



# Practical Guide to CPA Risk Management

Presented by:

Bill Thompson, CPA RPLU

CPA Mutual RRG

Gainesville, FL

**CPA Mutual**<sup>®</sup>

INSURANCE COMPANY  
OF AMERICA  
RISK RETENTION GROUP

Providing Services to CPAs by CPAs Since 1987

# Practical Guide to CPA Risk Management

*“I don’t give anyone advice only my opinion”*

*John Wooden*

# Practical Guide to CPA Risk Management

## Post Enron

- CPAs in the cross hairs
- Regulatory Environment
- Legal System
  - Increase in litigation and settlement cost
  - Fewer motions granted for summary judgment
  - Impartial juries?
- Current Economic Climate

# Practical **Guide to CPA Risk Management**

What risks/cost are you trying to manage?

- Professional and firm reputation
- Money
- Insurability
- Time

# Practical Guide to CPA Risk Management

## Money

Claim Stats (05/19/2014)	Total Pd and Incurred		Number of claims/Incidents		Average
Acct Services	\$ 9,498,482	5.73%	316	14.11%	\$ 30,058
Audits	\$ 81,150,117	48.96%	506	22.60%	\$ 160,376
Business Advice	\$ 954,961	0.58%	55	2.46%	\$ 17,363
Compilations	\$ 7,764,537	4.68%	116	5.18%	\$ 66,936
Data Processing	\$ 404,396	0.24%	21	0.94%	\$ 19,257
Entertainment	\$ 865,000	0.52%	2	0.09%	\$ 432,500
Fiduciary	\$ 2,926,569	1.77%	63	2.81%	\$ 46,453
Investment Advice	\$ 6,511,807	3.93%	59	2.64%	\$ 110,370
Litigation Support	\$ 918,736	0.55%	45	2.01%	\$ 20,416
MAS	\$ 2,900,468	1.75%	21	0.94%	\$ 138,118
Reviews	\$ 10,658,092	6.43%	95	4.24%	\$ 112,190
SEC	\$ 5,654,801	3.41%	27	1.21%	\$ 209,437
Tax	\$ 35,525,179	21.44%	913	40.78%	\$ 38,910
<b>Totals</b>	<b>\$165,733,144</b>		<b>2,239</b>		<b>\$ 74,021</b>

# Practical Guide to CPA Risk Management

## Money

<u>Audit:</u>	Total Paid and Incurred	Paid Percentage	Claims/Incidents	Claim Percentage
A/R	\$ 1,221,675	1.5%	13	2.6%
GAAP Dept	\$ 922,033	1.1%	9	1.8%
GAAS Dept	\$ 4,583,738	5.6%	31	6.1%
Failure to detect going concern	\$ 36,639,719	45.2%	124	24.5%
imp inv eval	\$ 2,498,321	3.1%	14	2.8%
other	\$ 17,218,878	21.2%	198	39.1%
% of Completion	\$ 88,213	0.1%	1	0.2%
Related Party	\$ 2,685,087	3.3%	8	1.6%
Und/Over Liab	\$ 12,759,614	15.7%	87	17.2%
<b>TOTAL</b>	<b>\$ 81,150,118</b>		<b>506</b>	

# Practical Guide to CPA Risk Management

## Case Study #1: Wolf in Sheep's Clothing

- Claim Report Date – 09/02/1994 Claim Closed Date – 03/06/1999
- Policy Limit - \$3,000,000                      Paid: \$3,219,802
- Audit Failure-Embezzlement/Bankruptcy
- Lesson Learned:
  - Change up/vary audit procedures;
  - Recommendations should be in writing; and
  - Be extremely careful with your audit workpapers

# Practical Guide to CPA Risk Management

## Case Study #2: DotCom Bust

- Claim Report Date – 03/12/2001 Claim Closed Date – 03/30/2004
- Policy Limit - \$5,000,000                      Paid: \$5,478,528 (plus \$400k)
- Audit Failure/Bankruptcy
- Lesson Learned
  - Qualification of partner in charge of audit – Tax Partner; and
  - Client retention – influential client but overly demanding



# Practical Guide to CPA Risk Management

## Money

Tax	Total Paid and Incured	Paid Percentage	Claims/ Incidents	Claim Percentage
Improper advice	\$6,497,618	18.3%	104	11.4%
Business Other	\$3,677,567	10.4%	160	17.5%
Business Prep Errors	\$5,379,878	15.1%	124	13.6%
S Corp Errors	\$856,437	2.4%	39	4.3%
Timely Filing Errors	\$1,034,579	2.9%	37	4.1%
Pers-Estate Tax	\$4,508,784	12.7%	87	9.5%
Pers - Imp Advice	\$4,938,381	13.9%	88	9.6%
Pers - Other	\$3,588,300	10.1%	94	10.3%
Pers Prep Errors	\$3,137,116	8.8%	123	13.5%
Pers - Timely Filing	\$1,906,518	5.4%	57	6.2%
	<b>\$ 35,525,178</b>		<b>913</b>	

# Practical Guide to CPA Risk Management

## TAX CLAIMS

- Improper or insufficient advice on §1031 exchanges
- Improper or insufficient advice on estate tax planning and late 706 filing
- Failure to advise on additional state filing obligations
- Improper or insufficient advice on §475 elections
- Missed credits/deductions after statute of limitations expires

# Practical Guide to CPA Risk Management

## Case Study #3: Better Late than Never?

- Claim Report Date – 09/05/2008 Claim Closed Date – 11/05/2010
- Policy Limit - \$4,000,000                      Paid: \$1,210,644
- Estate Tax Return
- Lesson Learned:  
    Engagement acceptance

