to complete the process
2. Minimization of disruption to day-to-day practice and routine
3. The need to obtain the acceptance of the changes from those that will be affected

As discussed earlier in this Chapter, the last of these three considerations may, in some situations, also be the most important; there is no point in abruptly making a change which, however strongly management is committed to the idea, may, in the worst case, propel the disintegration of the firm. Thus, the timing of the actual introduction of changes, especially those that involve significant changes in firm governance or culture, should not be rushed. Equally, these may be the changes most strongly indicated by the self-assessment. Accordingly, there is only general guidance to be given on the subject of timing: use *all deliberate speed*.

In some ways, the same principles which guided a firm to use a fast or slow track in the self-assessment process itself will probably be a good guide again at this implementation phase. Indeed, a firm which chose to undertake the self-assessment in slow and steady phases may well structure its assessment process so that, upon completing any given questionnaire, it then goes through the phase of approval and implementation of needed changes before proceeding to the next risk category. A firm which chose the fast track, on the other hand, is likely to lose momentum if implementation does not follow immediately or as fast as possible allowing for the development of whatever policies or systems must be developed or selected for the implementation to proceed. Hopefully, the dictum “all deliberate speed” will seem appropriate to both types of firms.

### **WHAT WILL AN INTEGRATED RISK MANAGEMENT PROGRAM LOOK LIKE?**

Precisely because accounting firms are so very diverse, there is no model package that can be distributed as a kind of universal vaccine to cure all problems and prevent all losses. Every firm is at a different stage of evolution towards recognition of and willingness to address the issues uncovered in a risk management survey. All that can be said is that risk management should meet the basic criteria discussed above and be responsive to the risks actually confronting the firm.

There are, however, some common threads to the kinds of mechanisms likely to be useful in meeting these needs. Among the specific solutions should be the development or improvement of replicable and reusable materials, and standardized forms and procedures, all of which will be designed toward creating a more efficient and risk-averse practice. Everything from new client and engagement acceptance forms through engagement letters, fee collection policies and procedures, opinion letter practices, formalized partner peer reviews, and all of the other processes discussed in the self-assessment process can and should be developed into standardized materials or procedures that will make the practice run more smoothly and uniformly. Ultimately, risk management tools should, both separately and as a package, improve the firm's ability to practice, and to serve its clients profitably within the ever more threatening climate facing the accounting profession.

Precisely because every firm that undertakes a risk management self-assessment will find that it identifies different needs in terms of implementation of new or revised policies and procedures from those identified by other firms, this is not the place to set out an exhaustive set of model forms, policy statements, and procedures. In addition, to do so

would transform this work, which is intended as a diagnostic tool, into an encyclopedia. However, help is at hand, in that such materials have been assembled in other works, and particularly in materials published by the AICPA. These have been referred to in the notes to the text, and are also set out in the bibliography which follows.

### **A TOOL—NOT A PANACEA**

The establishment of an effective risk management program by a firm cannot be accomplished overnight by the wave of a wand, magic, or otherwise. Rather, it is a process to be developed in stages. Most importantly, it cannot be accomplished in a vacuum. The mere fact that a firm or its management has decided upon a self-assessment (or has been propelled into undertaking one by its insurers) does not signify that it will help the firm in any way. Rather, risk management generally, and the self-assessment as the first step in the process, can only be effective if the leadership in the firm is willing to *lead* in accepting the need for and in starting the process of integrating risk management into the firm's culture.



## **Part 2**

# **Quality/In Control (QUIC) Survey for CPA Firms Questionnaires**

***Note:*** The questionnaires in Part 2 can also be found on the diskette that accompanies this publication





## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### QUESTIONNAIRE 1—FIRM LEADERSHIP AND MANAGEMENT STRUCTURE

1. This questionnaire has been developed with two purposes in mind:
  - a. To assemble and organize the information regarding the firm's existing risk management systems
  - b. To give the firm's management an opportunity to develop an initial, benchmark view of its risk management programs, for purposes of comparison with the answer and analysis sheet
2. This questionnaire should be completed by whichever of the managing partner, managing executive, or by the members of the management or executive committee of the firm is appropriate to the management of the firm.
3. The following steps should be taken in answering the survey.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A* (not applicable).
  - b. The firm may decide to supplement the answers, as follows.
    - i. If the firm later decides either to prepare a formal policy statement concerning management structure and allocation of responsibility, or to seek outside help to review the policies, practices, or management structures in place that relate to the questions, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures in more detail should be attached.
4. When the questionnaire has been completed, turn to the answer and analysis sheet. By comparing your firm's responses to the material set out in the answer and analysis sheet, you will determine the extent to which your current structure succeeds or fails in providing secure and effective risk management oversight, and the particular areas that may benefit from additional attention or restructuring.

**A. GENERAL MANAGEMENT STRUCTURE**

	YES	NO	N/A
1. Is there a written Partnership (or equivalent) Agreement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to question 1 is <i>yes</i> , has it been reviewed by the partners within any of the following intervals?			
a. One year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Five years	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Ten years	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Does the partnership agreement have in it any provision that in any way restricts or delays the freedom of withdrawing or retiring partners from practicing as CPAs?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the partnership agreement or the partner compensation formula adopted by the partnership tend to favor origination of business over time spent in the conduct of engagements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Which of the following best describes the management structure of the firm?			
a. Single managing partner	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Single managing executive who is a CPA	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Single managing executive who is not a CPA	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Managing or executive committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. If you answered question 5 by selecting <i>a</i> , <i>b</i> or <i>c</i> , to which of the following does the managing partner or executive report?			
a. The whole partnership	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. A committee of the partnership	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Which of the following best describes the meeting schedule of the committee or partnership referred to at 5 <i>d</i> , 6 <i>a</i> , or 6 <i>b</i> ?			
a. Weekly (or more than once per week)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Biweekly	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Monthly	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Quarterly	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Semiannually	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Annually	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Only as incidents occur	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 1—Firm Leadership and Management Structure**

**B. RISK MANAGEMENT OVERSIGHT**

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
8. Are any individual partners or CPAs designated by the managing partner or executive or committee as any of the following? If appropriate, answer <i>yes</i> to more than one.			
a. Firm Professional Regulations, Ethics and Procedures Partner	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Firm Loss Prevention or Risk Management Partner	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Firm Professional Liability Insurance Coverage Partner	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Firm Claims Management Partner	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Firm Quality Control Partner	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Firm Professional Staff Oversight Partner	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. If the answer to any part of question 8 was <i>no</i> , are there any subordinate committees which either collectively have the function or have a member designated as any of the following? If appropriate, answer <i>yes</i> to more than one.			
a. Firm Professional Regulations, Ethics and Procedures Partner or Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Firm Loss Prevention or Risk Management Partner or Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Firm Professional Liability Insurance Coverage Partner or Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Firm Claims Management Partner or Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Firm Quality Control Partner and Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Firm Professional Staff Oversight Partner and Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**B. RISK MANAGEMENT OVERSIGHT** *(continued)*

	YES	NO	N/A
10. Which of the following best describes the intervals between reports to the person or committee, as the case may be, of each of the persons who are designated to the functions described in questions 8 and 9?			
a. Weekly (or more than once per week)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Biweekly	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Monthly	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Quarterly	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Semiannually	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Annually	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Only as incidents occur	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. Do the functions of any of the persons who are designated to the functions described in questions 8 and 9 include responsibility for any of the following? If appropriate, answer <i>yes</i> to more than one.			
a. Prepare review and approve all new client and engagement acceptance policies and procedures (as defined in the guidelines).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Prepare or review and approve all standard forms used in the new client and engagement acceptance process, including engagement and nonengagement letters.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Prepare or review and approve all variances to standard billing arrangements.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Prepare or review and approve all policies and procedures regarding entrepreneurial activities with clients, directorships, and trading in client securities.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Prepare or review annual conflicts of interest disclosure statements by all professional staff.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Prepare or review and approve all opinion letters and audit reports.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Prepare or review and approve the policy or procedure as to who may sign audit reports.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
h. Prepare or review and approve the policies and procedures for regular internal peer reviews by partners, and reviews of partners' clients and matters.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 1—Firm Leadership and Management Structure**

**B. RISK MANAGEMENT OVERSIGHT** *(continued)*

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
i. Prepare or review and approve the policies and procedures for evaluating CPA firm mergers and lateral hires.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
j. Prepare or review and approve the policies and procedures for assuring compliance by branch offices with all practice and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
k. Supervise internal peer reviews by partners and reviews of partners' clients/matters.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
l. Supervise compliance with risk management policies and procedures by branch offices or merged CPA firms or lateral hires.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
m. Supervise or review of all professional staff work and performance evaluation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
n. Supervise policies and procedures to identify and deal with partners and professional staff with drug, alcohol, or substance related impairment problems.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
o. Supervise, review, and approve policies regarding continuing professional education.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
p. Supervise policies and procedures for training and continuously or regularly informing partners and professional staff regarding ethics and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
q. Supervise policies and procedures for introducing newly hired, laterally hired, and merged firm professional personnel to professional regulations, ethics and procedures, and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
r. Address all actual or potential professional regulations, ethics and procedure violations, grievance, malpractice or other claims or problems.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
s. Supervise all dealings with professional liability insurers and brokers regarding coverage and claims.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
t. Supervise or review and approve risk management policies for multidisciplinary and assurance services practices.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
u. Prepare, supervise, or review and approve all disaster recovery (meaning, if the firm's premises are damaged or unreachable because of a disaster) policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### QUESTIONNAIRE 2—RISK MANAGEMENT STRUCTURE

1. This questionnaire has been developed with the following two purposes in mind:
  - a. To assemble and organize the information regarding the firm's existing control structures, policies, and procedures in the areas of risk management, loss prevention, and ethics compliance
  - b. To give the firm's management an opportunity to develop an initial, benchmark view of its control over all aspects of risk management, for purposes of comparison with the Answer and Analysis Sheet
2. This questionnaire should be completed by whichever committee chair or partner of the firm who currently has the greatest share of responsibility for oversight of the risk management process.
3.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A*.
  - b. The firm may decide to supplement the answers, as follows:
    - i. If the firm later decides either to prepare, or to supplement its formal policy statement and procedures concerning risk management and ethics compliance, and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to these questions, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures in more detail should be attached.
4. Some of the questions inquire about particular quality control functions that parallel questions on the Firm Leadership Management Questionnaire. The reasons for repeating these inquiries include the following:
  - a. The need to corroborate the responses to the questionnaire completed by the management and staff of the reviewed firm—because the view from the “trenches” may be very different from the perception of senior management
  - b. The need to determine whether the firm has risk management policies and procedures which are adequate and appropriate to the firm's size and practice areas
  - c. The need to determine whether the firm's policies and procedures have been effectively communicated to the individual(s) responsible for quality control functions and to the professional staff generally
5. When the questionnaire has been completed, turn to the Answer and Analysis Form. By comparing your firm's responses to the material set out in the Answer and Analysis Form, you will determine the extent to which your current controls, policies, and procedures succeed or fail in providing secure and effective risk management oversight of the firm's practice, and the particular aspects that may benefit from additional attention or restructuring.

**A. RISK MANAGEMENT STRUCTURE**

	YES	NO	N/A
1. Have you reviewed the firm's Partnership Agreement within the last year?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Does it contain restrictions on the right of former partners to practice after departure from the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
a. Do the compensation provisions conflict with the firm's policies or procedures regarding new business or clients (by putting undue pressure, or giving undue reward for bringing in new clients)?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Do your responsibilities include requiring you to report to any of the following?			
a. A member of the firm's management or executive committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. A committee of the partnership other than the Management or Executive Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. The Management or Executive Committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. If the answer to item c is <i>yes</i> , are you a member of the Management or Executive Committee because of your risk management/ ethics responsibilities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Do you meet or report to the person referred to in item 3—			
a. Only as need arises?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Weekly?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Monthly?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Quarterly?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Annually?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Do your functions include responsibility for the following?			
a. Prepare, review, and approve all new client and engagement policies and procedures (as defined in the introductory materials).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Prepare or review and approve all standard forms used in the client intake process.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Prepare or review and approve all variances to standard billing arrangements.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Prepare or review and approve all policies and procedures regarding independence and conflicts issues, moonlighting activities and directorships.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



**Questionnaire 2—Risk Management Structure**

**A. RISK MANAGEMENT STRUCTURE** *(continued)*

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
e. Prepare or review and approve all policies and procedures regarding insider trading and securities trading by employees of the firm.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Prepare or review and approve all engagement letters.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Prepare or review and approve all variances from standard form engagement letters.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
h. If your answer to item g is <i>no</i> or <i>N/A</i> , there is a policy and procedure for review and approval by someone other than the initiating partner.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
i. Prepare or review and approve the policy or procedure as to who may sign opinion, reports, engagement letters and other client correspondence.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
j. Prepare or review and approve the policies and procedures for regular peer reviews by partners, and second partner review of engagements.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
k. Prepare or review and approve the policies and procedures for evaluating firm mergers and lateral hires of partners or senior professional staff.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
l. Prepare or review and approve the policies and procedures for assuring compliance by branch offices with all practice and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
m. Supervise peer reviews and engagement reviews by partners.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
n. Supervise compliance with risk management policies and procedures by branch offices/merged firms/lateral hires.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
o. Supervise or review of all professional staff work and performance evaluation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
p. Supervise policies and procedures to identify and address the impairment problems of partners or professional staff resulting from drug, alcohol, or substance abuse.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
q. Supervise or review and approval of policies regarding continuing professional education (CPE).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**Risk Management**

**A. RISK MANAGEMENT STRUCTURE** *(continued)*

	YES	NO	N/A
r. Supervise policies and procedures for training and continuously or regularly informing partners and professional staff regarding ethics and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
s. Supervise policies and procedures for introducing newly hired, laterally hired, and merged firm professional personnel to ethics and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
t. Address all actual or potential ethics, grievance, malpractice or other claims or problems.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
u. Address specific client issues that were handled less than fully competently.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
v. Supervise all dealings with professional liability insurers and brokers regarding coverage and claims.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
w. Supervise or review and approval of risk management policies for special practice areas.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
x. Give guidance on questions involving professional ethics to partners and professional staff of the firm.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. As to <i>all</i> of the areas listed in items 5a to 5x as to which you do <i>not</i> have any responsibility, is there another partner or committee of the firm with responsibility for <i>all</i> of these areas?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. As to each partner or committee identified in item 6, do you coordinate your risk management responsibilities, or report to, or meet on a regular, at least monthly basis with such partner or committee?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. With respect to each of the following questions (which you answered affirmatively at item 5 above), have you had occasion in the one year prior to this survey to actually exercise any of the following responsibilities in connection with any partner or professional staff person or client issue?			
a. Prepare, review, and approve all new client or engagement policies and procedures (as defined in the introductory materials).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Prepare or review and approve all standard forms used in the client intake process.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Prepare or review and approve all variances to standard billing arrangements.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 2—Risk Management Structure**

**A. RISK MANAGEMENT STRUCTURE** *(continued)*

	YES	NO	N/A
d. Prepare or review and approve all policies and procedures regarding independence and conflicts issues, moonlighting activities and directorships.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Prepare or review and approve all policies and procedures regarding insider trading and securities trading by employees of the firm.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Prepare or review and approve all engagement letters.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Prepare or review and approve all variances from standard form engagement letters.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
h. If your answer to item g is <i>no</i> or <i>N/A</i> , there is a policy and procedure for review and approval by someone other than the initiating partner.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
i. Prepare or review and approve the policy or procedure as to who may sign opinion, reports, engagement letters and other client correspondence.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
j. Prepare or review and approve the policies and procedures for regular peer reviews by partners, and second partner review of engagements.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
k. Prepare or review and approve the policies and procedures for evaluating firm mergers and lateral hires of partners or senior professional staff.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
l. Prepare or review and approve the policies and procedures for assuring compliance by branch offices with all practice and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
m. Supervise peer reviews and engagement reviews by partners.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
n. Supervise compliance with risk management policies and procedures by branch offices/merged firms/lateral hires.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
o. Supervise or review of all professional staff work and performance evaluation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
p. Supervise policies and procedures to identify and address the impairment problems of partners and professional staff resulting from drug, alcohol, or substance abuse.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
q. Supervise or review and approval of policies regarding CPE.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**Risk Management**

**A. RISK MANAGEMENT STRUCTURE (continued)**

	YES	NO	N/A
r. Supervise policies and procedures for training and continuously or regularly informing partners and professional staff regarding ethics and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
s. Supervise policies and procedures for introducing newly hired, laterally hired, and merged firm professional personnel to ethics and risk management policies and procedures.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
t. Address all actual or potential ethics, grievance, malpractice or other claims or problems.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
u. Address specific client issues that were handled less than fully competently.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
v. Supervise all dealings with professional liability insurers and brokers regarding coverage and claims	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
w. Supervise or review and approve risk management policies for special practice areas.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. As to all matters in item 8 to which the answer is <i>yes</i> , were these ultimately resolved either by you, or in accordance with your recommendations?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. Are you aware of matters identified in item 8 which were addressed by others during the same period?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. As to each of the matters identified in item 10, in your view were they resolved appropriately?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. In addition to matters referred to at item 8 above, in relation to item 5t, answer the following.			
a. Have there been any instances where any person within the firm has alleged a violation of the AICPA Code of Professional Conduct, State Board of Accountancy, or State Society Rules of Ethics or Conduct against any member or professional staff person of the firm within the three years preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Have there been any complaints to the grievance or discipline authorities against any member or professional staff person of the firm within the three years preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. With respect to all matters falling within item 12a and 12b, were you responsible for handling these matters?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 2—Risk Management Structure**

**A. RISK MANAGEMENT STRUCTURE** *(continued)*

	YES	NO	N/A
d. If, as to any matters referred to at item 12c, the answer was <i>no</i> , in your view, were such matters appropriately handled by the firm, and appropriately resolved?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. Do you have adequate library resource materials to perform your risk management functions?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. Do you have available to you the following?			
a. AICPA Code of Professional Conduct and State Board of Accountancy and State Society Rules of Ethics or Conduct for all states in which the firm practices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Independent Standards Board Rules, for example, the U.S. Securities and Exchange Commission (SEC) and the U.S. Department of Labor (DOL) if applicable to the firm's practice	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Rules from the AICPA SEC Practice Section (SECPS), if the firm is a member	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Audit Risk Alerts for all industries served by the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. Do you have adequate staff, time (relative to your other obligations in the firm), and other resources to perform all of your risk management functions?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
16. Have you requested the firm's management to make changes in the risk management policies and procedures that have been rejected?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. Have you requested the firm's management to make changes in the allocation of resources (including your time) to the risk management functions which have been rejected?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



**QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS**  
**QUESTIONNAIRE 3—NEW CLIENT AND ENGAGEMENT ACCEPTANCE**

1. This questionnaire has been developed with the following two purposes in mind:
  - a. To assemble and organize the information regarding the firm's existing new client and engagement acceptance policies and procedures
  - b. To give the firm's management an opportunity to develop an initial, benchmark view of its new client and engagement acceptance policies and procedures, for purposes of comparison with the answer and analysis sheet
2. This questionnaire should be completed by the managing partner or other partner of the firm who currently has the greatest share of responsibility for oversight of the new client and engagement acceptance process.
3. The following steps should be taken in answering the survey.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A*.
  - b. The firm may decide to supplement the answers, as follows.
    - i. If the firm later decides either to prepare, or to supplement its formal policy statement concerning new client and engagement policies and procedures, and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to the questions, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures in more detail should be attached.
4. When the questionnaire has been completed, turn to the answer and analysis sheet. By comparing your firm's responses to the material set out in the answer and analysis sheet, you will determine the extent to which your current policies and procedures succeed or fail in providing secure and effective risk management oversight in the area of new client and engagement acceptance, and the particular aspects that may benefit from additional attention or restructuring.

**A. CLIENT ACCEPTANCE—GENERAL**

	YES	NO	N/A
1. Does the firm have a standard prospective or actual new client form?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Is it possible for the firm to accept a client without the standard new client form being completed?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Is there a partner or committee that is responsible for oversight of client acceptance?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Is the partner or committee available to review new clients on a daily basis?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Does the partner or committee have authority to reject proposed new clients and engagements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. In the event of a disagreement with the introducing partner, does any partner or committee have authority to reject a proposed new client?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Does the firm solicit business by entering "beauty contests" sponsored by prospective clients?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. a. Does the firm have written policies and procedures to review the potential for independence violations or conflicts of interest before participating in such solicitation?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Which of the following describes how recently the policy statement was last circulated?			
i. Within the last three months	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Three to six months ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. Seven to twelve months ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iv. More than one year ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Is a new client form required before the firm engages in such solicitation?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. Are any of the following circulated within the firm?			
a. The names of prospective new clients to be solicited by beauty contests	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. The names of prospective new clients and related party entities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. The names of officers and directors of prospective new clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Completed copies of the firm's prospective new client form	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. The nature of the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Other information regarding prospective new clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



**Questionnaire 3—New Client and Engagement Acceptance**

**A. CLIENT ACCEPTANCE—GENERAL** *(continued)*

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
11. As to any information circulated as described at question 10, to which of the following is it circulated?			
a. To all professional staff in the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. To all partners in the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. To designated partners or staff	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Is there any screening by an individual or committee (other than the introducing partner) of prospective new clients and engagements for any purpose other than to assess the potential for independence violations and conflicts of interest with other clients?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. If the answer to question 12 is <i>yes</i> , does the review assess any of the following issues (answer <i>yes</i> to each category that applies)?			
a. The ability and willingness of the client to pay fees at the level they are likely to reach	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. The areas of knowledge and expertise that are likely to be required in the engagement and the existence within the firm of the skills and expertise to enable it to be competently handled	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. The need to limit the scope of engagement to matters within the firm's competence, or within the client's ability or willingness to pay fees	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Special risks which may be associated with the particular client, the type of client or industry, or the nature of the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Thorough review of potential new client's financial information and condition, including financial statements (year-end and interim), cash flow and working capital, debt payments, tax returns, registration statements, reports to regulatory agencies, 10Ks, 10Qs, 8Ks, and so on	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Contact with potential new clients, as follows:			
i. Predecessor accountants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Attorney	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. Banker	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iv. Owner, major shareholders, or top management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Review of prior management letter	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**Risk Management**

**A. CLIENT ACCEPTANCE—GENERAL** (continued)

	YES	NO	N/A
h. Stability of relationships (meaning, among and between owners or partners and between married parties)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
i. Any planned acquisitions, mergers, or dispositions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
j. Debt or financing agreements, loan covenants, including violations or waivers, restructuring plans, and debt ratios	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
k. Specialized regulatory requirements, tax, or accounting practices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
l. Potential adverse economic, political, or social conditions that may affect client or industry	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
m. Involvement in regulatory or other investigations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
n. The terms of the client engagement letter	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. If there is a partner or committee with authority to reject clients (see question 5 above), does that partner or committee also have authority to direct which partner shall manage the engagement, including the authority to designate someone other than the introducing partner?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. Have any potential clients been rejected in the past few years preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
16. If there is a partner or committee with authority to reject clients (see question 5 above), does that partner or committee also have authority to terminate clients?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. Have any client relationships been terminated by the firm during the year preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>B. CLIENT ACCEPTANCE—POLICY</b>			
18. Does the firm have a written policy statement concerning the following?			
a. The requirement that a standard new client acceptance form must be submitted to the responsible partner or committee with respect to all prospective new clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. The requirement that a standard new client or engagement acceptance form must be submitted to the responsible partner or committee with respect to all prospective new engagements for existing clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 3—New Client and Engagement Acceptance**

**B. CLIENT ACCEPTANCE—POLICY** *(continued)*

	YES	NO	N/A
c. That no work may be commenced for a prospective new client, or on a new engagement for an existing client, until the approval of the responsible partner or committee has been given	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. A prohibition against the following:			
i. Undisclosed financial arrangements between any partners, or staff members and clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Undisclosed financial interest in any client	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. Partners or staff from being directors or officers of client entities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iv. Any “moonlighting” activities without prior written approval	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
19. How recently, of the following, were the policy statements referred to at question 18 last circulated?			
a. Within the last three months	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Three to six months ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Seven to twelve months ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. More than one year ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20. When the new client is an entity, does the standard form new client and acceptance form include the following items?			
a. Names of all parent (and higher) entities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Names of all subsidiary entities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Names of all related, associated and affiliated entities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Names of all officers and directors?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. At what point any parent, subsidiary, associated entity will be involved in the engagement, including the names of the officers and directors of all involved entities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**B. CLIENT ACCEPTANCE—POLICY** *(continued)*

	YES	NO	N/A
21. Does the new client and acceptance form seek to include the following items?			
a. Results of discussion with prior accountants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Type of service or reports requested	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. In litigation support engagements, the nature of the engagement, and the existence of any potential conflicts of interest otherwise unconnected, concerning engagements conducted for other unrelated clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22. When a new client acceptance form is delivered to the partner or committee responsible, state which of the following represents the longest that the partner or committee ever takes to make the review?			
a. One business day	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Two business days	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Three to five business days	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Longer than five business days	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>C. ASSIGNING PERSONNEL TO CLIENTS/ENGAGEMENTS</b>			
23. Is there a partner or committee (other than the partner introducing the new client and engagement) responsible for assigning professional staff to engagements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
24. Does the firm always require the following to have experience appropriate to the engagement before the person is assigned to an engagement?			
a. Staff	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Supervisors and managers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Partner-in-charge of the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Other partners involved	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
25. Can the partner introducing a new client and engagement be required by the partner and committee responsible for assigning professional personnel to engagements to allow another partner to oversee the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 3—New Client and Engagement Acceptance**

**D. ENGAGEMENT LETTERS**

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
26. Does the firm have written forms of client engagement letters?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
27. Does the firm require an engagement letter to be written/tailored for the following:			
a. All new clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Existing clients, with respect to all new engagements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
28. Does the firm's time billing system allow time to be recorded prior to any of the following events:			
a. Approval of the partner or committee responsible for client acceptance to open the client/file	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Development and delivery of a proposed engagement letter	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Receipt from the client of a countersigned engagement letter	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
29. Is there a partner and committee, other than the partner introducing a new client matter, responsible for reviewing new client engagement letters to ensure that they are appropriately tailored to the client situation?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
30. If the firm's time billing system permits time to be recorded prior to receipt from the client of a countersigned engagement letter, is there any procedure in place to ensure that new clients actually countersign and return engagement letters?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>E. NONENGAGEMENT LETTERS</b>			
31. Does the firm have a written policy requiring that a nonengagement letter be sent to all persons and entities who consult for the firm but where either the firm or the prospective client declines the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
32. If there is such a policy, was a copy of the policy statement referred to at question 31 last circulated?			
a. Within the last three months	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Three to six months ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Seven to twelve months ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. More than one year ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



## QUALITY IN CONTROL SURVEY FOR ACCOUNTING FIRMS

### QUESTIONNAIRE 4—THE ENGAGEMENT MANAGEMENT

1. This questionnaire has been developed with two purposes in mind:
  - a. To assemble and organize the information regarding the firm's existing control structures, policies, and procedures in the areas of engagement management, including quality review, oversight of professional staff, branch office, lateral principal, and merged practice controls, and training
  - b. To give those within the firm involved in engagement management an opportunity to review the state of policies and procedures in place, by comparing their response with the answer and analysis sheet
2. This questionnaire should be completed by the managing principal or other partner(s) or principal(s) of the firm who currently has or have the greatest share of responsibility for oversight of engagement management. However, since there may be several persons in the practice who may have equal and significant responsibilities in the engagement process, this questionnaire and associated answer sheet should be reviewed carefully by each of them. This information should be shared with tier two or lower staff, as it may provide insight to them as to the responsibilities of the firm, as well as themselves, to their clients in the conduct of an engagement.
3. The following steps should be taken in answering the survey.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A* (not applicable).
  - b. The firm may decide to supplement the answers, as follows.
    - i. If the firm later decides either to prepare, or to supplement its formal policy statement and procedures concerning engagement management, and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to these areas, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures for engagement management in more detail should be attached.

