

## Engagement Letter Essentials

By Suzanne M. Holl, CPA

Engagement letters help CPA firms improve communication with clients, document engagements more effectively, and protect the firm from litigation. Letters should be as detailed as possible in describing the nature and extent of the services that the firm is being retained to perform, as well as the services that the firm is not being retained to perform.

Similarly, engagement letters should be as detailed as possible regarding the client's responsibilities and obligations that will facilitate the engagement (e.g., providing necessary documents and accurate information in a timely manner).

The following guidelines of do's and don'ts are provided to assist you in writing effective engagement letters.

### Engagement letters should...

- State the purpose of the engagement.
- Define the scope and limits of the engagement (specifically what the firm will and won't do).
- Specify known negative conditions or adverse situations.
- Note client instructions, responsibilities, deliverables and dates.
- Note reliance on facts provided by the client.
- Outline terms of fee collections and the consequences of late payment.
- Include a stop-work clause.
- Indicate the firm's record retention policy.
- Include third-party service provider language, if applicable.
- Confirm client's acknowledgement to the terms of the agreement and request client's signature.

### Additional considerations...

- Include warnings regarding inadequate internal controls.
- Explain limitations regarding financial statement distribution.
- Include alternative dispute resolution language (i.e., mediation for all disputes, and an arbitration clause for fee disputes only).
- Efficacy of limitation of liability clauses.

### Engagement letters should not include...

- **Marketing information.**

Defer promotional information and other forms of marketing to other documents. The engagement letter should be viewed as a contract and composed accordingly. It is not the place to convince a client that your firm is the answer to all their problems. An engagement letter limits your services, rather than selling your services. Wording such as, "We are particularly suited for this type of work" may be appropriate for a proposal letter, but not for an engagement letter.

- **All-encompassing language.**

An engagement letter should not contain all-encompassing language. Because an engagement letter limits the scope of your firm's work, avoid superlatives and absolutes. For example, use words such as "notice, examine, follow, observe, study, investigate, test, watch and comment on." However, avoid words and terms such as "all, every, analysis, any, absolute, complete, confirm, judge, determine, totally, thorough, validate and verify."

- **Legal jargon or ambiguity.**

Make the engagement letter easy for the client to understand. Don't use abbreviations or words only a CPA would understand. Any ambiguity in the engagement letter will most likely be decided in the client's favor in a court of law, so keep the language simple and clear.

#### **Additional areas to consider**

- Limit the use of unilateral language to lower-risk engagements (signed engagement letters are always the strongest "first line of defense.")
- Avoid evergreen letters - update letters annually to reflect changes in the scope of the engagement.
- Avoid usurious interest charges. Instead, assess a "late fee" for unpaid balances.

#### **General engagement letter tips**

- Every engagement letter should include the full or exact name of the client, entity type, specific state names and tax years for tax engagements, and purpose of engagement.
- Review the letter with the client and get agreement regarding the terms and conditions before beginning the work.
- Update engagement letters at least once per year.
- Update engagement letters whenever engagements change.

The best way to improve client communications and manage risk is to use a detailed engagement letter that the client understands and signs. A well-documented engagement, and a strong defense, begin with an effective engagement letter.

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