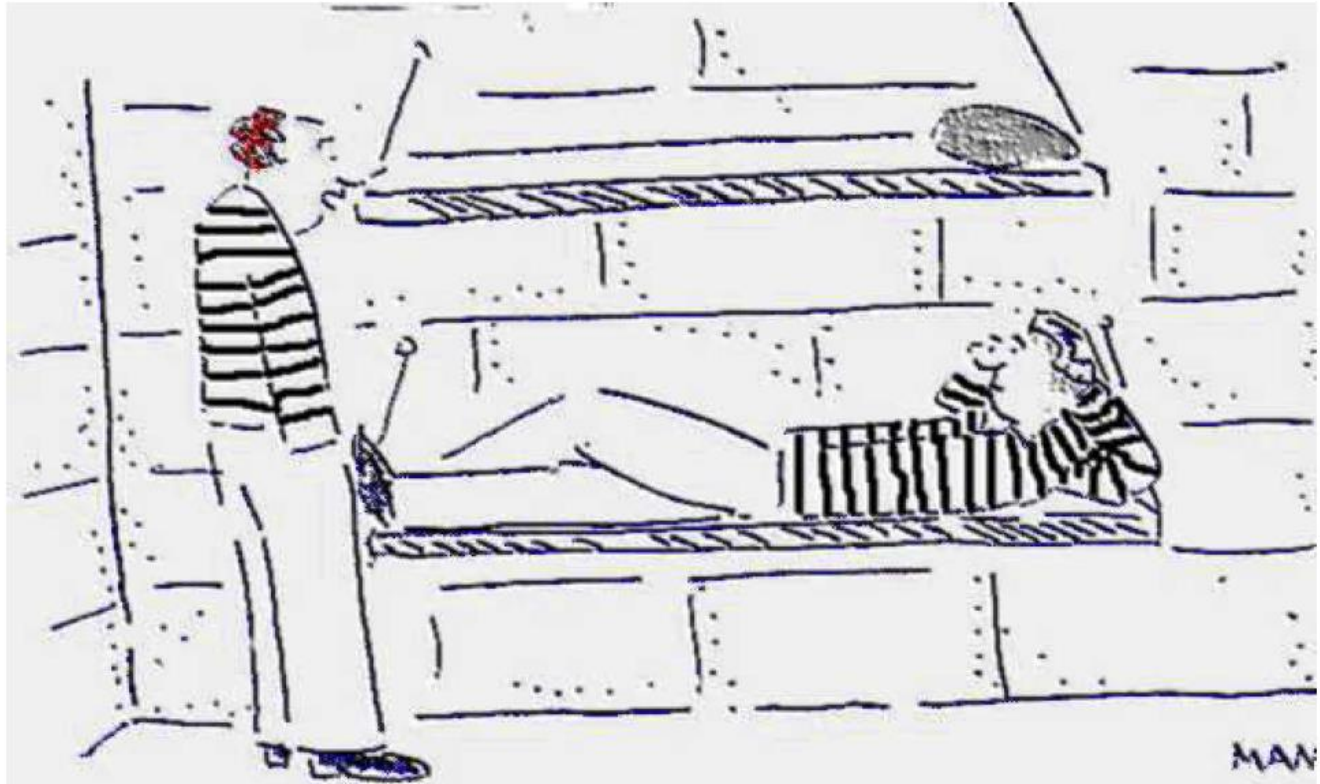
# Practical Guide to CPA Risk Management

## Case Study #4: Take the Fifth

- Claim Report Date – 03/26/2004 Claim Closed Date – 07/21/2010
- Policy Limit - \$2,000,000                      Paid: \$1,990,833
- Tax Planning - §1031
- Lesson Learned:  
    Stay clear of “off the cuff” advice

# Practical **Guide to CPA Risk Management**

## Professional and Firm reputation



The long and short of it was that generally accepted accounting principles weren't as generally accepted as I thought.



# POLL

# **Practical Guide to CPA Risk Management**

## **KEYS TO REDUCE RISK EXPOSURE**

- **CLIENT SELECTION**
- **CLIENT RETENTION**
- **COMMUNICATION**

# Practical Guide to CPA Risk Management

What can you do to help reduce problem clients?

- Screen all Clients
  - Background checks
  - Credit reports
  - Criminal reports and DMV reports
  - Prior auditor inquiries
- Identify problem clients early:
  - Ask careful thorough questions
  - Be wary of fee resistance
  - Be wary of advice resistance
  - Trust Your Gut
  - Trust Your Staff



# Practical Guide to CPA Risk Management

## Case Study #5: Should have know better

- Claim Report Date – 07/05/2006 Claim Closed Date – 11/07/2008
- Policy Limit - \$1,000,000                      Paid: \$90,576
- Deductible - \$10,000
- Compilation and Tax - Embezzlement
- Lesson Learned:
  - CLIENT ACCEPTANCE
  - Have a clear engagement letter outlining terms of engagement and stick to it – get everything regarding the engagement in writing.

# Practical Guide to CPA Risk Management

What can you do to help reduce problem clients?

- Adopt client retention and acceptance policies and test your compliance – Rank your Clients
- Receive adequate fees for the risk assumed!
- Monitor client specific industries and be aware of changes in economic cycle
- Provide for easy access to legal counsel – assign “gate keeper”
- INDEPENDENCE/do not become an advocate
- Avoid complacency

# Practical Guide to CPA Risk Management

## Case Study #6: Piece of Cake

- Claim Report Date – 09/20/1995 Claim Closed Date – 10/01/1998
- Policy Limit - \$2,000,000                      Paid: \$1,947,720
- Deductible - \$25,000
- Audit - Fraud
- Lesson Learned:  
    Perform adequate due diligence prior to accepting new client.  
    Do not become so complacent you lose your professional skepticism.

# Practical Guide to CPA Risk Management

Other Risk factors to consider relating to operating characteristics and financial stability – Identify Problem Clients

- Significant capital requirements
- Financials contain significant estimates involving highly subjective judgments or are subject to change in near term
- High vulnerability to rapidly changing technology
- High dependency on debt
- Unusually rapid growth
- Executive Compensation tied directly to operating results

# Practical Guide to CPA Risk Management

## *KPMG Study – Analysis of Global Patterns of Fraud*

### Typical Fraudster –

- 36-45 yr old male
- Works in finance or finance related role
- Holds senior mgt position
- Employee of Company for >10 years
- Does not work alone
- Average time to detect fraud in 2011 is 3.4 years

### Motivational Factors -

- Greed
- Trying to meet company goals

# Practical Guide to CPA Risk Management

## What Happens to Fraudsters?

- 51% are Prosecuted
- 98% Prosecuted are Convicted
- 31% of Those Convicted Are Sent to Jail
- 11% spend more than 1 year in Jail

# Practical Guide to CPA Risk Management

What Else can you Do?

- Professional Practices Dept
- Revise partner compensation
- Communication:
  - Internal
  - External

# Practical Guide to CPA Risk Management

## 3<sup>rd</sup> Party Communication

- Best policy is to refuse to provide them
- Request client send directly to 3<sup>rd</sup> party
- Obtain written permission from client before disclosure



# Practical Guide to CPA Risk Management

## Communication; The Role of the Engagement Letter:

- Describes the scope of work to be done
- Explains limitations on the accountant's work
- Defines the client's responsibilities
- Describes fee arrangements and payment terms
- Satisfies professional standards
- Helps protect the accountant from unwarranted litigation
- Communicates in plain English!