4. Some of the questions inquire about particular quality control functions that parallel other questions in “Questionnaire 1—The Firm Leadership and Management Structure,” “Questionnaire 2—The Risk Management Partner,” and “Questionnaire 7—The Professional Staff.” The reasons for repeating these inquiries include the following:
  - a. The need to corroborate the responses to the questionnaires completed by the management of the reviewed firm, because the view from the “trenches” may be very different from the perception of senior management
  - b. The need to determine whether the firm has engagement management policies and procedures which are adequate and appropriate to the firm’s size and practice areas
  - c. The need to determine whether the firm’s policies and procedures have been effectively communicated to other individual(s) responsible for engagement management functions and to the professional staff generally
5. When the questionnaire has been completed, turn to the answer and analysis sheet. By comparing your firm’s responses to the material set out in the answer and analysis sheet, you will determine the extent to which your current controls, policies, and procedures succeed or fail in providing appropriate and effective engagement management oversight of the firm’s practice, and the particular aspects that may benefit from additional attention or restructuring.

**A. ENGAGEMENT POLICIES AND PROCEDURES**

	YES	NO	N/A
1. Does the firm have written policies or procedures for conducting engagement process reviews by or of partners?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to question 1 is <i>yes</i> , do these policies include any of the following elements [for purposes of this questionnaire, <i>regular</i> means at least annually]?			
a. Quality review of all engagements before being forwarded to the client	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Regular meetings with engagement partners to consider the following questions.			
i. As regards prior engagement performance, answer the following.			
• Are engagements being fulfilled as promised?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Were the appropriate resources applied to prior engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Were estimates tracked back to performance to determine realization?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



**Questionnaire 4—The Engagement Management**

**A. ENGAGEMENT POLICIES AND PROCEDURES** *(continued)*

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
ii. Were staff debriefed by engagement partner(s) after each engagement in terms of realization and performance of staff assigned to the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. Was the client interviewed after each engagement by the manager or engagement partner to determine the overall level of satisfaction with the services rendered?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iv. Was the description of services in the engagement letter followed?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
v. If the description of services defined in the engagement letter was not followed, were written descriptions of modifications to the engagement developed and sent to and agreed upon by the client?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
vi. Does the client's work file(s) include copies of the signed engagement letter and all subsequent correspondence relating to the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
vii. Were senior partners, or high level consulting staff, actively involved in the entire engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Are there standard engagement letter templates that the firm uses?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Are there requirements that a department level partner reviews every engagement over a predefined low dollar value engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. If the answer to question 1 is <i>yes</i> , is the review process documented?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. If the answer to question 3 is <i>yes</i> , is there a standard review recording form?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Does the firm have policies and procedures for conducting due diligence examinations of all engagements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**A. ENGAGEMENT POLICIES AND PROCEDURES** *(continued)*

	YES	NO	N/A
6. If the answer to question 5 is <i>yes</i> , do these policies and procedures include the following:			
a. Checking the following:			
i. Qualifications of resources assigned to the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Qualifications of external resources contracted to assist the firm in engagement execution	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Are written policies and procedures provided to contracted resources prior to being engaged to assist with any engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Are extensions to engagements to be recorded and approved?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. If the answer to question 6c is <i>yes</i> , were checks done to determine that the policies had been followed?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Do policies provide for reporting inadequately defined scope or issues that arise after an engagement is begun?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. If the answer to question 6e is <i>yes</i> , are there procedures for modifying the scope of the engagement and gaining client approval?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Are there procedures for checking clients for conflicts of interest and independence issues?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Does the firm conduct <i>all</i> of the checks listed in question 6 with respect to all new professional staff hires?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. Does the firm have policies and procedures for conducting regular engagement performance reviews?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. If the answer to question 8 is <i>yes</i> , do the procedures include meetings with the following?			
a. One or more partners responsible for the staff members' performance on the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Peer review of staff by associates with whom they worked on the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 4—The Engagement Management**

**A. ENGAGEMENT POLICIES AND PROCEDURES** *(continued)*

	YES	NO	N/A
10. If the answer to either question 9a or 9b is <i>yes</i> , do the meetings deal with the following?			
a. The quality of the staff member's work during the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Staff member's realization on the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Contribution of the staff member to (engagement performance)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Were there discoveries or information gained that could be used effectively in future engagements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. Are there policies and procedures to enable both partners and staff members to consult with partners other than those originally assigned to the engagement where the staff member is concerned about or disagrees with any aspect of the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Are there written policies and procedures in place to encourage all employees to identify and report problems with associated staff or contractors assigned to engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. If the answer to question 12 is <i>yes</i> , are these reports investigated by partners or senior management?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. If the answer to question 12 is <i>yes</i> , is any action taken to provide feedback to the staff concerning findings?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. Has a partner in the firm been designated to respond to questions involving professional ethics when these arise?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
16. Does the firm's library include current editions of the following?			
a. The AICPA Code of Professional Conduct	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Rules of Ethics from the State Board of Accountancy and State Society of CPAs, if applicable, from each state in which the firm practices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Ethics or Conduct Rules from other Independent Standards Boards, for example, the U.S. Securities and Exchange Commission (SEC) or the U.S. Department of Labor, if applicable to the firm's practice	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Standards from the AICPA SEC Practice Section, if the firm is a member	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**B. ENGAGEMENT PROCESS**

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
1. Are there defined processes for performing an engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to question 1 is <i>yes</i> , are there formal training sessions to educate staff on these processes?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Are staff proactive in following the engagement process?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Do partners review engagements in light of generally accepted engagement processes?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## QUALITY/IN CONTROL SURVEY FOR ACCOUNTING FIRMS

### QUESTIONNAIRE 5—CONTINGENCY PLANNING FOR TECHNOLOGY FAILURES

1. This questionnaire has been developed with the following two purposes in mind:
  - a. To assemble and organize the information regarding the firm's existing control structures, policies, and procedures in the areas of contingency planning
  - b. To give those within the firm involved in contingency planning an opportunity to review the state of policies and procedures in place, by comparing their response with the answer and analysis sheet
2. This questionnaire should be completed by the managing partner or other partner(s) of the firm who currently has/have the greatest share of responsibility for contingency planning.
3. The following steps should be taken in answering the survey.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A* (not applicable).
  - b. The firm may decide to supplement the answers, as follows.
    - i. If the firm later decides either to prepare or to supplement its formal policy statement and procedures concerning contingency planning, and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to these areas, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures for contingency planning in more detail should be attached.
4. When the questionnaire has been completed, turn to the answer and analysis sheet. By comparing your firm's responses to the material set out in the answer and analysis sheet, you will determine the extent to which your current controls, policies, and procedures succeed or fail in providing appropriate and effective contingency plan oversight of the firm's practice, and the particular aspects that may benefit from additional attention or restructuring.

**A. CONTINGENCY PLAN**

	YES	NO	N/A
1. Does the firm have written policies or procedures for continuing operations in the event of a disaster?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to question 1 is <i>yes</i> , do these policies include any of the following elements (for purposes of this questionnaire, <i>regular</i> means at least annually)?			
a. Review of the plan to include completeness and changes that may have been implemented in the past year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Plan test includes the following:			
i. Review of the written plan (and) performing a "desktop" review of the plan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Actual testing of the plan in a live demonstration	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Update of the contingency plan if new hardware, software, or office (locations) are added during the (year, or if Internet, telecommunications, or utility service providers have changed)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Continuous review of plan effectiveness	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. If the answer to question 1 is <i>yes</i> , is the review process documented?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. If the answer to question 3 is <i>yes</i> , is there a standard review recording form?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Does the plan call for the implementation of an Emergency Response Team (ERT)?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. If the answer to question 5 is <i>yes</i> , answer the following.			
a. Are team responsibilities set up so that the team members are—			
i. Empowered to act in an emergency?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Trained in the appropriate actions to take in an emergency?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Is the firm following the four-level definition of disasters or something similar?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Is each member of the ERT aware of his or her area of responsibilities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. If the answer to question 6c is <i>yes</i> , were these evaluated in the last test?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 5—Contingency Planning for Technology Failures**

**A. CONTINGENCY PLAN** *(continued)*

	YES	NO	N/A
e. Do all members of the ERT have a current list of contacts in an emergency?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. If the answer to question 6e is <i>yes</i> , are these contacts aware of the firm's plan and do they know these individuals are authorized to act on behalf of the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Do members rotate an on-call schedule, and are all employees notified of who is on should an emergency occur?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Are backups tested at least monthly to ensure that files can be read?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. Is a full server load done at least biannually to ensure the firm has the ability to restore all server resources in an emergency?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. If the answer to question 8 is <i>yes</i> , does the procedure include the following?			
a. Switching operations to the alternate server(s) and/or site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Validating that all software executes and the firm has the ability to print hardcopy output	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. Does the firm have the following?			
a. A complete hardcopy listing of all current software and versions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. A current hardcopy of all inventory to include network and peripheral equipment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Notification of switching of telecommunications services to a remote site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. The ability to continue to provide services at remote locations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. Has the firm reviewed its network security to prevent intrusion or acts of vandalism?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Does the firm have a written Privacy Statement that defines the security and privacy of client information at all times?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. If the answer to question 12 is <i>yes</i> , are staff and clients aware of the firm's policies?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**B. ACCEPTABLE USE POLICY**

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
1. Does the firm have a current Acceptable Use Policy that adequately defines the firm's position on use of the technology resources?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Are all employees and contractors with access to firm technology required to review this policy at least annually?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Is employees' use of technology monitored for infringement of firm policy?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Do Partners and Principals of the firm fully understand the legal liability and risk exposure that inappropriate use of technology may entail?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### QUESTIONNAIRE 6—HUMAN RESOURCES MANAGEMENT

1. This questionnaire has been developed with the following two purposes in mind:
  - a. To assemble and organize the information regarding the firm's existing control structures, policies, and procedures in the areas of human resource management, including peer review, oversight of professional staff, branch office, lateral partner and merged practice controls, and training
  - b. To give those within the firm involved in human resource management an opportunity to review the state of policies and procedures in place, by comparing their response with the Answer and Analysis Sheet
2. This questionnaire should be completed by the managing partner or other partner(s) of the firm that currently has/have the greatest share of responsibility for oversight of human resource management, including the hiring and review of professional staff—peer review programs, training and continuing professional education (CPE) and lateral hire, practice mergers and branch office oversight. In addition, the questionnaire should be completed by the senior personnel executive employed by the firm with responsibility for any of the following areas.
3.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A*.
  - b. The firm may decide to supplement the answers, as follows:
    - i. If the firm later decides either to prepare or supplement its formal policy statement and procedures concerning human resource management, and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to these areas, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures in more detail should be attached.
4. Some of the questions inquire about particular quality control functions that parallel questions on the Firm Management, Risk Management Partner, and Individual Partner Questionnaires. The reasons for repeating these inquiries include the following:
  - a. The need to corroborate the responses to the questionnaires completed by the management of the reviewed firm because the view from the “trenches” may be very different from the perception of senior management
  - b. The need to determine whether the firm has human resource management policies and procedures which are adequate and appropriate to the firm's size and practice areas
  - c. The need to determine whether the firm's policies and procedures have been effectively communicated to the individual(s) responsible for human resource management functions and to the professional staff generally

5. When the questionnaire has been completed, turn to the Answer and Analysis Form. By comparing your firm's responses to the material set out in the Answer and Analysis Form, you will be able to determine the extent to which your current controls, policies, and procedures succeed or fail in providing appropriate and effective human resource management oversight of the firm's practice, and the particular aspects that may benefit from additional attention or restructuring.

**A. SUPERVISION AND HIRING PRACTICES**

	YES	NO	N/A
1. Does the firm have written policies or procedures for conducting peer reviews by or of the partners?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to item 1 is <i>yes</i> , do these policies include any of the following elements (for purposes of this questionnaire, <i>regular</i> means at least annually)?			
a. Regular reviews of bills, where partners are responsible for bill issuance, to check for any form of overcharging by the partner or those supervised by the partner	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Regular meetings with either a more senior partner in the same practice area or office, or a reviewing committee, to consider the following matters:			
i. Performance (by reference to specific criteria, including compliance with firm policies as to engagement letters, billing/collection, client communication, appropriate use of firm resources, timeliness, and diligence)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Client development	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. Work satisfaction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iv. Ability to work with other partners and professional staff	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
v. Level of billings and hours worked	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
vi. Performance goals for the next year, including compensation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
vii. Involvement in firm management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
viii. Long-term planning for the partner's role in the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 6—Human Resources Management**

**A. SUPERVISION AND HIRING PRACTICES** *(continued)*

	YES	NO	N/A
c. Periodic meetings, held at least once every year, with either a more senior partner in the same practice area or office, or a reviewing committee, to review the partner's handling of specific matters or clients for which the partner has management responsibility, including a detailed evaluation of the matters listed in item b.i. with respect to at least three clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. A requirement that partners have a regular physical health check-up	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. If the answer to item 1 is <i>yes</i> , is the review process documented?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. If the answer to item 3 is <i>yes</i> , is there a standard review recording form?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Does the firm have policies and procedures for conducting "due diligence" examinations of potential lateral partner recruits, both individually and where relevant, group practice, or firm mergers or acquisitions?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. If the answer to item 5 is <i>yes</i> , do these policies and procedures include the following?			
a. Check the following:			
i. Academic qualifications with institutions attended	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. CPA license	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Check personal references.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Check grievance or discipline records.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Check the existence, scope, adequacy, and claims record of current and prior professional liability insurance.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Check (with the individual's consent) client references (to the extent that this is consistent with professional rules).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Check bank and credit references.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Check clients for conflicts of interest and independence issues.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Does the firm conduct <i>all</i> of the checks listed in item 6 with respect to all new professional staff hires?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**A. SUPERVISION AND HIRING PRACTICES** *(continued)*

	YES	NO	N/A
8. Does the firm have policies and procedures for conducting regular staff reviews?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. If the answer to item 8 is <i>yes</i> , do the procedures include meetings with the following?			
a. One or more partners for whom the staff member regularly works	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. One or more partners, or human resources staff person to whom the associate does not normally report	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. If the answer to item 7a or 7b is <i>yes</i> , do the meetings address the following?			
a. The quality of the staff member's work since the last review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. The staff member's diligence since the last review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Compensation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. The firm's plans and practice preferences for the staff member until the next review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. The staff member's goals until the next review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Have problems been encountered by the staff member in the following areas?			
i. Discrimination (sex, age, race, and so on)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Harassment from clients, partners, or other staff members	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iii. Awareness of noncompliance with the AICPA Code of Professional Conduct, state board of accountancy ethics rules, or other ethic rules applicable to specific services or professions practiced within the firm by partners or other staff members.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
iv. Awareness of conflict of interest with clients, unreported financial interests with clients, other independence issues, or insider trading of securities involving any employee of the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
v. Awareness of alcohol or drug problems involving any employee of the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. Are there policies and procedures to enable both partners and staff members to consult with partners other than those originally assigned to the engagement in which the staff member is concerned about or disagrees with any aspect of the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 6—Human Resources Management**

**A. SUPERVISION AND HIRING PRACTICES** *(continued)*

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
12. Are there written policies and procedures in place to encourage all employees to identify and report suspected alcohol or drug impairment problems involving any employees of the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. If the answer to item 12 is <i>yes</i> , is there a partner or senior human resources staff person to whom such problems can be reported in confidence?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. If the answer to item 12 is <i>yes</i> , are the policies regularly disseminated?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. Does the firm have written policies and procedures prohibiting the issuance of reports and opinions unless signed off by two partners, one of whom is not assigned to work on the engagement in question, or otherwise approved by a committee established for the purpose?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
16. If the answer to item 15 is <i>yes</i> , are these policies and procedures regularly circulated?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. Are you aware of the issuance of any report or opinion in the twelve months preceding this survey in which the report or opinion was issued by a single partner without either the countersignature or approval of another partner or committee?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18. If the answer to item 17 is <i>yes</i> , have the policies and procedures been changed since the issuance of the report or opinion?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
19. If the firm has any branch offices, are there any policies or procedures for conducting regular branch office reviews to ensure compliance by branch offices with all of the firm's risk management and loss prevention policies and procedures?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20. To your knowledge, have these policies and procedures been regularly followed with respect to all of the firm's branch offices in the two years preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21. Has a partner in the firm been designated to respond to questions involving professional ethics when these arise?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**A. SUPERVISION AND HIRING PRACTICES** *(continued)*

	YES	NO	N/A
22. Does the firm's library include current editions of the following?			
a. The AICPA Code of Professional Conduct	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Rules of ethics from the State Board of Accountancy and State Society of CPAs, if applicable, from each state in which the firm practices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Ethics or Conduct Rules from other Independent Standards Boards, for example, the U.S. SEC or the U.S. DOL, if applicable to the firm's practice	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Standards from the AICPA SEC Practice Section (SECPS) (if the firm is a member)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**B. PROFESSIONAL DEVELOPMENT**

1. Are all professional personnel in compliance with the relevant state CPE requirements for all states in which your firm practices?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Are all professional personnel in compliance with the relevant state licensing requirements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Is there a partner or human resource (or other) staff person responsible for maintaining CPE records and course materials?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the firm conduct internal training or other CPE programs?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### QUESTIONNAIRE 7—PROFESSIONAL STAFF

1. This questionnaire has been developed with the following two purposes in mind:
  - a. To determine what risk management policies and procedures are effectively in place within the firm, from the perspective of nonmanagement partners and professional staff
  - b. To determine how responsive the firm is to problems encountered during the course of practice
2. This questionnaire should be completed by selected nonmanagement partners and professional staff from every practice area, and from every office in the firm.
3. The following steps should be taken in answering the survey.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A* (not applicable).
  - b. The firm may decide to supplement the answers, as follows.
    - i. If the firm later decides either to prepare, or to supplement its formal policy statement and procedures concerning risk management and ethics compliance, and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to these questions, it will be helpful to have those who complete the questionnaire expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, constructive suggestions for changing policies, procedures, or control systems should be encouraged.
4. Some of the questions inquire about particular quality control functions that parallel questions on “Questionnaire 1—Firm Leadership and Management,” and “Questionnaire 2—Risk Management Structures.” The reasons for repeating these inquiries include the following:
  - a. The need to corroborate the responses to the questionnaire completed by the selected nonmanagement partners and professional staff of the reviewed firm because the view from the trenches may be very different from the perception of senior management
  - b. The need to determine whether the firm has risk management policies and procedures which are adequate and appropriate to the firm’s size and practice areas
  - c. The need to determine whether the firm’s policies and procedures have been effectively communicated to the individual(s) responsible for quality control functions and to the professional staff generally

**Risk Management**

5. When the questionnaire has been completed, it should be returned to the partner or committee overseeing the survey, for their review in the context of the answer and analysis sheet. By comparing your firm's responses to the material set out in the answer and analysis sheet, it will be possible to determine the extent to which the firm's current controls, policies, and procedures succeed or fail in providing secure and effective risk management oversight of the firm's practice, and the particular aspects that may benefit from additional attention or restructuring.

**A. CLIENT INTAKE ISSUES**

	YES	NO	N/A
1. Have you introduced a new client or new engagement to the firm in the last twelve months?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Did you complete and submit to the relevant partner or committee any kind of new client/engagement form (a new engagement form) following your first meeting with the client concerning the matter and before commencing work?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Within which of the following intervals did you receive a clearance to proceed with the new client or engagement?			
a. Within twenty-four hours	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Within forty-eight hours	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Within five business days	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Do you or a managing partner in your practice area regularly participate in the new client intake and conflict of interest review process?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. If the answer to question 4 is <i>yes</i> , answer the following.			
a. Does the system work efficiently?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Have you ever spotted a potential conflict of interest?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. If so, did you report it to the relevant partner or committee?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. If so, in your view was it resolved appropriately?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



**B. AREAS OF PRACTICE AND ASSIGNMENT OF PROFESSIONAL STAFF**

	YES	NO	N/A
1. Is your work limited to one area of professional practice?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Are you assigned to work permanently with the same partner(s)/professional staff (as applicable)?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. If the answer to question 2 is <i>no</i> or <i>N/A</i> , in which of the following are you assigned work by a single partner?			
a. In one practice area	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. In a management capacity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. If you work simultaneously for more than one partner or with changing professional staff, in which of the following ways are conflicts over priority usually resolved?			
a. Resolved by a single partner with assignment responsibility	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. In favor of the partner who shouts the loudest	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. By requiring the staff person to juggle and complete all assignments without direction or intervention by any partner or firm management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Are these resolutions generally appropriate?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Are all of your work assignments within your own areas of experience?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. If the answer to question 6 is <i>no</i> , have you been asked to work on engagements involving areas of practice completely new to you in the twelve months prior to this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. If the answer to question 7 is <i>yes</i> , was any of your time on the learning curve billed to the client?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. If the answer to question 8 is <i>yes</i> , was the client informed prior to the commencement of services that you had no prior experience in this area of practice?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. As to such matters, were there others in the firm already familiar with this area of practice?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

(continued)

**C. MANAGEMENT OF CLIENTS AND BILLINGS  
(MANAGERS ONLY RESPOND TO THIS  
SEGMENT)**

	YES	NO	N/A
1. If you introduce a new client or engagement to the firm, do you have the right to retain control of the conduct of the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to question 1 is <i>yes</i> , do you customarily retain control even of engagements outside your normal area of practice?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Does the firm have any system in connection with new clients or new engagements requiring a manager with experience in the particular area of practice involved to have final authority of the conduct of the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Is the system or rule enforced in all cases, including clients or engagements introduced by senior or management partners?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Does the firm's compensation structure fairly compensate you for clients or work introduced but not performed or controlled by you?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. When you introduce a new client or engagement, do you personally complete the standard new client information sheet?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Within the year preceding this survey, have you introduced a new client or engagement on which you have performed significant services <i>before</i> the following?			
a. Completing the standard new client or engagement information sheet	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Receiving independence and conflict of interest clearance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. A decision was made by someone other than you as to which partner should be assigned responsibility for management of the client or engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. As to clients or engagements introduced by you in the twelve months prior to this survey, were any engagements other than on standard billing terms?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Was there any element of entrepreneurial involvement in the client's business either by you individually or your family members, or by the firm as part of the fee arrangement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. As to any nonstandard billing engagement, was anyone else's approval obtained in advance of entering into the fee arrangement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**C. MANAGEMENT OF CLIENTS AND BILLINGS  
(MANAGERS ONLY RESPOND TO THIS  
SEGMENT) (continued)**

	YES	NO	N/A
11. Did you receive a countersigned engagement letter from all new clients, or regarding all new engagements within the one year prior to this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. If the answer to question 11 is <i>yes</i> , within which of the following intervals did you receive the countersigned letter?			
a. Before commencing significant work for the client or on the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Within one week of commencing significant work for the client or on the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. More than one week after commencing work for the client or on the engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. Did any engagement letters received vary from the firm's standard form (if any)? Answer <i>N/A</i> if there is none.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. As to any engagement letters varying from the firm's standard form, did you obtain anyone else's approval of the variance in advance?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. Did you meet with any prospective clients during the one year preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
16. Of the following, when did you complete any standard form new client or contact information sheet?			
a. Prior to seeing the potential client	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. After seeing the potential client but before receiving word that the firm was to be engaged by the potential client	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. If the answer to question 16a and 16b was <i>no</i> , did you perform any kind of potential conflict of interest or independence check prior to meeting with the potential client?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18. As to any such meetings with potential clients who did not subsequently retain the firm, did you subsequently send a nonengagement letter?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
19. If the answer to question 18 is <i>yes</i> , did you use a standard form?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20. If the answer to question 19 is <i>no</i> , did anyone else review or approve the letter you sent?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

(continued)

**C. MANAGEMENT OF CLIENTS AND BILLINGS  
(MANAGERS ONLY RESPOND TO THIS  
SEGMENT) (continued)**

	YES	NO	N/A
21. Did the nature or identity of any client undergo a change (for example, merger or corporate takeover) in any ongoing engagement during the one year preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22. As to each engagement to which your answer to question 21 was <i>yes</i> , respond separately, with respect to each engagement, to questions 7 to 14 in the section of this questionnaire entitled "C. Management of Clients and Billings," as if the change in the client were a new client.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>D. GENERAL RISK MANAGEMENT ISSUES</b>			
1. Have any engagements worked on by you ended in the year preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to question 1 was <i>yes</i> , was a Closing Letter sent to the client?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. If the answer to question 2 was <i>yes</i> , which of the following was the form of the letter?			
a. A standard form	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. A form approved by a partner other than the person who signed it	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Have you or any engagements or clients controlled or worked on by you, been subject to internal peer or quality control review at any time in the three years preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Have you participated in conducting an internal peer or quality control review of any partner, or of any client or engagement controlled by anyone other than you, in the three years preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Have you participated in any formal performance evaluation of any accountant in the firm in the three years prior to this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Are you or any family members an officer, director or manager of any client business of the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**D. GENERAL RISK MANAGEMENT ISSUES** *(continued)*

