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*Section Six: Internal Controls*

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**CHAPTER TWENTY-ONE: INTERNAL CONTROLS**

The Importance of Internal Controls

Letters

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**CHAPTER TWENTY-TWO: RECORD RETENTION**

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**CHAPTER TWENTY-THREE: DISENGAGING**

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## PREFACE

The *CPA's Guide to Effective Engagement Letters: Implementing Successful Loss Prevention Practices*, 12th Edition, provides the tools you need to compose effective engagement letters. It is intended as a practical hands-on device that can sit on your desk for ready access. The book is composed primarily of annotated parts of an engagement letter, which you can piece together to create an entire engagement letter, and actual letters that you can customize for your own purposes.

The engagement letter has evolved from a general practice management tool to a necessity for accounting firms and sole practitioners alike. Although the content of an engagement letter may vary depending on the specific type of engagement, the purpose of every engagement letter is to define and include the expectations that a CPA and a client have of each other. The engagement letter opens channels of communication between you and your client. More important, it documents this communication.

You can reap a number of benefits by creating thorough yet straightforward letters for new engagements, repeat engagements, and, especially, changed engagements. Primarily, the engagement letter fosters a clear understanding of both your responsibilities and those of your client. By setting out this understanding, you will minimize your chances of facing litigation, because the engagement letter will leave little or no room for misunderstanding—a common cause of lawsuits. If you do find yourself in the middle of a lawsuit, then the engagement letter will serve as documented proof of the duties that were outlined for the engagement. Finally, a well-constructed engagement letter also provides an opportunity to explore other potential business with your client. Down the road your client may want you to provide a service that is outside the parameters of the engagement letter. In that case, you should amend the original engagement letter and seek additional fees to accommodate the added service.

### ABOUT THE PRODUCT

The product is made up of eight sections: 1) Financial Statements, 2) Tax Preparation and Planning, 3) General Accounting, 4) Other Engagements, 5) Other Letters, 6) Internal Controls, 7) Record Retention and Destruction Policy, and 8) Disengaging. Sections One through Four include suggested wording and sample letters that deal with their particular subjects; Section Five contains sample letters covering miscellaneous subjects. Section Six provides a discussion of internal controls, with an emphasis on how they pertain to small-business clients. It also includes a general internal controls letter that warns of general defalcation, a short letter warning of defalcation, and a tailored response. Section Seven provides a template for constructing a firm's record retention and destruction policy.

Within Sections One through Four are chapters relating to more specific subject matter. The suggested wording in each chapter is designed to take you from the engagement letter's introduction to its closing. For example, in the first part of

Chapter One, "Audit Engagement Letters," each page is divided into two columns.

- The left-hand column offers suggested wording about a specific subject.
- The right-hand column contains comments that are relevant to the subject area. Be sure to read these important advisory comments.

Following the suggested wording are the sample letters that pertain to that subject.

## HOW TO USE THIS GUIDE

*CPA's Guide to Effective Engagement Letters* is a collection of paragraphs for engagement letters. It cannot be used as a form product, because the format will not allow you to simply copy letters for use in your practice. An engagement letter should be customized to a specific client's situation. The letter should also reflect the specific needs of your practice. Form letters short-circuit the process of evaluating the client and the job to be undertaken. An individualized engagement letter shows that you put thought into the agreement. Although we have included samples of entire letters, from "Dear" to "Sincerely," with blanks to fill in names and services, boilerplate letters are what we are trying to avoid.

The sample letters and material contained in this product have been used successfully by CPAs; they were not developed merely for publication purposes. The product can be used by anyone who participates in or decides on the continuance or acceptance of clients. It can be used as a resource in composing engagement letters, or as a tool for teaching someone how to compose engagement letters.

You will gain the most value from this product when you do more than simply copy the sample engagement letters and customize them for your practice. It is more important to understand the purpose behind engagement letters and what they are meant to accomplish. Once you understand the engagement process and use the engagement letters correctly, you will be in a win-win situation: You will be able to create successful, trouble-free engagements that foster further business.

The ongoing engagement process of which an engagement letter is a vital part begins with deciding whether or not to take on an engagement. That process begins with client screening, the purpose of which is to evaluate the risks versus the rewards of any given engagement. Properly screening clients before accepting an engagement can help prevent anything from minor headaches to professional liability claims against you. There are times, too, when even the most experienced accountant will encounter a situation or a client relationship that calls for disengaging. For this reason the subjects of client screening and disengagement are also addressed in Chapter 23, "Disengaging."

To illustrate pitfalls CPAs encounter with engagement letter usage, see the "Case Studies." Drawn from actual claims, these case studies help you understand the importance of the engagement letter in your practice and risk management endeavors.

To compose an engagement letter using this book, do the following:

- Locate the appropriate subject area(s). Use the Table of Contents as a guide.
- Read the suggested wording in the left-hand column.
- Mark the paragraph(s) that would work for your particular engagement.
- Pay special attention to the comments in the right-hand column.
- Be sure to customize the letter by adding wording that is specific to your practice and client.

In some cases, optional paragraphs have been inserted to give you the choice of selecting whichever language you want. The rationale for the optional paragraph is explained in the comments. Often the optional paragraphs refer to finer points from a legal perspective.

*CPA's Guide to Effective Engagement Letters* was compiled and edited with resources from CAMICO Mutual Insurance Company. CAMICO's defense attorneys have found that much of their policyholders' litigation could have been avoided if the CPAs had retained more thorough documentation. Since the engagement letter is the first step in the documentation process, they realized that perhaps CPAs simply needed more help in writing engagement letters. Thus, CAMICO began developing suggested wording to help CPAs compose appropriate engagement letters for a variety of situations.

We encourage your questions or comments regarding this edition of *CPA's Guide to Effective Engagement Letters*. In particular, please note what areas you would like to see covered by additional letters.

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## 2. REVIEW ENGAGEMENT LETTERS

### *Suggested Wording*

2.1 We are pleased to confirm our understanding of the arrangements for our review of the financial statements of <Company> for the year ending <date, year>.

2.2 This letter confirms the services you have asked our firm to perform and the terms under which we have agreed to do that work. Please read this letter carefully because it is important to both our firm and you that you understand what you can and cannot expect from our work. In other words, we want you to know the limitations of the services you have asked us to perform. If you are confused at all by this letter or believe we have misunderstood what you need, please call to discuss this letter before you sign it.

### Scope of Services

2.3 We will [*if applicable*: prepare and] review the balance sheet of <Client Name> as of <date>, and the related statements of income, retained earnings, and cash flows for the year then ended, and the related notes to the financial statements, and issue an accountant's report on such financial statements in accordance with the "review standards" as set forth in the Statements on Standards for Accounting and Review Services (SSARSs) promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants (AICPA) and applicable ethical principles established by the AICPA's Code of Professional Conduct.

### *Comments*

2.1c Address the engagement letter to a specific person, if possible. Indicate the title of the person at the inside address and at the signature block at the end of the engagement letter if that person will be signing on behalf of an entity (e.g., Ric Rosario, President). Clearly identify the client by its full and legally correct name and, if an entity, set forth the nature of the entity the first time the entity's name is mentioned in the text of the letter (e.g., Unique Products, a California corporation).

2.3c This section complies with SSARSs requirements through **SSARS No. 23**.

## Suggested Wording

**[Use this language if the reviewed financial statements will be accompanied by supplementary information:** Management has requested that supplementary information accompany the reviewed financial statements for purposes of additional analysis, although it is not a required part of the basic financial statements. The supplementary information is the responsibility of management. **[If reviewed by CPA:** Such information will be derived from, and related directly to, the underlying accounting and other records that will be used to prepare the financial statements. Such supplementary information will be subjected to the inquiry and analytical procedures applied in our review of the basic financial statements. We will not audit the supplementary information and, as such, will not express an opinion on the supplementary information as part of this engagement.] **[If NOT reviewed by CPA:** We will not audit or review the supplementary information and, as such, will not express an opinion, a conclusion, or provide any assurance on such supplementary information as part of this engagement.]