# Practical Guide to CPA Risk Management

## Engagement Letters and Lessons Learned:

- *Avoid engagement creep (or de-creep)*
- *Be very careful when coding time*
- *Familiarity breeds complacency*
- *Communicate ALL issues in writing*
- *Consider who signs the engagement letter*
- *Consider who receives the engagement letter*

# Practical Guide to CPA Risk Management

## OTHER TIPS FOR DRAFTING ENGAGEMENT LETTERS

- Involve Legal Counsel in Developing Engagement Letters
- Periodically Evaluate any Changes in the Law Governing Engagement Letters
- Ask your Malpractice Carrier
  - Subpoena coverage clause
  - Limitation of liability and Indemnification agreements
  - “Stop Work” Clause
  - Choice of Venue
  - Foreign Transactions

# **Practical Guide to CPA Risk Management**

## **Engagement Letters**

### **Subpoena Coverage Clause:**

In the event we are required to respond to a subpoena, court order or other legal process for the production of documents and/or testimony relative to information we obtained and/or prepared during the course of this engagement, you agree to compensate us at our hourly rates, as set forth above, for the time we expend in connection with such response, and to reimburse us for all of our out-of-pocket costs incurred in that regard.

# Protect Your Firm with Indemnification Clauses

You may ask yourself, "Do I really need to get this engagement letter signed?" That answer is an emphatic, "Yes!" Read on. In case you hadn't heard, Grant Thornton won a \$700,000 settlement from a former client. It seems this client wanted to blame Grant Thornton for its own failure. The client did this after lying to the auditors about internal problems that were previously noted by regulators.

How did Thornton prevail? The firm had inserted an indemnification clause in its engagement letter. The clause stated that if the client made any false representations to Grant Thornton, the client would be responsible for paying legal fees should a suit arise. This was a great idea that now has paid off in court.

Gary H. Barnes, who has been a defense counsel for CPA Mutual since inception of the company, recommends using the following sentence in the paragraph of your engagement letter that describes client responsibilities:

*[Client] hereby promises that it will make every diligent effort to maintain proper books and records that accurately reflect its business activities, that it will be completely truthful with [audit firm] and that [audit firm] may rely upon both oral and written statements and responses to questions. [Client] further promises to immediately advise [audit firm] if it becomes aware of any inaccuracy in its record-keeping or dishonesty in any of its business dealings, including its statements to [audit firm]. [Client] acknowledges that the promises are the cornerstone of its relationship with [Audit Firm], are made to induce [Audit Firm] to accept this audit engagement, and that [Audit firm] would not accept this audit engagement without such promises.*

The SEC and some states forbid the use of indemnity clauses in engagement letters, but there is no prohibition about spelling out client responsibilities in a way (as above) that might allow the audit firm to later hold the client accountable for breaking its promises. In any event, laws vary from state to state, so it would be wise for you to consult with your firm's counsel in your state.

Barnes also offers the following indemnity clauses that may help limit your firm's exposure to lawsuits. However, keep in mind that the use of some indemnification clauses may be prohibited by certain federal, state and/or local regulations applicable to your engagement. Further, some indemnity language appropriate for nonattest services may not be appropriate for attest services because of the accountant's duty to remain independent or other applicable professional regulations. Before selecting which indemnification clause is right for you, we recommend you consult with your firm's counsel in your state.

---

## **Suggested Limitation of Liability Clauses for Engagement Letters:**

### **Damages Limited to Lesser of Actual Damages for Fees Paid**

By signing this Engagement Letter, you agree that our liability arising from this engagement shall be limited to the lesser of any actual damages which may have been caused by our acts or omissions, or the amount of the fees which you pay for our services.

### **Damages Limited to Liquidated Damages Only**

By signing this Engagement Letter, you agree that our liability arising from this engagement shall be limited to no more than \_\_\_ % of the fees which you pay us for the performance of this engagement.

### **Limit Damages by Referral to Arbitration**

By Signing this Engagement Letter, you agree to submit any dispute concerning the quality or timeliness of our services to final and binding arbitration conducted under The Rules of the American Arbitration Association which pertains to the resolution of claims against accountants. The arbitrator shall have the authority to award compensatory damages, but only for such damages as found to have been directly and solely caused by acts, errors, or omissions committed in violation of our professional duties. The arbitrator (or one of the arbitrators) shall be a certified public accountant with at least \_\_\_\_\_ years of experience in public accountancy.

## **Indemnity for Defense Costs In Engagement Letters:**

### **"Loser Pays" Agreement**

Should Suit be brought concerning the quality or timeliness of our performance of services in this engagement, it is agreed that the party who prevails shall be entitled to recover its attorney fees. If plaintiff is awarded judgment greater than the largest offer of settlement made within \_\_\_ days after the service of suit, plaintiff shall be deemed to have prevailed. Otherwise, defendant shall be deemed to have prevailed.

### **Agreement To Pay Defense Costs – Breach of Agreement Not To Sue**

By signing and returning a copy of this Engagement Letter, the undersigned client agrees that any issued concerning the quality or timeliness of the work in this engagement shall not form the basis for legal action, and agrees not to bring suit. Should suit be brought in violation of this agreement, the undersigned client agrees to pay the legal fees incurred in the defense of such action.

### **Agreement to Pay Defense Legal Costs-No Prohibition Against Suit**

In addition to the fees for services described in this Engagement Letter, the undersigned client agrees to pay an amount equal to any and all legal fees incurred by this firm in connection with this engagement, including (by way of illustration and not limitation) legal fees incurred for advice on any issued relating to this engagement; incurred in connection with any suit to recover the fees due for this engagement; incurred by this firm in responding to any subpoenas or other legal process relating to this engagement; and incurred in the defense of any action brought against this firm.

---

*This publication is the sole and exclusive property of CPA Mutual Insurance Company of America and cannot be reprinted with the express permission of CPA Mutual.*

# Practical Guide to CPA Risk Management

## Case Study #7: One for the Good Guys

- Claim Report Date – 06/01/2005 Claim Closed Date – 06/29/2006
- Policy Limit - \$5,000,000                      Paid: \$-0-
- Deductible - \$100,000
- Review and Tax services- Embezzlement
- Lesson Learned:  
    Adding loss limiting language to your engagement letter might actually help you defend a claim.



# POLL

# Practical Guide to CPA Risk Management

What I worry about?