	YES	NO	N/A
8. If the answer to question 7 is <i>yes</i> , did you perform the following?			
a. Notify the partners responsible for the client engagement and the firm's professional liability insurance prior to accepting the appointment.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. If the answer to question 8a is <i>no</i> , notify anyone in the firm prior to accepting the appointment.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. If the answers to questions 8a and 8b are both <i>no</i> , have you informed anyone in the firm of the appointment at any time?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Do you or any members of your immediate family have any financial interest in any client business, or with any client in any business?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. If the answer to question 9 is <i>yes</i> , did you perform the following?			
a. Notify the partner responsible for the firm's professional liability insurance, prior to accepting the interest.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. If the answer to 10a is <i>no</i> , notify someone in the firm prior to accepting the interest.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. If the answers to 10a and 10b are both <i>no</i> , inform someone in the firm of the interest at any time.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. Have you at any time loaned or borrowed money to or from any client of the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. If the answer to question 11 is <i>yes</i> , did you perform the following?			
a. Notify the partners responsible for the client engagement and the firm's professional liability insurance, prior to making or accepting the loan.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. If the answer to 12a is <i>no</i> , notify someone in the firm prior to making or accepting the loan.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. If the answers to 12a and 12b are both <i>no</i> , inform someone in the firm of the loan at any time.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. Do you ever have occasion to issue opinion letters or audit reports in the course of your practice?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**D. GENERAL RISK MANAGEMENT ISSUES (continued)**

	YES	NO	N/A
14. If you answered question 13 <i>yes</i> , did you perform the following?			
a. Issue any in the one year preceding this survey.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Ensure that the letter or report is in a standard form approved by the firm.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Ensure that the letter or report was reviewed by someone else in the firm before being issued.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Ensure that someone else countersigned it.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. As to any such letter not in standard form, were the form and substance of the letter (or the variance) approved by anyone else in the firm prior to issuance?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Partners in Branch Offices, Merged Practices, or Lateral Hires Only</b>			
16. Did you join the firm within the three years prior to this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. Prior to or immediately upon your arrival at the firm, were any formal steps taken to appraise you of the firms policies and procedures as to the following?			
a. New client and engagement acceptance, including conflicts and independence checking and new client procedures	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Billing arrangements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Standard forms of the following:			
i. Engagement letters	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ii. Opinion letters and audit reports	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Internal peer or matter reviews	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Entrepreneurial activities, including serving as a manager, officer, or director for a client	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Multidisciplinary or assurance practice areas	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18. As to any answers to question 17 which were <i>yes</i> , which of the following describe the manner in which the information was imparted?			
a. Perfunctory	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Acceptable	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Thorough	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**D. GENERAL RISK MANAGEMENT ISSUES** *(continued)*

	YES	NO	N/A
19. Has there been any follow-up to determine whether these policies and procedures have been adopted by you (or your group)?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>All Respondents</b>			
20. Are you aware of any of the following during the three years prior to this survey?			
a. Breaches of the applicable professional standards by any partner or professional staff person	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Billing disputes with clients not amounting to litigation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Litigation with clients over unpaid bills	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Reasons to believe that any client or third party has an actual or potential claim of any kind against the firm or any partner or professional staff person	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21. As to all matters as to which the answer to question 20 was <i>yes</i> , but which did not involve you, answer the following.			
a. Have you reported it (or did someone else do so) on a timely basis, when the circumstances occurred?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. In your view, was the action taken by the firm appropriate?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22. Are you aware of any partner, professional, or clerical staff person in the firm who has or may have an alcohol, drug, or substance-induced impairment problem?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
23. If the answer to question 22 is <i>yes</i> , answer the following.			
a. Have you (or has someone) reported it to anyone else in the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. In your view, has the firm taken appropriate action?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
24. Have you or has anyone else to your knowledge or belief traded in the securities of a client at any time since joining the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
25. As to any instance to which the answer to question 24 is <i>yes</i> , was the permission or approval of anyone in the firm obtained prior to such trading?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
26. Does the firm have a policy which you know about for monitoring securities transactions by members and employees of the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**D. GENERAL RISK MANAGEMENT ISSUES (continued)**

	YES	NO	N/A
27. If the firm has a procedure for monitoring securities transactions, are you and is everyone of whom you know in complete compliance with the policy?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
28. Have you participated in or attended any Continuing Professional Education Program at any time in the three years preceding this survey in the following?			
a. Within the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Outside the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
29. Have you needed to consult with anyone in the firm with respect to any concern arising from the application of the relevant professional standards to a client, matter, or internal firm problem at any time during the one year preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
30. As to any matter to which your answer to question 29 was <i>yes</i> , answer the following.			
a. Did you consult with someone?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Was it someone designated to address such issues?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Was the consultation successful in resolving the issue?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
31. In your opinion, or to your knowledge, are there any specific client matters that were handled by the firm less than adequately or competently in the three years preceding this survey?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
32. As to any matters as to which your answer to question 31 was <i>yes</i> , answer the following.			
a. Did you or have you reported your concerns to anyone in the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. In your view, was the firm's response adequate or appropriate?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
33. In your opinion, are the firm's policies and procedures in connection with all of the matters covered in this survey regularly and adequately communicated to the following?			
a. You	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Partners	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Other professional staff people	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### QUESTIONNAIRE 8—CLIENT RELATIONS MANAGEMENT, AND HANDLING PROBLEMS AND CLAIMS

1. This questionnaire has been developed with the following two purposes in mind:
  - a. To assemble and organize the information regarding the firm's existing policies and procedures for managing client relationships and responding to and addressing professional regulations, ethics and firm procedures, discipline, and sanction matters, and actual or potential malpractice claims
  - b. To give management an opportunity to review the state of policies and procedures in place, by comparing their response with the answer and analysis sheet
2. This questionnaire should be completed by all partners with risk management responsibility, all partners responsible for managing client relationships, any partner with responsibilities (or who is designated as) professional regulations, ethics and firm procedures partner, and the partner or committee responsible for professional liability insurance.
3. The following steps should be taken in answering the survey.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A* (not applicable, which includes "don't know").
  - b. The firm may decide to supplement the answers, as follows.
    - i. If the firm later decides either to prepare or supplement its formal policy statement and procedures concerning the management and handling of potential problems and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to these areas, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures in more detail should be attached.

**Risk Management**

4. In the best-run firms, professional regulations, ethics, and firm procedures problems and potential and actual malpractice claims are bound to arise, and are not necessarily limited to any given practice area. Of vital importance, therefore, is the preparation and dissemination of clear policies and procedures for addressing these occurrences so that they are appropriately handled and responded to from the earliest possible moment. The reasons for conducting these inquiries among all of the partners with any responsibilities in this area include the following:

- a. The need to corroborate the responses to the questionnaires within the management of the reviewed firm
- b. The need to determine whether the firm has policies and procedures which are adequate and appropriate to the firm's size and practice areas
- c. The need to determine whether the firm's policies and procedures have been effectively communicated to the professional staff generally

5. When the questionnaire has been completed, turn to the answer and analysis sheet. By comparing your firm's responses to the material set out in the answer and analysis sheet you will determine the extent to which your current controls, policies, and procedures in dealing with problems are adequate, and the particular aspects that may benefit from additional attention or restructuring.

**A. IDENTIFYING PROBLEMS**

	YES	NO	N/A
1. Is there a written policy requiring that all client communications be responded to within the following intervals?			
a. One business day	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Some other fixed time limit	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Is there a policy or procedure requiring calendar management of all client engagements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Is there a policy or procedure requiring that every client engagement automatically include regular communications with clients?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Is there a policy requiring that every invoice sent to each client be accompanied by a covering letter?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. For firms with more than one professional, is there a policy requiring that every client engagement be assigned to a team including more than one professional?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. (For firms with more than one professional) is there a partner in every office of the firm designated to deal with client complaints?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 8— Client Relations Management, and Handling Problems and Claims**

**A. IDENTIFYING PROBLEMS** *(continued)*

	YES	NO	N/A
7. For firms with more than one professional, is there a policy requiring that all client complaints be reported to a partner other than the partner managing the engagement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. Is there a partner in every office of the firm designated to deal with professional regulations, ethics, and firm procedures questions raised by other partners or associates?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Is there an express, written policy requiring professional regulations, ethics, and firm procedures, or malpractice issues to be reported to an identified partner or committee immediately any CPA becomes aware of such issues?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. If the answer to question 9 is <i>yes</i> , are issues explicitly and expressly defined for these purposes to include the following?			
a. Errors made by or omissions of partners (or shareholders), professional or support staff not corrected before the effects of the errors or omissions reached beyond the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Allegations of wrongdoing or impropriety made by any person outside the firm concerning any person inside the firm, whether or not relating to the firm's practice or a client engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Allegations of wrongdoing or impropriety made by any employee or agent of the firm with respect to any other employee, partner (or shareholder) or agent of the firm whether or not relating to the firm's practice or a client engagement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Motions or applications for sanctions against the firm or any partner (or shareholder) or staff member in any tribunal or proceeding	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. The occurrence of any matter or event occasioned by the firm's engagement for or by a client which could cause the client harm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. All claims, whether verbal or in writing, alleging that the firm, or any partner (or shareholder) or professional employee, has committed malpractice, regardless of whether a formal claim for damages or restitution is made	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**Risk Management**

**A. IDENTIFYING PROBLEMS** *(continued)*

	YES	NO	N/A
g. All threats, whether verbal or written, to lodge a complaint with the grievance or discipline authorities with respect to the firm or any partner or associate	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
h. Any perceived professional regulations, ethics and firm procedures violation by any other CPA within the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
i. Any billing dispute with clients not amicably resolved within the normal course of the firm's billing policies and procedures	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. Do the written expressions of policy referred to in questions 9 and 10 make express and explicit that the firm actively encourages early reporting in order to help deal with, control, and ameliorate problems?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Are the policies referred to in questions 9, 10, and 11 regularly disseminated at least twice per year?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. Are the policies referred to in questions 9, 10, and 11 explained to all new CPA hires, lateral partner recruits, and practice or office merger members?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>B. RESPONSE PROCEDURES</b>			
1. Is one partner or committee responsible for responding to all matters arising within the firm described in question 10 of the preceding section entitled "A. Identifying Problems"?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Is that person or committee the same person responsible for the firm's professional liability insurance arrangements?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Has the firm prepared a detailed policy and procedure statement for dealing with any such problem from the moment they are reported?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 8— Client Relations Management, and Handling Problems and Claims**

**B. RESPONSE PROCEDURES** *(continued)*

	YES	NO	N/A
4. Which of the following most closely represents the <i>first</i> step to be taken in responding to the report of any such problem?			
a. Commence a detailed investigation, including the creation of a written record of all interviews.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Interview all persons with knowledge informally to gain a preliminary view of the scope of the problem.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. If the matter concerns a current client engagement, contact the client.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Even if the a claim is within the scope of the firm’s “deductible,” contact the firm’s professional liability insurer.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Which of the options in question 4 is the <i>second</i> step to be taken in these circumstances?			
4a. Commence a detailed investigation, including the creation of a written record of all interviews.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4b. Interview all persons with knowledge informally to gain a preliminary view of the scope of the problem.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4c. If the matter concerns a current client engagement, contact the client.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4d. Even if the a claim is within the scope of the firm’s “deductible,” contact the firm’s professional liability insurer.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Is a partner (or shareholder) of the firm designated to deal with any press or media enquiries concerning any such matters?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Does that partner (or shareholder) have available to him or her outside professional consultants to advise and assist in responding to such enquiries?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. Has the partner (or shareholder) met with such outside consultants, other than in connection with any specific incident, to help formulate general response policies?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Does the firm meet at least annually with its professional liability insurers to review risk management procedures generally (apart from any review of either claims or premiums)?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



**QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS**  
**QUESTIONNAIRE 9—DISASTER RECOVERY AND BUSINESS CONTINUITY**

1. This questionnaire has been developed with the following two purposes in mind:
  - a. To assemble and organize the information regarding the firm's existing preparations, policies, and procedures in the event of any occurrence (*disaster*) which renders part or all of the firm's business functions inoperable
  - b. To give the firm's management an opportunity to determine the degree to which its disaster recovery preparations are known and understood around the firm
2. This questionnaire should be completed by whichever committee chair or partner of the firm, currently has the greatest share of responsibility for oversight of the firm's day-to-day operations, by the firm's management, and by a cross-section of partners, professional and support staff.
3. The following steps should be taken in answering the survey.
  - a. In the initial self-administration of this survey, the responses should be *yes*, *no*, or *N/A* (not applicable).
  - b. The firm may decide to supplement the answers, as follows.
    - i. If the firm later decides either to prepare or supplement its formal policy statement and procedures concerning disaster recovery, and regarding the allocation of responsibility for these matters, or to seek outside help to review the policies, practices, or management structures in place that relate to these questions, it will be helpful to expand the simple answers from the initial survey into descriptive language.
    - ii. In expanding the responses, any existing firm documents that describe the relevant policies or procedures in more detail should be attached.
4. Some of the questions parallel questions that also appear on "Questionnaire 2—Risk Management Structures." The reasons for repeating these inquiries include the following:
  - a. The need to corroborate the responses to the questionnaire completed by the management and staff of the reviewed firm because the view from the trenches may be very different from the perception of senior management
  - b. The need to determine whether the firm has disaster recovery policies and procedures which are adequate and appropriate to the firm's size and practice areas
  - c. The need to determine whether the firm's policies and procedures have been effectively communicated to the individual(s) responsible for implementing the business continuity plan, and to the professional and support staff generally

**Risk Management**

5. When the questionnaire has been completed, turn to the answer and analysis sheet. By comparing your firm's responses to the material set out in the answer and analysis sheet, you will determine the extent to which your current policies and procedures succeed or fail in providing you with an adequate comfort level that your firm is properly prepared to address a disaster.

**A. IMPACT ANALYSIS**

	YES	NO	N/A
1. Has an impact study of catastrophic events been performed by the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Has the firm identified functions and services it considers critical (meaning, for which continuity is required at all times)?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Does the firm have a business continuity plan in the event of catastrophic events?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the plan envisage specific disaster scenarios causing different levels of disruption?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Has the firm examined alternative methods for conducting its business, depending on the degree of disruption?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Does the plan provide for uninterrupted provision of services identified as critical?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Does the plan provide for recovery time frames for all functions and services?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>B. PLAN PREPARATION AND MAINTENANCE</b>			
1. Is the plan in writing?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Within which of the following intervals is the plan updated?			
a. Semiannually	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Annually	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. As needed	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Has the plan ever been tested? If so, within which of the following intervals was the most recent test?			
a. Within the last year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. More than one year ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



**Questionnaire 9—Disaster Recovery and Business Continuity**

**B. PLAN PREPARATION AND MAINTENANCE**

*(continued)*

	YES	NO	N/A
4. To which of the following has a hard copy of the plan been distributed?			
a. To all partners	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. To all other professional staff	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. To all support and administrative staff	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Is the distribution always acknowledged in writing?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Is the distribution repeated regularly? If so, within which of the following intervals was it last distributed?			
a. Within the last year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. More than one year ago	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. To all new hires	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Has a recovery site been formally arranged?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. If so, is it fully equipped?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. If not, does the contract for the site specify the services and support the firm will receive?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. Is the location clearly identified in every version of the business continuity plan?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. Have the personnel (at all levels) in the recovery team been identified?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Has the recovery team been trained?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. Has critical equipment been identified?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. Has telephone service for the recovery site been secured?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. If so, is it a different telephone number from the firm's normal number?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
16. If so, is the number clearly included in every version of the business recovery plan?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. If the number is different, does the plan include detailed provision for notifying clients and all callers to the firm?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18. In the event of a disaster is there an emergency contact list?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**B. PLAN PREPARATION AND MAINTENANCE**

*(continued)*

	YES	NO	N/A
19. If so, does it include the following?			
a. Telephone numbers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Beeper numbers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Cellular phone numbers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20. Is the emergency list distributed to the following?			
a. All partners	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. The recovery team	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. All personnel	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21. Is there an employee responsible for plan maintenance?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>C. SUPPORT FUNCTIONS</b>			
1. Are administrative and support staffing requirements part of the plan? If so, does the plan include provision for the following:			
a. Internal staff	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Outside support	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Has the appropriate administrative and support staff been included in the recovery team?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Are recovery team members aware of their individual responsibilities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Are office supplies necessary to conduct business available at the recovery site?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. If not, are arrangements in place for immediate delivery from off-site?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Has an inventory of core support materials (meaning, firm documents) been taken?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. If the answer to question 6 is <i>yes</i> , is it assembled and organized?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. If the answer to question 7 is <i>yes</i> , where is a copy stored?			
a. At the recovery site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Elsewhere off-site from the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Are any systems or records maintained through a service bureau or vendor?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. If the answer to question 9 is <i>yes</i> , are there provisions for these services included in the firm plan?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Questionnaire 9—Disaster Recovery and Business Continuity**

**D. FIRM RECORDS**

	YES	NO	N/A
1. Where are new client and engagement records retained?			
a. At the recovery site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Elsewhere off-site from the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to either question 1a or 1b is yes, are provisions made to ensure client confidentiality?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Are copies of all firm policies and procedures available at the recovery site?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Where are copies of the firm's human resource and employee records kept?			
a. At the recovery site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Elsewhere off-site from the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Where are closed files archived?			
a. At the recovery site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Elsewhere off-site from the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Answer the following.			
a. Are original documents archived, and photocopied, microfilmed, or imaged, for record retention purposes?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. If backup files are stored off-site on a network server or otherwise, are firewalls, password protect, encryption, or other security measures in place?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Are there written policies and procedures in place to access the files from the remote site when needed?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. If materials are retained in this way, how are copies maintained?			
a. At the recovery site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Elsewhere off-site from the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. Where are copies of the firms billing system and billing records maintained?			
a. At the recovery site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Elsewhere off-site from the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*(continued)*

**E. RISK MANAGEMENT**

	<b>YES</b>	<b>NO</b>	<b>N/A</b>
1. Are backups made of the firm's calendar and deadline control system maintained at least weekly?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If the answer to question 1 is <i>yes</i> , where are they stored?			
a. At the recovery site	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Elsewhere off-site from the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Has the business recovery plan been reviewed by the following?			
a. The risk management partner or committee?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. The firm's professional liability insurer	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the plan provide for immediate notification when the plan is put into effect to the following:			
a. All partners, professional, and support staff of the firm	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Clients	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Vendors or service providers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Mail and courier services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Is the business recovery plan included as part of all new employee training?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Does the recovery team include representatives from the following?			
a. Firm management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Risk management partner or committee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Chief administrator or office manager	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Human resources manager	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Information technology staff	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Accounting and billing department	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Representatives of professional and support staff	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

# **Part 3**

## **Quality/In Control (QUIC) Survey for CPA Firms**

### **Answer and Analysis (Crib) Sheets**



## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 1— FIRM LEADERSHIP AND MANAGEMENT STRUCTURE

#### I. FUNCTION

This questionnaire is designed to explore the following two things:

- The extent to which the firm's management is actually aware of the scope of ethics and risk management in today's practice environment
- The extent to which the firm's management has actually addressed each of the fundamental risk management issues by establishing an effective management structure (consistent with the firm's culture) to oversee and thereby limit and control the risks that arise in the course of the firm's practice

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to "Questionnaire 1—Firm Leadership and Management Structure," have completed the process of responding to the questionnaire. Then an initial, twofold review can begin. First, each individual should consider his or her responses in the light of this crib sheet, and then everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the current state of the firm's management structure for the control of practice risks. Once there is agreement as to what is in place, the question of what gaps exist, and what can be done to fill them—consistent with the inevitable tensions between the firm's management culture and the dangers inherent in doing nothing—can be addressed.

A third level of comparison will also assist, namely comparison of the responses to this questionnaire with the responses to "Questionnaire 2—Risk Management Structures." To the extent that the responses of the firm's senior management do not accord with the views of the partner(s) actually charged with the day-to-day oversight of risk management, the firm will also have to address what adjustments in the actual system of risk management that is in place are necessary, appropriate and actually possible in order to bring perception closer to reality.

When these three evaluations have been completed, the firm can proceed to the more detailed questionnaires. When completed, these should also be reviewed twice alongside the applicable crib sheets; first, by the people who actually responded, and then by the individual partners or committee responsible for risk management. This will yield the same kinds of contrasting insights—what is perceived to be in place by those actually in the relevant trenches, against what management believes to be happening. Whether there is great congruence or significant disagreement, the responses will demonstrate, in each area studied, the degree to which the risk management system exists and functions, exists but does not function adequately, or does not exist. Again, based on this analysis, the firm can make practical and meaningful judgments as to whether changes are required and, if so, which are appropriate.

For many firms, the answers yielded by these reviews will either reassure, or, without more analysis, enable those firms to decide upon and implement any needed changes to their risk management functions and procedures. For some, on the other hand, the answers yielded by these reviews may create dilemmas or the potential for internal conflict of a kind that lead the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources. Many of the professional liability insurers have staff that are knowledgeable and available to give guidance in many areas.

### **II. SCOPE**

This crib sheet, and its companions relating to the other QUIC Survey questionnaires, are designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive management structure, appropriately staffed, to control the risks that are inevitable in the increasingly complex activity that is the practice (of public accounting). Thus, the answers and analysis contained in the crib sheets are intended to perform the following two functions:

- Explanations and definitions of *problems*—risks—that the underlying questionnaire is intended to uncover in the context of your particular firm
- General reviews of the ethical and legal liability issues which may arise if the management of these issues falls short of adequate

It is not the intention of the authors that the crib sheets constitute a complete analysis on CPA firm leadership and management in general. Rather, it is our purpose to help firms to determine whether they have in place systems, policies, and effective procedures to enable them, internally, to supervise their practices so as to be able to anticipate, and to research (in whatever detail is appropriate) and to respond to specific issues as and when they may arise, but before they become threatening. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered, to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of its practice.

### **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed, meaning: Why are we asking you this? Second, the broad implications of each response (*yes, no, or N/A*) are discussed. Third, the level of importance which we attach to dealing with gaps which you may have uncovered in your policies or procedures is explained.



## IV. ANSWERS AND ANALYSIS

### A. GENERAL MANAGEMENT STRUCTURE

#### *Questions 1 and 2*

The significance of these questions lies in the problems which may lurk in written agreements, especially older agreements which have not been reconsidered in the recent past. We take no position as to whether firms are safe in relying on local partnership (or corporations) law rather than their own individualized documents, but suggest that there are many benefits from a writing properly expressing the special arrangements within a firm. The next two questions raise particular concerns about issues which are frequently improperly addressed in such agreements.

#### *Question 3*

The laws of most states do not prohibit, but do restrict (usually on the basis of the reasonableness in scope, geographic area, and duration) the use of clauses in partnership or employment agreements that restrict the freedom of former partners or employees to practice their profession after leaving a firm. Does your partnership agreement have such a provision? If so, the whole subject should be reexamined, after carefully reviewing the relevant law in the jurisdiction of the firm's base, and perhaps everywhere there are offices. In addition, if the only way partners are prevented from leaving is by employment or partnership agreement provisions which penalize them financially, this may suggest that a broader review is appropriate about the way the firm operates, and the way in which its members are compensated and are given the appropriate incentives to remain.

#### *Question 4*

The significance of this question goes to the firm's ability to control three aspects of its practice—*who* are taken on as clients; *who decides* who is accepted as a client; and who decides on the *assignment of responsibility* within the firm for client matters. The danger implicit in this question is that if a firm compensates either “finding” or “minding” clients too heavily, and at the expense of “grinding”—doing the work—then the pressure may lead to the “finders” and “minders” either themselves taking decisions, or putting excessive pressure on the firm to decide these issues in ways that ultimately expose the firm to major claims from the clients or third parties. These issues are addressed at greater length in the “Questionnaire 4—New Client and Engagement Acceptance.” However, if problems in that area are subsequently identified, the place to begin in looking for ways to solve them may well be in the fundamental partnership compensation structure of the firm, as described in the partnership agreement. While this may be a painful matter to address, it is suggested that multimillion dollar claims which at root arise because new client and engagement is improperly controlled, and which in turn is a side effect of the compensation structure, may well be worse than facing up to, and fixing this underlying problem.

#### *Questions 5 and 6*

These questions are fundamental to the analysis of risk management. We take no position as to the appropriate governance model for any firm, *provided* that the structure embraces three basic elements: both day-to-day and policy management (between full partnership meetings) is effectively *delegated* to a central executive authority in a manner acceptable to and understood by the partners; *all* management functions report to that executive

authority; and, where the authority resides in an individual, there is a clear, understood and prearranged *succession* in place at all times, including a deputy during temporary absences. Effective *risk* management is impossible unless the firm has in place effective general management.

### Question 7

Meeting schedules are only significant to the extent that you conclude in response to questions 5 and 6 that the firm's general management structure does not meet all three of the criteria listed above. To that extent, the committee, or the whole partnership—as the case may be—that retains central management authority must meet frequently enough to be able to provide a level of centralized decision making sufficient to mitigate the deviation from these criteria. Again, effective *risk* management is impossible unless the firm has in place effective general management.

## B. RISK MANAGEMENT OVERSIGHT

### Questions 8 and 9

The significance of these questions is that they help to establish the existing level and sophistication of risk management in your firm. The issue, of course, goes beyond the allocation of titles, and is really addressed to the allocation of functions. The purpose of these questions is to help identify which functions have already been recognized as important, and allocated to individuals or committees to handle. In some firms, to the extent they have dealt with all or any of the listed issues, they have assigned all to one individual or committee. Depending on the size of the firm (and therefore the scale of the responsibility), this may be entirely appropriate. However, the question here is to determine what functions have already been identified and allocated.

- *Choice a.* This is frequently an advisory function, which provides two or three vital services to the partnership and its staff. First, actually listening to and advising on ethics issues that are recognized and caught before they become problems. By being there and providing on-the-spot expert counseling, matters which might otherwise degenerate into problems can be forestalled. Second, if the position is structured and understood as one where the occupant can be consulted in situations where problems involving other persons have already arisen to the knowledge or belief of partners or staff members, then again, early intervention may at least enable the firm to mitigate the greater harm which might flow from waiting until a full blown crisis has arisen. Third, the position can be used as part of the internal education program, to insure that everyone in the firm is fully and adequately informed of the firm's commitment to practice within the constraints of applicable professional regulations, ethics and procedures, and to ensure that everyone is familiar with the firm's specific risk management policies and procedures.
- *Choice b.* This position involves the delegation of *all* of the functions listed in B.11. to one individual or committee. Provided that the individual or committee is given the resources (including the time) to perform the function adequately, this is obviously the best way for firms to be sure that all of the elements of risk management are being adequately addressed. To the extent that any elements of the risk management functions are *not* included in the portfolio—and not appropriately delegated or assigned to others—the program is less than complete, and the risk management function is not being fully performed.