**[Use this language if you are preparing the referenced financial statements:** The objective of this review engagement is to prepare financial statements in accordance with the financial reporting framework you selected, based on information provided by you, and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with that framework. It is our understanding that you have selected accounting principles generally accepted in the United States of America (U.S. GAAP) as your financial reporting framework and, as such, that is the framework we will use for this engagement.]

## Comments

## Suggested Wording

**[Use this language if you are NOT preparing the referenced financial statements:** The objective of this review engagement is to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the financial reporting framework you selected. It is our understanding that you have selected accounting principles generally accepted in the United States of America (U.S. GAAP) as your financial reporting framework and, as such, that is the framework we will use for this engagement.]

A review differs significantly from an audit of financial statements, in which the auditor provides reasonable assurance that the financial statements, taken as a whole, are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing control or fraud risks; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (e.g., cancelled checks or bank images); or performing other procedures ordinarily occurring in an audit. Thus, a review does not provide assurance that we will become aware of all significant matters that would be disclosed in an audit. Therefore, a review provides only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with U.S. GAAP.

## Comments

*Suggested Wording*

Our review will consist primarily of inquiries of company personnel and analytical procedures applied to financial data, and we will require a letter from management at the conclusion of our engagement that confirms certain representations made during the course of our review. As we will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, we, accordingly, will not express such an opinion on them. Because we are not performing an audit, <Client Name> agrees not to record or describe our services as an "audit" or "auditing" in its minutes, public comments or other books of record.

This engagement cannot be relied upon to disclose errors, fraudulent financial reporting, misappropriation of assets, or illegal acts that may have occurred. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. We will also report to the appropriate level of management any evidence or information that comes to our attention regarding any potential illegal acts that may have occurred, unless they are clearly inconsequential.

*Comments**Suggested Wording***Responsibilities of Management**

2.4 Management is responsible for making all financial records and related information available to us and for providing us with unrestricted access to individuals within <Client Name> with whom we determine it necessary to communicate. By your signature below, you understand and agree that management is responsible for the accuracy and completeness of the records, documents, explanations, and other information provided to us, including management's significant judgments for the engagement. The information provided by management, including the responses to our inquiries, will not be verified, corroborated, or audited.

As outlined in this letter, we may assist in the preparation of your financial statements and we may advise you about appropriate accounting principles and their application, but the final responsibility for the preparation and fair presentation of the financial statements in accordance with U.S. GAAP remains with you. Also, as part of our engagement, we may propose standard, adjusting, or correcting journal entries to your financial statements. Management, however, has final responsibility for reviewing and accepting the proposed entries and understanding the nature and impact of the proposed entries to the financial statements.

*Comments*

2.4c This section complies with SSARs requirements through SSARS No. 23.

Suggested Wording	Comments	Suggested Wording	Comments
<p>By your signature below, you acknowledge management's responsibility for all management decisions and responsibilities, including designating qualified individuals with the suitable skills, knowledge, and/or experience to be responsible and accountable for overseeing [if applicable: the preparation of your financial statements and] any bookkeeping or other services performed as part of this engagement. This includes designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; as well as identifying and ensuring that the organization complies with the laws and regulations applicable to its activities. We will have no responsibility to identify or communicate deficiencies in your internal control as part of this engagement.</p>		<p>If, for any reason, we are unable to complete our review of your financial statements, we will not issue a report on such statements as a result of this engagement.</p>	
<p>In addition, your signature below further acknowledges that you understand and agree that you are responsible for preventing and detecting fraud, and for establishing and maintaining internal controls, including monitoring ongoing activities.</p>		<p>[Optional: Our report on the financial statements is presently expected to read as follows: &lt;Insert appropriate report here&gt;]</p>	
<p><u>Written Report</u></p>	<p>2.5c This section complies with SSARSs requirements through SSARS No. 23.</p>	<p>By your signature below, you agree to include our review report in any document that contains the referenced financial statements which indicates that we have performed a review of such financial statements; and to obtain our written permission before releasing such information.</p>	
<p>2.5 We expect to issue an unmodified review report addressed to &lt;Client Name&gt;'s board of directors. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary for us to report known departures from U.S. GAAP, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement.</p>		<p>2.6 Information your personnel will give us will include &lt;list items&gt;. Your personnel must give us this information on time for us to be able to issue our report.</p>	<p>2.6c You can also indicate that you will submit a list of specific schedules (to be prepared) to the client. Consider providing due dates for the client-prepared material.</p>
		<p>2.7 We expect to begin our review on approximately &lt;date&gt; and to complete and issue our report no later than &lt;date&gt;.</p>	
		<p>2.8 &lt;Name of Firm Representative&gt; is the engagement partner for the review services specified in this letter. &lt;His/Her&gt; responsibilities include supervising &lt;Firm&gt;'s services performed as part of this engagement and signing or authorizing another qualified firm representative to sign the review report.</p>	<p>2.8c This language complies with the requirements under Statement on Quality Control Standards (SQCS) No. 8.</p>

Suggested Wording	Comments
<p><b>USE OF THIRD-PARTY SERVICE PROVIDERS</b></p>	
<p>2.9 Unless you indicate otherwise, our firm may transmit confidential information that you provided us to third parties in order to facilitate delivering our services to you. For example, such transmissions might include, but not be limited to, &lt;identify examples&gt;. We have secured confidentiality agreements with all our service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have the appropriate procedures in place to prevent the unauthorized release of confidential information to others. We will remain responsible for the work provided by any third-party service providers used under this agreement. By your signature below, you consent to having confidential information transmitted to entities outside the firm. Please feel free to inquire if you would like additional information regarding the transmission of confidential information to entities outside the firm.</p>	<p>2.9c This paragraph should be used if you are using third-party service provider(s) to assist you in performing professional services for your clients.</p>
<p><b>RECORD RETENTION</b></p>	
<p>2.10 It is our policy to keep records related to this engagement for &lt;number&gt; years. However, &lt;Firm Name&gt; does not keep any original client records, so we will return those to you at the completion of the services rendered under this engagement. When records are returned to you, it is your responsibility to retain and protect your records for possible future use, including potential examination by any government or regulatory agencies.</p>	<p>2.10c If you believe there is even a remote chance of a claim with a current client, keep copies of the client's records and the workpapers. If you are asked to return client records, make copies for your files and return the originals. Get a signed, itemized receipt when you turn the records over to the client.</p>
<p>By your signature below, you acknowledge and agree that upon the expiration of the &lt;number&gt;-year period &lt;Firm Name&gt; shall be free to destroy our records related to this engagement.</p>	<p>The firm should establish a record retention policy. Before destroying records, consider the following steps: (1) send a letter to the last known address of the client, (2) inform the client that its records will be destroyed unless the client calls the firm by a specific date, and (3) if a client picks up his or her records, get a signed, itemized receipt.</p>