- Estate tax returns – Trustee Engagements
- Bankruptcy Trustees
- New legal theories: i.e. “Deeping Insolvency”
- Affordable Care Act – Obamacare
- “kids” doing audits
- Electronic Discovery/Digital Files



# Practical Guide to CPA Risk Management

## Case Study #8: Throw in the Towel

- Claim Report Date – 05/26/2005 Claim Closed Date – 06/29/2007
- Policy Limit - \$1,000,000                      Paid: \$86,047
- Deductible - \$5,000
- Audits – Failure to detect Embezzlement
- Lesson Learned:  
Make sure engagement is adequately staffed and supervised.

# Practical Guide to CPA Risk Management

## Defense Nightmares!

- Experience/Supervision

# Practical Guide to CPA Risk Management

## Defense Nightmares!

- Experience/Supervision
- IM: “hey dude...the senior running this job is an idiot! Lol 😊”



# Practical Guide to CPA Risk Management

What I worry about?

- Estate tax returns – Trustee Engagements
- Bankruptcy Trustees
- New legal theories: i.e. “Deeping Insolvency”
- Affordable Care Act – Obamacare
- “kids” doing audits
- Electronic Discovery/Digital Files


# Practical Guide to CPA Risk Management

## Data Storage Math

- 1 bit = 0 or 1
- 1 Byte = 8 bits
- 1 Megabyte (MB) = 1,000 Bytes  $\approx$  500 typed pages of text
- 7 Megabytes  $\approx$  3,500 typed pages  $\approx$  1 bankers box
- 1 Gigabyte (GB) = 1,000,000 Bytes  $\approx$  143 cardboard boxes

# Practical Guide to CPA Risk Management

Data Storage Math (Con't)		
Device	Capacity	Boxes
Laptop Hard Drive	40 GB	5,714
DVD	4.7 GB	671
CD	700 MB	100
Camera Card	1 GB	143
Thumb Drive	2 GB	286
USB Watch	256 MB	36
USB Knife	256 MB	36
USB Pen	512 MB	72
iPod	4 GB	571
Web Storage (i.e. AOL)	<u>2 GB</u>	<u>285</u>
<b>Total</b>	<b>55.424 GB</b>	<b>7,914</b>

 Weiser | Weiser LLP *Enterprising Minds*

3

# Practical Guide to CPA Risk Management

## Metadata - Overview

*You're invisible now, you got no secrets to conceal.*

Bob Dylan, "Like A Rolling Stone." © 1965, 1993 Special Rider Music

- Electronic documents contain embedded information
- Some information is visible, some ("metadata") is not
- Recoverable metadata include:
  - Author(s) name(s)
  - File Creation date and time
  - Last print date and time
  - Total Editing Time
  - Track changes
  - Hidden text

# Practical Guide to CPA Risk Management

## WRAP UP

- CLIENT SELECTION
- CLIENT RETENTION
- COMMUNICATION
- BE PRO-ACTIVE



# Practical Guide to CPA Risk Management

## QUESTIONS AND COMMENTS

Contact Information:

Bill Thompson

wthompson@cpamutual.com

800-543-3029

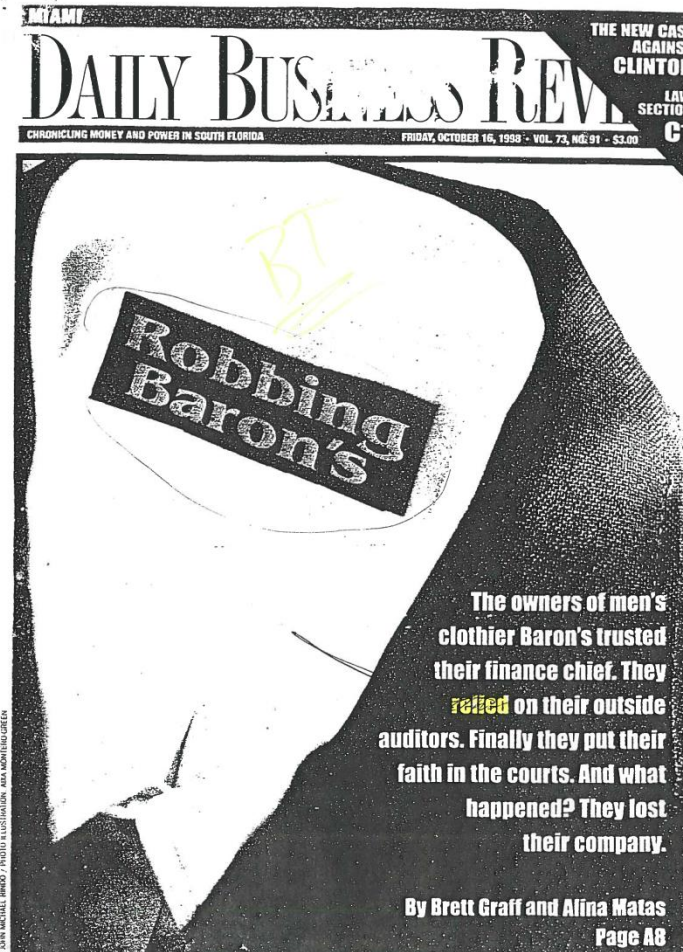
www.cpa mutual.com

# Practical Guide to CPA Risk Management

## Recent Headlines:

- “Ater Wynne law firm, Perkins & Co. accounting firm pay \$14.65 million to settle lawsuit from burned Grifphon investors”
- “Rihanna, Ex-Accountants Settle Action Over 'Ill-Gotten' Fees”
- “Accounting Class Actions Kept Steady Pace in 2013, Could Rise”
- “Calif. CPA Accused Of Falsifying Tax Returns On \$28M Sale”
- “Cohen Milstein Sellers & Toll PLLC Announces the Investigation of ChinaCast Education Corporation”
- “Bankrupt Retailer Sues Rose Snyder Over \$2.9M Tax Refund ”
- “Vancouver accountant accused of embezzling \$1M from criminal justice non-profit pleads guilty to fraud”

# Practical Guide to CPA Risk Management





THE CLOTHERS: Meryl and Norman Lanson owned menswear chain Barons of Fort Lauderdale, but lost it to a bidder in bankruptcy court. They are galled that the bidder is a longtime friend, and blame the loss on auditors' failing to discover embezzlement by their controller.

*NOT what he said when he sued us!*

### III-SU

The couple who owned and lost the auditors and lawyers —

By BRETT GRAFF AND ALINA MATAS  
Review Staff

Over a cordial lunch one afternoon at a Japanese restaurant in North Miami Beach, Meryl and Norman Lanson, then-owners of the men's clothing chain Barons, shared an idea with the company's accountant and outside auditor.

