



You just never know what is going to happen when you get in front of a judge. That is why most cases settle

If You Really Want to Reduce Your Exposure

Encourage your clients to follow the SEC's rules requiring that audit committees be established for all public companies, even if your client is not a public company.

When it comes to mitigating risk of malpractice, one of the most significant steps that can be taken is establishing a regular and formal communication mechanism with the Board of Directors. There is a natural hesitancy for an auditor to impose himself on the Board of Directors. On the other hand, the auditor should be hesitant to communicate with an audit committee. If your client does not have an audit committee, recommend that one be established. The establishment of an audit committee can provide a great formal mechanism for the auditor to maintain ongoing communications with the Board of Directors.

While recognizing that there are professional standards, which give guidelines regarding the auditor's responsibilities as they relate to communicating with the audit committee, it is prudent to view AU Section 380 as the minimum standards for communicating with a client. And even though AU Section 9380 limits those to whom a practitioner must report to, it is in the best interest of the practitioner to keep those who sit in an oversight position informed and apprised of the auditor's concerns. No board likes to be surprised when something goes awry. We have seen that when something does go awry (particularly when it happens quickly), auditors get sued. Because of the belief that accountants should have forewarned those in the oversight position and the further belief that auditors have deep pockets, they are usually dragged into a lawsuit.

Sometimes they are dragged into the suit simply to create pressure and create more costs for other defendants. However, the more the Board (through the audit committee) is informed of the difficulties being experienced by the company, the less likely it will be that the auditor will be dragged into a lawsuit.

One basic truth about human nature must be remembered: when events turn sour, people often go through emotional stages of denial and desperation before coming to grips with reality. A group of officers in a company that is experiencing trouble are not the most objective observers.

An auditor cannot rely on management to be properly representing the whole truth about a situation to board members who may have financial, emotional and reputational stakes themselves in the outcome of the company. One of the answers to this dilemma is to encourage your client to set up an audit committee with at least one independent person on it. We believe that for higher risk engagements, this type of set up is a must.