Suggested Wording	Comments
<p><b>FEES &amp; BILLINGS—GENERAL</b></p>	
<p>2.11 Our fees for this work will be at our regular hourly rates for the individuals involved plus direct out-of-pocket expenses. Payment for service is due when rendered, and interim billings may be submitted as work progresses and expenses are incurred.</p>	<p>You may wish to provide copies (not originals) of the workpapers if the client requests them. If you will be giving the client copies of the work papers, number consecutively each of the pages copied and get a signed, itemized receipt. If you have questions or concerns about whether papers belong to you or to the client, or about whether you should give the client copies of the workpapers, call your firm's risk advisor.</p>
<p>2.12 Statements for our services will be sent on a &lt;monthly, weekly, biweekly, etc.&gt; basis. Currently, billing rates for our staff are: &lt;list rates&gt;.</p>	<p>2.12c It is unethical to base a fee for preparing a tax return on the amount saved in taxes, because a properly prepared tax return results in proper tax liability and there is no basis for computing a savings. Consider progress billings, especially in the case of audits. Without such a provision, the entire contract is tied to the audit, so that payment cannot be enforced until after full performance by the auditor. Consider billing every other week for significant engagements and first-year audit clients.</p>

Suggested Wording	Comments	Suggested Wording	Comments
<p>2.13 Billings become delinquent if not paid within &lt;number&gt; days of the invoice date. If billings are not paid within &lt;number&gt; days of the invoice date, at our election, we may stop all work until your account is brought current, or we may withdraw from this engagement. &lt;Client&gt; acknowledges and agrees that we are not required to continue work in the event of &lt;Client&gt;'s failure to pay on a timely basis for services rendered as required by this engagement letter. &lt;Client&gt; further acknowledges and agrees that in the event we stop work or withdraw from this engagement as a result of &lt;Client&gt;'s failure to pay on a timely basis for services rendered as required by this engagement letter, we shall not be liable for any damages that occur as a result of our ceasing to render services.</p>	<p>2.13c Late charges are legal. They are not subject to usury. However, they should be in a reasonable amount, such as 1% per month or 10% per annum. The number of days set forth in this section should be the same as those used in the section describing when payment is due. Thus, if payment is due within 30 days of the invoice date, if the statement is not paid within 30 days, it then begins to accrue late charges.</p>	<p>2.16 This retainer is not intended to be an estimate of the total cost of the engagement. Your retainer will not earn interest while held by our firm.</p>	<p>2.16c This paragraph is optional. Consider keeping retainers in a client trust account. Among other things, if kept in a client trust account, the retainer is not subject to claims of the firm's general creditors in the event of insolvency or bankruptcy. Accordingly, it provides the clients with an element of protection.</p>
<p>In the event any statement or invoice rendered by us to &lt;Client&gt; is not paid within &lt;number&gt; days of the date of the invoice, then a late charge shall be accrued on the unpaid amount at the rate of &lt;number&gt;% per month from that date until paid.</p>	<p><i>Caveat:</i> A penalty for not paying an invoice must be denominated as a late charge. It cannot be called interest without full compliance with federal and state truth-in-lending and other laws.</p>	<p>This retainer is not an estimate of the total cost of the engagement. The retainer will be deposited into our general account and may be commingled with our other funds. No interest shall accrue or be paid on the funds held as a retainer.</p>	<p>However, for ease of administration, the firm may prefer to deposit the retainer into its general account. Use this paragraph in such cases.</p>
<p>2.14 Progress billings will be presented every two weeks or upon completion of a project, whichever is earlier.</p>		<p>2.17 We will require a retainer of \$&lt;amount&gt;, which will be applied to current billings as registered. In the event the retainer is exhausted during the engagement, we will require one or more additional advance retainer fee deposits. The amount of the additional retainer will depend on the amount of the work remaining. In the event that the work is in progress when the initial retainer or additional retainers are exhausted, there will be no obligation on our part to continue with this engagement until additional retainer fee deposits have been received.</p>	<p>2.17c This paragraph is optional. A replenishing retainer is very useful when dealing with a problem client or one who has a poor payment performance history.</p>
<p>FEES—RETAINERS</p>		<p>2.18 In the event that these bills are not paid on a timely basis, we will apply the retainer to pay the amounts owing. We will stop our work until the retainer balance is replenished to the full amount required. If this is not done within &lt;number&gt; days after the application of the retainer to the unpaid balance, we reserve the right to withdraw from this engagement and return any unused portion of the retainer.</p>	<p>2.18c Use this paragraph with difficult clients or clients with recurring payment problems.</p>
<p>2.15 We require a retainer prior to starting work. This retainer is applied to the final billing. Any retainer in excess of the final billing will be refunded. A retainer of \$&lt;amount&gt; is necessary to begin work on this engagement.</p>	<p>2.15c Most ongoing engagements lend themselves well to the use of retainers. Use this method if a client's payment habits have been a problem or if the client's ability to pay is questionable. To avoid fee disputes, be sure the client knows that the amount of the retainer is not an estimate of the total fee for the engagement.</p>	<p>2.19 A retainer of \$&lt;amount&gt; is due after the first week of work is completed, with regular &lt;weekly/biweekly/monthly&gt; billings as the work progresses.</p>	

## Suggested Wording

2.20 We will bill you prior to each quarter for an advance retainer of <number>% with your first quarterly payment of \$<amount> to be made upon signing this agreement. Final billing of any balance will follow completion of the work.

## FEES—CHANGE IN CIRCUMSTANCES

2.21 In our engagement letter of <date>, we said that unforeseen or changed circumstances might affect our original fee estimate of \$<amount>. It now seems likely that they will, and we want to bring this matter to your attention.

2.22 Both unforeseen and changed circumstances have occurred during the course of the engagement. We did not anticipate the problems we have encountered with your accounting procedures. These include certain shortcuts and irregular practices. Also, we did not make allowance for: <list circumstances>.

2.23 These changes are being dealt with on a continuing basis. We are spending nearly <quantifiable multiple> as many hours as indicated on our estimate. Therefore, the original fee must be revised, and our best estimate is that the total fee will be approximately \$<amount>. If you find this new estimate acceptable, please sign this letter and return it to us.

## Comments

2.20c The firm should establish a policy as to percentage requested for retainers.

2.21c Document a change in circumstances as an addendum to the engagement letter.

## Suggested Wording

## FEES—REIMBURSEMENT FOR LITIGATION

2.24 In addition, you further agree that in the event our firm or any of its employees or agents is called as a witness or requested to provide any information whether oral, written, or electronic in any judicial, quasi-judicial, or administrative hearing or trial regarding information or communications that you have provided to this firm, or any documents and workpapers prepared by <Firm> in accordance with the terms of this agreement, you agree to pay any and all reasonable expenses, including fees and costs for our time at the rates then in effect, as well as any legal or other fees that we incur as a result of such appearance or production of documents.

## LIMITATION OF LIABILITY CLAUSE

2.25 In recognition of the relative risks and benefits of this agreement to both the client and the accounting firm, the client and the accounting firm have discussed and have agreed on the fair allocation of risk between them. As such, the client agrees, to the fullest extent permitted by law, to limit the liability of the accounting firm to the client for any and all claims, losses, costs, and damages of any nature whatsoever, so that the total aggregate liability of the accounting firm to the client shall not exceed \$<amount> or <agreed factor> times the accounting firm's total fee for services rendered under this agreement, whichever is greater. The client and the accounting firm intend and agree that this limitation apply to any and all liability or cause of action against the accounting firm, however alleged or arising, unless otherwise prohibited by law.

## Comments

2.25c Before automatically using the suggested limitation of liability language in your engagement letters we strongly encourage you to review this language with your risk advisor or legal counsel, as appropriate, for possible modification. Also, it is important to note that the SEC forbids the use of indemnity clauses in engagement letters with public companies.