The Lansons were expecting a child, and told they were thinking of asking David Peterson, the company's controller, to be the godfather.

What a great idea, responded Peterson. It was, he says, a happy conversation. There's little chance the Lansons will ever lunch together again. And no chance the Lansons will confer on Peterson any more family honors.

Today, the child is 7 years old. Peterson is on no parole after serving 18 months for embezzling almost \$3 million from Fort Lauderdale-based Barons' accounting firm — the well-known practice of

— recently settled for \$2.4 million a professional negligence suit filed by the clothes.

And after 15 years, the Lansons no longer own Barons'.

"We lost everything," says Meryl Lanson. "Everything is changed."

What's wrong? To the Lansons the answer is simple: "Cobble was looking out for us," says Meryl Lanson, an outgoing and engaging 45-year-old who considers herself and her husband to be the victims of several villains — their one-time friend Peterson for stealing money and bleeding their company to death; their accountants for not catching him; and, most recently, their attorney, not getting them enough money from their former auditors to enable them to keep their company.

It's true that the story of how the Lansons lost the family business, once one of Florida's most successful retail chains, involves thievery and broken trust. But it's also a cautionary tale for business owners. "None of that," says the Lansons' former attorney Ronald Kopplov, "relieves the owner of the business of the responsibility to do what he needs to do to safeguard his own business."

#### The beginning

The story begins in 1980. That's when Peterson, a former shoe store owner and one-time staff accountant, moved to South Florida from Atlantic City, N.J., and joined Lanson's Stores Inc., a men's clothing chain started by the Lanson family in the early 1960s. In 1983, Lanson bought Barons' Stores, and Peterson became the controller for both chains. Some three years later, a family squabble led to a split of the two stores, and Norman Lanson remained the owner of Barons, with Peterson as controller.

Times were good then. Barons had 16 stores throughout Florida generating \$20 million in annual sales. At the company's heyday, Norman Lanson drew a \$4,000 weekly salary as president. Meryl Lanson charged \$7,000 wardrobe shopping sprees on the company's credit card. They belonged in the country club on Williams Island in Aventura. They traveled extensively, and felt confident about leaving the company in Peterson's hands.

"He was the best," says Meryl Lanson. "When too was living well, accordingly well for a \$150,000 a year controller. He lived in a waterfront house in Parkettes in Fort Lauderdale that had a \$10,000 month-

## ited arrangements

Baron's menswear chain blame years of embezzlement and the actions who say the owners could have done more to help themselves

*If making this much my work*

### COVER STORY

ly mortgage. He kept another house in Atlantic City, for which he paid \$7,250 a month. The Lansons chalked up his lifestyle to a side business, a beauty parlor he co-owned. As it turned out, however, it was Baron's that was paying for his lifestyle. Peterson wrote checks to himself from Baron's payroll accounts every month. Every month, that is, except for two: September and October. Those were the two months that requested every year when it set out to audit Baron's.

— named Baron's as a training ground for their newest people, and I knew it," recalls Peterson, 52, who these days works as a waiter at a Broward Morrison's cafeteria.

#### Timing the theft

Peterson would write checks to himself from the payroll account, always in amounts smaller than \$10,000. He wouldn't record the checks on that account. Instead, he would record expenses in other accounts, such as advertising. When the bank statements arrived, he would throw out the sheet that listed the checks written that month because it showed checks made out to him. But he was always sure not to steal money in September and October, because those were the months the auditors requested.

Peterson's total payments to himself varied each year. In 1992, he embezzled \$344,397. By the end of 1993, he had helped himself to a total of almost \$3 million.

In December 1993, everything unraveled. During the audit, a young accountant asked for the November paperwork. Peterson knew he had stolen that month.

"I was looking for that a few days ago," he told her. "I couldn't find it." He gave her the paperwork for another month, one in which he knew he hadn't stolen any money.

"I was waiting for her to tell a supervisor. Who would have told her. Oh, so. We need that. Call the bank and get it," Peterson says today. "But she didn't."

"It didn't matter. Unbeknownst to Peterson, the flags had already been raised by the company's banker the day before. While getting ready to leave home for a meeting at her son's preschool, Meryl Lanson got a call from her banker at BankAtlantic.

He told her the bank had gotten a check back because Peterson had forgotten to endorse it. More important, the banker said, he had checked other payments in the account and found numerous other checks made to Peterson. One was for \$7,250.

"I automatically knew he didn't make \$7,250 a week," Meryl Lanson recalls. "I was out of my mind."

— Say later, the auditor asked to see the statements for the whole year. That night Peterson was arrested. Eventually he admitted to the embezzlement, and the company re-

covered about \$250,000. had to be blind," Peterson says of the accounting firm. "If they had stuck to the most fundamental guidelines of auditing, they would have caught this."

Who was at fault, or the Lansons, became the key issue in the bitter legal fight that ensued between Baron's and

#### Exchanging blame

The Lansons believe that if their outside auditors were doing their job, they should have detected the embezzlement.

In their suit, Baron's alleged that Peterson relied on Peterson's assistance for its audits, instead of relying on independent records. The firm audited only payments journals and general ledgers, and reviewed only selected expense accounts, allowing Peterson to know which accounts he could falsify. They also claimed the accounting firm didn't do enough tests, didn't document shortcomings in Baron's internal controls, and didn't supervise the employees doing the audits.

Peterson says that to conceal his theft he went out of his way to make the auditors' job as easy as possible. "This audit was a piece of cake for me," he says.

For his part, Peterson called Galbraith to his assessment of Peterson's embezzlement. What Peterson got

*How'd he know*

*Mathematically. Explain this to BSVR*

THE AUDITOR: ... of Miami's company's performance saying the Lansons should have taken more precautions at Barons'. Nevertheless, ... settled the Lansons' professional malpractice suit for \$2.4 million.



See BARON'S, Page A10

## Baron's

From Page A9

away with, he says, was the Lanson's fault for not being more skeptical about his affluent lifestyle.

And his lawyers say their audits were properly performed and conformed with Generally Accepted Accounting Principles for the type of business that Baron's was.

There was nothing wrong, he says, in reviewing the same two months every year because the Baron's audits were meant to certify the accuracy of the company's balance sheet for the bank. In addition, he says, the auditors always conducted a random review of checks issued during the year. It is standard practice for auditors to have a threshold amount for the checks to be reviewed.