- *Choices c and d.* These may be viewed as discrete functions that can (or should) be handled either as part of overall risk management or by a separate litigation or insurance specialist. However, the issues which are addressed in performing either of these functions require a detailed knowledge of all of the other elements of the risk management policies and procedures in effect in the firm. Accordingly, if the person or committee with either of these functions are different from the partner or committee responsible for the other risk management functions, then the partner or committee charged with the insurance or claims functions should be required to work in committee with *all* those bearing any of the other risk management functions.
- *Choice e.* See the preceding discussion of choices *a* and *b*.
- *Choice f.* The risk management issues associated with hiring (including partner lateral hiring), peer review of partners, and supervision of professional staff, are covered in depth in “Questionnaire 6—Human Resources Management.” However, it is crucial to understand again that these issues should be addressed as part of an overall risk management system, and that those responsible for specific segments should not be separate islands, but should be working in an effective and fully integrated system.

*Question 10*

Meeting schedules are only significant to the extent that you conclude in response to questions 8 and 9 that the firm’s risk management structure is not fully centralized. To that extent, the committee(s) that retain management authority over the particular issues, and the partner or committee responsible for centrally controlling each constituent element, must meet frequently enough to be able to provide a level of centralized decision making sufficient to insure continuing oversight of all of the functions. Effective risk management is impossible unless the firm has in place effective and regular centralized oversight of all of these management functions. The more infrequently the relevant groups meet, the more likely it is that the functions are being incompletely performed.

*Question 11*

The significance of this question is that, taken collectively, the subquestions identify all of the crucial elements of greatest risk normally encountered in CPA practice. The importance of each subquestion is to determine whether the firm has separately allocated management responsibility for assessing and controlling the risk elements involved in these categories. The implication of each *no* answer, therefore, is that a significant risk element is not being managed, and attention needs to be given to allocating responsibility for such oversight to the appropriate person or committee in the firm’s risk management structure. Although each of the subquestions relate to topics discussed at length in the respective questionnaires, set out below is a brief explanation of why each item is a matter of concern.

- *Choice a.* Control of intake of new clients is crucial to the avoidance of claims. This function includes the following key issues: Is there independent decision making as to the acceptance of new clients? Is the conflict of interest checking system adequate in principle, including partners, based upon the nature of the expertise required, and not the identity of the introducer? These issues are fully explored in “Questionnaire 3—New Client and Engagement Acceptance.”

- *Choice b.* The use of engagement letters, the need for non-engagement letters, and the adequacy of the new client engagement forms, and all other standard intake documents are controversial but in our view vital to effective risk management. We address the detailed reasons for reviewing policies, procedures and forms in the Crib Sheet applicable to Questionnaire 3. For present purposes, we note that the answers which you are now reviewing, are merely intended to guide you in determining which areas are already effectively overseen. The scope of need for additional systems will become more apparent only when the subordinate questionnaires are reviewed.
- *Choices c and d.* The areas of billing arrangements and entrepreneurial relationships with clients are today two sources of disputes between (CPA) firms and clients, and therefore of claims against firms.
- *Choice e.* Because of recent experiences by a number of CPA firms it is now routine for all staff members to be asked to comply with policies and procedures that restrict their (and their families') investment activities so as to avoid actual or perceived conflicts with clients.
- *Choices f and g.* A rapidly developing area of substantive law is that involving liability to third parties for opinion letters. Key to managing risk in this area is the existence and enforcement of policies and procedures insuring independent review, within the firm, before partners with client responsibility can issue opinions. We address the detailed reasons for reviewing policies, procedures and forms in the crib sheet applicable to the Questionnaire 2 and "Questionnaire 7— Professional Staff."
- *Choice h.* Internal peer review of partners is not many CPAs' idea of a "good thing;" CPAs are customarily resistant to the idea that anyone else can or should tell them "how to practice." However, an essential ingredient of managing risk is to know what your peers are up to. Mere monthly financial or time reports, however sophisticated, do not speak to this. We address the detailed reasons for internal peer review, and discuss some of the different ways (more, or less intrusively) that this can be accomplished, in the crib sheet applicable to Questionnaire 6.
- *Choices i, j, k, and l.* The dangers of inadequate due diligence in lateral partner hire and CPA firm, or practice mergers are all too apparent—but many firms do not do for themselves in practice that which they would insist upon for their corporate clients. We review what ought to be done, and how, in the crib sheet applicable to Questionnaire 6. For the present purposes, we note that the answers to Questionnaire 1, which you are now reviewing, are merely intended to guide you in determining which areas are already effectively overseen. The scope of need for additional systems will become more apparent only when the subordinate questionnaires are reviewed.
- *Choice m.* Again, the crib sheet to Questionnaire 6 sets forth in greater detail the appropriate level and form of staff supervision for risk management purposes. Here, we are asking whether you, the management of the firm, have specifically recognized and delegated or assigned these risk management functions.
- *Choice n.* Statistics vary, but it is frequently said that up to 10 percent of the population is afflicted with a drug or alcohol or other dependency or addiction problem. It is self-evident that this high incidence can mean serious claims against the firm, as well as the individuals involved. The question here is whether management has assigned the task of seeking to identify problems at the earliest possible stage, so as to prevent claims and, hopefully, enable valuable staff (or partners) to be helped before the problems become irreversible.

- *Choices o, p, and q.* Effective risk management includes and requires effective training and education, and the perception among every element of the firm that these issues are important to senior management. These questions seek to establish whether your firm has addressed these issues. Again, the crib sheet to Questionnaire 6 discusses these issues at greater length, while Questionnaire 7 seeks to test whether the staff in the trenches actually receives the expected training and education as well as their perception of the importance which management gives to this and other aspects of risk management.
- *Choice r.* Regrettably, there is no foolproof, fail-safe risk management system. Accountants are, sadly, fallible (occasionally). Claims and other incidents will, inevitably, arise. Are you prepared? What is appropriate in the way of advance preparation is discussed in the crib sheet to “Questionnaire 8—Client Relations Management and Handling Problems and Claims.”
- *Choice s.* This question again addresses the issue of whether your firm has integrated risk management and insurance functions. Unless those responsible (where they are not identical) are working together, neither can be fully effective.
- *Choice t.* The issue here is whether multidisciplinary or assurance service practices—or other practices with a particularly high risk of claims—have separately reviewed risk management in their practices in conjunction with those having the overall risk management responsibility within the firm. Here again, if the “experts” are not being used, a less than complete job is being done.
- *Choice u.* Bombs, floods knocking out whole city blocks, fires (or floods from firefighting), and earthquakes have all caused significant disruption to accounting firms large and small in recent months. Are you prepared? Are your staff prepared? Are your clients prepared? These issues and various planning approaches for addressing such catastrophes are discussed at length in the crib sheet to “Questionnaire 9—Disaster Recovery and Business Continuity.”

## **V. SUMMARY**

Your answers to this questionnaire should give you strong indications of which of the other QUIC Survey questionnaires are most pertinent to your firm. Thus, if your answers indicate to you that proper attention has not yet been given to some of the risk management functions identified in the questionnaire, both the detailed questionnaires and the crib sheets will help you formulate policies and procedures appropriate to your firm’s needs. Even where your answers indicate that you have some areas “under control,” there is great value to testing your assumptions that these functions are actually being managed in the manner you anticipate, by having questionnaires completed and reviewed even in those areas.



## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 2— RISK MANAGEMENT STRUCTURE

#### I. FUNCTION

This questionnaire is designed to explore the following two things:

- The scope of the responsibilities and authority of the partner(s) designated by the firm to oversee the firm's existing risk management policies and procedures
- The extent to which the firm's senior management is aware of the activities of those designated to oversee and control the risks that arise in the course of the firm's practice, including any perceived limitations in the existing risk control structure

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to the "Questionnaire 2—Risk Management Structures," have completed the process of responding to the questionnaire. Then an initial, twofold review can begin. First, each individual should consider his or her responses in the light of this crib sheet, and then everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the current state of the firm's management structure for the control of practice risks. Once there is agreement as to what is in place, the question of what gaps exist, and what can be done to close them—consistent with the inevitable tensions between the firm's management culture and the dangers inherent in doing nothing—can be addressed.

A third level of comparison will also assist, namely comparison of the responses to this questionnaire with the responses to "Questionnaire 1—Firm Leadership and Management Structure." To the extent that the responses of the firm's senior management do not accord with the views of the partner(s) actually charged with the day-to-day oversight of risk management, the firm will also have to address what adjustments in the actual system of risk management that is in place are necessary, appropriate and actually possible in order to bring perception closer to reality.

When these three evaluations have been completed, the firm can proceed to the more detailed questionnaires. When completed, these should be also be reviewed twice alongside the applicable crib sheets; first, by the people who actually responded, and then by the individual partners or committee responsible for risk management. This will yield the same kinds of contrasting insights—what is perceived to be in place by those actually in the relevant trenches, as against what management believes to be happening. Whether there is great congruence, or significant disagreement, the responses will demonstrate, in each area studied, the degree to which the risk management system exists and functions, exists but does not function adequately, or does not exist. Again, based on this analysis, the firm can make practical and meaningful judgments as to whether changes are required and, if so, which are appropriate.

For many firms, the answers yielded by these reviews will either reassure or enable those firms to decide upon and implement any needed changes to their risk management functions and procedures. For some, on the other hand, the answers yielded by these reviews may create dilemmas or the potential for internal conflict of a kind that leads the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources. Many of the professional liability insurers have staff members that are knowledgeable and available to give guidance in many areas, as no doubt, are other independent consultants.

### **II. SCOPE**

This crib sheet, and its companions relating to the other QUIC Survey questionnaires, are designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive management structure, appropriately staffed, to control the risks that are inevitable in the increasingly complex activity that is the practice of accounting. Thus, the answers and analysis contained in the crib sheets are intended to perform the following two functions:

- Explanations and definitions of the key *problems*—risks—that the underlying Questionnaire is intended to uncover in the context of your particular firm
- General reviews of the accounting and legal liability issues which may arise if the management of these issues falls short of adequate

It is not the intention of the authors that the crib sheets constitute a complete analysis on the risk management structure of the firm. Rather, it is our purpose to help firms to determine whether they have in place systems, policies, and effective procedures to enable them, internally, to supervise their practices so as to be able to anticipate, and to research (in whatever detail is appropriate) and to respond to specific issues as and when they may arise, but before they become threatening. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of its practice.

### **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subquestion, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed: Why are we asking you this? Second, the broad implications of each response (*yes*, *no*, or *N/A*) are discussed. Third, the level of importance which we attach to dealing with gaps which you may have uncovered in your policies or procedures is explained.



## IV. ANSWERS AND ANALYSIS

### A. RISK MANAGEMENT STRUCTURE

#### *Question 1*

The significance of this question lies in the problems which may lurk in written agreements, especially older agreements which have not been reconsidered in the recent past. We take no position as to whether firms are safe in relying on local partnership law rather than their own individualized documents, but suggest that there are many benefits from a writing properly expressing the special arrangements within a firm. As a partner with risk management knowledge or expertise, have you either considered on your own initiative, or been asked to have the agreement reviewed recently—particularly with the issues raised in question 2 in your mind? A *no* answer may indicate that this should now be attended to.

#### *Question 2*

*Choice a.* This question should be considered in the context of question 5a to 5d below. At issue is whether there is adequate *independent* review and control of new business or client issues, such that partners who introduce or manage client engagements cannot either compel or drag the firm into relationships or engagements which have a high likelihood of generating problems or even claims. The partnership agreement is relevant here only to the extent that the firm's compensation structure gives undue weight to client generation such that there are inherent pressures either not to have any, or to have inadequate review of the new client and engagement acceptance and client management processes.

#### *Questions 3 and 4*

The purpose of these questions is to assess the level of attention, and the manner of oversight, of the firm's senior management, to the risk management responsibilities delegated to you. We suggest that risk management is key to long-term success in today's litigious environment. The higher level at which the views of those responsible for risk management are regularly considered, the stronger is your firm's risk management structure. Accordingly, the optimum answers are *yes* to question 3c and 3d, and *no* or *N/A* to questions 3a and 3b; and *no* or *N/A* to questions 4a, 4d, and 4e, and *yes* to questions 4b or 4c. While other arrangements may be adequate, we suggest that you, and the firm, need to consider whether risk management is taken sufficiently seriously if the management structure, and the level and frequency of reporting do not recognize its significance to the long-term health of the firm.

#### *Question 5*

The significance of this question is that, taken collectively, the subquestions identify crucial elements of greatest risk normally encountered in the CPA practice. The importance of each subquestion is to determine whether the firm has separately allocated management responsibility for assessing and controlling the risk elements involved in these categories. The implication of each *no* answer, therefore, is that unless another partner or committee has been assigned this element of risk management responsibility (such that there is no other partner or committee who can and will answer *yes* when responding to this questionnaire), a significant risk element is not being managed. Obviously, if that is the conclusion, then attention needs to be given to allocating responsibility for such oversight to the appropriate person or committee in the firm's risk management structure. While

each of the subquestions relate to topics discussed at length in the respective QUIC Survey questionnaires addressed to the specific risk management categories, set out below is a brief explanation of why each item is a matter of concern.

- *Choices a and b.* Control of new clients and engagements is crucial to the avoidance of claims. This function includes the following key issues: Is there independent decision making as to the acceptance of new clients and engagements? Is the checking for independence issues adequate and effective? Is the assignment of staff, including partners, based upon the nature of the expertise required, and not the identity of the introducer? These issues are fully explored in “Questionnaire 3—New Client and Engagement Acceptance.”
- *Choices c and d.* The area of billing and collection disputes can lead to claims. Also of concern are other areas of independence and conflict disputes, including moonlighting activities.
- *Choice e.* This issue is obviously of greatest concern to firms with engagements of publicly held companies. For those firms, the issue is of great significance, both because of instances in which accounting firm employees (professional and nonprofessional staff) have been convicted of insider trading, and because of the danger that an (over)zealous prosecutor in the future might seek to prosecute the partnership as a whole. In that context, the Federal Sentencing Guidelines are also of great significance, because a firm which has made reasonable efforts to prevent the prohibited conduct will benefit from those efforts in responding to such charges. A number of firms have publicly announced the establishment of very rigorous controlled trading policies and procedures for just these reasons (as well as to give comfort to their clients). Risk management concerns related to stock ownership and the illegal use of insider information apply to all personnel, including firm partners and principals. Firm management may want to consult the Insider Trading and Securities Fraud Enforcement Act of 1988 and other similar laws which prohibit the use of nonpublic information. Does a *no* answer for your firm indicate the avoidance of an issue which in fact needs to be addressed?
- *Choices f, g, h, and i.* The use of engagement letters is an effective risk management procedure for today’s CPA. The preparation, review, and approval of these important communication tools are the foundation to a strong risk management structure within the firm. Key to managing risk in the area of other communication, reports, and opinions is the existence and enforcement of policies and procedures ensuring appropriate review, within the firm, before the reports or opinions are released. We address the detailed reasons for reviewing your firm’s policies, procedures, and forms in this area in the crib sheet applicable to “Questionnaire 7—Professional Staff.” Again, however, a *no* or *N/A* answer to *any* of these subquestions—unless there is some other partner or committee who will answer yes—indicates a serious gap in your firm’s risk management controls.
- *Choices j and m.* An essential ingredient of managing risk is to know what your peers are up to. Mere monthly financial or time reports, however sophisticated, do not speak to this. Lack of partner oversight is a huge problem in claims for all size firms. Effective firm management will include a clear understanding of policies that enable this oversight to occur within the regular course of business. We address the detailed reasons for peer review, and discuss some of the different ways (more, or less intrusively) that this can be accomplished, in the crib sheet applicable to “Questionnaire 6—Human

Resources Management.” A *no* or *N/A* answer suggests that you may be avoiding a necessary element of risk management. The issue could be framed as follows (to paraphrase the old TV announcement): “It’s year-end. Do you know what all of your partners are doing?”

- *Choices k, l, and n.* The dangers of inadequate due diligence in lateral partner hire and accounting firm mergers are all too apparent—but many firms do not do for themselves in practice that which they would insist upon for their corporate clients. We review what ought to be done, and how, in the crib sheet applicable to Questionnaire 6. For the present purposes, we note that the answers to “Questionnaire 2—Risk Management Structures,” which you are now reviewing, are merely intended to guide you in determining which areas are already effectively overseen. The scope of need for additional systems will become more apparent only when the subordinate questionnaires are reviewed. Again, the crib sheet to Questionnaire 6 sets forth in greater detail the appropriate level and form of staff supervision for risk management purposes. Here, we are asking whether you, the management of the firm, have specifically recognized and delegated or assigned these risk management functions.
- *Choice p.* Statistics vary, but it is frequently said that up to 10 percent of the population is afflicted with a drug or alcohol or other dependency or addiction problem. It is self-evident that this can lead to serious claims against the firm, as well as the individuals involved. The question here is whether management has assigned the task of seeking to identify problems at the earliest possible stage, so as to prevent claims—and, hopefully, enable valuable staff (or partners) to be helped before the problems are irreversible.
- *Choices q, r, and s.* Effective risk management includes and requires effective training and education, and the perception among every element of the firm that these issues *matter* to senior management. These questions seek to establish whether your firm has addressed these issues. Again, the crib sheet to Questionnaire 6 discusses these issues at greater length, and Questionnaire 7 seeks to test whether the staff in the trenches actually learns from and values the training and education—as well as their perception of the importance which management gives to this and other aspects of risk management. If your answer is *no* or *N/A*, you should be concerned about what this says about the attitudes towards, and the level of awareness of risk management and control among the partners and staff of the firm.
- *Choices t and u.* Regrettably, there is no foolproof, fail-safe risk management system. CPAs are, sadly, fallible (occasionally). Claims and other incidents will, inevitably, arise. Are you prepared? What is appropriate in the way of advance preparation is discussed in the crib sheet to “Questionnaire 8—Client Relationship Management, Handling Problems and Claims.”
- *Choice v.* This question again addresses the issue of whether your firm has integrated risk management and insurance functions. Unless those responsible (where they are not identical) are working together, neither can be fully effective.
- *Choice w.* Bombs, floods knocking out whole city blocks, fires (or floods from firefighting), and earthquakes have all caused significant disruption to accounting firms large and small in recent months. Are you prepared? Are your staff members prepared? Are your clients prepared? These issues and various planning approaches for dealing with such catastrophes are discussed at length in the crib sheet to “Questionnaire 9—Disaster Recovery and Business Continuity.”

- *Choice x.* Staff members and perhaps partners will have questions regarding professional ethics—to whom do they turn? Where do they go to resolve these issues or dilemmas? Members of the firm need to know where to bring these issues.

### *Question 6*

If you have answered *no*, then to the extent of the areas you have identified as not being someone's specific responsibility, these are areas of your firm's practice to which inadequate attention is being paid, from the point of view of risk management. Each of the topics covered by questions 6*a* to 6*x* are significant, and should be the specific responsibility of a partner or committee of the firm.

### *Question 7*

Risk management cannot be effective if it is an isolated process. It must be integrated in every direction, meaning, among all those with specific areas of responsibility, all those with overall management responsibility, and all of the individual professionals and management staff of the firm. Unless the appropriate reporting arrangements, committee structures and training and information distribution systems are in place, the firm's risk management is not fully in place. Accordingly, a *no* or *N/A* answer indicates that there is room for improvement in your firm's management of its practice.

### *Questions 8 and 9*

As to each of the areas in question 8 as to which you answered *yes*, but would answer *no* in question 9, you have probably identified not just a specific incident but a management problem, in that a problem inadequately handled in the past is not likely to be handled any better in the future unless and until the underlying management structure or policies have been addressed.

### *Questions 10 and 11*

Similarly, as to each of the areas in question 10 as to which you answered *yes*, but would answer *no* in question 11, you have probably identified not just a specific incident but a management problem, in that a problem inadequately handled in the past is not likely to be handled any better in the future unless and until the underlying management structure or policies have been addressed.

### *Question 12*

If the answer to 12*a* or 12*b* is *yes*, and to 12*c* and 12*d* is *no*, you have again probably identified another area of practice in which the underlying risk management policies and procedures are inadequate. It is rare for incidents to occur which are truly isolated, in the sense that they arise despite and in the face of the existence of clearly defined firm culture, and procedures designed to prevent the kind of problem which arose. Usually, problems arise because the subject has been inadequately addressed in advance, rather than in defiance of an explicit policy, regardless of the category of problem concerned. Accordingly, even if you regard the resolution of the specific problem as appropriate, this is in fact only a proper answer if part of the response was to improve the risk management structure so as to prevent or at least inhibit future violations.

*Questions 13 and 14*

Opinions will differ as to what is an “adequate” library in this (or any) area. However, it is suggested that the items listed in question 14 are the *minimum* which a firm should maintain on hand to enable it to respond promptly and accurately to problems as they arise. It is also vital to insure that these resources are kept up to date at all times. A *no* answer to *any* of question 14a to 14d is an indication that your firm is inadequately supported with the basic tools to provide a proper level of response when problems arise.

*Question 15*

A *no* or *N/A* answer to this question indicates the existence of a potentially serious problem. If you are inadequately supported, or if you are not enabled to spend adequate time on your risk management responsibilities—whether for reasons tied to the firm’s compensation structure, or simply the press of other nondelegable management functions—then the firm’s priorities in this area are misplaced. To quote an old cliché, “An ounce of prevention is worth a pound of cure.” However good the firm’s record in terms of malpractice claims or complaints, unless you are satisfied that the good record is the result of planning and management rather than blind chance, you should be concerned if you were unable to answer this question with a *yes*.

*Questions 16 and 17*

If this answer is a *yes* to either of these questions, then the issues should be revisited—as often and for as long as necessary to bring about the required changes. The price of failing to manage risk is increasingly likely to be claims, and as we can read in the press, some individual claims are capable of crippling, or even destroying substantial and previously highly regarded firms. There is no guarantee, even with appropriate risk management structures in place, that all claims or problems will be avoided; on the other hand, prudent management reduces a firm’s exposure to claims, is clearly preferable to the alternative, and may even have valuable secondary benefits. To the extent that the firm controls such matters as new client and engagement acceptance, engagement management and its human resources, the firm’s clients will be the better served; to that extent, in today’s competitive marketplace, that can only be an important advantage.



## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 3— NEW CLIENT AND ENGAGEMENT ACCEPTANCE

#### I. FUNCTION

This questionnaire is designed to explore the following two things:

- The scope of the firm's existing new client and engagement acceptance policies and procedures, and the degree to which they are implemented
- The extent to which the existing policies and procedures effectively control the risks associated with or which can arise from the new client and engagement acceptance process

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to the "Questionnaire 3—New Client and Engagement Acceptance," have completed the process of responding to the questionnaire. Then an initial, twofold review can begin. First, each individual should consider his or her responses in the light of this crib sheet, and then everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the current state of the firm's management structure for the control of the new client and engagement acceptance process. Once there is agreement as to what is in place, and how the process is operating, the question of what gaps or problems exist, and what can be done to close them—consistent with the inevitable tensions between the firm's management culture and the dangers inherent in doing nothing—can be addressed.

A third level of comparison will also assist, namely comparison of the responses to this questionnaire with the responses to "Questionnaire 1—Firm Leadership and Management Structure," and "Questionnaire 2—Risk Management Structures." To the extent that the responses of the firm's senior management and its risk managers do not agree with the views of the partner(s) and administrators actually charged with the day-to-day oversight of the new client and engagement acceptance process, the firm will also have to address what adjustments in the actual system are necessary, appropriate and actually possible in order to bring perception closer to reality.

For many firms, the answers yielded by this review process will either reassure or enable those firms to decide upon and to implement any needed changes to their new client and engagement acceptance policies and procedures. For some, on the other hand, the answers yielded by this review may create dilemmas or the potential for internal conflict of a kind that lead the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources. Many of the professional liability insurers have staff that are knowledgeable and available to give guidance in many areas as, no doubt, are other independent consultants.

## **II. SCOPE**

This crib sheet, and its companions relating to the other QUIC Survey questionnaires, is designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive system of new client and engagement acceptance, appropriately overseen, to control the risks that are inevitable if new clients and matters are inadequately screened, reviewed, and controlled. Thus, the answers and analysis contained in this crib sheet are intended to perform the following two functions:

- Explanations and definitions of the key *problems*—risks—that the underlying questionnaire is intended to uncover in the context of your particular firm
- General reviews of the accounting and legal liability issues which may arise if the management of these issues falls short of adequate

It is not the intention of the authors that the crib sheets constitute a complete analysis of the new client and engagement acceptance process. Rather, it is our purpose to help firms to determine whether they have in place systems, policies, and effective procedures to enable them, internally, to supervise the process so as to be able to anticipate, and to control the various new client and engagement acceptance problems and issues as and when they may arise, but before they become threatening. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of its practice.

## **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed, meaning: Why are we asking you this? Second, the broad implications of each response, which may be *yes*, *no*, or *N/A* (not applicable), are discussed. Third, the level of importance attached to addressing gaps which you may have uncovered in your policies or procedures is explained.

## **IV. ANSWERS AND ANALYSIS**

### **A. CLIENT INTAKE REVIEW—GENERAL**

#### *Question 1*

It is *essential* that every firm have a highly detailed new client and engagement acceptance questionnaire or form. Accordingly, any *no* or *N/A* answer immediately and automatically triggers loud alarm bells. Without an appropriate form, no meaningful control of the new client and engagement acceptance process is possible. In addition, the lack of such a form is likely to lead to billing and collection problems.

The new client form should encompass *at least* the following matters:

- Name and address of the client
- Names of all officers or directors of a corporate entity



- Names of all related, subsidiary, associated, or parent entities of the client
- Intended billing arrangements
- The identity of partners and others involved in introducing the new client
- A description of the nature and scope of the engagement; any limitations agreed with the client on the terms of the engagement; and the specific areas of expertise likely to be required
- When a prior accounting firm was utilized by the client, a *detailed* explanation for the reasons underlying the change; and confirmation that the prospective client has given permission to call upon the prior accountant
- Any special circumstances concerning the client that should be disclosed to the partners and committee responsible for new client acceptance prior to the accepting the engagement

*Question 2*

Assuming that the firm does have an appropriate new client and engagement acceptance form, its mere existence is of no value *unless its use is required in all circumstances, and without exception*. The best way to ensure that this is the case is to structure each of the file opening, time recording, and billing systems in such a way that they cannot be operated *in any way* until *each* of the following two conditions have been met: (1) The standard form has been *fully* completed, and signed by a partner. (2) The form has been reviewed and approved as discussed below at questions 3, 4, 5, and 6.