Suggested Wording	Comments	Suggested Wording	Comments
<b>MEDIATION CLAUSE</b>			
<p>2.26 If any dispute arises among the parties hereto, the parties agree to first try in good faith to settle the dispute by mediation administered by the &lt;Name of Association&gt; under its applicable rules for resolving professional accounting and related services disputes before resorting to litigation. Costs of any mediation proceeding shall be shared equally by all parties.</p>	<p>2.26c through 2.30c Read these comments carefully before deciding to use mediation and arbitration clauses and seek <i>legal counsel</i> before using these techniques.</p> <p>An alternative to using these clauses in an engagement letter is to have a separate letter or agreement for this purpose, with provisions for signatures and date of agreement. This eliminates the possibility of being accused of “burying” the mediation or arbitration language in an engagement letter.</p>	<p>2.27 If any dispute arises among the parties hereto, the parties agree to first try in good faith to settle the dispute by mediation administered by &lt;Name of Association&gt; under its applicable rules for resolving professional accounting and related services disputes. If the parties are unable to resolve the dispute through mediation within &lt;number of days (e.g., 60)&gt; days from the date notice is first given from one party to the other as to the existence of a dispute and the demand to mediate, then the dispute will be resolved by arbitration if this agreement provides that the particular dispute is subject to arbitration, or by whatever other lawful means are available to them if this agreement does not provide for arbitration of the particular dispute. Costs of any mediation or arbitration proceeding shall be shared equally by all parties.</p>	
	<p><i>Mediation</i> is a process in which the parties in a dispute choose a third party to listen to the dispute. The mediator does not make a decision but tries to clarify the issue and encourages both sides to reach their own agreement or compromise. The language used in paragraphs 2.26 through 2.30 is <i>general</i> language suggested for use in an engagement letter, and it leaves certain decisions, such as the manner of selecting arbitrators, qualification of arbitrators, time limits, or order of proof, up to the rules of the association.</p>		
	<p>Paragraph 2.26 is general mediation language and does not address a time frame. As an alternative mediation clause, you can use paragraph 2.27 to limit the time period in which to try to resolve the matter through mediation, so that you are not forced to wait interminably while a recalcitrant former client delays the mediation process in an effort to delay the ultimate arbitration.</p>		
	<p>Note that mediation is recommended in <i>all</i> disputes, but arbitration is recommended only in <i>fee disputes</i>.</p>		

Suggested Wording	Comments	Suggested Wording	Comments
<b>ARBITRATION CLAUSE</b>			
<p>2.28 Client and accountant both agree that any dispute over fees charged by the accountant to the client will be submitted for resolution by arbitration in accordance with the applicable rules for resolving professional accounting and related services disputes of &lt;Name of Association&gt; except that under all circumstances the arbitrator must follow the laws of &lt;Name of State&gt;. Such arbitration shall be binding and final. <b>IN AGREEING TO ARBITRATION, WE BOTH ACKNOWLEDGE THAT, IN THE EVENT OF A DISPUTE OVER FEES CHARGED BY THE ACCOUNTANT, EACH OF US IS GIVING UP THE RIGHT TO HAVE THE DISPUTE DECIDED IN A COURT OF LAW BEFORE A JUDGE OR JURY AND INSTEAD WE ARE ACCEPTING THE USE OF ARBITRATION FOR RESOLUTION.</b></p>	<p>2.28c <i>Binding arbitration</i> is the most formal alternative dispute resolution technique. In this form of arbitration, two parties agree to allow a neutral third party to settle a dispute. Binding arbitration is authorized by statute, and the decision made by the third party is enforceable in court with limited judicial review. However, it does not allow for full development of facts. Use the language in paragraph 2.28 for binding arbitration.</p>	<p>2.29 Client and accountant both agree that any dispute over fees charged by the accountant to the client will be submitted for resolution by arbitration in accordance with the applicable rules for resolving professional accounting and related services disputes of &lt;Name of Association&gt; except that in all circumstances the arbitrator must follow the laws of &lt;Name of State&gt;. Such arbitration shall be binding and final. The arbitration shall take place at &lt;location nearest accountant's office (e.g., Los Angeles, California)&gt;. Any award rendered by the arbitrator pursuant to this Agreement may be filed and entered and shall be enforceable in the Superior Court of the County in which the arbitration proceeds. <b>IN AGREEING TO ARBITRATION, WE BOTH ACKNOWLEDGE THAT, IN THE EVENT OF A DISPUTE OVER FEES CHARGED BY THE ACCOUNTANT, EACH OF US IS GIVING UP THE RIGHT TO HAVE THE DISPUTE DECIDED IN A COURT OF LAW BEFORE A JUDGE OR JURY AND INSTEAD WE ARE ACCEPTING THE USE OF ARBITRATION FOR RESOLUTION.</b></p>	
	<p>Alternatively, use paragraph 2.29 for binding arbitration and to specify the location of the arbitration rather than leaving that decision up to an organization such as the American Arbitration Association.</p>		
	<p>On balance, in most cases for fees, the accountant should be the prevailing party, although there is some risk that the client will prevail. Accordingly, you may want to add the language in paragraph 2.30 to either paragraph 2.28 or 2.29 as a provision for recovery of attorneys' fees if your state allows for attorneys' fees to be recovered in an action only if provided for by statute or an agreement between the parties. The paragraph may also deter a client from engaging in frivolous fee disputes, or it may encourage settlement of such disputes because it increases the client's financial risk related to litigating fees.</p>	<p>2.30 The prevailing party shall be entitled to an award of reasonable attorneys' fees and costs incurred in connection with the arbitration of the dispute in an amount to be determined by the arbitrator.</p>	
	<p>You may want to explicitly provide that the costs related to the arbitration shall be borne equally by the parties, shall be borne by the losing party, or shall be as allocated by the arbitrator. If the agreement is silent in that regard, the arbitrator in his or her award may assess arbitration fees, expenses, and arbitrator's compensation equally among the parties, to the party that incurred the expense, or to one or more of the parties, as the arbitrator deems appropriate.</p>	<b>CLOSINGS</b>	
		<p>2.31 If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.</p>	
		<p>2.32 If this letter correctly expresses your understanding of the terms of our engagement, please sign the enclosed copy where indicated and return it to us [along with your check for \$&lt;amount&gt;].</p>	

## 8. ESTATE/TRUST TAX PREPARATION ENGAGEMENT LETTERS

### *Suggested Wording*

### *Comments*

8.1 Thank you for selecting our firm to prepare the estate tax return for the estate of <name of estate holder>. This letter confirms the arrangements for our services.

8.2 This letter confirms the services you have asked our firm to perform and the terms under which we have agreed to do that work. Please read this letter carefully because it is important to both our firm and you that you understand what you can and cannot expect from our work. In other words, we want you to know the limitations of the services you have asked us to perform. If you are confused at all by this letter or believe we have misunderstood what you need, please call to discuss this letter before you sign it.

8.3 We will prepare the federal estate tax return, the decedent's final individual income, and the fiduciary income tax returns and compiled summary of account and recapitulation of cash with supporting exhibits of cash receipts, cash disbursements, distributions, gain or loss on sales, and property on hand, for submission to the probate court.

