

Engagement Letters



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SUMMARY

Client relationships, malpractice claims, and the ability to be paid for work done can all be dependent on whether the appraiser prepared for the valuation engagement adequately. Most professionals equate engagement letters with fee policies and disclosures. While that is an important element of any engagement letter, it is not the focus of this article. This article will focus on other elements that should be addressed and often are not.

Business appraisers are increasingly competent understanding the technical aspects of valuing businesses and reporting on that work. Unfortunately, some are learning the hard way that their expertise and care should be extended to preengagement work with the client. Client relationships, malpractice claims, and the ability to be paid for the work done can all be dependent on whether the appraiser prepared for the engagement adequately.

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Engagement letters are critically important and should be used in every case. It is always advisable to reduce the relationship to writing for the following reasons:

- **Manage expectations:** It is always advisable to put in writing such terms as the timing of the work, when the report or conclusions can be expected, the form of communicating the conclusions, the cost of the engagement, and other elements that could be a source of contention as the engagement progresses—or long after it is completed.
- **Scope:** It is equally important to express what the appraiser will be doing and what services will not be performed. For example, in most cases the valuation expert will not be auditing the financial statements of the client. This should be clearly stated in the engagement letter.
- **Communicate qualifications:** The advantage of reinforcing the qualifications and experience of the appraiser should be obvious.
- **Client responsibilities:** While the client's expectations are usually obvious, it may not be so clear to the client that they play a key role in the success of the engagement and that the appraiser has expectations, too. The appraiser's expectations regarding access to data, assistance from client personnel, completeness and reliability of financial records and projections, should all be clearly stated.
- **Getting paid:** Obviously, financial term agreements in advance, and in writing, are more easily enforced than oral agreements. A "handshake" agreement is open to conflicting interpretations and should be avoided. Anyone who has been in the business for any length of time recognizes that the collection rate on oral agreements is much lower than the rate on engagements where there was a written agreement in advance of the work.

An engagement letter is a contract between the appraiser and the client. Identifying the client is sometimes not as easy as it sounds. It is, however, a general rule that whoever is going to pay the bill is the client. The letter should be addressed to the client. In a litigation matter, the addressee on the

letter (identity of the client) is extremely important. If the client is the attorney the letter should be addressed accordingly. If, for any number of reasons, the attorney does not wish to be the client the letter should not be addressed to the attorney even though most, if not all, of the contact will be with the lawyer.

If the valuation is to be performed in the context of litigation there are special requirements for the engagement letter. It is highly recommended that you discuss the engagement letter with the attorney to clarify all the elements. For example, the client may be paying the bill but the work is to be done at the direction of the attorney. This should be clearly stated in the engagement letter and the client should understand this dynamic. Further, the issue of privileged communications, or lack of it, should also be addressed so that the client understands how communications will be handled. Of course, if the appraiser is not sure of the nature of these concerns, the attorney should be able to assist in the appropriate wording. Most lawyers are very familiar with these issues and are willing to assist the expert in being properly retained.

For those who do work in the courts, it is not uncommon to be hired by "both sides" in a dispute to provide neutral valuation services and consultation. In cases such as this, the letter should be addressed to both parties and signed by both parties. In particularly contentious situations, we have found that having all parties and the attorneys for all parties listed as the clients and signing the contract reduces or eliminates problems at the end of the engagement. It certainly slows down the start-up of the engagement. In all cases that delay is far better than a delay at the end of the engagement when payment is due and one or more of the parties and/or their lawyer want to argue over the terms of the engagement.

There are other considerations that are unique to business appraisers when constructing an engagement letter. The first is the valuation date. While this is clear in some cases it can be difficult to nail down in others. Particularly in the context of litigation, it may be difficult to get all parties (the attorney, your client, and you) to agree on the appropriate valuation date. It is not uncommon that there are two or more dates requiring a valuation. Especially in cases with multiple valuation dates, it is advantageous to establish the dates in advance of the engagement. This is another point that may cause a delay in beginning the work on the valuation but it is well worth waiting until the scope of the work needed is clarified and agreed upon.

Similarly, the standard of value that will be used in the valuation work should be established in the engagement letter process. This often requires some time educating the client and, if applicable, their attorney. Since the standard of value used will dictate the amount of work to be done and the level of reporting it is important to establish this matter in advance of providing an estimated cost.

Certified Public Accountants and other specialized professionals such as Certified Fraud Examiners need to be particularly cognizant of client expectations. Since valuation work involves intensive financial analysis clients might perceive that any fraud or errors will be discovered by, and reported by, the appraiser. This is not an irrational perspective but it can be very treacherous for the appraiser. It is recommended that wording that limits the appraiser's liability, and lowers the client's expectations in this regard, should be included. Some suggested wording is, "Our services cannot be relied on to disclose errors, irregularities, or illegal acts, including fraud or defalcations that may exist."

Other issues that should be addressed in an engagement letter covering valuation services are:

- Whether a written report is to be issued.
- If a written report is not required, it should be stated that no written report will be issued and if the client later decides they want a written report it will be covered by a separate agreement.
- If a written report is to be issued the audience should be defined and limited. Wording such as, "Any reports prepared by us may not be published or used in any other manner without the

written consent of this firm" are highly recommended. This wording only works, of course, if the engagement letter properly defines the approved "manner".

- If there are known limitations on the scope of work, or the scope of the report, these should be identified. For example if a "preliminary estimate of value" is to be provided as opposed to a full valuation report, that term should be defined and the work that is usually performed in a valuation engagement, that will not be done, should be specifically identified.

Common Errors

Many appraisers do not use engagement letters. Others use them and, according to insurance experts and others, are in worse shape than if they had not used an engagement letter at all. The following are common mistakes that should be avoided:

- Not using engagement letters. This is maybe the most obvious but, unfortunately, it is the most common error.
- Using a standard form letter. An engagement letter should be tailored to each individual client and engagement. One size does not fit all. While the terms and conditions relating to fees and collection policies may be static for all clients, the rest of the letter is probably unique given the circumstances of each engagement.
- Assuming that a pre-existing engagement letter with the client firm covering tax and/or accounting services is adequate to cover valuation services. Your malpractice insurance representative or a lawyer who practices in the area of professional malpractice defense will confirm this for you.
- Using the engagement letter as a sales piece. Malpractice insurance representatives repeatedly warn that using contracts in this manner opens the professional up to disputes regarding whether the services "promised" in the contract were actually provided. The engagement letter should succinctly and concisely describe the work that will be done and, where possible, describe what specifically will not be done. Save the sales talk for other communications.
- Not requiring a signed engagement letter before work starts. It is best to give your client the time and space needed to review and sign the engagement letter before you begin work. Your client is most motivated at the beginning of the engagement. In the middle of the engagement, or after the report is issued, is not a good time to get the contract signed.
- Poorly constructed billing and collection policies. In the event of a dispute between the parties, the courts, arbitrators, and mediators rely on the written contract. Be aware that if the appraiser wrote the contract there is a general rule that any ambiguity in the wording will be interpreted in the favor of the party that did not prepare the contract. It is highly advisable, therefore, that great care is taken in this area and that an attorney is consulted to review this section of your contracts to assure that it is both adequate and consistent with applicable state laws where you practice.
- Unsigned engagement letters. A well-constructed and comprehensive engagement letter is ineffective if the client has not signed it and returned it to the professional. The client signature assures that there can be no claims that they did not receive and read the letter.

A well-managed valuation practice includes the regular use of comprehensive engagement letters. At times they may seem to be a nuisance and unneeded. In the long run, they will save the professional a lot of grief that comes from misunderstandings, unpaid bills, and even litigation.

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