*Question 3*

Assuming that the firm has both an appropriate new client and engagement acceptance form and both of the controls described at question 2 above, the system is still of no value *unless there is fully independent oversight and control of the new client and engagement acceptance decisions*. This applies to all firms with more than one partner or principal. The key element here is *objectivity*. The essential requirement is that the partner or committee have the final authority to determine whether, or on what conditions, the engagement should be accepted by the firm. The introducing partner should have no veto or right to circumvent this decision-making process—the future financial well-being of the firm and of every individual partner may depend on this. At least arguably, several of the recent major claims against and settlements by national and prestigious accounting firms resulted, at root, from their failure to control the new client and engagement acceptance process—whether inadequate checks on the entity or its management, inadequate “smell testing,” or inadequate staffing for accounting issues. If the firm takes on clients for the short-term billings believed available, without reviewing all of the matters listed at question 1 above, sooner or later a claim will arise that could have been avoided or protected against.

Although some firms have reservations about this kind of strictly enforced, objective review, partly justified on the ground that it is intrusive upon the prospective client, we suggest that such misgivings are ill-founded. On the contrary, desirable clients to whom the process is carefully explained should be *reassured* by the thoroughness of the process—which they will rightly see as being for their own protection, as well as for the benefit of the firm and its existing clients.

### Question 4

Again, as to all firms with more than one partner or principal, unless the answer to this question is *yes*, the firm cannot adequately respond to the needs of potential new clients—unless the rules discussed at questions 1, 2, and 3 above are going to get bent. Accordingly, *no* or *N/A* answers should constitute another alarm bell that the system may not be adequate to protect against inappropriate engagements.

### Questions 5 and 6

For the reasons set out in the prior responses, it will be clear that even objectivity within a thorough review process will ultimately provide no protection unless the reviewing partner or committee has the *authority* to make decisions binding upon the introducing partner, not responsibility without authority. The issue here is to counterbalance the obvious—and usually appropriate and commendable—impulse to accept all potential new clients with the necessary level of caution and care to avoid the risks attendant of accepting engagements which carry unacceptable levels of risk. The purpose of question 6 is to indicate that an appeals process may be appropriate in some firms, but that whatever consideration is given to the introducing partner's views and wishes, the firm, not the introducing partner *must* make the final decision in each case.

### Question 7

The significance of beauty contests within the general category of client development is that they may pose potential dangers in the realm of client conflicts. Since meetings held with potential clients for such purposes may involve the disclosure of confidential or sensitive information, it is important to look closely before entering beauty contests. It is because of these potential dangers that a *yes* answer requires careful attention to questions 8 and 9.

### Question 8

- *Choice a.* If the answer to question 7 was *yes*, it is important that the firm have clearly defined policies and review procedures in place to address, identify, and avoid the potential dangers described. Accordingly, a *no* or *N/A* here exposes a potential gap in the new client and engagement acceptance system.
- *Choice b.* If the appropriate policy and procedure exists, is it known to and understood by the partners? This question addresses the issue of how to communicate with individual firm members in situations in which actual controls are hard to devise. Whereas the system of file opening, time recording, and billing can have internal controls effectively embedded in them, it is harder to control an activity that partners are supposed to be engaged upon when they are not doing client work, namely client development. Accordingly, it is suggested that, absent other ways of actually controlling these activities, there should be regular and *frequent* circulation of this policy, and of the reasons for its existence. It is suggested that it may be inadequate to circulate this information at intervals of no longer than one year.

*Question 9*

A *yes* answer indicates that a thorough and appropriate level of inquiry is being undertaken in advance of engaging in this form of client development. Presumably, after performing the requisite due diligence, the relevant new client and engagement acceptance partner or committee can make a reasoned judgment as to whether the risks of losing other potential clients are outweighed by the potential benefits of acquiring the client to be solicited at the beauty contest. On the other hand, *no* or *N/A* answers raise concerns that any other precontest review may not be adequate to guard against the risks identified at question 7.

*Question 10*

The point of this question is that even highly sophisticated systems have built-in limitations, the most significant of which is that they can only compare information that is within the data base. Although that may be extensive—even complete—in relation to the firm's current clients, almost by definition, it cannot completely encompass several other categories in which independence issues may nevertheless arise, including new partners and staff members, changes in financial positions since the information was last requested, and client organization changes. Accordingly, some level of hands-on review of the new client and engagement acceptance form information remains indispensable. This question, it should be noted, except for 10a, is not limited to beauty contests.

- *Choices a, b, and c.* For the reasons spelled out above, as to firms which engage or intend to engage in beauty contests, independence issue checks, including hands-on as well as computer reviews if available, should be conducted *before* entering such situations.
- *Choices d and e.* It may be unduly burdensome to circulate highly detailed information such as the entire new client form, unless specific grounds for concern have been noted. It may depend on the structure of the new client and engagement acceptance review and oversight process, and the people involved, whether this kind of detail needs be circulated outside of those directly involved in this process.
- *Choice f.* Clearly, to the extent that any information other than the identity of the prospective client is circulated beyond those actually responsible for the new client and engagement acceptance process, this information should be included in the material distributed.

*Question 11*

The issue of how widely, and how much information should be circulated will depend on a variety of factors particular to each firm: the size of the firm, the nature and diversity of practice areas, the sophistication of computer or other independence and conflict checking systems, and so on. All that can be said with certainty as to which answers are right for your firm is that, at least, everyone with explicit responsibilities for or in connection to the new client and engagement acceptance review process should receive copies of all information available relating to prospective new clients. To the extent that others may have either knowledge of potential problems, perhaps within the practice areas to which a new client's engagement would be assigned, or conflicts of interest, those others should also be circulated.

### Question 12

Independence issues and conflicts of interest are only two of the aspects of the new client and engagement acceptance responsibility. Other new client and engagement acceptance issues can, if not adequately addressed, have equally dramatic and unfortunate consequences (see question 13.). Accordingly, a *no* answer may, after you have reviewed question 13 be recognized as an appropriate cause for concern.

### Question 13

- *Choice a.* Failure to address the basic question of ability to pay will ultimately (and probably sooner rather than later) lead to trouble either within the firm, or with the client, and probably both. Since billing disputes may result in malpractice (counter) claims, attention paid to billing arrangements, and the client's ability to pay, are better addressed *before* and not after engagement.
- *Choice b.* This is an occasionally ignored matter, but it too goes to the heart of the new client and engagement acceptance decision making process in a well-managed firm. It is also a key element in managing risk. There are two issues. First, does the firm have the knowledge and expertise to handle the engagement competently? If the answer is *no*, the engagement should be declined. But even if the answer is *yes*, the second issue is whether the expertise is available without disturbing existing commitments, or whether the "learning curve" will be steep and expensive to an extent disproportionate to the likely billing from the client. If these issues are not being directly addressed, then the firm's professional and financial management may be inadequate.
- *Choice c.* This is a key element of managing risk in the new client and engagement acceptance process. Most instances of clients whose engagement presents risk to the firm, whether in terms of the likelihood of the collection of billings, or because of the risks of potential third-party claims are susceptible to limitation of risk, *provided that* the limitation is built in to the terms of engagement. There is nothing wrong, and often everything right, about foreseeing, considering, and evaluating the potential risks of a prospective client or engagement, and clearly providing for the manner in which the engagement will be conducted so as to address these issues. Such provision can properly include express limitation upon the scope of the firm's engagement, and upon the nature and extent of services to be provided. The right time and place to make such provision is in the original engagement letter. Accordingly, a *yes* answer suggests that the firm has recognized and is utilizing this risk limiting approach. *No* or *N/A* answers, on the other hand, suggest that you may be ignoring a valuable risk limiting device.
- *Choice d.* This is a corollary of choice 10c. It may be that if your firm regularly engages in high-risk practices, such as securities or regulatory matters, you should be evaluating new engagements in those areas using special, standard measures, and special terms of engagement. On the other hand, if you propose to enter such an area, and have limited prior experience, special consideration should be given before the engagement is accepted as to whether it is appropriate for the firm, and if so, on what terms. As with 10c, a *yes* answer suggests that the firm has recognized and is utilizing this risk limiting approach. *No* or *N/A* answers, on the other hand, suggest that you may be ignoring risks in the haste to expand or develop the firm's practice or billings.

- *Choices e to n.* As mentioned in question 12, the new client and engagement acceptance process is enhanced by a thorough review of other client matters, information and third-party inquiry, not just independence and conflicts of interest issues. Items listed in choices 13f through 12p should certainly be included, if appropriate, during the new client and engagement acceptance process. The more completely the review of client information before accepting the engagement, the more your firm will understand the client's entity and be in an excellent position to better serve the client. Accordingly, a *yes* answer suggests that the firm has recognized the benefit of a thorough review process and is utilizing this risk limiting approach. *No* or *N/A* answers, on the other hand, suggest that you may be ignoring a very valuable risk limiting device.

*Question 14*

Equally important as evaluating clients prior to engagement is ensuring that the firm assigns appropriate personnel to supervise the work to be performed. Effective risk management requires that firms not allow the introducing partner to control a client's matters if those matters are outside the scope of that partner's practice and expertise. This often impinges upon the compensation structure, which may need to be reviewed in order to allow for appropriate risk management. It ought to be apparent that neither the client nor the firm will be well served by any other system, and yet there are well-documented examples of firms (and their insurers) paying out on substantial claims at least partly resulting from engagements being handled by "finders" who were not qualified to be "minders". Unless your firm has a partner or committee with the power (and the will to use it) to enforce appropriate assignment of engagements and clients to the properly qualified partner and staff, the level of risk *management* may be inadequate. Accordingly, a *yes* answer indicates that your firm is dealing appropriately with this issue, while *no* or *N/A* answers indicates a potentially serious problem.

*Question 15*

This question is intended to serve as a check on those firms which answered *yes* to questions 13 and 14. Thus, a *yes* answer again indicates that the firm is indeed taking this aspect of risk management seriously, while a *no* or *N/A* answer suggests that, even if the power exists, perhaps its application should be reviewed.

*Question 16*

Although rejecting or terminating clients is not a matter entered into lightly by any firm, the firm can do much to manage risk by effectively terminating clients when problems do arise. Part of managing this process is giving the responsibility and the authority to manage these situations to the partner or committee responsible for risk management. A *yes* answer indicates that this issue is appropriately under control; *no* and *N/A* indicate a need to establish appropriate policies and procedures.

*Question 17*

This question is intended to serve as a check on those firms which answered *yes* to question 16. Thus, a *yes* answer again indicates that the firm is indeed taking this aspect of risk management seriously, while a *no* or *N/A* answer suggests that, even if the power exists, perhaps its application should be reviewed.

## **B. CLIENT ACCEPTANCE—POLICY**

### *Question 18*

This question addresses the firm's policies regarding the fundamentals of checking for independence issues. For a firm to adequately control against independence violations, it is essential that its policies and procedures encompass *all* of the elements addressed here. Any gap is likely to leave the firm open to the creation of relationships which can result in independence violations. However painful it may be to turn away business, the costs—both financial, and in loss of reputation, and potential loss of existing clients—of allowing independence issues to exist may be much greater.

- *Choice a.* Objective oversight of every new client engagement is essential. *Yes* is the only proper answer to this question; any other answer indicates a need to review the new client and engagement acceptance process.
- *Choice b.* Because independence violations may exist—with new engagements and may arise with existing clients—independence checking is also called for in all new engagements. This is an area often overlooked, but independence violations can arise this way, with the same consequences as from any other ethics problem. *Yes* is the only proper answer to this question; any other answer indicates a need to review and restructure your firm's new client and engagement acceptance process.
- *Choice c.* This is a key component of the new client and engagement acceptance process. Since the process is intended to *precede* the commencement of work, *yes* is the only proper answer to this question; any other answer indicates a need to review and restructure your firm's new client and engagement acceptance process.
- *Choice d.* This question is directed towards improper interests of the firm or of individuals within the firm, in the client's business or affairs.
  - i. Much has been written about the inadvisability of the creation of such relationships, but the fundamental question is whether they are *disclosed*. Accordingly, this question asks whether the firm has an expressed policy against undisclosed financial arrangements or interests with clients. *Yes* is the only proper answer to this question; any other answer indicates a need to review and restructure your firm's risk management policies in this area.
  - ii. Because of the serious problems which arise when firms or individual partners have business interests in a client or the client entity, and the inherent conflict with the CPA's obligation to remain objective, the very strongly preferred policy is the absolute prohibition of such relationships. Although it is recognized that some firms still engage in these practices, we suggest that these firms should review the literature and reconsider their policies. We suggest that any other answer than *yes* should be cause for serious concern in any firm.
  - iii. Because of the serious problems that arise when firms permit individual partners or staff to become officers or directors in client enterprises, the very strongly preferred policy is the absolute prohibition of such relationships. While it is recognized that some firms still engage in these practices, we suggest that these firms should review the literature and reconsider their policies. We suggest that any other answer than *yes* should be cause for serious concern in any firm.

- iv. The moonlighting activities of staff members may present a risk factor to the CPA's firm. Firms have been involved in lawsuits resulting from these activities, and it is therefore imperative that the firm have a policy in place which addresses moonlighting activities of staff members of the firm.

*Question 19*

If the appropriate policies and procedures for new client and engagement acceptance process exist, are they known to and understood by the partners? There should be regular and *frequent* circulation of this policy, and of the reasons for its existence. It is suggested that any intervals above six months between circulation of this information may be inadequate.

*Question 20*

A policy of and procedures for conducting the new client and engagement acceptance process is limited if the information sought and reviewed is inadequate. It is suggested that *all* of the information enquired about in subquestions 20*a* through 20*e* is necessary for a complete review. Accordingly, the answer to each should be *yes*; any other answer suggests that the system, and the new client and matter forms should be carefully reviewed and revised.

*Question 21*

Completeness of the new client and engagement acceptance process also requires that all of the information referred to in these subquestions be elicited on the new client and engagement form. Question 13 above explains in principle why each of these items individually is necessary. The issues are raised again here as a cross-check, because it is in the new client and engagement form that the information necessary for the review referred to at question 13 must be obtained. Again, therefore, a *yes* answer is appropriate for each subquestion, and any other raises issues as to the thoroughness of the new client and engagement acceptance process.

*Question 22*

In order for the individual partners to accept the restraints which an effective new client and engagement acceptance process is intended to provide, its response must be fast and efficient. It is suggested that 22*a*, one day, is the appropriate answer. Any system that takes longer than two days may be unacceptable to both the partners and to clients.

**C. ASSIGNING PERSONNEL TO CLIENTS AND ENGAGEMENTS**

*Question 23*

Equally important as evaluating clients is ensuring that the firm assigns appropriate personnel to supervise the work to be performed. Effective risk management requires that firms not allow the introducing partner to control a client's engagement if those matters are outside the scope of that partner's practice or expertise. This often impinges upon the compensation structure, which may need to be reviewed in order to allow for appropriate risk management. It ought to be apparent that neither the client nor the firm will be well served by any other system, and yet there are well-documented examples of firms (and their insurers) paying out on substantial claims at least partly resulting from matters being handled by "finders" who were not qualified to be "minders." Unless your firm has a partner or committee with the power (and the will to use it) to enforce appropriate

assignment of matters and clients to the properly qualified partner and staff, the level of risk *management* may be inadequate. Accordingly, a *yes* answer indicates that your firm is dealing appropriately with this issue, while *no* or *N/A* answers indicates a potentially serious problem.

### *Question 24*

- *Choice a.* There is nothing wrong with allowing staff members to work on client engagements outside their prior experience *provided* that one important condition is met. There must be a partner or senior accountant with the requisite knowledge to properly supervise the work; also it should be noted that there may be a cost to the firm in such assignments, namely the “learning curve,” some of which may not be recoverable from the client. Thus, while a *yes* answer may be desirable, it is probably unrealistic, and a *no* answer is only problematic if these learning-curve issues are not recognized and properly addressed.
- *Choice b.* See the discussion on choice a, above.
- *Choice c.* See the discussion on question 23, above.
- *Choice d.* See the discussion on question 23, above

### *Question 25*

The key issue here is that the system discussed at question 23 must be enforceable within the partnership, regardless of the seniority in the firm of the introducing partner. Even very substantial billings to a firm are ultimately of negative value if claims arise and must be paid as a result of a malpractice lawsuit. As insurance costs escalate, and as the deductibles borne by firms increase, it becomes easier to recognize that these risks are real and tangible. Once this becomes apparent, it may be easier for firms to restructure their management arrangements so as to require all partners to relinquish some individual autonomy in order to protect the firm as a whole from potential losses.

## **D. ENGAGEMENT LETTERS**

### *Question 26*

It will be apparent from other answers in this crib sheet that engagement letters are an essential element of effective risk management in the new client and engagement acceptance process. They provide a necessary foundation to the conduct and management by the firm of the entire client relationship. Much more than money issues need to be incorporated in the engagement letter. A clear description of the scope of the engagement, including any agreed limitations on the functions which the firm has agreed to perform are an essential ingredient. The identity of partners responsible and other staff to be assigned, obligations of communication—in both directions—between firm and client, collection, and dispute resolution are also all matters which should be included. It has been said that with respect to long-standing existing clients, such letters should be avoided, as clients would be offended. This is a mistake. Clients almost invariably respect firms for demonstrating business-like management of their affairs; and, at the other extreme, as one commentator correctly noted, there is no law preventing long-time clients from suing for malpractice. They should be treated like all new clients, and both sides will be better protected by the reduction to writing of the nature and scope of the relationship.



*Question 27*

There should be *no exceptions* to the rule requiring engagement letters. Again, this serves to avoid misunderstanding, and to keep the relationship formal (as well as creating an appropriate record for both sides in terms of work requested and billing obligations). Accordingly, the answer to both 27*a* and 27*b* should be *yes*.

*Question 28*

The requirement of engagement letters should be strictly enforced. This is easy to accomplish, by preventing file and billing numbers from being issued, or time being recorded (or later transferred, absent specific approval from firm management) at any time prior to receipt of the engagement letter. This control, properly overseen and enforced, also serves to ensure that all of the other new client and engagement acceptance process policies and procedures are followed.

- *Choice a.* The independent partner and committee in charge of the new client and engagement acceptance process must be required to give explicit approval before time is recorded. If the answer to this subquestion is *yes*, then regardless of the new client and engagement acceptance process policies in place, the *controls* necessary to enforce those policies are inadequate. Only a *no* answer demonstrates a control system in place which will effectively prevent the new client and engagement acceptance process from being subverted, avoided, or sidestepped.
- *Choice b.* Again, mere development and delivery of a proposed letter is an inadequate basis for commencing work. However, so long as the rest of the new client and engagement acceptance process has been completed, and the approval of the appropriate partner and committee given, this is clearly a much more limited risk than those flowing from commencing work prior to completion of the basic review process. Thus, while a *no* answer clearly indicates prudence in these matters, a *yes* answer here indicates that the firm is taking some risk involved in not having an engagement letter agreed to and signed by the client.
- *Choice c.* This represents the optimum time at which the control system should operate to enable time charging to commence. Thus, a *no* answer indicates maximum prudence, while a *yes* answer merely demonstrates that a degree of risk may, in given cases, be acceptable to the firm.

*Question 29*

This is an essential check on the operation of the new client and engagement acceptance process discussed at question 26. It is imperative not only that the control operate to insure that *an* engagement letter is received countersigned by the client in the file, but also that the engagement letter be properly tailored to the client and the engagement. Accordingly, a *yes* answer demonstrates the appropriate level of oversight, while *no* or *N/A* indicates a potential gap.

*Question 30*

For the reasons expressed above, a *yes* answer demonstrates the appropriate level of oversight, while *no* or *N/A* indicates a potential gap in the new client and engagement acceptance process.

## **E. NONENGAGEMENT LETTERS**

### *Question 31*

Although certainly not a high-risk area, many firms are utilizing nonengagement letters or declination letters. These are used especially in cases in which perhaps significant time was spent with a potential client, or if the CPA firm suspects that the individual may perceive the CPA firm as providing additional work or assistance. Such letters can be both short and polite, noting simply that the discussion or meeting took place but that the CPA or the firm declines to accept the engagement. If the CPA wishes to elaborate, the letter should nevertheless not include any accounting advice other than, if relevant, to seek other accounting services. Accordingly, a *no* answer to this question should not give rise to concern about the potential for the exposure of the firm to claims, but the firm may wish to give some consideration to situations that would merit the use of nonengagement letters.

### *Question 32*

If the appropriate policy for sending nonengagement letters exists, is it known to and understood by the partners? There should be regular and *frequent* circulation of this policy, and of the reasons for its existence. It is suggested that any intervals above six months between circulation of this information may be inadequate.

## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 4 — THE ENGAGEMENT MANAGEMENT

#### I. FUNCTION

This questionnaire is designed to explore the following:

- The scope of the firm's existing control structures, policies and procedures in the area of engagement management, including assignment and supervision of professional staff, branch office, lateral partner and merged practice controls, and training; and
- The extent to which the perceptions of these policies and procedures among those responsible for engagement management match those of the partners and associates

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to "Questionnaire 4—The Engagement Management," have completed the process of responding to the questionnaire. Then an initial, twofold review can begin. First, each individual should consider his or her responses in the light of this crib sheet, and then everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the current state of the firm's engagement management procedures. Once there is agreement as to what is in place, and how the processes are operating, the question of what gaps or problems exists, and what can be done to fill them can be addressed.

A third level of comparison will also assist, namely, comparison of the responses to this questionnaire with the responses to the separate "Questionnaire 7—The Professional Staff." To the extent that the responses of the partners and committee responsible for engagement management do not accord with the views of the partners and associates around the firm, the firm will also have to address what adjustments in engagement management are necessary and appropriate.

For many firms, the answers yielded by this review process will either reassure or enable those firms to decide upon and to implement any needed changes to their engagement policies and procedures. For some, on the other hand, the answers yielded by this review may create dilemmas or the potential for internal conflict of a kind that lead the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources.

## **II. SCOPE**

This crib sheet, and its companions relating to the other QUIC Survey questionnaires, are designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive system of engagement management, appropriately overseen, to control the risks that are inevitable if engagement management issues are inadequately reviewed and controlled. Thus, the answers and analysis contained in this crib sheet are intended to perform the following two functions:

- Explanations and definitions of the key *problems*—risks—that the underlying questionnaire is intended to uncover in the context of your particular firm
- General reviews of the accounting and legal liability issues that may arise if the management of these issues falls short of adequate

It is not the intention of the authors that the crib sheets constitute a complete process. Rather, it is our purpose to help firms to determine whether they have in place systems, policies, and effective procedures to enable them, internally, to oversee the issues that are likely to arise in managing their engagements. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of practice.

## **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed, meaning: Why are we asking you this? Second, the broad implications of each response (*yes, no, or N/A*) are discussed. Third, the level of importance, which we attach to addressing gaps that you may have uncovered in your policies or procedures, is explained.

## **IV. ANSWERS AND ANALYSIS**

### **A. ENGAGEMENT POLICIES AND PROCEDURES**

#### *Question 1*

To be consistently successful, a firm should be governed by written policies and procedures that define how services are delivered clients. These procedures help limit risk and exposure to the firm by documenting the engagement process for all services offered by the firm.

#### *Questions 2, 3, and 4*

Although the partners of the firm should review the policies themselves, it is equally important that the results of the policies be reviewed regularly as well. The partners should conduct periodic quality reviews of random engagements to determine whether the policies are being followed and are effective. This process should include periodic meetings. Sometimes, this review may be ongoing, in that staff should be regularly debriefed after engagements are complete to determine whether the engagement could have been executed more efficiently or whether knowledge was gained in the execution process that

the firm might use in future engagements. This review process should lead to better executed engagements, thereby limiting risk, but a more important benefit may be increased profits through efficiencies.

Although informal reviews are effective, they are not as effective as written reviews. The review process is not a time to point fingers or to lay blame for engagements that went bad. Nor are they only to be done for engagements that lost money and not for those that made profits. Reviews often show just the opposite. The knowledge gained from engagements that encountered problems are as valuable as that gained in highly successful ones. To better utilize the information gathered, the firm might elect to use a standard engagement analysis form to be completed by each member of the engagement team. These can then be summarized for partners to evaluate.

*Questions 5, 6, and 7*

Although review by the staff executing the engagement may bear valuable information, there are times when it is important to make this process more formal. For firms conducting engagements in which there is a high level of risk, this process must be escalated into a formal process. These examinations would consider the qualifications of staff assigned to engagements, and whether the staff was used optimally based on both the time and talent that was expended.

With more CPA firms contracting nonaccounting resources for multidiscipline engagements, the partners have the additional requirement to audit and track the performance of nonfirm resources. The firm must also carefully manage and track the performance of these entities and their employees or individual independent contractors to ensure they meet CPA standards.

*Questions 8, 9, and 10*

Performance reviews again are not a process to judge staff, but to determine how partners may better utilize staff in future engagements. These performance reviews are also not limited to a single staff person's performance, but to how staff performs as a team. Rarely are engagements so structured that staff works in a vacuum, but rather the success of an engagement is more focused on how the staff performs as a group. Therefore, understanding how to create teams of people who are more productive, the more profitable the firm will be.

Having all partners involved in the process will help everyone learn more of the capabilities of staff, and therefore, learn where staff can be used more effectively. Regular partner and staff meetings can accomplish this best during the engagement process. Although debriefings at the conclusion of an engagement have value, it is much easier to fine-tune the engagement and take care of problems as they arise than when it is too late. Regular meetings during an engagement can serve to keep everyone on target and for everyone to learn a little something in the process.

*Questions 11 and 12*

Although we would like to think that everyone in the firm has the same mission, or that every personality is just like yours, the fact is everyone is not the same. There are times that staff may not be able to work under an engagement partner or manager. There is no right or wrong here; more often, it is simply different personalities. This does not mean any

partner should accept someone who does not abide by written policy or who does not bring value to the firm, but to remove an individual without due cause is not the profitable avenue either. The firm should have mechanisms in place so that staff is comfortable approaching a partner and discussing an issue without concern of repercussions.

Staff should also feel comfortable addressing other staff members in a professional manner, and working together for the betterment of the firm. This includes discussing issues with third-party contractors involved in the engagement, as well as firm staff.