Suggested Wording	Comments
<p>8.4 We will prepare the return from the information you provide and, generally, we will process it through an outside computer service. We will not audit or verify the data you submit, although we may ask you to clarify it. You should retain all the documents and records that form the basis of the estate tax return. The documents may be necessary to prove the accuracy and completeness of the returns to a taxing authority. You have the final responsibility for the estate tax returns and, therefore, you should review them carefully before you sign them. We may furnish you with questionnaires and/or work sheets to help you compile the necessary information. This will not only make it easier for you to organize it, but will help keep our fee to a minimum.</p>	

Suggested Wording	Comments
<p>8.5 In preparing the estate tax returns, we will not independently determine values, except where the values could be determined by reference to market quotations contained in <i>The Wall Street Journal</i> or other equally reliable sources. All other valuation services will &lt;may&gt; be performed by outside parties.</p>	<p>8.5c If there is real estate included in the estate's assets, insist that a real estate appraisal be conducted by a competent party.</p>
<p>In preparing the estate tax returns, we will not independently determine values. We are not &lt;business or real estate&gt; appraisers or valuers. All valuation services will be performed by qualified third parties who will be chosen on a timely basis by &lt;representative of the estate (e.g., the trustee)&gt;. The &lt;representative of the estate&gt; will be solely responsible for selecting the third-party appraisers or valuers. The parties agree that we may rely on the values determined by said third-party appraisers or valuers in preparing the estate tax returns and that we shall not be liable for any damages that may result from the use of said values in the event they are not accepted by the relevant taxing authorities.</p>	<p>If there is an interest in a closely held business, recommend that an appraisal be made by a competent professional appraiser, unless the interest is relatively modest in amount. There are circumstances where there may be a stock purchase agreement or other restrictions on transfer, where value can be determined by reference to a written contract. If the interest in a closely held business is not a material item in the total estate, you could agree to determine a valuation. If you agree to do this, cover it specifically in the engagement letter.</p>
	<p>Undertake those determinations where there are valuations that can be determined simply based on arithmetic computations once the appropriate assumptions have been determined. This would cover the valuation of annuity contracts or similar arrangements, or the valuation of an installment note.</p>
	<p>Probably the most difficult valuation issue is the interest in limited partnerships. What you will do in this situation is difficult to cover in an engagement letter, because you cannot foresee what difficulties may be encountered. In this case, handle the valuation of the limited partnerships with an addendum to the engagement letter.</p>
	<p>Consider using this paragraph, because the market quotations in <i>The Wall Street Journal</i> do not reference possible accrued dividends or interest on bonds. This paragraph also makes it clear that it is the obligation or duty of the representative of the estate to obtain on a timely basis the independent valuations from third parties.</p>

Suggested Wording

8.6 If the appraisal provided by the third party contains valuation discounts from fair market value, we strongly recommend that you discuss the discounts tax ramifications with the appraiser. Excessive valuations discounts are often subject to close scrutiny by taxing authorities and should be used only after you have full knowledge of the benefits and risks that they pose.

8.7 Please note that any person or entity subject to the jurisdiction of the United States (includes individuals, corporations, partnerships, trusts, and estates) having a financial interest in, or signature or other authority over, bank accounts, securities, or other financial accounts having an aggregate value exceeding \$10,000 at any time during the calendar year in a foreign country, shall report such a relationship. Although there are some limited exceptions, filing requirements also apply to taxpayers that have direct or indirect control over a foreign or domestic entity with foreign financial accounts, even if the taxpayer does not have foreign account(s). For example, a corporate-owned foreign account would require filings by the corporation *and* by the individual corporate officers with signature authority. Failure to disclose the required information to the U.S. Department of the Treasury may result in substantial civil and/or criminal penalties.

Comments

8.6c This paragraph should be used where the estate contains one or more assets that the third-party appraiser could subject to valuation discounts (e.g., real estate, corporate stock, or an interest in a family limited partnership or other pass-through entity).

8.7c This paragraph should be considered for estates that may be subject to the additional reporting requirements.

Suggested Wording

If you and/or your entity have a financial interest in, or signature authority over, any foreign accounts, you are responsible for providing our firm with all the information necessary to prepare the Report of Foreign Bank and Financial Accounts (FBAR) required by the U.S. Department of the Treasury in order for the FBAR to be received by the Department on or before the due date. Beginning with the 2017 tax filing season, the FBAR filing deadline is April 15 and follows the federal income tax due date guidance, which notes that if the tax due date falls on a weekend or legal holiday, the form is considered timely filed if filed on the next business day. An automatic six-month extension will be granted to October 15 of each tax year. Electronic filing of the FBAR is mandatory using the Bank Secrecy Act (BSA) e-filing system for the Financial Crimes Enforcement Network (FinCEN). If you would like our firm to submit your electronic FBAR (FinCEN Form 114) on your behalf, we must receive a signed consent form (FinCEN Form 114a) from you prior to submitting the foreign reporting form. If you do not provide our firm with information regarding any interest you may have in a foreign account, or if we do not receive your signed authorization to file your foreign reporting form, we will not be able to prepare and file any of the required disclosure statements.

Comments

Suggested Wording	Comments
<p>Additionally, the Internal Revenue Service (IRS) also requires information reporting on foreign interests or activities under applicable Internal Revenue Code (IRC) sections and related regulations, and the respective IRS tax forms are due when your income tax return is due, including extensions. The IRS reporting requirements are in addition to the U.S. Department of the Treasury reporting requirements stated above. Therefore, if you have any direct or indirect foreign interests that require disclosures to the IRS, you must provide us with the information necessary to prepare the applicable IRS forms.</p>	
<p>Failure to timely file the appropriate forms with the U.S. Department of the Treasury and the IRS may result in substantial monetary penalties. By your signature below, you accept responsibility for informing us if you believe that you may have foreign reporting requirements with the U.S. Department of the Treasury and/or IRS and you agree to timely provide us with the information necessary to prepare the appropriate form(s). We understand that the foreign reporting requirements are very complex, so if you have any questions regarding the application of the U.S. Department of the Treasury and/or the IRS reporting requirements to your foreign interests or activities, please ask us for advice in that regard. We assume no liability for penalties associated with the failure to file or untimely filing of any of these forms.</p>	

#### INVESTMENT ADVICE

8.8 In our relationship, we are often advisors, not advocates, with regard to investment advice. We will advise you on the implications, if any, of specific matters you bring to our attention.

8.8c and 8.9c There are two types of investment advice: general and specific. General investment advice includes tax planning and advising on the timing of sales of residences. Specific investment advice is given when a client brings a specific investment proposal to a CPA for advice. You should warn clients about investment risks. Don't be tempted to just tell them what they want to hear.

Suggested Wording	Comments
<p>8.9 We are not &lt;choose appropriate title: investment counselors, brokers, stock agents&gt;. We can only advise you on the implications of this investment in light of today's tax laws and economy.</p>	<p><i>It is important that you document any communications about investment advice with a client.</i></p>
	<p>Give the client a written statement as to the tax implications of a specific investment and a disclaimer regarding due diligence. Avoid giving advice as to whether to invest or not. Warn clients about the risks inherent in all tax advice, the risks in the particular situation, and any absence of judicial authority, conflict in the courts, absence of clear regulation, or other factors that make their outcome uncertain.</p>
	<p>Promoting investments or accepting commissions or any other compensation from a group underwriting or sponsoring the investment is prohibited in some states. Check your states laws for the legality of accepting commissions and contingent fees. Acceptance also may create a clear conflict of interest in rendering advice to a client. And if the investment vehicle is a security, the situation may expose the firm to claims involving securities law violations.</p>
	<p><b>IRC § 7525 CONFIDENTIAL CLIENT COMMUNICATION PRIVILEGE</b></p>
<p>8.10 Federal law has extended the attorney-client privilege to some, but not all, communications between a client and the client's CPA. The privilege applies only to non-criminal tax matters that are before the IRS or brought by or against the U.S. government in a federal court. The communications must be made in connection with tax advice. Communications solely concerning the preparation of a tax return will not be privileged.</p>	<p>8.10c The attendant language should be used in any engagement where it appears the privilege might be reasonably expected to apply at any point during the engagement. The language should be used expansively (i.e., it is better to include the language in the engagement letter and then later not need the language than to not include the language and then need it).</p>

## Suggested Wording

In addition, the confidentiality privilege can be inadvertently waived if the contents of any privileged communication are discussed with a third party, such as a lending institution, a friend, or a business associate. We recommend that you contact us before releasing any privileged information to a third party.