Baron's books, he says, were reviewed by a combination of junior employees supervised by more experienced auditors. They performed according to accepted training and standards, he says. Audits to detect fraud are planned only when the accountants have reason for something in particular or when there are outside shareholders.

"They don't teach you in school how to audit a chief," he says.

More important, he says, the Lanson never told him that Peterson had a key to the check-writing machine. Assuming he didn't have a key and that



**THE ATTORNEY:** Ronald Kopplov, as the Lanson's attorney, advised them to accept a settlement on excess of \$2 million. In April, they signed the agreement, but in July they complained to the Florida Bar that he hadn't represented their interests.

Norman Lanson was writing the checks, the accountants believed Peterson was virtually unable to commit fraud.

Nonetheless, he says something did catch his attention, and every year he'd bring it up with Norman Lanson. "I'd tell him, 'Mr. Lanson, your gross profit is not what it should be. Why are your expenses so high?'"

says Norman Lanson would get "defensive" and respond that he and Peterson had closely reviewed the expenses and there was no fat to be eliminated.

Responds Norman Lanson: "He's a liar."

### Business practices

Indeed, finger-pointing and name-calling were rampant during the litigation. Attorneys for Lanson began digging for faults in the way the Baron did business: They didn't safe-

guard the check-writing machine key; didn't double-check-bank statements themselves and ask questions; and didn't look into their chief financial officer's lifestyle.

At times, the search for evidence got plain nasty, as when the auditors attorneys tried to suggest that Peterson might have been colluding with Meryl Lanson.

During the deposition of Baron's assistant controller Deborah Ladino, attorney Steven Eisenberg, representing Peterson, asked whether she had heard that Peterson had falsified the Lanson's son's "Seminole" signature. Ladino said: "You have to say that again."

Eisenberg repeated the question. "No," Ladino answered.

Ronald Kopplov, who was Baron's attorney, told Eisenberg the question was insulting. Eisenberg replied: "I don't make this stuff up, pal."

Meryl Lanson doesn't dispute that she and Peterson were close. After all, he was their son's godfather, and Peterson and Meryl Lanson often would go shopping together.

"Only somebody very close to you can do something like this," she says. But she adds, to insinuate that there was something beyond friendship between her and Peterson was an indication of weakness in her case.

"They had no other defense," she says. "They want to wear you down so you throw your hands up and say, 'I give up.' Peterson, what says he is gay, says the same thing in court."

the rumor was fabricated by his former boyfriend: "Meryl Lanson was a very elegant, refined woman."

### Blaming the accountants

Attorneys for evidence against Peterson. They thought they struck gold when, looking through boxes of paper work provided by Peterson, they came across a sheet titled "Items to be Returned From Baron's Workbooks."

The sheet apparently had instructions that certain documents be removed from the files to be handed over to Baron's as part of the discovery process, the pretrial exchange of potential evidence by opposing parties. Impeding discovery is illegal.

But the sheet instructed an unnamed person to change references to conversations between the accountants and Peterson as if they had been held with Norman Lanson instead. Typed on the page was this comment: "The question of [Peterson's] integrity and consequently the validity of his explanations will be the subject of inquiry in litigation."

Baron's attorney Kopplov believed he had a smoking gun. The sheet seemed to be evidence that Peterson wanted to cover up how he had conducted Baron's audits and that the auditors recognized that they had relied excessively on Peterson.

"I had them on the defensive," he says. "I had them on the defensive," he says. "That was good for Baron's, consider-

ing the case had become even more critical to the company's survival.

In September 1997, Baron's voluntarily sought bankruptcy court protection under Chapter 11 in the Broward Division of U.S. Bankruptcy Court.

### Creditors watch

The Lanson blame the bankruptcy on the embezzlement, saying it eroded their cash flow, reduced their credit line and consequently their inventory, and ultimately lowered their sales. Witnesses for the company, however, said Baron's fell victim to stifler competition and bad management.

The company listed \$8.6 million in assets and \$3.3 million in liabilities. The assets included an estimated \$4 million from the expected outcome of the lawsuit against Peterson.

Now that the company was in Chapter 11, another group was closely following the lawsuit — its creditors.

Alan Glist, owner of clothing manufacturer Alan Start and a close friend of the Lanson, became chairman of the creditors committee. In persuading creditors to back the suit against the accounting firm, Kopplov pointed to the "smoking gun" sheet.

"We were hearing numbers to the tune of \$5 [million] to \$10 million," says Glist. Kopplov says he never led anyone to believe they could get that much money from Peterson.

Lawyer Richard E. Brodsky says there was no smoking gun. The items to be taken from the file contained "false" entries.

"I didn't want to share with a competitor," Kopplov says. "I didn't want to share with a competitor," Kopplov says. "I didn't want to share with a competitor," Kopplov says.

What's more, he says, the items removed were later put back and made available to creditors.

He filed a motion in March to remove the sheet as evidence. But the case was settled before the motion was heard.

The settlement was another bitter chapter for the Lanson. At a March 23 mediation meeting, Kopplov and his co-counsel Marc Cooper with the Florida Bar, claiming they didn't represent the Lanson's interests as individuals. Their main contention is that the attorneys did not name them as individual plaintiffs and pressed them to settle. The Lanson were angry because once the payout was determined, they learned they would get less than 9 percent of the settlement money.

Kopplov and Cooper maintain they did nothing wrong. Kopplov says the court and creditors developed in ways to allocate the money. He says he didn't name the Lanson as individual plaintiffs because Baron's, as a 100 percent owner, was the entity that had suffered the damage, and under the rules of professional malpractice litigation, money would be paid to the Lanson.

settled because it was in everyone's best interest. A jury could be persuaded that the Lanson did share responsibility for not keeping closer tabs on their books.

"Our goal," says Cooper, "was to bring the largest amount of money to give them the best possible shot at coming out of the bankruptcy."

Says Kopplov: "The question is, how much of that money embedded could you lay on?"

You come to a realization that there is a real possibility that you may not get more of that if you go to trial.

The final confirmation hearing in bankruptcy court, scheduled for next month — to approve the allocation of the proceeds of the company's sale — calls for the Lanson to get \$53,000 in cash, a 1995 Mercedes-Benz valued at \$22,000, and \$120,000 worth of their guarantees on company debt. Also, they will be paid

about 25 percent of two shareholder loans totaling \$220,000 they made for Baron's.

Other fees to be paid out: \$700,000 for Kopplov and his co-counsel, Cooper; \$110,000 for Baron's bankruptcy lawyer Sonya Saliks; \$110,000 for the creditors' attorneys.

