THE PITFALLS OF AN IMPRECISE ENGAGEMENT LETTER

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Recent New York cases illustrate how the failure to carefully consider the importance of an engagement letter for all aspects of client engagements can expose accountants to malpractice claims that otherwise would be untimely and barred by the statute of limitations.

In New York, a claim for accounting malpractice must be commenced within three years after the matter in question took place. The accrual period starts when the accountant's work product (e.g., a tax return or an audit opinion) is presented to the client regardless of whether the client is aware of any negligence at that time. However, New York's three-year statue of limitations may be extended in certain circumstances where the accountant has "continuously represented" that client.

New York's highest court, the Court of Appeals, recently held in the case *Williamson v. PricewaterhouseCoopers LLP* that the "continuous representation" doctrine did not apply when an audit client merely entered into annual engagements with the accounting firm for the provision of "separate and discrete audit services" for each audit year. A mere general "continuing professional relationship" between the plaintiff and its auditor, held the court, was not the same as "a course of representation as to the particular problems (conditions) that gave rise to the plaintiff's malpractice claim."

The court held that the continuous representation doctrine did not save the plaintiff's otherwise untimely audit failure claims because the plaintiff "entered into annual engagements with defendant for the provision of separate and discrete audit services for [its] year-end financial statements, and once defendant performed the services for a particular year, no further work as to that year was undertaken."

In *Apple Bank for Savings v. PricewaterhouseCoopers LLP*, the court applied the reasoning of the *Williams* decision but reached a different result in the context of the accountant's provision of tax services. In that case, PricewaterhouseCoopers audited the bank's year-end financial statements and prepared its annual income tax filings for the years 2000 through 2004. The bank commenced suit in October 2006, and PricewaterhouseCoopers moved to dismiss the claims as time-barred insofar as they were based on the services provided for the years 2000 through 2002. Following the holding of the *Williamson* case, the court dismissed the claims based on the audit services or the years 2000 through 2002 "because each was governed by a separate engagement letter and each engagement ended more than three years before Apple's

complaint was filed."

However, the court reached the opposite conclusion when it considered the tax preparation services. The letter memorializing the provision of tax services stated that they were "estimates of the professional fees for preparation of the federal, state, and local income tax returns…and review of the estimated tax declarations." Unlike the audit engagement letters, which expressly stated that additional services would be the subject of a separate written agreement, the tax services letters merely indicated that any additional services would be subject to an additional fee, suggesting to the court that additional services were contemplated.

The dangers of an imprecise engagement letter were further illustrated in *Tayebi v. KPMG LLP*. In that case, the engagement letter provided that KPMG would provide the following services regarding the plaintiffs' involvement in a tax advantaged investment: (1) "Meet with you to discuss the U.S. federal income tax implications associated with participation in their investment" and (2) "Provide client with an opinion letter that addresses the U.S. federal income tax consequences associated with participation in the investment program based upon your unique facts and circumstances." KPMG claimed that the action was barred by the statute of limitations because it was commenced more than three years after the delivery of the opinion letter. KPMG asserted that according to the engagement letter, KPMG's representation of the plaintiff terminated upon the delivery of the opinion letter.

The court, however, disagreed. It observed that the engagement letter noted that the law is "subject to change, retroactively and/or prospectively," and, therefore, "[u]nless you specifically engage us to do so in writing, we will not update our advice for subsequent changes or modifications to the law and regulations, or to the judicial and administrative interpretations thereof." Based on this language, it appeared to the court that "it was only as to updates about changes in the law and regulations that KPMG was excluding from its future services" and the language "hardly indicates an intent by KPMG to dissociate itself from plaintiffs'" future transactions.

These cases graphically illustrate that the nature and scope of the engagement letter plays a key role in determining whether the parties contemplated continuous representation. Accordingly, it is important to confirm all professional services in a carefully considered engagement letter signed by the client every year. We would be pleased to consult with you when you are in doubt about the manner to properly confirm an engagement or the risk management potential of an engagement letter.