If we are asked to disclose any privileged communication, unless we are required to disclose the communication by law, we will not provide such disclosure until you have had an opportunity to argue that the communication is privileged. You agree to pay any and all reasonable expenses that we incur, including legal fees, that are a result of attempts to protect any communication as privileged.

## USE OF THIRD-PARTY SERVICE PROVIDERS

8.11 Unless you indicate otherwise, our firm may transmit confidential information that you provided us to third parties in order to facilitate delivering our services to you. For example, such transmissions might include, but not be limited to, <identify examples>. We have secured confidentiality agreements with all our service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have the appropriate procedures in place to prevent the unauthorized release of confidential information to others. We will remain responsible for the work provided by any third-party service providers used under this agreement. By your signature below, you consent to having confidential information transmitted to entities outside the firm. Please feel free to inquire if you would like additional information regarding the transmission of confidential information to entities outside the firm.

## Comments

8.11c This paragraph should be used if you are using third-party service provider(s) to assist you in performing professional services for your client's

## Suggested Wording

## RECORD RETENTION

8.12 It is our policy to keep records related to this engagement for <number> years. However, <Firm Name> does not keep any original client records, so we will return those to you at the completion of the services rendered under this engagement. When records are returned to you, it is your responsibility to retain and protect your records for possible future use, including potential examination by any government or regulatory agencies.

By your signature below, you acknowledge and agree that upon the expiration of the <number>-year period <Firm Name> shall be free to destroy our records related to this engagement.

## Comments

8.12c If you believe there is even a remote chance of a claim with a current client, keep copies of the client's records and your workpapers. If you are asked to return client records, make copies for your files and return the originals. Get a signed, itemized receipt when you turn them over to your client.

The firm should establish its own record retention policy. Before destroying records, the following steps should be considered: (1) send a letter to the last known address of the client, (2) inform the client that its records will be destroyed unless it contacts the firm by a specific date, (3) if a client picks up its records, get a signed, itemized receipt.

You may wish to provide copies (not originals) of your workpapers if the client requests them. If you give the client copies of the workpapers, number consecutively each of the pages copied and get a signed, itemized receipt. If you have questions or concerns about whether papers belong to you or to the client, or about whether you should give the client copies, call the firm's risk advisor.

## FEES &amp; BILLINGS—GENERAL

8.13 Our fees for this work will be at our regular hourly rates for the individuals involved plus direct out-of-pocket expenses. Payment for service is due when rendered, and interim billings may be submitted as work progresses and expenses are incurred.

Suggested Wording	Comments
<p>8.14 Statements for our services will be sent on a &lt;monthly, weekly, biweekly&gt; basis. Currently, billing rates for our staff are: &lt;list rates&gt;.</p>	<p>8.14c It is unethical to base a fee for preparing a tax return on the amount saved in taxes, because a properly prepared tax return results in proper tax liability and there is no basis for computing a savings. Consider progress billings, especially in the case of audits. Without such a provision the entire contract is tied to the audit, so that payment cannot be enforced until after full performance by the auditor. Consider billing every other week for significant engagements and first-year audit clients.</p>
<p>8.15 Billings become delinquent if not paid within &lt;number&gt; days of the invoice date. If billings are not paid within &lt;number&gt; days of the invoice date, at our election, we may stop all work until your account is brought current or withdraw from this engagement. &lt;Client&gt; acknowledges and agrees that we are not required to continue work in the event of &lt;Client&gt;'s failure to pay on a timely basis for services rendered as required by this engagement letter. &lt;Client&gt; further acknowledges and agrees that in the event we stop work or withdraw from this engagement as a result of &lt;Client&gt;'s failure to pay on a timely basis for services rendered as required by this engagement letter, we shall not be liable for any damages that occur as a result of our ceasing to render services.</p>	<p>8.15c Late charges are legal. They are not subject to usury. However, they should be in a reasonable amount, such as 1% per month or 10% per annum. The number of days set forth in this paragraph should be the same as those used in the paragraph describing when payment is due. Thus, if payment is due within 30 days of the invoice date and if the statement is not paid within 30 days, it then begins to accrue late charges.</p> <p><i>Caveat:</i> A penalty for not paying an invoice must be denominated as a late charge. It cannot be called interest without full compliance with federal and state truth-in-lending and other laws.</p>
<p>In the event any statement or invoice rendered by us to &lt;Client&gt; is not paid within &lt;number&gt; days of the date of the invoice, then a late charge shall be accrued on the unpaid amount at the rate of &lt;number&gt;% per month from that date until paid.</p>	
<p>8.16 Progress billings will be presented every two weeks or upon completion of a project, whichever is earlier.</p>	

Suggested Wording	Comments
<b>FEES—RETAINERS</b>	
<p>8.17 We require a retainer prior to starting work. This retainer is applied to the final billing. Any retainer in excess of the final billing will be refunded. A retainer of \$&lt;amount&gt; is necessary to begin work on this engagement.</p>	<p>8.17c Most ongoing engagements lend themselves well to the use of retainers. Use this method if a client's payment habits have been a problem or if its ability to pay is questionable. To avoid fee disputes, be sure the client knows that the amount of the retainer is not an estimate of the total fee for the engagement.</p>
<p>8.18 This retainer is not intended to be an estimate of the total cost of the engagement. Your retainer will not earn interest while held by our firm.</p>	<p>8.18c <i>This paragraph is optional.</i> Consider keeping retainers in a client trust account. Among other things, if kept in a client trust account, the retainer is not subject to claims of the firm's general creditors in the event of insolvency or bankruptcy. Accordingly, it provides the clients with an element of protection.</p>
<p>This retainer is not an estimate of the total cost of the engagement. The retainer will be deposited into our general account and may be commingled with our other funds. No interest shall accrue or be paid on the funds held as a retainer.</p>	<p>However, for ease of administration, the firm may prefer to deposit the retainer into its general account. Use this paragraph in such cases.</p>
<p>8.19 We will require a retainer of \$&lt;amount&gt;, which will be applied to current billings as registered.</p>	<p>8.19c <i>This paragraph is optional.</i> A replenishing retainer is useful when dealing with a problem client or one that has a poor payment performance history.</p>
<p>In the event the retainer is exhausted during the engagement, we will require one or more additional advance retainer fee deposits. The amount of the additional retainer will depend on the amount of the work remaining. In the event that the work is in progress when the initial retainer or additional retainers are exhausted, there will be no obligation on our part to continue with this engagement until additional retainer fee deposits have been received.</p>	

Suggested Wording	Comments
<p>8.20 In the event that these bills are not paid on a timely basis, we will apply the retainer to pay the amounts owing. We will stop our work until the retainer balance is replenished to the full amount required. If this is not done within &lt;number&gt; days after the application of the retainer to the unpaid balance, we reserve the right to withdraw from this engagement and return any unused portion of the retainer.</p>	<p>8.20c Use this paragraph with difficult clients or clients with recurring payment problems.</p>
<p>8.21 A retainer of \$&lt;amount&gt; is due after the first week of work is completed, with regular &lt;weekly/biweekly/monthly&gt; billings as the work progresses.</p>	
<p>8.22 We will bill you prior to each quarter for an advance retainer of &lt;number&gt;% with your first quarterly payment of \$&lt;amount&gt; to be made upon signing this agreement. Final billing of any balance will follow completion of the work.</p>	<p>8.22c The firm should establish a policy as to percentage requested for retainers.</p>
<p><b>FEES—CHANGE IN CIRCUMSTANCES</b></p>	
<p>8.23 In our engagement letter of &lt;date&gt;, we said that unforeseen or changed circumstances might affect our original fee estimate of \$&lt;amount&gt;. It now seems likely that they will, and we want to bring this matter to your attention.</p>	<p>8.23c Document a change in circumstances as an addendum to the engagement letter.</p>
<p>8.24 Both unforeseen and changed circumstances have occurred during the course of the engagement. We did not anticipate the problems we have encountered with your accounting procedures. These include certain shortcuts and irregular practices. Also, we did not make allowance for: &lt;list circumstances&gt;.</p>	