By the time of the settlement, it was clear the Lanson had lost control of their company. Baron's creditors put the company up for bid in April, after deciding the \$2.4 million wouldn't be enough to reorganize it. Four offers came in. But finding out the name of the winning bidder felt like a kick in the teeth to the Lanson. It was B.A.R. Acquisition Corp., owned by Alan Glist, their longtime friend and the legal guardian of their son.

Glist resigned as chairman of the creditors committee, and days later bought the company for \$883,700, roughly 28 percent of the value of the chain's \$3.3 million in inventory.

While the Lanson say Glist betrayed them, he says he did what was necessary to keep the business from closing. "I don't know, the last thing I wanted to happen was for my relationship with Meryl and Norman to be damaged in any way," says Glist.

Their company goes, Norman Lanson, at 66, has started selling real estate for Coldwell Banker Residential Real Estate. Meryl Lanson says she's writing a book. But she says she's not ready to write a book about the events of the last few years.

The Lanson say they haven't spoken to Glist since he bought their company. They haven't spoken to Peterson since he went to prison; they're not speaking to Kopplov and, certainly, they're not speaking to Peterson.

"When the party's over," says Meryl Lanson, "everybody leaves."

Dear Valued Customer:

Effective immediately, your company's commercial account has been transferred to another bank for two coffee makers, a gift certificate to our favorite office supply store, and a fax machine to be named later. You should receive a Welcome Kit from your new bank shortly. Thank you for your years of loyal business. Good luck in the future.

# Is your business on the trading block?

The future of your business could be turned upside down overnight, without warning. And with it, all the confidence and comfort you developed in your banking relationship.

Colonial Bank is committed to establishing solid relationships with local business and comfort you developed in your banking relationship.

Free yourself of your worry and hassles of your big bank. Call (305) 523-3401 or visit one of our 17 South Florida locations and tell us what We Can Do for you.

professionals who know the marketplace and will provide you with fast turnaround, quick decisions and quality products. And that can mean the difference between your business prospering or merely pressing on.

Free yourself of your worry and hassles of your big bank. Call (305) 523-3401 or visit one of our 17 South Florida locations and tell us what We Can Do for you.

**COLONIAL BANK**

www.colonialbank.com

Member FDIC

## DIVERSIFY OVERSEAS

**T. Rowe Price International Stock Fund—performance potential plus diversification.** If you want to diversify for enhanced return potential with reduced risk, don't overlook international equity investing with T. Rowe Price.

Our International Stock Fund—one of the oldest and largest international no-load mutual funds—follows a prudent strategy of investing in the stocks of established companies outside the United States. It has proven itself over a period of up and down markets, in times of both a weak and a strong U.S. dollar. In fact, the fund received one of Morningstar's highest ratings—four stars—for its overall risk-adjusted performance. This rating reflects how well the fund has balanced returns with risk relative to 801, 348, and 103 international stock fund peers for the 3-, 5-, and 10-year periods ended 8/31/98, respectively.

Of course, international investing has special risks, including currency fluctuation. As with any stock fund, there will be price fluctuations. Past performance cannot guarantee future results. No sales charges.

Call 24 hours for your free investment kit including a prospectus

Invest With Confidence



The Best Real Estate Information on the Planet

100% No Load

For online services (305) 262-6236 or (800) 888-4120

### Superb Online Services

- ✓ Focused mortgage leads with phone numbers
- ✓ Full tax roll data in seconds
- ✓ All foreclosure information - now with owner phones
- ✓ Instant valuations
- ✓ Comparables before your competition
- ✓ 24 hour customer service - free training

### ISC PROLIST

- ✓ Daily new homeowner leads with phone numbers
- ✓ Professional reports and labels
- ✓ Faxed or mailed daily
- ✓ Online bulletin board transfer via modem
- ✓ Computer disks and tapes in all popular formats
- ✓ No PC? No time? No problem! Just call PROLIST

Items to be removed from workpapers

1. All review comments and points for next year's audit *Done*
2. Should fix up WP 2
3. Routing sheets
4. WP 5 - did we issue the reportable conditions letter? Its not in the file *No per TA*
5. Planning memo includes some vague procedures that we will be undertaking. May be subject to scrutiny in the event of litigation.
6. Client's letterhead and unnecessary correspondence -
7. Audit planning form contains indications that the control environment is adequate. However if the controls were functioning properly, we wouldn't have the reportable conditions that we found at WP5.
8. Rep letter is not signed by the former controller. *It was removed*
9. WP50-2 etc. Haphazardly choosing a sample is open to questioning in litigation. *Done*
10. 58 remove or revise explanation - alludes to non-GAAP accounting principle *Done*
11. Remove all audit programs. *Done*
12. 80-3 Audit work performed using unexecuted commitment for BNA line of credit. If its not necessary - take out of papers. *its not superfluous*
13. Maybe don't give them the p&I file also since the 1992 #'s weren't adjusted to perform the analytics. *she agreed*
14. There are various references in the papers to conversations with Mr. The question of his integrity and consequently the validity of his explanations will be the subject of inquiry in litigation.

*Waver*

*modified  
referred to  
conversations  
with  
Done*



February 9, 2001

MAR

5 2001

Mr. Kent Keeling  
CPA Mutual Insurance Company  
2831 NW 41 Street, Suite E  
Gainesville, FL 32606-6690

98077

Insured: [REDACTED] & Company, P.C.  
[REDACTED], CPA  
Claim No. CPA 980777  
Matter: [REDACTED], Inc.

Dear Kent:

Pursuant to our conversation yesterday, please find details of costs incurred in defending [REDACTED] & Company, P.C., and J. [REDACTED], CPA, in connection with the above referenced case. As you know, [REDACTED] Company, P.C., and [REDACTED], CPA, were completely exonerated of the allegations. Obviously, to obtain such a verdict required extensive time, cooperation and preparation of the lawyers and defendants. [REDACTED], P.C., incurred expenses and lost time described below.

Lost time/trial depositions/preparation:

[REDACTED]

101.0 hrs @	110.00	\$11,110.00
236.0 hrs @	90.00	21,240.00
50.0 hrs @	65.00	3,250.00
8.0 hrs @	60.00	480.00
21.5 hrs @	23.00	494.50
15.5 hrs @	30.00	465.00
1.0 hrs @	20.00	20.00
		<u>\$37,059.50</u>

Expenses:

Federal Express charges	\$510.59
Telephone	71.63
Travel expenses	265.65
Parking	70.00
Total Expenses	<u>\$917.87</u>

Total Lost Due to Litigation - \$37, 977.37.

