



Alternative Dispute Resolution for Accounting and Related Services Disputes

By Vincent J. Love and Thomas R. Manisero

Given the ongoing changes in accounting, auditing, tax and consulting standards; the scope of services provided; the proliferation of reporting frameworks; and the exponential increases in the number, complexity, velocity, and internationalization of business transactions, disputes between CPAs and their clients may seem insignificant. Nevertheless, the number of disputes is large and growing. Therefore, CPAs serving as accountants, auditors, tax preparers, or business advisors—and

the users of these services—should be familiar with the benefits and disadvantages of the various available alternative dispute resolution (ADR) forums to resolve disputes, especially since the alternative, traditional litigation, is often more expensive, time consuming, and public.

This article addresses the pros and cons of different ADR forums, discusses the mental attitude necessary to successfully resolve a dispute, and suggests the inclusion of ADR clauses in engagement letters. One important consideration for CPAs is to have the wording of any

ADR clause approved by a professional liability insurer and legal counsel. Virtually all professional liability insurers encourage non-binding forms of dispute resolution and usually encourage (or do not object to) binding arbitration clauses in CPAs' engagement letters, although some do not permit (or may object to) binding forms of ADR. Outside the scope of this article is the effect of an ADR clause on any dispute between a CPA and a third party. This is a complicated, diverse, and changing area of the law, and CPAs are encouraged to seek legal advice under such circumstances.

Setting the Stage for ADR

The primary ADR methods available to CPAs and their clients—that is, mediation and arbitration—relate to the prevention of disputes through the inclusion of risk sharing and dispute resolution provisions in engagement letters. They are governed under the AAA's Accounting and Related Services Arbitration Rules and Mediation Procedures (<https://community.adr.org/docs/DOC-1442>). The most important ingredient in these rules is the parties' recognition and acceptance that the process is fair and impartial. This fairness and impartiality must be incorporated in the ADR provisions included in a CPA's engagement letter.

It is also important to ensure that the wording of the ADR clause does not affect a CPA's independence with respect to any attestation services provided to a client. The AICPA Code of Professional Conduct (section 1.228) provides guidance relating to CPAs' use of dispute resolution forums and liability limitation clauses. If a client files financial statements with the SEC, CPAs should understand the SEC's and PCAOB's independence requirements before inserting an ADR or limitation of damages clause into an engagement letter. Normally, the inclusion of ADR clauses will not affect CPAs' indepen-

dence; however, SEC registrants and certain other governmental regulated enterprises are precluded from including an indemnification or liability limitation provision in an engagement letter, other than one related to a knowing misrepresentation by management.

As a general rule, the parties should make an effort to resolve a dispute through reasonable negotiations before ADR (or worse, litigation) is considered.

The inclusion of an ADR clause in an engagement letter does not absolve a CPA of liability for failure to comply with the relevant professional standards, or a client for misleading or lying to its CPA. Some state boards of accountancy require CPAs to self-report awards or settlements exceeding a given dollar amount related to allegations of professional malpractice, regardless of the dispute resolution forum. The Uniform Accountancy Act, in Model Rule 11.2(a)(6), addresses CPAs' obligation to self-report certain situations:

Any judgment, award, or settlement of a civil action or arbitration proceeding of \$150,000 or more in which the licensee was a party if the matter included allegations of gross negligence, violation of specific standards of practice, fraud, or misappropriation of funds in the practice of accounting; provided, however, licensed firms shall only notify the Board regarding civil judgments, settlements or arbitration awards directly involving the firm's practice of public accounting in the state.

CPAs should be familiar with the rules of the board of accountancy in the juris-

diction where they are licensed or performing the service. New York, for example, requires that a CPA self-report a judgment in excess of \$25,000, whether granted in a court of law or arbitration. It does not, however, address a mediation or negotiated settlement. Understanding the rules governing the practice of public accounting in the appropriate jurisdiction is thus important in determining the type of ADR provision to include in an engagement letter.