### *Questions 13 and 14*

A partner of the firm should follow up on any report of conflict or problem and must not assume where the problem may lie, but be willing to look openly at all sides. Once the partner(s) has investigated an event, there must also be feedback to staff. Keeping all the staff involved and being open is often more productive than attempting to “keep the lid on.”

### *Question 15*

It is also ineffective to have all the partners involved in reviews outside their area of responsibility, because many partners may not be versed in human resources directives and might react incorrectly to a problem with staff during an engagement. It is generally recommended that a partner involved with human resources be a first contact if there is a problem between the staff assigned to an engagement, or issues between staff and partners of the firm. See “Questionnaire 6—The Human Resource Management,” for more information.

### *Question 16*

Although everyone in the firm should be familiar with the AIPCA Code of Professional Conduct, many in the firm may not be. It is particularly important if the firm engages in multidisciplinary services, such as technology consulting and services, to ensure that non-CPA staff has also reviewed the Code of Professional Conduct and the Code of Ethics and follows them.

## **B. THE ENGAGEMENT PROCESS**

From the creation of the engagement letter to the final deliverables, the firm must know what is to be done, in what order, and by whom, to be successful and to limit its risk. Since the firm does many different types of engagements, and there may be many partners who are empowered to engage for services in the name of the firm, there is no simple way to determine how much risk you have unless you document the processes and create structure for everyone to follow.

The AICPA defines many of the acceptable engagement methods; however, there is still a great deal of room for variance. A firm must fine-tune and monitor engagements on a regular basis. Chapter 4, “Managing Risk,” provides extensive information on a phased approach to the engagement process that better defines the engagement process as a manageable task.

## QUALITY/IN CONTROL SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 5— CONTINGENCY PLANNING FOR TECHNOLOGY FAILURES

#### I. FUNCTION

This questionnaire is designed to explore the following two things:

- The scope of the firm's existing control structures, policies and procedures in the area of contingency planning, including assignment and supervision of professional staff, branch office, lateral partner and merged practice controls, and training
- The extent to which the perceptions of these policies and procedures among those responsible for contingency planning match those of the partners and staff

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to the "Questionnaire 5—Contingency Planning for Technology Failures," have completed the process of responding to the questionnaire. Then, an initial twofold review can begin. First, each individual should consider his or her responses in the light of this crib sheet, and then everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the current state of the firm's contingency planning procedures. Once there is agreement as to what is in place, and how the processes are operating, the question of what gaps or problems exists, and what can be done to fill them, can be addressed.

For many firms, the answers yielded by this review process will either reassure or enable those firms to decide upon and to implement any needed changes to their contingency planning policies and procedures. For some, on the other hand, the answers yielded by this review may create dilemmas or the potential for internal conflict of a kind that lead the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources. Many of the professional liability insurers have staff members who are knowledgeable and available to give guidance in many areas, as no doubt, are other independent consultants.

#### II. SCOPE

This crib sheet, and its companions relating to the other QUIC Survey questionnaires, are designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive system to limit the impact of a catastrophic failure or other emergency that could interrupt your operations. Thus, the answers and analysis contained in this crib sheet are intended to perform the following two functions:

- Explanations and definitions of the key *problems*—risks—that the underlying questionnaire is intended to uncover in the context of your particular firm
- General reviews of the accounting and legal liability issues that may arise if the management of these issues falls short of adequate

The crib sheets are not meant to constitute a complete process. Rather, the purpose is to help firms to determine whether they have in place systems, policies, and effective procedures to enable them, internally, to oversee the issues that are likely to arise during an emergency. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered, to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of its practice.

### **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed, meaning: Why are we asking you this? Second, the broad implications of each response (*yes, no, or N/A*) are discussed. Third, the level of importance, which we attach to addressing gaps that you may have uncovered in your policies or procedures, is explained.

### **IV. ANSWERS AND ANALYSIS**

#### **A. CONTINGENCY PLAN**

##### *Question 1*

The dependence on technology has changed many of the inherent methods for backup and recovery should “the lights go out.” The economic impact of even a short network outage (or service failure by Internet, telecommunications, or utility service providers) can be significant. The potential risk associated with not giving contingency planning its proper due is equally high.

Further, changes created by a merger, expansion, changing software, hardware, Internet, telecommunications, or utility service providers; or even updating a version of existing software can have a negative effect on your established written procedures. Without immediate, or annual testing, the firm can have no guarantees that should a true emergency arise that systems will respond.

##### *Question 2*

Review of the plan is often two-part. First, a “desktop” review in which key individuals review the written contingency plan and determine whether the plan is adequate. However, a desktop review does not necessarily ensure that software versions will work together, that phone companies will switch over connections, or that backup systems will truly restore and function. An annual test is necessary and should be as close to real life as possible. Although such a test should be done by all firms, the larger the firm, multioffice firms, or firms offering extended services, are at the highest risk and should not consider testing as optional.



*Question 3*

To protect the firm from negligence suits, the review process should be documented noting inefficiencies and failures during the test as well as any corrective actions taken.

*Question 4*

To be consistent, the firm should create a form listing all the components tested, when the test was run, and the results. The Information Technology partner and the firm's managing partner should sign off on the report.

*Question 5*

To function properly, the Contingency Plan must be managed by a selected group. This group, the Emergency Response Team (ERT), must have written directions, and the authority to act for the firm. The ERT is chaired by the Managing Partner, President, or CEO and is composed of senior management to include the head of Information Technology (you pick the title) and the Comptroller. The ERT either develops the Plan or assigns responsibility and approves the end product.

*Question 6*

Often businesses believe that Contingency Plans are only for catastrophic failures. Today, we know that failures or emergencies of even a few hours have an economic impact as well as create risk. We have identified at least four levels of risk ranging from an hour to those crises lasting longer than 72 hours. Chapter 4 discusses these and actions to take in preparing for each in some detail.

*Question 7*

Having an adequate data backup and recovery methodology is critical to the success of any contingency plan.

*Question 8*

Unless backup (systems) are tested, there is no way to be sure that they are adequate, that all needed files are present, and that the backup media can be used to restore a fully functional operations.

*Question 9*

To fully test backup systems, all components should be considered. This includes servers, network equipment, even telecommunications. If an alternative site will be used in an emergency, then the test must be done from the alternate site.

*Question 10*

Document the firm's infrastructure servers as the roadmap for restoration when an emergency occurs. Knowing what hardware and software is needed by staff to complete their mission ensures that these components can be replaced quickly and with minimal error.

### *Question 11*

The potential for intrusion is very real, and no firm should ignore the possibility of loss of information, or system failure from either external or internal theft. Such occurrences fall under contingency planning because of the potential of these intrusions to leave harmful viruses, worms, or zombies on your network that would lead to catastrophic failure.

### *Questions 12 and 13*

Every public accounting firm should have a written privacy statement. The privacy statement should be on the firm's web site as well as in written form available to all clients. Additionally, privacy disclosure notices are required to be distributed to individual [as opposed to business] clients in accordance with the FTC rule, *Privacy of Consumer Financial Information*. A few helpful hints include:

- Provide easy access for your Privacy Statement and Privacy Disclosure Notice.
- Consult with legal counsel regarding the wording of the statement and notice.
- Ensure that your staff knows your policy and that it is followed!
- Be clear on what to tell your clients.

## **ACCEPTABLE USE POLICY**

### *Question 1*

The Acceptable Use Policy defines the acceptable use of information technology equipment, software, and communications (equipment) as provided by your firm. Everyone in the firm must be expected to follow the written policy, *without exception*. The policy should be (in writing and placed) on the firm Intranet for easy access.

To be effective, the policy must include all technology of the firm, to include not only traditional hardware and software, but also (hand-held devices and cellular phones) as well. An employee using the technology resources of their employer for inappropriate or illegal activities is common and the cause of risk to the firm.

### *Question 2*

All employees of the firm should review the Acceptable Use Policy annually. The Acceptable Use Policy must be part of the new employee orientation.

### *Question 3*

There are various options for monitoring the use of a firm's technology. For instance, electronic mail, (a) source of significant potential liability, can be monitored from various software packages designed to scan and analyze text for inappropriate verbiage.

### *Question 4*

The assumption in many firms is that liability comes from staff. Actual cases indicate that the firm's Acceptable Use Policy is most often ignored by the partners of the firm who feel they are not bound by the same standards as everyone else. Also, partners who do not use technology on a regular basis may not be aware of the potential risk (that arises from) not using technology responsibly.

## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 6— HUMAN RESOURCES MANAGEMENT

#### I. FUNCTION

This questionnaire is designed to explore the following two things:

- The scope of the firm's existing control structures, policies, and procedures in the area of human resources management, including assignment and supervision of professional staff, branch office, lateral partner and merged practice controls, and training
- The extent to which the perceptions of these policies and procedures among those responsible for human resources management match those of the partners and associates

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to the "Questionnaire 6—Human Resources Management," have completed the process of responding to the questionnaire. Then an initial, twofold review can begin. First, each individual should consider his or her responses in the light of this crib sheet. Then, everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the current state of the firm's human resources management procedures. Once there is agreement as to what is in place, and how the processes are operating, the question of what gaps or problems exist, and what can be done to fill them can be addressed.

A third level of comparison will also assist, namely comparison of the responses to this questionnaire with the responses to the separate "Questionnaire 7—Professional Staff." To the extent that the responses of the partners and committee responsible for human resources management do not accord with the views of the partners and associates around the firm, the firm will also have to address what adjustments in human resources management are necessary and appropriate.

For many firms, the answers yielded by this review process will either reassure or enable those firms to decide upon and to implement any needed changes to their human resources policies and procedures. For some, on the other hand, the answers yielded by this review may create dilemmas or the potential for internal conflict of a kind that lead the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources. Many of the professional liability insurers have staff members that are knowledgeable and available to give guidance in many areas, as no doubt, are other independent consultants.

## **II. SCOPE**

This crib sheet, and its companions relating to the other QUIC Survey questionnaires are designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive system of human resources management, appropriately overseen, to control the risks that are inevitable if human resources management issues are inadequately reviewed and controlled. Thus, the answers and analysis contained in this crib sheet are intended to perform the following two functions:

- Explanations and definitions of the key *problems*—risks—that the underlying questionnaire is intended to uncover in the context of your particular firm
- General reviews of the accounting and legal liability issues which may arise if the management of these issues falls short of adequate

It is not the intention of the authors that the crib sheets constitute a complete process. Rather, it is our purpose to help firms to determine whether they have in place systems, policies, and effective procedures to enable them, internally, to oversee the issues which are likely to arise in managing their personnel. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of this element.

## **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed, meaning: Why are we asking you this? Second, the broad implications of each response (*yes*, *no*, or *N/A*) are discussed. Third, there is an explanation of the level of importance which attached to dealing with gaps that you may have uncovered in your policies or procedures.

## **IV. ANSWERS AND ANALYSIS**

### **A. SUPERVISION AND HIRING PRACTICES**

#### *Question 1*

While analyzing professional liability claims against CPAs for tax return preparation, the majority of claims resulted from practitioner error (and consequently undiscovered by reviewers). This was conclusive regardless of the type of tax return prepared—individual, corporate, partnership, or estate. Accordingly, this practice of having formalized and regular periodic reviews of partners' work is an important component in effective risk management and one that other professions have adopted rigorously and as a matter of course for similar reasons. Furthermore, any firm interested in adopting any elements of TQM will find that an important part of that approach to providing professional services is demonstrating a commitment to reviewing the quality of service provided at every level of the firm. Accordingly, if the answer is *no*, your firm has probably not yet recognized the need for these procedures, and should consider beginning the process of constructing such a program.

*Question 2*

There are various possible levels of intensity with which peer review can be conducted. The subquestions explore some of the different approaches. A *yes* to all of the subquestions indicates a very thorough peer review system. Although adoption of a program encompassing all of these elements is indeed desirable, the firm culture in some firms will make this impractical, at least from a starting point of no meaningful prior partner review process, which is exemplified by *no* answers either to question 1, or to each subquestion of question 2. Those firms should move in stages to construct a program that develops over time

- *Choice a.* In several studies made of the causes of malpractice claims, disputes over billing contribute to claims (in the form of counterclaims). At its most basic level, therefore, the firm can and should use billing and collection oversight as one element in its program of peer review of partners and supervision of senior staff members to ensure that charges are appropriate to the work requested and actually collected. The best way to avoid serious disputes with clients or worse is to institute and maintain a meaningful and independent review process for billing and collection activities. Accordingly, unless the answer is *yes*, your firm needs to review its policies and procedures in this area.
- *Choice b.* Even a program of regular meetings between senior or management level partners and individual partners (usually in the context of compensation review) do not meet the criteria of peer review unless they have a structured and uniform agenda, and unless the elements discussed go to the fundamentals of both the expectations and the performance of the individual in every aspect of his or her work, and unless there is appropriate follow-up. Accordingly, the subitems suggest the main elements of a thorough review process. To the extent the answers are *no*, the process probably needs expanding.
- *Choice c.* This subquestion describes the process that other professions regard as the crux of peer review, namely the detailed review of the conduct of specific client engagements by each partner on a regular basis. Ultimately, there is no doubt that this is desirable, both as a means of ensuring continuing uniform high quality of service to clients, as well as identifying partners who are experiencing problems. In most firms, the answer is still *no*; this should change, and will, both in firms which recognize the affirmative need to develop TQM, and in firms which seek to improve the management of their practices.
- *Choice d.* There are several reasons for the inclusion of this subquestion. Most dramatically, a significant fraction of malpractice and discipline cases arise from professionals with substance abuse problems. The earlier these problems are identified, the more likely it will be that the affected person can be helped with therapy to return to full and effective performance of his or her responsibilities, *and* the more likely that serious malpractice or discipline problems can be averted. More generally, the good health of individual members of the firm is of obvious financial value to the individual and to the firm, so that preventive health care is a valuable tool in maintaining productivity. Of course, to be effective as a risk management tool, partners must consent to at least limited waiver of the doctor-patient privilege. This should be encouraged, not only with respect to tests for substance abuse, but also for other conditions which may affect the individual's capacity to perform his or her work appropriately. This policy, properly promulgated, should be perceived as a positive and supportive policy for the individual partners and for the firm collectively.

### *Questions 3 and 4*

For the reasons set out at question 2*d*, above, the peer review process must be structured to be effective. To give confidence in the process, this also requires some level of formality, in terms of written checklists of issues to be covered, and a record of the process, and responses. The record need not necessarily involve written commentary on that part of the review relating to the handling of specific client matters, if that is viewed with concern, but should relate to all of the other elements of the process discussed in question 2.

### *Question 5*

The dangers of inadequate due diligence in lateral partner hire and accounting firm mergers are all too apparent, but many firms do not do for themselves in practice that which they would insist upon for their corporate clients. Unless risk management policies, procedures and controls are uniformly in effect throughout the firm, including in branch offices, wherever located, they cannot have the intended protective effect. Most attorneys who defend accounting malpractice claims can site examples of claims that occurred because of a branch office failure. It is therefore important, both as part of the due diligence process and in terms of compatibility of practice philosophies, to determine whether potential lateral partner hires and practice, branch office, or accounting firm merger candidates are used to being subject to the same level of risk management as is the norm in your firm. A *no* answer should be a serious cause for concern in reaching hiring or merger or acquisition decisions.

### *Question 6*

The items listed in the subquestions comprise what are presumably standard due diligence inquiries. The point of itemizing them here is to provide a brief checklist for your firm to test the thoroughness of its procedures. Overall, the aim should be, at the very least, to perform for the intended partner, practice group, firm, or unit to be merged or acquired, the same level of risk management as is the case within the firm—before the decision to hire or merge or acquire is reached. Accordingly, the answer ought to be *yes* to *every* item; to the extent that this has not been past practice, this should be carefully reviewed.

### *Question 7*

Sadly, there are some glib con artists around to make it imperative to take thorough precautions before concluding hiring decisions. Did the candidate *really* graduate, pass the CPA exam, have a current license, and so on? Time spent checking the basic facts on the resume may save enormous embarrassment later. A *no* answer ought to be unacceptable.

### *Question 8*

Basic human resources management requires regular reviews of all employees. This should be applicable in firms large and small. A *no* answer ought to prompt a reconsideration of the management of your employee relationships.

### *Question 9*

The significance of this question lies in question 9*b*, since the answer to 9*a* is, presumably, *yes*. It is important for employees to be able to communicate concerns, and to hear evaluations from people who are independent of the day-to-day reporting structure. Furthermore, this communication is also important in giving a formal structure to the

evaluation of the manager as well as of the subordinate; in other words, this kind of evaluation also has a place in the partner review process previously discussed. Accordingly, if the answer to 9b is not *yes* as yet, consideration should be given to adding this component to the staff evaluation process.

*Question 10*

To be effective, either in terms of the evaluation itself, or in terms of appropriate communication with the evaluated employee, the review process must be structured. To give confidence in the process, this also requires some level of formality, in terms of written checklists of issues to be covered, and a record of the process, and responses. The record should relate to all of the elements of the process discussed in the subquestions. Particular attention should be paid to choice 10f. An important element of risk management is identifying problems in the firm at an early stage; it is usually staff members who are confronted with these issues first, and it is important to use that knowledge constructively, to catch problems before they ripen into crises. Accordingly, this aspect of staff reviews should be taken very seriously, and the firm's commitment to reporting of and constructive response to problems should be stressed. If the answer to this item is *no*, again, we recommend a review of your firms' human resources policies.

*Question 11*

A vital component of effective risk management is providing skilled and knowledgeable advice and assistance to members and staff of the firm when potential questions arise relating to the proper handling of matters, or, specifically, matters involving accounting disagreements or ethics. Because, in the case of staff members, these will usually involve other people with whom the person raising the issue is working closely in the first place, and often specifically the manager or partner to whom the staff member is reporting on the engagement in question, it is essential that such advice be available from an independent person, at partner level. Many firms have therefore designated an ethics partner. This person may but need not be the same as the partner responsible for risk management, but should certainly be part of the risk management structure. If you answered *no* to this question, there is a serious gap in this aspect of risk management which should be studied and repaired.

*Questions 12, 13, and 14*

Malpractice and discipline cases involving accountants with substance abuse problems do occur. The earlier these problems are identified, the more likely it will be that the affected person can be helped with therapy to return to full and effective performance of his or her responsibilities, *and* the more likely that serious malpractice or discipline problems can be averted. Again, therefore, a vital element of effective risk management is prompt and appropriate response when these problems are observed. For such response to occur, the circumstances must be promptly reported, not hidden. Therefore, a *no* answer to question 12, 13, or 14 indicates that the firm has not clearly or effectively educated its members and staff to the need for prompt reporting, or has no proper management structure or response procedures in place to receive and deal with such reports. In either event, this should be remedied.

### *Questions 15 and 16*

Key to managing risk involving the issuance of opinions or reports is the existence and enforcement of policies and procedures ensuring independent review, within the firm, before partners with client engagement responsibility can issue formal reports or opinion. However little professionals appreciate being second guessed, the fiduciary obligation among partners entitles the partnership, as of right, to require individual partners to submit documents which will bind the partnership for such review, in the interest of protecting the entity and all of the individual members. Accordingly, these two questions explore the procedures in place to control the issuance of such reports. Any answer other than *yes* to these questions should be a cause for serious concern as to the management of this aspect of the practice.

### *Questions 17 and 18*

For the reasons set out at questions 15 and 16, above, if the answer to question 17 is *yes* and to question 18 is *no*, then the firm should waste no time restructuring its procedures and policies in this area of its practice.

### *Questions 19 and 20*

Unless risk management policies, procedures, and controls are uniformly in effect throughout the firm—including in branch offices, wherever located—they cannot have the intended protective effect. Most attorneys who defend accounting malpractice claims can site examples of claims that occurred because of a branch office failure. It is therefore important to determine whether, in the view of partners and staff members working in branch offices, the same level of risk management is indeed in place there. Any answer other than *yes* should be a serious cause for concern both within the branch and for the firm as a whole.

### *Question 21*

For the reasons set out at question 11, above, this is a vital element of effective risk management. If the answer is *no*, this gap should be addressed promptly.

### *Question 22*

If there is an ethics partner, he or she needs basic resources on site with which to perform basic research on issues presented. If there is no such partner, there is an equal need for individuals to be able to find answers to professional ethics dilemmas. The list is informational, not exclusive of other publications. If your firm does not have such resources on site, you should be concerned about your ability to handle problems promptly and appropriately.

## **B. PROFESSIONAL DEVELOPMENT**

### *Questions 1, 2, 3, and 4*

Continuing Professional Education (CPE) is an important component of effective risk management. Firms which conduct CPE internally are able to provide targeted programs meaningful and useful to their practices. In addition outside CPE of high quality is readily available in most practice specialties. Questions 1 and 4 are informational; the answers to questions 2 and 3 should be *yes*.



## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 7— PROFESSIONAL STAFF

#### I. FUNCTION

This questionnaire is designed to explore the following two things from the perspectives of partners and professional staff not involved in senior management of the firm:

- What risk management policies and procedures are actually in place and operating effectively (or otherwise)
- How the firm's senior management, and those responsible for risk management, respond when problems arise

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to all of the other questionnaires have completed the process of responding to them. Then, a twofold review can begin. First, each individual asked to respond to this questionnaire should consider his or her responses in the light of this crib sheet. Second, firm management should compare the responses to this questionnaire with the responses to the questionnaires dealing with all of the detailed risk management categories. This process is intended to lead to a consensus as to the current state of the firm's management structure for the control of practice risks. Once there is agreement as to what is in place, the question of what gaps exist, and what can be done to fill them—consistent with the inevitable tensions between the firm's management culture and the dangers inherent in doing nothing—can be addressed.

For many firms, the answers yielded by these reviews will either reassure or, without more, enable those firms to decide upon and to implement any needed changes to their risk management functions and procedures. For some, on the other hand, the answers yielded by these reviews may create dilemmas or the potential for internal conflict of a kind that leads the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources. Many of the professional liability insurers have staff that are knowledgeable and available to give guidance in many areas, as no doubt, are other independent consultants.

#### II. SCOPE

This crib sheet, and its companions relating to the other QUIC Survey questionnaires, are designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive management structure, appropriately staffed, to control the risks that are inevitable in the increasingly complex activity that is the practice of (public accounting). Thus, the answers and analysis contained in the crib sheets are intended to perform the following two functions:

- Explanations and definitions of the key *problems*—risks—that the underlying Questionnaire is intended to uncover in the context of your particular firm
- General reviews of the ethical and legal liability issues which may arise if the management of these issues falls short of adequate

It is not the intention of the authors that the crib sheets constitute a complete analysis on CPA firm management in general. Rather, it is our purpose to help firms to determine whether they have in place systems, policies, and effective procedures to enable them, internally, to supervise their practices so as to be able to anticipate and research (in whatever detail is appropriate), and respond to specific issues as and when they may arise, but before they become threatening. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of its practice.

### **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed, meaning: Why are we asking you this? Second, the broad implications of each response, *yes*, *no*, or *N/A*, are discussed. Third, the level of importance attached to dealing with gaps which you may have uncovered in your policies or procedures is explained.

### **IV. ANSWERS AND ANALYSIS**

#### **A. CLIENT INTAKE ISSUES**

##### *Question 1*

Control over new clients and new engagements acceptance is essential for the management of risk within CPA firms. It is arguable that many malpractice claims, including some of those leading to massive payments, have their origin in the failure of firms to establish and maintain effective intake procedures. The first question is merely informational, to see whether you have had recent actual experience of what is involved in introducing a new client or matter in your firm.

##### *Question 2*

It is *essential* that every firm have a highly detailed new client and engagement acceptance form; that there be a policy requiring completion of the form *and* the approval of firm management before work commences on the new client or engagement. Accordingly, any *no* or *N/A* answer immediately and automatically triggers loud alarm bells. Without an appropriate form, and procedures to enforce its proper use, no meaningful control of the new client and engagement acceptance process is possible.

*Question 3*

In order for the individual partners and staff members to accept the restraints which an effective new client and engagement review process is intended to provide, its response must be fast and efficient. It is suggested that one day, choice 3*a*, is the appropriate answer, including any necessary backup to replace those normally responsible when circumstances require. Any system that takes longer than two days is likely to be unacceptable to both the partners and to clients.

*Question 4*

This question is intended to determine whether you or anyone in your practice group regularly receives information concerning prospective new clients and participates in making the decision as to whether to accept the client or engagement. If the answer is *no*, there may be a danger of accepting clients and engagements without an objective look at important issues.

*Question 5*

A review by the firm's management of the responses to questions 5*a* and 5*b* will help determine the general view of the current working of the intake system. *No* answers to questions 5*c* or 5*d* should trigger real concerns that the system is failing and needs review.

**B. AREAS OF PRACTICE AND ASSIGNMENT OF PROFESSIONAL STAFF**

*Questions 1 and 2*

These are informational, to help assess the significance of later answers.

*Question 3*

The issues raised here relate to whether work assignments are related only to practice specialty or are made including other management criteria. To the degree to which assignments are made across practice areas, work may be performed inefficiently, and expensively. To the extent this is the case, fee disputes can result, which can lead to malpractice claims.

*Question 4*

This question tests the degree to which there is true management of these decisions. Clearly, the preferred responses are *yes* to question 4*a* and *no* to questions 4*b* and 4*c*. To the extent that a number of partners and staff members perceive the reality differently and give different answers, there may be a problem requiring attention.

*Question 5*

To the extent that a number of partners and staff members perceive that the appropriate answer is *no*, there may be a problem requiring attention.

*Questions 6 and 7*

There is nothing intrinsically wrong with assigning people to work outside their normal areas of expertise provided that the following two conditions are met: (1) that someone *with* the required level of knowledge is supervising the engagement; and (2) that the client is not improperly billed for learning time. In addition, it is most important that the client be

informed of and consent to services being performed by an employee without prior experience in the practice area. This is a *major* issue in many of the highly publicized audit failures involving the larger accounting firms.

### *Questions 8 and 9*

The appropriate answer to this question is *no* unless the client expressly agreed otherwise. To the extent clients are being billed for the learning curve, fee disputes can result, which can lead to malpractice claims. Accordingly, a *yes* answer to question 8, or a *no* answer to question 9 should be of serious concern to those responsible for risk management.

### *Question 10*

This question goes to the financial as well as the risk management within the firm. A *yes* answer would obviously be additional reason for concern.