Suggested Wording	Comments
<p>8.25 These changes are being dealt with on a continuing basis. We are spending nearly &lt;quantifiable multiple&gt; as many hours as indicated on our estimate. Therefore, the original fee must be revised, and our best estimate is that the total fee will be approximately \$&lt;amount&gt;. If you find this new estimate acceptable, please sign this letter and return it to us.</p>	
<p><b>FEES—REIMBURSEMENT FOR LITIGATION</b></p>	
<p>8.26 In addition, you further agree that in the event our firm or any of its employees or agents is called as a witness or requested to provide any information, whether oral, written, or electronic in any judicial, quasi-judicial, or administrative hearing or trial regarding information or communications that you have provided to this firm, or any documents and workpapers prepared by &lt;Firm&gt; in accordance with the terms of this agreement, you agree to pay any and all reasonable expenses, including fees and costs for our time at the rates specified in our engagement letter, as well as any legal or other fees that we incur as a result of such appearance or production of documents.</p>	

Suggested Wording	Comments
<b>LIMITATION OF LIABILITY CLAUSE</b>	
<p>8.27 In recognition of the relative risks and benefits of this agreement to both the client and the accounting firm, the client and the accounting firm have discussed and have agreed on the fair allocation of risk between them. As such, the client agrees, to the fullest extent permitted by law, to limit the liability of the accounting firm to the client for any and all claims, losses, costs, and damages of any nature whatsoever, so that the total aggregate liability of the accounting firm to the client shall not exceed \$&lt;amount&gt; or &lt;agreed factor&gt; times the accounting firm's total fee for services rendered under this agreement, whichever is greater. The client and the accounting firm intend and agree that this limitation apply to any and all liability or cause of action against the accounting firm, however alleged or arising, unless otherwise prohibited by law.</p>	<p>8.27c Before automatically using the suggested limitation of liability language in your engagement letters we strongly encourage you to review this language with your risk advisor or legal counsel, as appropriate, for possible modification. Also, it is important to note that the SEC forbids the use of indemnity clauses in engagement letters with public companies.</p>

Suggested Wording	Comments
<b>MEDIATION CLAUSE</b>	
<p>8.28 If any dispute arises among the parties hereto, the parties agree to first try in good faith to settle the dispute by mediation administered by the &lt;Name of Association&gt; under its applicable rules for resolving professional accounting and related services disputes before resorting to litigation. Costs of any mediation proceeding shall be shared equally by all parties.</p>	<p>8.28c through 8.32c Read these comments carefully before deciding to use mediation and arbitration clauses and seek legal counsel before using these techniques.</p> <p>An alternative to using these clauses in an engagement letter is to have a separate letter or agreement for this purpose, with provisions for signatures and date of agreement. This eliminates the possibility of being accused of "burying" the mediation or arbitration language in an engagement letter.</p> <p><i>Mediation</i> is a process in which the parties in a dispute choose a third party to listen to the dispute. The mediator does not make a decision but tries to clarify the issue and encourages both sides to reach their own agreement or compromise. The language used in paragraphs 8.28 through 8.32 is <i>general</i> language suggested for use in an engagement letter, and it leaves certain decisions, such as the manner of selecting arbitrators, qualification of arbitrators, time limits, or order of proof, up to the rules of the association.</p> <p>Paragraph 8.28 is general mediation language and does not address a time frame. As an alternative mediation clause, you can use paragraph 8.29 to limit the time period in which to try to resolve the matter through mediation, so that you are not forced to wait interminably while a recalcitrant former client delays the mediation process in an effort to delay the ultimate arbitration.</p> <p>Note that mediation is recommended in <i>all</i> disputes, but arbitration is recommended only in <i>fee</i> disputes.</p>

## Suggested Wording

8.29 If any dispute arises among the parties hereto, the parties agree to first try in good faith to settle the dispute by mediation administered by <Name of Association> under its applicable rules for resolving professional accounting and related services disputes. If the parties are unable to resolve the dispute through mediation within <number of days (e.g., 60)> days from the date notice is first given from one party to the other as to the existence of a dispute and the demand to mediate, then the dispute will be resolved by arbitration if this agreement provides that the particular dispute is subject to arbitration, or by whatever other lawful means are available to them if this agreement does not provide for arbitration of the particular dispute. Costs of any mediation or arbitration proceeding shall be shared equally by all parties.

## Comments

## Suggested Wording

## ARBITRATION CLAUSE

8.30 Client and accountant both agree that any dispute over fees charged by the accountant to the client will be submitted for resolution by arbitration in accordance with the applicable rules for resolving professional accounting and related services disputes of <Name of Association>, except that under all circumstances the arbitrator must follow the laws of <Name of State>. Such arbitration shall be binding and final. IN AGREEING TO ARBITRATION, WE BOTH ACKNOWLEDGE THAT, IN THE EVENT OF A DISPUTE OVER FEES CHARGED BY THE ACCOUNTANT, EACH OF US IS GIVING UP THE RIGHT TO HAVE THE DISPUTE DECIDED IN A COURT OF LAW BEFORE A JUDGE OR JURY AND INSTEAD WE ARE ACCEPTING THE USE OF ARBITRATION FOR RESOLUTION.

## Comments

8.30c *Binding arbitration* is the most formal alternative dispute resolution technique. In this form of arbitration, two parties agree to allow a neutral third party to settle a dispute. Binding arbitration is authorized by statute, and the decision made by the third party is enforceable in court with limited judicial review. However, it does not allow for full development of facts. Use the language in paragraph 8.30 for binding arbitration.

Alternatively, use paragraph 8.31 for binding arbitration and to specify the location of the arbitration rather than leaving that decision up to an organization such as the American Arbitration Association.

On balance, in most cases for fees, the accountant should be the prevailing party, although there is some risk that the client will prevail. Accordingly, you may want to add the language in paragraph 8.32 to either paragraph 8.30 or paragraph 8.31 as a provision for recovery of attorneys' fees if your state allows for attorneys' fees to be recovered in an action only if provided for by statute or an agreement between the parties. The paragraph may also deter a client from engaging in frivolous fee disputes, or it may encourage settlement of such disputes because it increases the client's financial risk related to litigating fees.

You may want to explicitly provide that the costs related to the arbitration shall be borne equally by the parties, shall be borne by the losing party, or shall be as allocated by the arbitrator. If the agreement is silent in that regard, the arbitrator in his or her award may assess arbitration fees, expenses, and arbitrator's compensation equally among the parties, to the party that incurred the expense, or to one or more of the parties, as the arbitrator deems appropriate.