Negotiation

As a general rule, the parties should make an effort to resolve a dispute through reasonable negotiations before ADR (or worse, litigation) is considered. The best and least expensive way to settle a dispute is to resolve it through negotiation when it first arises, as this minimizes the disruption to the parties' business relationship. Another benefit of a negotiated settlement is that the parties can be creative in designing the settlement, which could, for example, include free services or extended payment periods for unpaid fees. CPAs are again cautioned, however, to consider independence, if applicable, in designing any resolution.

Businesspeople know how to negotiate; nevertheless, in certain circumstances egos or other issues can interfere with a reasonable analysis of the underlying facts and circumstances, which in turn undermines the negotiation process. The parties must control their emotions and rationally focus on the business aspects of the dispute. If either party enters the negotiations in bad faith, it will be a fruitless waste of time and money. It is generally wise to have an attorney involved in the negotiations, particularly to draft a potential settlement agreement. If the parties believe they are too emotionally tied into underlying issues, they should consider having someone else conduct the negotiations.

Mediation

Business owners or managers generally feel more comfortable with mediation than with other forms of ADR because it is nonbinding. A neutral third party, the mediator, facilitates a negotiated resolution to the dispute. The mediator acts as an intermediary between the parties, helping them focus on the business and legal issues and the relative strengths and weaknesses of each side's positions. Mediation can only work if both sides have a positive attitude and understand that, while the resolution may not be the best one for them, it can be an acceptable one.

Mediators, unlike arbitrators, do not decide disputes; their role is to encourage the parties to reach an equitable settlement of their differences. A mediator's greatest asset is the ability to gain the confidence and trust of the parties. Other necessary qualities include maintaining objectivity, tenacity, a thick skin, and the ability to convince the parties to step outside of their emotions, to focus on the real issues in dispute, and to be reasonable in their demands.

There are variations to the normal mediation process. Depending on the parties' desires and the provisions of the ADR clause, a mediator can render a nonbinding opinion on the dispute or issue a binding award (a process known as "Med/Arb"). These variations are not common, but they indicate how an ADR clause in an engagement letter can be tailored to specific needs and personalities.

The major benefit of mediation is that it brings the parties to a mutually agreed-upon resolution. Neither the CPA nor the client may be totally happy with the result, but they can both be satisfied that the dispute is resolved. Mediation also produces a timely settlement that can remain confidential. Another advantage is that it is flexible; the parties can design the rules that will govern the process.

Since mediation does not take place within an adversarial atmosphere, it enables the parties to explore creative solutions. Finally, other than a negotiated settlement, it is most often the least costly method of dispute resolution.

The mediation process does, however, have some drawbacks. Each side exposes its position, thereby giving the other party the opportunity to gain some limited knowledge that could be used later, if the mediation fails, in binding arbitration or at trial. In addition, all parties must truly want to resolve the dispute; it requires a

**The major benefit
of mediation
is that it brings
the parties to
a mutually
agreed-upon
resolution.**

good faith belief in the process and a willingness to accept a less-than-total win. If a mediation fails due to lack of good faith, it delays the end of the dispute and can add to the cost of resolution.

Arbitration

The most common form of formalized ADR is binding arbitration. Arbitration is similar to courtroom litigation, since the parties argue their positions and present evidence to an impartial trier-of-fact. The trier-of-fact in arbitration is one or more impartial people (known as an arbitration panel) whose decision will be binding on the parties. Arbitration is, however, less

formal than courtroom litigation and its timing is much more flexible.

Just as parties in litigation can appeal to a higher court, arbitration awards can also be appealed within the process under the American Arbitration Association's (AAA) Optional Appellate Rules, but only if the parties either include the appeal process in the engagement letter or subsequently agree to the submission of any decision to the appeal process. One party cannot unilaterally commence the appeal process unless it has been specifically included in the arbitration agreement.

One benefit of arbitration is that it is private and often confidential. Arbitrators' decisions are not made public except with the consent of the parties (although, as stated above, CPAs may be required to self-report an arbitration decision to an appropriate board of accountancy). Unlike judicial decisions, arbitration awards do not create legal precedent.