## **C. PARTNER OR MANAGER CONTROL OF CLIENTS AND BILLINGS**

### *Question 1*

There must be fully independent oversight and control by the firm not only of intake but also of decisions affecting the supervision of clients and their engagements, including who is assigned the responsibility for controlling the client's affairs within the firm. This applies to all firms with more than one principal or partner. The key element here is preserving (*independence and freedom from conflicts of interest*). The essential requirement is that the manager or committee (or, ultimately, the management committee) have the final authority to determine whether, or on what conditions, the engagement should be accepted by the firm. The introducing partner or manager or CPA should have no veto or right to circumvent this decision-making process under any circumstances. The future financial well-being of the firm and of every individual partner may depend on this. At least arguably, many significant claims against and settlements by accounting firms result, at root, from failure to control the intake process—whether conflict checking, or inadequate “smell testing”, or inadequate limitation of the representation, or failure to assign a partner with the necessary specialized expertise to take responsibility for the client's affairs. If the firm takes on clients for their billing potential, without reviewing all of these engagements, sooner or later a major claim will arise that could have been avoided, or protected against. Accordingly, the proper answer is *no*, and *yes* should give rise to serious concern about the firm's risk management practices.

### *Question 2*

This, of course, is the potential worst case; unless the answer is *no*, the firm should give serious attention to reconsidering its approach to the management of its practice.

### *Question 3*

This is the inverse of question 2, the answer should be *yes*, for the reasons set out in the preceding answers.

*Question 4*

Unless the appropriate control system is operated across the board, regardless of seniority or position within the firm, it is fundamentally worthless. Again, unless the answer is *yes*, the firm should give serious attention to reconsidering its approach to the management of its practice.

*Question 5*

This may be the key question with respect to the issues discussed in the preceding questions; it is essential, if any management system is to be acceptable, that partners or managers not be penalized if engagements that they introduce are assigned to the control of others. If this is the result of the adoption of a risk management system, it will be undermined and ultimately fail. However painful, therefore, the compensation structure may need to be reviewed if it interferes with the acceptance of appropriate risk management. Unless the answer to this question is *yes*, such a review may be called for.

*Question 6*

Assuming that the firm does have an appropriate standard new client engagement and acceptance form, its mere existence is of no value *unless its use is required in all circumstances, and without exception*. The best way to ensure that this is the case is to structure each of the file opening, time recording, and billing systems in such a way that they cannot be operated *in any way* until the standard form has been *fully* completed, and signed by the introducing partner or staff member; and then reviewed and approved by those responsible for oversight of the intake procedures. Accordingly, the only appropriate answer to this question is *yes*; any other suggests an inadequate intake review process.

*Question 7*

For the reasons set out in the preceding answers, a *yes* answer to any of questions 7a, 7b, and 7c indicates, in each case, a serious deficiency in the firm's intake control procedures, which should be promptly addressed and remedied.

*Question 8*

There is nothing magical about hourly billing; indeed the move toward alternative billing arrangements has much in its favor. What is at issue here is the word *standard*. If there are alternative billing arrangements in use, it is important that these be understood and monitored.

*Question 9*

Because of the serious problems that arise when firms, or individual partners or staff members, have business interests in the client enterprise, and the inherent conflict with the CPA's duty to remain objective when rendering professional services, the very strongly preferred policy is the absolute prohibition of such relationships. Although it is recognized that a number of firms engage in these practices, we suggest that these firms should review the literature and reconsider their policies. We suggest that any answer other than *no* should be cause for serious concern in any firm.

### *Question 10*

Again, independent oversight of nonstandard billing arrangements is *essential*. Any answer other than *yes* should be cause for serious concern in any firm.

### *Question 11*

It will be apparent from other answers in this crib sheet that engagement letters are an essential element of effective risk management at the intake stage. They provide a necessary foundation to the conduct and management by the firm of the whole client relationship. Much more than money issues need to be incorporated in the engagement letter. A clear description of the scope of the engagement, including any agreed limitations on the functions which the firm has agreed to perform, are an essential ingredient. The identity of the partners or managers responsible and other staff to be assigned, obligations of communication—in both directions—between firm and client, collection, withdrawal, and dispute resolution are also all matters which should be included. It has been said that with respect to long-standing existing clients such letters should be avoided, as clients would be offended. This is a mistake. Clients almost invariably respect firms for demonstrating business-like management of their affairs; and, from the other extreme, as one commentator correctly noted, there is no law preventing long-time clients from suing for malpractice. They should be treated like all new clients, and both sides will be better protected by the reduction to writing of the nature and scope of the relationship.

### *Question 12*

Choice 12*a* represents the optimum time at which the control system should operate to enable time-charging to commence. Thus, a *yes* answer indicates maximum prudence, while a *no* answer merely demonstrates that a degree of risk may, in given cases, be acceptable to the firm, in that the risks in this situation are likely to be limited to whether or not the prospective client will agree the terms of the letter—assuming that the firm promptly withdraws if no such agreement is reached. The longer the delay, the greater the risks of creating an unwaivable conflict, or of establishing a relationship that will end up being uncompensated. Although a *yes* answer to question 12*b* is therefore probably an acceptable level of risk in many instances, a *yes* answer to question 12*c* should be viewed as disquieting and a cause for reviewing this aspect of intake procedures.

### *Question 13*

This question, by itself, is informational; the risk management issue lies in the answer to question 14.

### *Question 14*

It is imperative not only that the control operate to ensure that *an* engagement letter is received—countersigned by the client—in the file, but also that as originating partner you have not incorporated (or omitted) terms that were approved or required by the responsible independent new client or engagement acceptance partner or committee. This step ought to precede the giving of the go-ahead to commence (services); at the very least it should precede the issuance of any bills to the client. Accordingly, a *yes* answer demonstrates the appropriate level of oversight, while *no* or *N/A* indicates a potential gap.

*Question 15*

This question, by itself, is informational; the risk management issues lie in the answers to questions 16 to 20.

*Question 16*

The significance of beauty contests, or any other meeting within the general category of client development, is that they pose particular dangers in the realm of client conflicts. Since meetings held with potential clients for such purposes often involve the disclosure of confidential information, unless the requisite conflict checks are done *in advance* of attending such meetings, two serious dangers exist. First, the firm may be put into the position of effectively being subject to the limitations of the professional relationship (with its implications for having to refuse subsequent engagements by other parties) without ever having the benefits of the relationship. Second, it is not impossible that such meetings will create conflicts with existing clients of the firm. It is because of these dangers that a *no* answer to 16*a* suggests the need for a careful review of the firm's intake procedures; even a *yes* to 16*b* indicates that while the firm has recognized the issues involved, the procedures adopted may be inadequate, because triggered too late to prevent potential problems.

*Question 17*

It may be sufficient to run a more basic conflict of interest check prior to a first client development or beauty contest meeting, and to reserve the full new client information sheet until closer to the time of actual engagement. Accordingly, a *yes* here may avoid the problems highlighted at question 16. However, a *no* here as well as at question 16 reinforces the concerns expressed in the answer to question 16.

*Question 18*

Whenever a CPA meets a prospective client in order to discuss potential engagement of the CPA by the client, the likelihood is that two things happen. First, that a professional relationship will be established; and, second, some (albeit very general) advice or opinion will flow from the CPA to the potential client. Even if no full-fledged professional relationship is established at such a meeting, the *appearance* that such a relationship has been created may be created in the mind of *the potential client*. In such event, the CPA may subsequently be held to the responsibilities of a CPA to that potential client, including liability for malpractice, despite what to the CPA appear good grounds for believing that no such relationship was ever created. There is only one certain way to avoid such liability, namely to follow up all such meetings which do not result in formal engagement with nonengagement letters. Such letters can be both short and polite, noting simply that the meeting took place but that the CPA or firm decline to undertake the representation. If the CPA wishes to elaborate, the letter should nevertheless not include any advice other than, if relevant, to seek other professional assistance, and, if appropriate, to give the name, address, and telephone number of the local CPA organization's referral service. Accordingly, a *no* answer to this question should give rise to real concern about the potential for the exposure of the firm to such claims.

*Question 19*

Although there is little magic to what should go into such a letter, the existence of a form within the firm denotes the existence of a clear policy and procedure for sending such letters, with a minimum of trouble. Accordingly, a *yes* indicates that this element of risk management has been thought through and implemented, while a *no* suggests a more haphazard approach that may need tightening.

*Question 20*

If risk management procedures are not fully standardized, there is no automatic control that the appropriate policy is actually being followed. Accordingly, in the absence of a standardized letter, there should be independent review (at least by circulating a copy of the letter after the fact) by the partner or committee responsible for risk management. Since this requires an extra step from the partner involved, since otherwise there would be no way the risk management partner or committee would know of the need for the letter, the use of a standardized form is probably preferable.

*Question 21*

The change in status or internal composition of entity clients can create precisely the same potential problems for a CPA firm as if the new structure had existed from the outset. Accordingly, with respect to each change in structure, it is important to rerun the new client or engagement checks and procedures. The significance of failing to do this is the same as omissions at the time of or prior to initial engagement.

*Question 22*

See the answers and analysis for questions 7 to 14 of the section that follows, entitled “C. Management of Clients and Billing.”

**D. GENERAL RISK MANAGEMENT ISSUES**

*Question 1*

This question is informational; its significance relates to questions 2 and 3 below.

*Question 2*

Increasingly, in many jurisdictions, the courts are imposing liability upon firms on the basis of failure to advise clients of changes in tax law in situations in which the firm believed that the representation had long since ceased—but if the client claims, in effect, “but I *thought* that he or the firm was my CPA on an ongoing basis.” Firms specializing in tax and estate planning are particularly vulnerable to such attacks. The only sure defense to this is to have a failsafe system of sending a *closing letter* at the end of transactions. The best place to monitor and control for the issuance of such letters is in the billing process, which can be structured so that whenever a bill is a final bill or, after a specified period without billings, a closing letter is required to be sent. It should also be noted that this can have a *positive* component, by encouraging the client to *engage* the firm in ongoing representation. Furthermore, from the TQM standpoint, this is also a vehicle for getting clients to evaluate the services provided, as part of the firm’s commitment to maintaining quality.



*Question 3*

If risk management procedures are not fully standardized, there is no automatic control that the appropriate policy is actually being followed. Accordingly, in the absence of a standardized letter, there should be independent review (at least by circulating a copy of the letter after the fact) by the partner or committee responsible for risk management. Since this requires an extra step from the partner involved, since otherwise there would be no way the risk management partner or committee would know of the need for the letter, the use of a standardized form is probably preferable. Accordingly, the better answer is *yes* to 3a, but *yes* to 3b suggests an acceptable alternative approach.

*Questions 4 and 5*

Two statistics from a recent ABA study of malpractice claims against lawyers help explain why internal peer review of CPAs' work is so important, given that the two professions are very similar in this respect. Even (or especially) at a senior level, the risk management approach that is taken is of great significance. First, even though lawyers admitted to practice for more than ten years comprised 43 percent of the group studied, they accounted for 66 percent of the claims. Second, substantive professional errors (as opposed, for example, to administrative errors) comprised 44 percent of all claims. Accordingly, this practice of having formalized and regular periodic internal reviews of partners' work is an important component in effective risk management and loss prevention, and one which other professions have adopted rigorously and as a matter of course for similar reasons. As the size and frequency of claims against CPAs increase, and as the deductible or loss retention by firms with respect to their malpractice insurance cover also increase, the accounting profession will have to accommodate to this practice. Accordingly, if the answers to questions 4 and 5 are both *no*, your firm has probably not yet recognized the need for these procedures and should begin the process of constructing such a program.

*Question 6*

The process of formal evaluation of subordinate accountants is much more customary than the internal peer review of partners. Nevertheless, this question is important, as a basis for confirming that your firm indeed does perform this basic quality control function. In reviewing the answers from partners in the trenches, the firm's management will note the level of involvement in the review process of partners without formal management responsibility as part of their review of the effectiveness of this evaluation process.

*Question 7*

Serious problems arise when firms or individual partners or staff members have business interests in the client enterprise, including holding management positions or directorships. Moreover, in these circumstances, there is an inherent conflict with the accountant's duty to remain objective when rendering professional services. For both these reasons, the very strongly preferred policy is the absolute prohibition of such relationships. Although it is recognized that a number of firms still regularly engage in these practices, we suggest that these firms should review the literature and reconsider their policies. This is both an insurance coverage and professional ethics issue. A CPA firm is either not independent or has a conflict of interest if employees or their family members serve as directors, officers, or members of client management. Insurance coverage limitation extends to the management of clients, not just serving as officer or director. For reference, an article in the February

2001 issue of *Journal of Accountancy* discussing the status of independence rules can be found on AICPA web site ([www.aicpa.org](http://www.aicpa.org)). We suggest that any other answer than *no* should be cause for serious concern in any firm.

*Question 8*

If the answer to all of the subquestions is *no*, then your firm's controls over these conflicts is seriously defective. Any *yes* answer means that at least the issues are being addressed at some management level. However, the appropriate response should go beyond mere knowledge of the information; not only should such relationships be reported promptly, they should be carefully reviewed and, in all probability, terminated as quickly as possible.

*Question 9*

For the reasons explained at question 7, the very strongly preferred policy is the absolute prohibition of such relationships. Although it is recognized that a number of firms still regularly engage in these practices, we suggest that these firms should review the literature and reconsider their policies. We suggest that any other answer than *no* should be cause for serious concern in any firm.

*Question 10*

If the answer to all of the subquestions is *no*, then your firm's controls over these conflicts is seriously defective. Any *yes* answer means that at least the issues are being addressed at some management level. However, the appropriate response should go beyond mere knowledge of the information; not only should such relationships be reported promptly, they should be carefully reviewed and, in all probability, terminated as quickly as possible.

*Question 11*

For the reasons explained at question 7, the very strongly preferred policy is the absolute prohibition of such relationships. Although it is recognized that a number of firms still permit these practices, we suggest that these firms should review the literature and reconsider their policies. We suggest that any other answer than *no* should be cause for serious concern in any firm.

*Question 12*

If the answer to all of the subquestions is *no*, then your firm's controls over these conflicts is seriously defective. Any *yes* answer means that at least the issues are being addressed at some management level. However, the appropriate response should go beyond mere knowledge of the information; not only should such relationships be reported promptly, they should be carefully reviewed and, in all probability, terminated as quickly as possible.

*Question 13*

A rapidly developing area of substantive law is that involving liability to third parties for opinion letters and audit reports. Key to managing risk in this area is the existence and enforcement of policies and procedures ensuring independent review, within the firm, before partners with client or matter responsibility can issue formal opinion letters or audit reports. However little accountants appreciate being second guessed, the fiduciary obligation among partners entitles the partnership, as of right, to require individual partners to submit documents which will bind the partnership for such review, in the interest of protecting the entity and all of the individual members. Accordingly, this and the following two questions explores the procedures in place to control the issuance of such letters. This question, and question 14a are informational.

*Questions 14 and 15*

Risk management procedures are more easily monitored when standardized. In addition, because of the heightened level of exposure, to the extent practicable, and within each relevant practice area, there should be independent review in advance of issuance of the opinion by a partner or committee responsible for issuing such opinions, which should always include a partner (other than the drafting partner) with knowledge of the relevant practice area. Accordingly, the better answer is *yes* to question 14*b*, and *yes* to question 14*c*, and *yes* to question 15 but the latter two are of greater significance. Although a *yes* to 14*d* denotes the best possible control over opinion letter issuance, it is the review, not the extra signature, which is important.

***Partners in Branch Offices, Merged Practices, or Lateral Hires Only***

*Question 16*

The dangers of inadequate due diligence in lateral partner hire and CPA firm, or practice mergers are all too apparent but many firms do not do for themselves in practice that which they would recommend to their own clients. Although the experience of recent lateral hires or partners from merging firms is, in effect, of historical significance, it is relevant with respect to future expansion as a check on the firm's policies to review what procedures were actually experienced by prior lateral hires. This question is therefore informational.

*Question 17*

As to any of the subquestions where the answer is *no*, the due diligence was deficient. To that extent, the firm's policies and procedures should be carefully reviewed before any new lateral hires or mergers are consummated.

*Question 18*

Even if the answers to the subquestions of question 17 is *yes*, it is important to know, from the perspective of a person who has undergone the due diligence process, how thoroughly it was conducted. Obviously, a *yes* answer to 18*a* should be a cause for concern.

*Question 19*

Unless risk management policies, procedures and controls are uniformly in effect throughout the firm, including in branch offices, wherever located, they cannot have the intended protective effect. At least one award or settlement in the tens of millions of dollars range occurred because of a branch office failure. It is therefore important to determine whether, in the view of partners and associates working in branch offices, the same level of risk management is indeed in place there. Any answer other than *yes* should be a serious cause for concern both within the branch and for the firm as a whole.

### ***All Respondents***

#### ***Question 20***

This question is informational, and serves as a cross-check for firm and risk management.

#### ***Question 21***

A vital element of effective risk management is prompt and appropriate response when problems do arise. For such response to occur, the incidents must be promptly reported, not hidden. Therefore a *no* answer to question 21*a* or 21*b* indicates that the firm has not clearly or effectively educated its members and staff to the need for prompt reporting, or has no proper management structure or response procedures in place to receive and deal with such reports. In either event, this should be remedied.

#### ***Questions 22 and 23***

Malpractice and discipline cases can originate with CPAs that have substance abuse problems. The earlier these problems are identified, the more likely it will be that the affected person can be helped with therapy to return to full and effective performance of his or her responsibilities, *and* the more likely that serious malpractice or discipline problems can be averted. Again, therefore, a vital element of effective risk management is prompt and appropriate response when these problems are observed. For such response to occur, the circumstances must be promptly reported, not hidden. Therefore a *no* answer to either part of question 23 indicates that the firm has not clearly or effectively educated its members and staff to the need for prompt reporting, or has no proper management structure or response procedures in place to receive and address such reports. In either event, this should be remedied.

#### ***Questions 24, 25, 26, and 27***

The issue of securities trading can cross two significant lines of law and professional regulations, ethics, and procedures. It may constitute insider trading within the meaning of the securities laws, and constitute improper conflicts of interest (because of the CPA's personal financial interest in the outcome of transactions). A number of firms have had unfortunate experiences where these two lines have been improperly crossed. There are various degrees of sophistication of the procedures and controls to seek to limit the opportunity for such breaches to occur. The proper answers to these questions are *no* to question 24 and *yes* to questions 25, 26, and 27. Any other answers are indicative of a serious risk management problem, if your firm has *any* clients which are publicly traded entities *or* which have access to or dealings with such entities.

#### ***Question 28***

CPE is an important component of effective risk management. Firms that conduct CPE internally are probably the most focused on providing targeted programs meaningful and useful to their practices. But outside CPE of high quality is available in most practice specialties; if your firm is not requiring participation, then much is being taken for granted that should not be.

*Questions 29 and 30*

A vital component of effective risk management is providing skilled and knowledgeable advice and assistance to members and staff of the firm when potential professional regulations, ethics, and procedures questions arise. Because these will usually involve other people with whom the person raising the issue is working closely in the first place, it is essential that such advice be available from an independent person at the partner level. Many firms have therefore designated an professional regulations, ethics, and procedures partner. This person may but need not be the same as the partner or manager responsible for risk management, but he should certainly be part of the risk management structure. Question 29 is informational; if you answered *yes* to question 29 and *no* to any part of question 30, then there is a serious gap in this aspect of risk management which should be studied and repaired.

*Questions 31 and 32*

No human enterprise can function perfectly at all times. If you are aware of any failures in client representation, more important is how these problems were handled when they arose. The earlier these problems are identified, the more likely it will be that the problem can be rectified, and the more likely that serious malpractice or discipline problems can be averted. Again, therefore, a vital element of effective risk management is prompt and appropriate response when these problems are observed. For such response to occur, the circumstances must be promptly reported, not hidden. Therefore a *no* answer to either part of question 32 indicates that the firm has not clearly or effectively educated its members and staff to the need for prompt reporting, or has no proper management structure or response procedures in place to receive and deal with such reports. In either event, this should be remedied.

*Question 33*

An essential ingredient of effective risk management is that the firm's commitment to this process is communicated to all its constituent elements clearly, regularly and completely. The process involves everyone, and can only work if it is known and understood by everyone working in the firm. A *no* answer to any component suggests a serious gap which should be remedied.



## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 8— CLIENT RELATIONS MANAGEMENT, AND HANDLING PROBLEMS AND CLAIMS

#### I. FUNCTION

This questionnaire is designed to explore the scope of the firm's existing control structures, policies, and procedures for managing client relationships and responding to and dealing with professional regulations, ethics and firm procedures, discipline and sanction matters, actual or potential malpractice claims, and other litigation brought or threatened against the firm.

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to "Questionnaire 8—Client Relations Management, and Handling Problems and Claims," have completed the process of responding to the questionnaire. Then an initial, twofold review can begin. First, each individual should consider his or her responses in the light of this crib sheet. Then everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the current state of the firm's policies and procedures for addressing these situations. Once there is agreement as to what is in place, and how the processes are operating, the question of what gaps or problems exist, and what can be done to fill them can be addressed.

For many firms, the answers yielded by this review process will either reassure or without more enable those firms to decide upon and to implement any needed changes to their policies and procedures for addressing these situations. For some, on the other hand, the answers yielded by this review may create dilemmas or the potential for internal conflict of a kind that lead the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources. Many of the professional liability insurers have staff that are knowledgeable and available to give guidance in many areas, as no doubt, are other independent consultants.

#### II. SCOPE

This crib sheet, and its companions relating to the other QUIC Survey questionnaires, are designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive system of new client-engagement control, appropriately overseen, to control the risks that are inevitable if clients and their matters are inadequately screened reviewed and controlled. Thus, the answers and analysis contained in this crib sheet are intended to perform the following two functions:

- Explanations and definitions of the key *problems*—risks—that the underlying Questionnaire is intended to uncover in the context of your particular firm

- General reviews of the professional regulations, ethics and firm procedures issues which may arise if the management of these issues falls short of adequate

It is not the intention of the authors that the crib sheets constitute a complete analysis on how to respond to actual or threatened claims against accounting firms. Rather, it is our purpose to help firms to determine if they have in place systems, policies, and effective procedures to enable them to respond appropriately, effectively, and expeditiously when these problems arise. We offer no nostrums or guarantees. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered, to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of its practice.

### **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed, meaning: Why are we asking you this? Second, the broad implications of each response (*yes*, *no*, or *N/A*) are discussed. Third, the level of importance attached to dealing with gaps which you may have uncovered in your policies or procedures, is explained.

### **IV. ANSWERS AND ANALYSIS**

#### **A. IDENTIFYING PROBLEMS**

##### *Question 1*

The most frequent complaint heard by regulators of professionals is that “he or she wouldn’t return my telephone calls (or, latterly, emails).” Staying in touch with clients, especially responding when they call is an *essential* ingredient of professional competence. Firms and individual CPAs should make a commitment to each and every client at the beginning of every engagement as to the time period within which they will return client’s calls or respond to their messages—and then stick to the policy in practice. If the assigned professional is not available for any reason, another staff person should respond, indicate when the professional will next be available, and offer to find another professional to respond to the client’s needs if the assigned professional will not be available soon enough to satisfy the client’s immediate need. Thus, a *yes* to question 1*a* is preferable to a *yes* to question 1*b*, but a *no* to both should be a cause for concern.

##### *Question 2*

There are no professional engagements that do not have some kind of deadline, even if they are not as significant as tax filing deadlines. Accordingly, every practice should have a calendar control system in place encompassing every professional engagement.

##### *Question 3*

A good calendar control system should automatically, from the moment a file is opened, establish regular client communications (whether by phone, email or letter) as entries on the calendar at appropriate intervals. The periodicity (length between) each communication may vary with different types of engagement, but there should be no exceptions to this rule.



*Question 4*

Similarly, the point most likely to generate client unhappiness (or worse) is the delivery of an invoice. Accordingly, every bill, to every client should be enclosed with a personalized letter to the client, including (at least) the following elements:

- a. A description of the work performed since the last bill, including an explanation of how the matter is progressing generally
- b. An invitation to the client to call if he or she has any questions regarding the bill
- c. An explanation of the progress to be expected before the next bill is issued

In this way, CPAs and their firms are likely to reduce client complaints, by establishing a better understanding of progress, and to identify problems—so as to be able to address them—as soon as they arise, and hopefully before they become insoluble.

*Question 5*

Team practice, wherever feasible, is greatly preferable to solo practice, wherever possible. This is because clients get the benefit of best practices when several people are monitoring their matters; because all the professionals on the matter learn from one another; and because when problems arise they are not hidden from view and can be identified, and often resolved early enough to prevent harm. In addition, because team practices involve regular oversight, there is encouragement to complete tasks efficiently, thus producing bills which clients pay promptly, in gratitude for efficient service.

*Question 6*

Professionals are (almost always) human, and errors are bound to occur. The key for CPA firms is to find ways to catch and correct these errors, preferably before they leave the office, but in any event if possible before they result in actual harm. This is best accomplished on an ongoing basis by designating one individual—who should be senior, but also independent of direct management responsibility—to handle this role. Studies of professional firms have shown that effective in-house professional standards counsel can save millions of dollars that would otherwise be lost to legal fees and to indemnity payments to disgruntled clients.

*Question 7*

Having designated an individual to perform this function, it is essential that every professional and support person in the firm be aware of the function, its purpose, and who the assigned individual is, and the importance ascribed in the firm to having people utilize the resource.

*Question 8*

As indicated in the previous answers, a vital component of effective risk management is providing skilled and knowledgeable advice and assistance to members and staff of the firm when potential questions relating to the proper handling of matters, or, specifically, matters involving professional regulations, ethics, and firm procedures and competence arise. Because, in the case of employed professionals, these will usually involve other people with whom the person raising the issue is working closely in the first place, and often specifically the partner or shareholder to whom the employed professional is reporting on the matter in question, it is essential that such advice be available from an

independent person, at the partner level. Many firms have therefore designated a professional regulations, ethics and firm procedures partner. This person may but need not be the same as the partner responsible for risk management, but he should certainly be part of the risk management structure. By creating this independent resource, two distinct goals are met. First, the firm is sensitized to the fact that these issues are taken seriously, and as a result. Second, accountants and staff at every level are more likely to report problems or raise questions significantly earlier than if the resource were not available. If you answered *no* to this question, there is a serious gap in this aspect of risk management which should be studied and repaired.

### *Question 9*

The appointment of a professional regulations, ethics, and firm procedures partner is only part of the process of sensitizing the firm to the importance of risk management. A corollary to this appointment should be the declaration and dissemination of clear policies to everyone in the firm about the functions of the professional regulations, ethics, and firm procedures partner, and explicitly stating the need to report concerns at the earliest possible moment. By emphasizing prevention, and the role of early reporting in reducing the level that problems might otherwise attain if left unrecognized or unattended, the firm will be educated to the value of the resource. Accordingly, a *no* answer indicates that this element of risk management has not yet been fully mastered.

