

Who Is The Client?

**John Pollock
Litchfield Cavo LCC**

Closely held private companies have unique qualities. The relationships between the owners, officers and employees are often personal. Sometimes, the people involved will serve a triple-role: owner, officer and employee. In these situations, the lines of demarcation between the entity and its owners are fuzzy.

These unique qualities may create a variety of management and control problems. Disputes among the owners concerning succession, transfer of ownership, deadlock, waste and mismanagement may all arise. These problems are often exacerbated because the owners live in the same area, are friends or family, or have dealt with one another before in a business environment.

For an accountant, closely held private companies are an important source of clients. This article suggests steps an accountant can take in representing such companies to maintain objectivity and integrity, avoid conflicts of interest and limit potential liability. The key is informing all concerned that the entity, not an individual owner, is the client.

For example, where several owners of a closely held private company retain an accountant to advise them on the formation of the business, financial planning or tax preparation, the accountant should notify all owners at the outset that he or she is to be the accountant for the entity, and cannot take sides with one or more of the owners if a dispute arises. This may be difficult where the accountant has a pre-existing relationship with one of the owners, or has previously worked for one the owners on his or her personal financial matters.

We recommend the use an annual engagement letter as a risk management tool to address these issues. At a minimum, the annual engagement letter should define:

- Who the client is;
- What services will be provided; and
- What are the limitations on the accountant's services.

If an accountant is providing services to both a closely held private company and one or more of that company's owners, we recommend drafting a separate, annual engagement letter for each.

Use of annual engagement letters allows the accountant to define his or her relationship with the company and its owners on a contractual basis. This

should be done at the outset of the relationship. Spelling out precisely who the accountant works for, and on what issues, may prevent misunderstandings regarding the accountant's role. If problems later arise, the letter is the "first line of defense" in limiting the scope of the accountant's liability to clients and third-parties.

Where similar services are being provided in successive years, it is advisable to enter into a new engagement letter each year. This is particularly important if there have been changes in management or ownership.

If possible, the engagement letter should be tailored to the specific assignment to minimize potential exposure. For example, the engagement letter should always specify that financial statements are intended only for the client's use and may not be sent to any third party without the accountant's prior written consent. Or, if the accountant is retained to conduct an audit in the context of determining the value of closely held private company, the letter should include language to protect the accountant against a suit by a disappointed party.

Closely held private companies can become loyal, long-standing clients. Using annual engagement letters to define precisely who the accountant represents and on what issues can help the accountant avoid conflicts of interest and limit liability in the event disputes arise.