Arbitration is generally quicker and less expensive than courtroom litigation; for example, the time-consuming and expensive process of discovery can be limited. Also, unlike jurors and judges, arbitrators are specifically selected because of their knowledge of the subject matter or the law involved in the particular dispute. The AAA has a panel of specifically identified arbitrators who are qualified to handle disputes relating to accounting and related services disputes; the panel includes CPAs, financial officers, and lawyers and judges who are familiar with the professional standards governing the profession.

The arbitration process can often be controlled by the parties and, to a certain extent, tailored to their needs. For example, the parties can, by mutual agreement, decide the number of arbitrators and how they are appointed, the limits of any discovery, and which issues are subject to the arbitration. If a restriction or condition is written into

the ADR clause, it can be incorporated into the procedures.

There also can be downsides to arbitration. In certain circumstances, arbitration can be costlier than litigation, as it typically requires higher filing fees than courts, and arbitrators' time can be expensive. When a dispute involves a relatively small amount of money, the costs and fees in the arbitral forums can outweigh the costs of going to court. In these instances, however, the parties can agree to arbitrate under the AAA's Expedited Rules, which streamline and accelerate the process, thus reducing the cost.

The arbitration process offers fewer barriers to entry than litigation and may lead to more claims being filed; however, the disbursements, costs, and awards related to arbitration tend to be less than in litigation.

While arbitrators may be chosen for their knowledge and understanding of the profession, they usually are unknown quantities from the lawyers' perspective. In courtroom litigation, attorneys can consider a judge's reputation and previous decisions when advising their clients about such items as the pace of the process, or the leanings of the judge, which are important considerations in the process.

In addition, while discovery is more limited in arbitration, this is not necessarily an advantage. The discovery process may be abused by some, but in many instances it is a necessary evil. Arbitrators do not have the same authority as judges to compel discovery and have virtually no power over non-parties. In some instances, this requires the parties to go to court to gain assistance with discovery.

While not as effective as mediation at saving relationships, arbitration is generally less acrimonious than litigation. It is also more flexible than litigation,

since the parties may agree on specifically tailored procedures.

Drafting Dispute Resolution Clauses

Dispute resolution clauses can be included in all engagement letters for all of the services a CPA firm renders. Clauses mandating mediation, since it is nonbinding, do not represent any problem. Before mandating arbitration in an engagement letter, however, a CPA firm should get the explicit approval of its pro-

While not as effective as mediation at saving relationships, arbitration is generally less acrimonious than litigation.

fessional liability insurer, as the inclusion of such a clause will affect the manner in which the insurer must handle an error or omissions claim. Some insurers may deny coverage if the engagement agreement requires binding arbitration, claiming that the insured CPA firm impaired their authority to control the defense of claims under the insurance policy.

The mediation/arbitration clause can be as simple or as definitive as a CPA and client desire. The following is an example of a simple arbitration clause:

Any controversy or claim arising out of or relating to this engagement letter, or breach thereof, shall be settled by arbitration administered by the American Arbitration Association in accordance with its Accounting and

Related Services Arbitration Rules and Mediation Procedures and judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

If the engagement letter does not include an arbitration clause, but the parties would like to take advantage of the AAA rules specifically designed for such disputes, the parties can agree to arbitrate by signing the following statement:

We, the undersigned parties, hereby agree to submit to arbitration administered by the American Arbitration Association under its Accounting and Related Services Arbitration Rules and Mediation Procedures the following controversy [cite briefly]. We further agree that we will faithfully observe this agreement and the rules, and that we will abide by and perform any award rendered by the arbitrator(s) and that a judgment of the court having jurisdiction may be entered upon the award.

The parties can tailor these standard clauses to meet their needs and desires. They may wish to set the venue, to limit discovery, to arrange for specific arbitrators, to allow for the appeal of any decision, and more. If they change the standard language, however, they should seriously consider retaining an attorney to draft such changes.

Below are some of the elements of an agreement that can be subject to modification by the parties.

Scope. A CPA firm and its client may wish to limit the application of the arbitration provision to disputes involving fees. Since fee disputes are the most common, using this type of clause may discourage the malpractice counterclaims that typically are interposed when a professional sues to collect a fee. The drawback is that all other disputes then go to a court of law for resolution; the result is splintered litigation, part in arbitration and part in court.