### *Questions 10 and 11*

Each of these categories represents a potentially serious threat to the firm, posing the risks of *embarrassment* and *damage to reputation; loss of time spent in responding; costs of defense; payment of any award* (to the extent of the firm's deductible and loss retention); *increase in insurance premiums*. As to each category, therefore, the firm needs to express with clarity two things. First, that early reporting within the firm of potential or actual problems is an important element in "damage control," and is the express policy of the firm. Second, the identity of the partner or committee to whom all reports or questions should be addressed. It is important to identify the different kinds of claims and issues; for instance, choice 10c might not come to the minds of staff otherwise familiar with the general policy. Nevertheless, employment claims and litigation are just as costly and potentially damaging as externally derived claims, and need to be dealt with equally promptly and effectively. As to any area identified in the subquestions as to which the answer is *no*, the firm should consider refining its stated policies so as to make its positions and the response mechanism clearly understood by everyone in the firm.

### *Question 12*

This aspect of risk management needs to become second nature to everyone in the firm, but that cannot be expected to occur overnight. Therefore, regular reinforcement is important. Merely expressing the policy in a manual which is neither reviewed nor recirculated will not suffice. A *no* answer suggests the need for consideration of additional mechanisms for communicating the firm's risk management policies and damage control procedures.

*Question 13*

This is an essential step in the process of alerting everyone in the firm to the importance attached to recognition and appropriate handling of potential problems. A *no* answer should be unacceptable.

**B. RESPONSE PROCEDURES**

*Question 1*

For all of the reasons set out in the crib sheets to “Questionnaire 1—Firm Leadership and Management Structure,” if risk management is to be effective, it is *essential* that it be centralized, and the responsibility be given to a single partner or committee. If the answer is *no*, then the firm should review its management structure to address this need.

*Question 2*

Since those responsible for risk management will develop the necessary information and skills required to deal on an informed basis with the firm’s insurers (both in connection with obtaining, or renewal of coverage, and in handling claims), the answer to this question should be *yes*.

*Question 3*

For all of the reasons set out at question 12 in the preceding section entitled “A. Identifying Problems,” this is essential as is the requirement of regular dissemination. Any answer other than *yes* should be unacceptable.

*Questions 4 and 5*

Most of this questionnaire is not in a multiple-choice format, but it is employed in these questions for an important reason. Although there are many *possible* reactions to problems or claims, some are better than others, and some are potentially seriously harmful. For instance, choice *4a* is *not* recommended; why create a written record (with the attendant dangers of discoverability) internally, when if it is necessary it may be better done (and more protectable) by outside counsel, as and when appointed. Accordingly, choice *4b* is much to be preferred. Choice *4c* may follow choice *4b* and may be very appropriate then, but not before the full story is known and has been considered, if appropriate *after* consultation with the firm’s insurers. Choice *4d* is therefore almost certainly the *second* appropriate step. All professional liability policies require prompt reporting as a *condition* of coverage. Insurers have been aggressive in disclaiming coverage where there were delays in reporting problems, and have succeeded in maintaining these positions in court. Insurers should *not* be regarded as the enemy in this process; they often have significant constructive advice, based on their much greater experience of claims than (hopefully) any individual firm. The fact that a claim is within the deductible does not usually affect the obligation to report.

*Question 6*

The harm that can follow inappropriate statements to the press can often be a great amplification of the harm of disclosure of the underlying problem. Dealing with the press requires tact, experience, skill, and a well-thought-out plan of the firm’s position, so as to throw the best possible light and, above all, minimize the possible damage. The following are *essential*.

## ***Risk Management***

- One person, with knowledge of the claims handling process, be designated as sole spokesperson for the firm.
- Every other person in the firm understand that they are *not* permitted to speak to the media—on or off the record—under any circumstances without express prior approval from the management of the firm.
- The designee to deal with the media must have a prepared statement and position in advance of any conversation or meeting.

### *Questions 7 and 8*

We may like to think of ourselves as able to do anything, but there are professional public relations consultants for a reason—they know how to deal with the media. If your firm has a high profile, or if a particular problem is likely to give it one, professionals may well be able to help you significantly in placing the correct spin on the story. Even if you do not have current needs for this assistance, good preparation for addressing future problems (or successes) suggests that interviewing and selecting a consultant “for a rainy day” may be time well spent.

### *Question 9*

Underwriters and brokers have been developing expertise in risk management as part of their livelihoods for many years. They are usually both flattered to be consulted, and likely to view your interest as a positive element in their evaluation of your firm. The answer ought to be *yes*. You might even learn something useful.

## QUALITY/IN CONTROL (QUIC) SURVEY FOR ACCOUNTING FIRMS

### ANSWER AND ANALYSIS SHEET 9— DISASTER RECOVERY AND BUSINESS CONTINUITY

#### I. FUNCTION

This questionnaire is designed to explore the scope of the firm's existing preparations, policies, and procedures for responding to and dealing with disasters that disrupt the firm's ability to conduct its practice. Such disasters can range from power outages to the destruction of the firm's premises, from whatever cause. Since each firm's needs will vary, the questionnaire, and this crib sheet were developed as a self-assessment tool and guide to be considered during the business continuity planning process. The focus of these questions is to review the components of an effective plan and to compare it to the firm's procedures for disaster recovery. Although the questionnaire and this crib sheet combine best practices of business continuity planning in the CPA firm environment, they do not replace a firm's individual responsibility in customizing its own business continuity plan. For many firms business continuity planning is considered a form of insurance and the planning process is the premium payment that is willingly paid to reduce exposure to a disaster.

This answer and analysis sheet (otherwise known as the crib sheet), to be most useful, should not be read or reviewed by anyone until all those asked to respond to "Questionnaire 9—Disaster Recovery and Business Continuity," have completed the process of responding to the questionnaire. Then an initial, twofold review can begin. First, each individual should consider his or her responses in the light of this crib sheet. Then, everyone who was asked to complete the questionnaire should meet to compare notes. This process is intended to lead to a consensus as to the adequacy of the firm's plans and preparations for addressing disasters. Once there is agreement as to what is in place, the question of what gaps or problems exist, and what should be done to fill them, can be addressed.

For many firms, the answers yielded by this review process will either reassure, or will enable those firms to decide upon and implement any needed changes to their disaster recovery planning. For some, on the other hand, the answers yielded by this review may create dilemmas or the potential for internal conflict of a kind that lead the firm to conclude that outside, independent, and specialist guidance is required in order to arrive at strategies and tactics for implementing needed changes. In that event, help is available from a number of sources. Many of the professional liability insurers have staff that are knowledgeable and available to give guidance in many areas, as no doubt, are other independent consultants.

#### II. SCOPE

This crib sheet, and its companions relating to the other QUIC Survey questionnaires, are designed to raise issues and provoke self-examination within your firm. The central purpose of the questions, and of this crib sheet, is to help you determine whether you have in place a comprehensive system of new client engagement intake control, appropriately

overseen, to control the risks that are inevitable if new client's engagements are inadequately screened, reviewed, and controlled. Thus, the answers and analysis contained in this crib sheet are intended to perform the following two functions:

- Explanations and definitions of the key *problems*—risks—that the underlying questionnaire is intended to uncover in the context of your particular firm
- General reviews of the ethical and legal liability issues which may arise if the management of these issues falls short of adequate

It is not the intention of the authors that the crib sheets constitute a complete analysis on what level of business continuity planning is necessary or appropriate for every CPA firm. Rather, it is our purpose to help firms to determine whether they have in place systems, policies, and effective procedures to enable them to respond appropriately, effectively, and expeditiously if a disaster should occur. We offer no nostrums or guarantees as to what preparations are required. Questions on the Socratic model and general guidance as to the meaning and significance of the questions are offered to enable each firm to reach its own comfort level (and, perhaps, the comfort of its professional liability insurers) in the management of its practice.

### **III. STRUCTURE**

The crib sheet follows precisely the numbering of the associated questionnaire. For each question and, where appropriate, for each subordinate part of the question, the crib sheet provides three levels of guidance. First, the significance of the question is reviewed meaning: Why are we asking you this? Second, the broad implications of each response, *yes*, *no*, or *N/A* (not applicable), are discussed. Third, the level of importance attached to dealing with gaps which you may have uncovered in your policies or procedures is explained.

### **IV. ANSWERS AND ANALYSIS**

#### **A. IMPACT ANALYSIS**

##### *Question 1*

Has management ever considered what would happen if, suddenly and with no warning, access to your firm's offices (or any office in a multibranch firm) became impossible? It would not have to be as dramatic as the World Trade Center bombing, or the flooding of the downtown area of Chicago that rendered square blocks of buildings both inoperative and inaccessible. It could be a fire in adjacent space. Or it could be a less than total disaster—an extended telephone or power problem to your building—which renders it impossible for your personnel to get to work or to function if they do arrive. What would happen? The first step in business continuity planning is to prepare a study of how your firm would or could function *tomorrow* if no express plans had been made to address various levels of disaster, from totally disabling to partial disruptions. If the answer to this question is *no*, you would do well to think about preparing such a study soon.

*Question 2*

An essential element of such a study is the establishment of priorities. What functions are most important internally, and in order to provide continuity of service to clients? What are luxuries, or otherwise inessential, that can be dispensed with “in a pinch”? And, of equal importance, what are the time frames within which those services and functions identified as essential would have to be reestablished, regardless of the severity of the occurrence causing the problem? Again, if the answer is *no*, it is time to address these issues.

*Question 3*

The Business Continuity Plan (plan) is a documented description of the following:

- The *actions* to be taken
- The *resources* to be used
- The *procedures* to be followed before, during and after a disaster which renders part or all of a firm’s business functions unavailable

An effective plan is critical to limiting loss and liability and may—

- \* Mitigate risk of catastrophic loss.
- \* Ensure orderly and rapid recovery.
- \* Provide a cost-effective balance of protective measures with insurance coverage.
- \* Ensure compliance with regulatory requirements; (for example, safeguarding of client assets).
- \* Reduce costs of insurance coverage.

An effective plan examines alternative methods for conducting business under various strategies and disaster scenarios using the following framework.

- \* Identify critical firm processes and recovery time frames. The firm should prioritize the functions that are necessary to do business, meaning, how long it can afford to wait to recover these functions or processes and the impact the recovery time will have on the firm.
- \* Define the firm’s minimum requirements and an action plan to safeguard these processes.
- \* Select workable alternatives that are cost-justifiable and limit firm exposure. The firm should examine the cost of the plan components against the potential damage to the firm in the long term, as well as potential liability, if the business is interrupted and no recovery plan were in effect.
- \* Prepare documented plans for recovery and business continuity. Formalize the plan and incorporate it into the policies of the firm.
- \* Test the plans and train firm members and employees. This includes the initial testing as well as regular plan maintenance.

*Question 4*

Obviously, there are all kinds of potential disaster, leading to different levels of disruption. The appropriate reaction, and the recovery response, as well as the time scale for the restoration of full activity and functioning will vary. It is important, in preparing the plan, to provide for such different levels of response. The appropriate reaction to a complete loss of power, which may last less than a day, or the complete crash of a computer system, will be less drastic than the reaction to a fire which guts the office, and requires a long-term, complete rebuilding of the firm's physical space. In the middle would be an event which leaves the office intact but inaccessible for weeks but which would require the intermediate substitution of all services without any long-term reconstruction. An example is the World Trade Center bombing. Unless the answer is *yes*, the plan is likely to involve overreaction to minor or limited disasters.

*Question 5*

Following from question 4, some events may require a limited response to enable limited services to continue. These include the ability to make immediate notification to all, or to an affected group of staff that they should stay home for one day—as opposed to implementation of the full-scale recovery plan. An element of any limited response must be an assessment of what services could be provided by the individuals affected. For instance, which CPAs have computers, faxes, and other resources at home that would enable them to operate off-site with the least disruption? This in turn can assist in the least disruptive redistribution of remaining assets during a crisis.

*Question 6*

The essential element in every plan should be to make provision that identifies the key elements needed to maintain the firm's minimum operations, and provide for that level of maintenance *at all times*, regardless of the scale of the disaster. If the answer to this question is *no*, the plan is inadequate.

*Question 7*

A full-fledged recovery plan should include, in effect, a reconstruction grid in the form of a flow chart. The time allotted for the restoration of each function should be realistic, based on each of the following two factors. First, what is deemed *necessary* for the operation of the firm. Second, what is *possible* within the constraints of what is both practicable and affordable, within the budget allocated for the operation of the recovery plan. A *no* answer suggests that the plan is incomplete.

**B. PLAN PREPARATION AND MAINTENANCE**

*Question 1*

The responses to the preceding section, entitled “A. Impact Analysis,” that a plan exists, make it clear that even a well-conceived plan that exists only in the head of the office manager is as good as no plan. If the answer is *no*, start work now.



*Question 2*

Even subtle changes in firm procedures—a change in computer equipment, or significant software, for instance—can render existing plans obsolete as to those functions. Choice 2c (“as needed”) usually equates to never. As a result, a regular schedule for reviewing the plan, and bringing it up to date with developments in the firm, is important. *Yes* to choice 2a is the better answer, and is acceptable to choice 2b.

*Question 3*

It is not necessary to close down the office or firm in order to stage an effective test. It can be done in stages or by functions. Tests should involve more active participation from those with a role in making the plan work effectively, but should also be performed in such a way as to familiarize all of the staff—professional and support—with the main logistical elements. A test can be held periodically, for instance, to check that everyone in the firm knows the site and telephone number of the premises to be used in the event the firm’s offices become inaccessible. More frequently, the system for backing up the computer data, and storing backups off-site, can be checked. If there has been no testing, the plan is unlikely to work smoothly if a disaster does occur; a *no* answer, and an answer indicating that the last test of any kind was more than a year ago, should both be unacceptable.

*Question 4*

The answer should be *yes* to *everyone* in the firm, down to the lowest level support staff member. It is important that everyone knows ahead of time what their role is and where they are supposed to go—including to stay away entirely, if that is the plan—once they have been formally notified that the plan is in effect. This will minimize the time that can be wasted in the heat of a crisis, which is the point when time is most precious.

*Question 5*

It will help the staff of the firm, professional and support, to take the plan seriously if required to acknowledge in writing receipt of a copy. In addition, if not thought too oppressive, the required acknowledgment may also be framed in such a way as to include confirmation that the signer has *read* the plan and understands his or her obligations if ever notified that it, or any pertinent part of it, is in effect. The preferred answer is therefore *yes*.

*Question 6*

For the reasons set out at question 2 for the regular revision of the plan, it should be distributed every time revisions are made. In addition, and in any event, the plan should be recirculated with regularity as a reminder to the staff of its existence, and the requirement of written acknowledgment (see question 5 above) should be enforced for every distribution. The answers ought to be *yes* to questions 6a and 6c.

*Question 7*

An essential ingredient of any business recovery plan must be the location from which the firm will operate while its offices are inaccessible. Obviously, no firm will plan to duplicate its entire facilities; that is why a *plan* is necessary. Rather, the plan must include the selection of some location with some facilities, where its operations can be organized. Firms may have an arrangement with businesses established to provide such services. They may make twinning type agreements with other professionals, such that each firm will share its

facilities with the other in the event of a disaster that forces one party from its own premises (subject to ensuring that client confidentiality will not be a problem). In any case, this is a crucial component. Organization of the recovery process is vastly eased if everyone knows ahead of time where the firm will be centered and managed during the crisis. If the answer is *no*, your planning is almost certainly inadequate.

### *Question 8*

Part of the planning, in the context of the flow chart and budgeting discussed at question 7 in section “A. Impact Analysis,” above, will be to decide what kind of emergency facilities the firm can afford. There is no rule that it has to be a fully equipped office. To the extent that it is not, however, the plan will have to allow time to acquire and set up those facilities which the location lacks. There is no one right answer to this question; the point is that the issues have been raised and considered ahead of time.

### *Question 9*

What is important, therefore, is that having decided what level of emergency location facilities to accept, the firm should take care to ensure that it remains *at all times* equipped up to the agreed standard. If the agreement is not specific, the plan may not prove effective when the crisis does occur.

### *Question 10*

Assuming that the plan indeed includes the selection of emergency facilities, it should clearly identify them. A *no* answer clearly suggests the need to revise the plan.

### *Questions 11 and 12*

Next to having emergency facilities selected and identified, the most important element of the plan is to identify *and train* appropriate personnel to aid in the recovery program. Preassigned roles can include a roster of other personnel to notify when the plan is put into effect, on the model of emergency call-ups by the army, as well as the more managerial functions involved in getting the emergency systems up and running. Training of everyone involved, like testing of the plan, should not be one-time occurrence. If or when a crisis occurs, it is important that the plan be familiar, and people’s jobs well known and understood, or time will be lost when it is most important to reestablish the firm’s operations.

### *Question 13*

If the emergency facilities selected do not have all of the equipment which will be needed to operate the firm during the recovery process, it is important that at least the firm’s requirements are clearly identified and listed in the plan, and this should include the identification of relevant suppliers. Again, a *no* answer means that time will be lost remedying these deficits when the arrangements could already be under way to fill the order list if it already existed.

*Question 14*

The third priority in the recovery process is reestablishing links with the rest of the world. This means a telephone system. How this need is to be met will depend in large measure on the nature of the facilities selected. However, it is crucial to know ahead of time *how* this will be handled and that it will be available *immediately* when the plan is put into effect. This is an essential element of any plan. If the answer is *no*, we recommend that this gap be plugged.

*Questions 15 and 16*

If the plan does not make arrangements, if these are possible, to have calls automatically rerouted as soon as the plan is put into effect, then by definition the telephone arrangements will involve a new number during the emergency. *If possible*, this number should be acquired in advance, and included in the plan. This will vastly speed the reestablishment of other firm functions and services.

*Question 17*

Whatever the arrangements for the telephone after establishing operations in the emergency location, it is essential to include in the plan arrangements to notify all of the firm's clients, and as many as possible of others likely to need to contact the firm, of the temporary number as quickly as possible. Again, assignment of preselected notification calls among the staff (including professional staff) as part of the plan will vastly increase the efficiency of the recovery process. A *no* answer suggests that further thought should be given to this process.

*Questions 18 and 19*

The necessary corollary of the arrangements for communicating the firm's temporary arrangements is the ready availability of the information needed concerning those to be contacted since all the firm's roladexes (or computer equivalents) are, by definition, now unavailable. In whatever form this information is kept in readiness for the emergency, it must be available for *immediate* use as soon as the plan is put into effect, and must include all of the information necessary to reestablish contact with those included.

*Question 20*

Precisely because it is a time of crisis, planning should allow for failures. Accordingly, redundancy is a good, not an objectionable goal, and every piece of information that is required by the plan to be available away from the firm's offices should be available to everyone. Accordingly, contact information should be available to everyone in the chain involved in the recovery operation. The answer should therefore be *yes* to each subitem.

*Question 21*

For the reasons set out at questions 2 and 6 above, it is essential that an individual be charged with responsibility for regular reviews and revisions of the plan. A *no* answer should trigger the appointment of someone to take on this task.

### **C. SUPPORT FUNCTIONS**

#### *Question 1*

It is not enough for the partners, professionals, and their secretaries to know how and where they are expected to function during the recovery process unless all of the essential support functions are operating also. Accordingly, it is just as important that the plan address how other services, such as time recording, billing, accounting, payroll, will function during the recovery process. Furthermore, since the plan may call for people to take on tasks different from or additional to their normal responsibilities during this period, it may require that some functions be performed by “temps.” In that event, the firm should at least identify a reliable source for such outside help, if not make actual provision to contract for such help if the plan is ever operated. On that assumption, all answers to this question should be *yes*.

#### *Questions 2 and 3*

It will be the support staff as much as the CPAs who keep the firm functioning during the recovery from a disaster. For them to do so efficiently, they should be represented on the recovery team in whatever way is appropriate to get the firm up and running after the plan is operated. A *no* answer to either of these questions indicates that insufficient attention is being given to the support roles in recovery from a disaster.

#### *Questions 4 and 5*

Basic things like letterhead stationery and envelopes are almost as important as computers and telephones for the running of the firm’s practice, especially if you want to appear to have matters under control. Accordingly, one of the elements of planning for the location of the emergency recovery site is to provide for a stock of the basic necessities to be on hand at all times, with your normal suppliers also holding some extra stock for use if the plan is operated. *No* answers indicate an element of the plan requiring more attention.

#### *Questions 6 and 7*

Whatever the degree of computer literacy of your firm, it is vital that the precious stock of documents generated by your firm is recoverable. A prerequisite to recovery is knowing what you have. If you do not already maintain an effective control and management system for documents generated in your firm’s practice, the preparation of the plan will demonstrate a clear reason for undertaking such a program that goes beyond the benefits in efficiency that will be yielded regardless of disasters. In addressing these issues, care should be taken to consider and to put in place both appropriate security systems (firewalls, passwords, encryption), as well as procedures for the recovery of data as needed. A *no* answer to either question should prompt consideration of this issue.

#### *Question 8*

Backup and off-site storage of computer data is the most basic element in preparing for a disaster. In one sense, if you have all of your data and software operating systems properly backed up and stored off-site, you could eventually mount a recovery of your firm’s operations. A *yes*, at least to question 8*b*, but preferably also to question 8*a*, is therefore the fundamental essential to effective recovery. A *no* should be remedied *immediately*.

*Questions 9 and 10*

If you rely on outside services for any of your operations, it will smooth the recovery if they are also part of the plan, and know what is expected if it is ever operated; in that event these questions should have *yes* answers.

*Question 11*

In the era of computerized research it may be that, during the recovery period, the most important outside resource for the firm's CPAs will be on the Internet. This may be true even if normally most research is done with software stored on an off-site network server or books. The availability of these services at the emergency recovery location may be an important element of the plan. In any event, the plan should include and address the firm's research needs, and make some appropriate provision. A *no* answer may result in serious handicaps to the practice during the recovery period.

**D. FIRM RECORDS**

*Question 1*

As indicated at question 8 in the preceding section entitled "Support Functions," backup, and off-site storage of computer data is the most basic element in preparing for a disaster. In one sense, if you have all of your data and software operating systems properly backed up and stored off-site, you could eventually mount a recovery of your firm's operations. It is essential that this step include the data and the software controlling the firm's new client and engagement acceptance process. The intake review process (like other basic risk management) *cannot* stop just because of a disaster. A *yes*, at least to question 1 *b*, but preferably also to question 1 *a* is therefore fundamental to being able to continue to process new matters and clients as part of an effective recovery. A *no* should be remedied *immediately*.

*Question 2*

Taking appropriate measures to protect material stored off-site is a part of the underlying obligation to maintain client confidentiality. If the information is readily obtainable at any off-site location, it should be protected so that it is accessible in readable form only to authorized firm personnel. A *no* answer should be remedied.

*Questions 3, 4, and 5*

It is important that, as far as possible, continuity of policy and procedures be maintained during the period of recovery. Accordingly, the need to re-invent the wheel should be avoided by having as much as possible of the firm's basic and current operating documentation available at the recovery site. Copies of policy and procedure manuals, human resource files and archives or inventories of closed files, should, as far as possible, be maintained off-site for use during the recovery process. If the answers to question 3 and one of the choices of questions 4 and 5 are *yes*, these items have been adequately addressed in the plan.

### *Questions 6 and 7*

Where original documents are most safely stored is a matter for the firm to determine. At the very least, an inventory of such documents should be maintained in case of destruction of the documents themselves, and a current copy of the inventory should be kept off-site, if relevant at the preselected recovery site (because the status of the originals will undoubtedly be a cause for concern following a disaster). In addition, appropriate security measures need to be in place to protect the confidentiality of information, and there needs to be clearly defined policies and procedures for retrieval of data as needed. A *yes*, at least to all of the elements of questions 6 to 7*b*, but preferably also to question 7*a* is therefore a necessary element of a complete plan.

### *Question 8*

For the reasons outlined as to other materials, the answer to this question should be *yes*.

### *Question 9*

An element essential for effective continuity in any firm is billing and collection. Accordingly, the necessary backups both of current data and the appropriate software must be maintained off-site, preferably at the recovery site. A *no* answer to all of question 9 should be a source of serious concern.

## **E. RISK MANAGEMENT**

### *Questions 1 and 2*

Calendar control is a key component of standard risk management procedures that is most likely to be interrupted by a disaster. No system of backing up of computerized data (assuming your calendar control is computerized) is going to be sufficiently current to prevent some loss between the time of the last backup and the restarting of the system at the recovery site. Nevertheless, every effort should be made to keep this material backed up as currently as possible, with the backup copies available at the recovery site at the earliest possible moment. Noncomputerized calendar controls are going to be *much* harder to recreate, which is another example of a way in which the preparation of the recovery plan may prompt reconsideration of the wisdom or adequacy of current practices, regardless of whether a disaster will ever happen. Only a *yes* answer to question 1 and one of the choices for question 2, preferably 2*a*, should be acceptable.

### *Question 3*

The plan is intended to preserve as much as possible of the firm's practice in functioning order during the recovery process. Integral to success is continued adherence to the standards of practice and risk management that are the firm's norm. As appears from earlier answers, new client and engagement acceptance, billing practices, and calendar control are among the essential risk management components of any effective recovery program. Accordingly, the adequacy of the provisions for these and other risk management concerns should be reviewed by the partner or committee responsible for risk management before the plan is finalized and circulated. Although there is no similar requirement with respect to the firm's insurers, it will certainly impress them and may assist in future premium negotiations. They may also have some useful insights and suggestions for the next addition. Accordingly, a *yes* to question 3*a* is important, and may be very worthwhile to question 3*b* also.

*Question 4*

For all the reasons set out at the relevant places elsewhere in this crib sheet, the answers should be *yes* to all of the elements of this question and the notification should take place as quickly as possible.

*Question 5*

The plan should not simply be included in a package of materials handed to newly hired employees, but should be the subject of separate mention and emphasis and acknowledged as with every circulation and distribution. If it is not known to and understood by everyone, its usefulness is diluted. The answer should be *yes*.

*Question 6*

For all of the reasons set out in this crib sheet, *all* of the groups referred to in the choices of this question need to be included in the recovery team. Any *no* answers should suggest a weak point in the plan which should be remedied.





....The need to manage risk goes beyond the negative incentives to avoid claims and the loss of productive time.... It is also about positive values: *servicing clients better and making the firm more profitable*. Good risk management policies, systems and procedures focus on how to help firms achieve these positive ends and, in the process, avoid or at least substantially reduce the threat or fact of claims....

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