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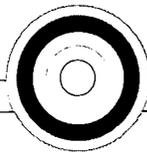
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HOW THE MADOFF FRAUD COULD AFFECT YOUR CPA PRACTICE

By Stephen Scarpati

With an estimated \$65 billion lost from trust funds, retirement plans, pensions, investment funds, inheritance monies, and nonprofit organizations, many people have been adversely affected by the Ponzi scheme perpetrated by Bernard L. Madoff. When you combine a lot of lost money with a lot of angry people, the result is a lot of lawsuits. The breadth of those lawsuits will encompass all associated with the affected organizations—including CPAs. Those messages were loud and clear at the May 27, 2009, breakfast symposium "Are CPAs the Next Madoff Victims? The Accountant's Liability," sponsored by *The CPA Journal*.

The audience at the symposium included CPAs from large, medium, and small firms, industry, and academia. Prior to the start of the event, this author spoke to a number of attendees who spoke excitedly about the importance of this issue to our profession. Some CPAs, from organizations that had invested with Madoff, were directly affected. Other CPAs had clients who lost money in the scandal. The amounts varied from organizations and persons who lost "a lot of money" to those who lost "a little bit." (Nobody mentioned specific dollar amounts.) For those in attendance who were not directly impacted, they knew from the news stories they'd seen about Madoff that the scandal pounded the investment community. All were aware that accountants would come under scrutiny. It quickly became clear to those in attendance, however, that there would be implications that extend beyond the immediate litigation parties. The sheer magnitude of the scandal has brought the accounting profession as a whole into the spotlight.

For many CPA firms, change is already under way. Following are four areas of CPA practice that are specifically affected as a direct result of the Madoff fraud.

Audit Procedures

It has been reported that Friebling & Horowitz, the audit firm for Madoff's operations, was not qualified to conduct the audit. Some people contend that there were sufficient red flags to alert other accounting firms that something was amiss with Madoff's audit firm. Inevitably, there will be finger-pointing at the auditors of the feeder funds, hedge funds, investment organizations, and others who invested with Madoff that they should have checked on the small firm that issued the reports on which they relied.

For CPAs in attestation engagements who rely on the work of other auditors, the alert is now raised. In some situations, additional procedures may be needed to sufficiently rely on the work of other auditors. A number of practitioners in attendance vowed to incorporate this step into their audit plans. What might have been a fairly routine matter in the past will now receive additional scrutiny in future audit engagements.

Advisory Services

It is expected that the Madoff lawsuits will drag in investment advisors, trustees, fiduciaries, and anyone who had some advisory-related role to any organization and any person who lost big with Madoff. No one knows how these lawsuits will be resolved, but it is certain that fiduciary standards will be put to the test.

CPAs who perform advisory services, especially investment advisory services, would be well advised to follow these cases closely. In addition, those CPAs who perform trustee and fiduciary roles of

any kind should also pay close attention. We can expect that professional standards will be vigorously debated in the courtrooms. Scrutiny must be given to how juries decide standards of professional conduct for various advisory services in these cases.

Practice Management

With all this discussion of lawsuits, now is the perfect time for CPAs to review their professional liability insurance coverage. There are two key questions CPAs should ask themselves:

- Are my coverage limits adequate for the businesses that I am in? This would be a very significant issue if, for example, a CPA firm has expanded the scope of the services that it offers clients since it purchased its current professional liability policy. It may be that the policy does not cover the new business and needs to be updated.
- What is my insurance carrier's reputation for dealing with claims? As the Madoff lawsuits develop and claims get made, it will become apparent which insurers stand behind their policies and which attempt to bail out at the first sign of trouble. If your carrier is among the latter, it may be time to switch insurance companies.

Tax Services

All of the attorneys on the symposium panel assured tax preparers that, under current legal liability standards, they have no obligation to go further than using the information they have been provided to prepare tax returns. Nonetheless, there was a sense of unease among many in attendance. Many CPAs were concerned that opportunistic lawyers and plaintiffs could put this standard in jeopardy. As a result, the topic of engagement letters was raised. Presently, it is not a common practice to utilize engagement letters for tax preparation services. It was pointed out, however, that an engagement letter would help avoid any misinterpretation of the services being provided. Although it is not customary for his firm, at least one practitioner in attendance promised to discuss the matter with his partners to determine if, in fact, there are certain tax engagements where an engagement letter might provide prudent protection.

Going Forward

CPAs should study the events of the Madoff scandal closely, from two perspectives. First is the technical aspect: Which professional standards are being scrutinized? The second is more complex: What does the general public expect from CPAs in these circumstances? Specifically, how will juries, which represent the general public, apply their own expectation standards to case verdicts? To the extent that either of these aspects is found lacking, the profession will have to learn from those shortcomings and adapt accordingly.

The Madoff breakfast symposium sponsored by *The CPA Journal* highlighted the fact that many CPA firms, not just those directly associated with litigation, are being touched by the scandal. With claims and lawsuits expected to last years, it is important that dialogues such as this symposium continue and that CPAs follow events closely to ascertain how the Madoff fraud fallout will affect their practice in the future. □

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