Governing law. It is common for parties to specify the law that will govern the contract and any disputes arising under, or relating to, the contract. For example, a CPA may wish to use the laws of a state that does not recognize punitive damages as a remedy in arbitration. It is highly recommended that a CPA discuss this subject with legal counsel.

Venue provisions. A CPA and client may want to add language specifying the place for any hearings. In specifying a locale, the parties also should consider 1) the cost and convenience (e.g., transportation, hotels, meeting facilities), 2) availability of qualified mediators and arbitrators, and 3) the applicable procedural and substantive law.

Arbitrator provisions. The parties may want to use arbitrator appointment systems, such as the party-appointed method in which each side designates one arbitrator and the two thus selected appoint the chair of the panel. The arbitration clause can also specify by name the individuals the parties want as their arbitrators.

Some complain that arbitrations may be lost on issues of fact that, in a court of law, would not have been relevant. To remedy this, the panel of arbitrators can include lawyers familiar with the relevant law, and these ideas can be incorporated into the arbitration agreement. The qualification requirements might also include specific educational, professional, or training experience. Furthermore, parties concerned about the number of arbitrators appointed in a case can predetermine whether the dispute shall be heard by one arbitrator or a panel of three.

Discovery. In disputes between providers of accounting services and their clients, much of the evidence is in the possession of the parties, or else it can be identified very specifically. Parties may want to limit discovery to the exchange of documents, with no depositions permitted. They also may agree

to permit depositions, but impose limits on their number and duration.

Bifurcation. The parties can provide for a bifurcated proceeding in their arbitration clause. For example, the parties could agree that evidence and testimony will first be given on the issue of liability, and then, only if liability is found, continue on the issue of damages. It should be noted, however, that not all cases lend themselves to bifurcation.

Remedies. Under a standard arbitration clause, an arbitrator may grant any remedy or relief deemed equitable within the

share of the arbitrator's fees. The contract also can provide that the losing party will shoulder all or some of these expenses.

Written opinions. Arbitrators in business disputes customarily render a monetary award without a written opinion. A lengthy written opinion can prolong a proceeding and might lead to unnecessary appeals. Often, an itemized award can eliminate the need to render an opinion; however, in some situations, parties might desire an award with written findings.

A Low-Cost, Low-Acrimony Alternative

CPAs and their clients generally appreciate the economics of resolving disputes at the lowest possible cost. It is possible to take all of one's disputes to litigation and, if necessary, to appeal all decisions to their ultimate conclusion. The result may be an enviable win/loss record. But at what cost, in both money and the firm's relationships?

Accounting firms that choose to include a mediation or arbitration clause in their engagement letters are urged to first consult their insurers. Including such a clause in an engagement letter may increase the number of disputes in the process; the total cost of resolving differences with clients should be less, however, and many relationships that would have been lost should be saved.

Finally, the AAA provides an excellent, comprehensive, and concise tutorial on mediation and arbitration, *A Guide to Commercial Mediation and Arbitration for Business People*, on its website (<https://community.adr.org/docs/DOC-1165>). □

Vincent J. Love, CPA/CFF, CFE, is the chairman of VJL Consulting, LLC, New York, N.Y., and a member of The CPA Journal Editorial Advisory Board. Thomas R. Manisero, JD, is a partner at Wilson Elser Moskowitz & Dicker LLP, White Plains, N.Y.

Accounting firms
that choose to include
a mediation or
arbitration clause in
their engagement
letters are urged
to first consult
their insurers.

scope of the agreement between the parties, except for an order mandating a CPA to perform a specific engagement or render a specified form of opinion or report. Sometimes, parties want to include or exclude certain specific remedies. Legal counsel should be consulted before the inclusion of such language.

Payment of fees and expenses. The fees and expenses of arbitration, including attorney's fees, can and should be dealt with in the arbitration clause. In the absence of a contractual allocation, the rule is that each party bears its own costs and attorney's fees, and its proportionate