# Practical Guide to CPA Risk Management

## *Insurability and Other Considerations*

- Limits
  - Per claim and aggregate
  - Noncumulation of limit provision
  - Prior Acts Date
  
- Deductibles
  - Per claim and aggregate
  - Defense
  - Indemnity



# Practical Guide to CPA Risk Management

## Insurability

POSTSCRIPT



*"You have a pretty good case, Mr. Pitkin.  
How much justice can you afford?"*

# Practical Guide to CPA Risk Management

“To be independent, **the auditor must be intellectually honest**; to be *recognized* as independent, he must be **free from any obligation to or interest in the client, its management, or its owners.**

\* \* \*

Independent auditors should not only be independent in fact, **they should avoid situations that may lead outsiders to doubt their independence.**”

**AU §220 - Independence**

In the Sky Box at  
the Super Bowl



Golf outing  
with the CEO  
and CFO

DATE

December 1991

30 S. Wacker Drive • Suite 1300  
Chicago Mercantile Exchange Building  
Chicago, Illinois 60605  
(312) 454-3027

ACCOUNT NUMBER

02129

Fed. Tax #03-0312496

COMMODITY TRADED

500 S&P Futures

Year End Statement

Scottsdale, AZ 85255

CONFIRMATION & STATEMENT

Net Results for the Year End of 1991

Net Profit/Loss	\$1,768,465.08
T. Bill Income (Acreation)	168,358.25
Other Income	2,773.56

Open Positions \$6,700,000.00 ✓ US T. Bills due March 19, 1992 — Market value —  
 Year End Segregated Account Balance \$115,405.31 *higher than est*

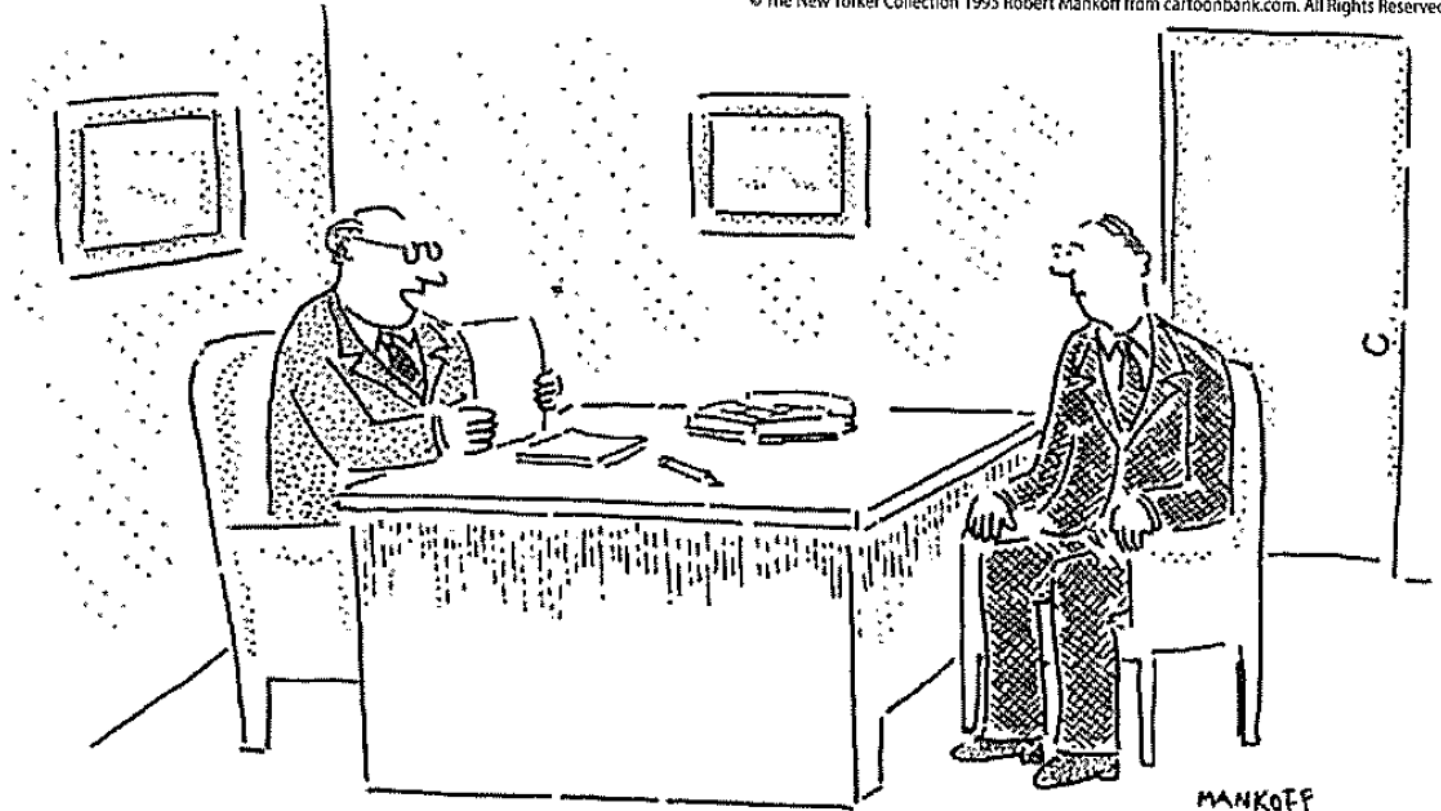
*✓ confirmed with [redacted] of [redacted]*

RETAIN FOR TAX RECORDS

TERMS AND CONDITIONS ON REVERSE SIDE

# Practical Guide to CPA Risk Management

© The New Yorker Collection 1995 Robert Mankoff from cartoonbank.com. All Rights Reserved.



*"I gotta tell ya, these embezzlement convictions raise a red flag."*



VEGAS 2012

# Practical Guide to CPA Risk Management

## Audit Team

	XYZ	Years in accounting	Years auditing Company X	% of time worked on Company X '96 audit	Comments
Partner	Partner	31	13	7.2%	Never saw a loan file at Company X
Manager	Partner	24	9		Never completed second partner function
	Senior	5	3	9.1%	Did not review '96 loan files
	[Staff-Member-In-Charge]	3	2	83.7%	Called away -- did no review
	Staff	2	21 months		Hired Jan 95
	Staff	1	0		Hired Sep 95
	Staff	0	0		Hired Summer 96