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Suggested Wording	Comments	Suggested Wording	Comments
<p>8.31 Client and accountant both agree that any dispute over fees charged by the accountant to the client will be submitted for resolution by arbitration in accordance with the applicable rules for resolving professional accounting and related services disputes of &lt;Name of Association&gt;, except that in all circumstances the arbitrator must follow the laws of &lt;Name of State&gt;. Such arbitration shall be binding and final. The arbitration shall take place at &lt;location nearest accountant's office (e.g., Los Angeles, California)&gt;. Any award rendered by the arbitrator pursuant to this Agreement may be filed and entered and shall be enforceable in the Superior Court of the County in which the arbitration proceeds. IN AGREEING TO ARBITRATION, WE BOTH ACKNOWLEDGE THAT, IN THE EVENT OF A DISPUTE OVER FEES CHARGED BY THE ACCOUNTANT, EACH OF US IS GIVING UP THE RIGHT TO HAVE THE DISPUTE DECIDED IN A COURT OF LAW BEFORE A JUDGE OR JURY AND INSTEAD WE ARE ACCEPTING THE USE OF ARBITRATION FOR RESOLUTION.</p>		<p>8.35 In order for us to begin this engagement, you must sign your name at the bottom of this page and return a signed copy of this engagement letter to us.</p>	
<p>8.32 The prevailing party shall be entitled to an award of reasonable attorneys' fees and costs incurred in connection with the arbitration of the dispute in an amount to be determined by the arbitrator.</p>		<p>8.36 We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us. This letter will continue in effect until cancelled by either party.</p>	
<p>CLOSINGS</p>			
<p>8.33 If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.</p>			
<p>8.34 If this letter correctly expresses your understanding of the terms of our engagement, please sign the enclosed copy where indicated and return it to us [along with your check for \$&lt;amount&gt;].</p>			

## 12. PERSONAL/BUSINESS MANAGEMENT ENGAGEMENT LETTERS

### *Suggested Wording*

### *Comments*

12.1 We have adopted a policy of advising our clients in writing of our understanding as to the scope of our service and asking them to confirm that their understanding is the same as ours.

12.2 This letter confirms the services you have asked our firm to perform and the terms under which we have agreed to do that work. Please read this letter carefully because it is important to both our firm and you that you understand what you can and cannot expect from our work. In other words, we want you to know the limitations of the services you have asked us to perform. If you are confused at all by this letter or believe we have misunderstood what you need, please call to discuss this letter before you sign it.

12.3 This letter is to confirm our understanding of the terms and objectives of our engagement as well as the nature and limitations of the services we will provide.

12.4 This letter confirms the arrangements for our services.

12.5 We plan to start the engagement on or about <date> [unless unforeseeable problems occur].

### 12.6 Bookkeeping and Accounting

#### Services: Books and Records

We will keep detailed journals and ledgers for you.

Suggested Wording	Comments	Suggested Wording	Comments
<p><b>12.7 Personal Financial Planning</b></p> <p>The financial planning process, though complex and sometimes tedious, is an important step toward achieving your personal financial goals. Our services will involve accumulating and organizing facts about your current and desired financial status and identifying your specific goals and objectives. This will be accomplished through a series of interviews and questionnaires. We will rely on your cooperation in providing us with complete and accurate information and documents concerning your personal financial situation.</p> <p>We will perform a detailed analysis of your financial circumstances; the primary objective of this phase of our engagement is to prepare an analysis of your financial situation and to assist you in developing a financial plan tailored to meet your current needs. Therefore, we will use our professional judgment and expertise to present you with appropriate alternatives to meet the specific financial goals and objectives identified.</p> <p>As part of this financial planning process you will, of course, be free to follow or disregard, in whole or in part, any recommendations we make. You will be responsible for any and all decisions regarding implementation of the recommendations; at your request, we will be available to assist you in implementing the agreed upon recommendations you deem appropriate and/or to coordinate implementation with any insurance agent, investment broker, or attorney of your choosing.</p>	<p>12.7c In accordance with the Statement on Standards in Personal Financial Planning Services (SSPFPS) No. 1, the CPA should communicate and document the specific scope and nature of the services to be provided, the compensation for such services, and any conflicts of interest that may exist.</p>	<p><b>12.8 Cash Disbursements</b></p> <p>Our office will look at all of the bills and invoices rendered to you and, if approved by you, will generate checks drawn on various checking accounts &lt;specify account numbers if known&gt;. These checks will be forwarded to you for your signature. &lt;Name of Partner&gt; will be the only other authority to sign checks but will only do so at your request and when all invoices paid have been approved by you. This authority is for your convenience. Where possible, all regular checks will require only your signature.</p> <p><b>12.9 Bank Account</b></p> <p>We will prepare checks and transfer funds in payment of normal monthly expenditures (such as, but not limited to, answering service fee and equipment lease charge). Bills of an unusual nature will require your special authorization before payment is made.</p> <p>12.10 Upon your authorization, we will open a checking account at &lt;Name of Bank&gt;. The account will be carried in your name, and you authorize checks to be drawn on the account by &lt;Person(s)&gt; in accordance with the restrictions per the bank signature cards.</p> <p><b>12.11 Cash Receipts</b></p> <p>We will receive monies from your agent and/or managers, to be deposited into your various bank accounts. We will collect monies payable directly to you from various sources. These monies will be deposited immediately and, at the time of the deposit, a copy of our internal memo (showing receipt of the money and the account to which it is deposited) will be generated and sent to you.</p>	<p>12.8c Some of your clients may ask you to sign checks without their signature at all. Make sure that all checks above a modest amount require more than one signature at your office and that checks of a significant amount are signed by the client.</p> <p>12.11c If significant internal controls weaknesses exist, you need to consider some form of communication with your client.</p>

<u>Suggested Wording</u>	<u>Comments</u>	<u>Suggested Wording</u>	<u>Comments</u>
<p>12.12 At the end of each month, upon receipt of bank statements, we will reconcile bank accounts and submit a detailed listing of each check drawn on your accounts, the opening and closing balance in the accounts, as well as cash receipts for the accounts.</p> <p>This listing will be accompanied by a copy of all checks generated during the period. We will run detailed general ledgers for you. If you would like, we will submit these general ledgers to you.</p>	<p>12.12c Have the client review, comment on, sign, and return the report so that the client can "verify" its accuracy.</p>	<p><b>12.14 Tax Matters</b></p> <p>You are required to file various tax returns and reports with governmental agencies. These include personal and corporate income tax returns, estimated tax returns, payroll tax returns, payroll deposits, and real property payments. You have requested that our firm prepare the following returns:</p> <p>&lt;List&gt;</p> <p>We will submit to you for your review and signature the returns you have asked us to prepare. You have the final responsibility for the accuracy and completeness of the returns; therefore, you should review them carefully before you sign them. Our firm is responsible for preparing only the returns listed above; should you request our services for preparing any other tax or informational returns, we will cover those services in a separate engagement letter.</p>	<p>12.14c For specific language for Income Tax Return preparation, please see the respective tax engagement letter chapters in this book.</p>
<p><b>12.13 Cash Management</b></p> <p>At your direction, we will also invest your excess funds in short-term securities such as treasury bills, savings accounts, commercial paper, or certificates of deposit in order to provide you with a maximum return on your funds consistent with your desired security and liquidity. There are no guarantees as to any specific results such as improved investment earnings or higher cash balances as a result of such short-term investments. Accordingly, we cannot, and do not, guarantee the outcome of your investment decisions. We are not investment experts or advisors. We will not advise you with regard to the appropriateness of any such investment decisions, nor are we responsible for any losses that may occur as a result of your investment decisions. We will merely carry out your instructions with regard to such investments.</p>	<p>12.13c Remind your client that there are no guarantees as to any specific results such as improved investment earnings or higher cash balances.</p>	<p><b>12.15 Insurance</b></p> <p>We will pay premiums for insurance bills that are either sent to us directly from your insurance company or forwarded to us by you. If you do not forward insurance premium billings to us, we cannot be responsible for a lapse or cancellation in your coverage.</p>	<p>12.15c Advise your client to seek professional insurance advice regarding the need for coverage, limits, etc. When CPAs undertake responsibility in any way for their clients' insurance, there is an increased professional liability risk because a claim may result from insufficient coverage.</p>
		<p><b>12.16</b> For insurance premium billings mailed directly to us by the insurance company, where payment must be authorized by you, you must be made aware that a delay in your authorization can result in a lapse or cancellation of coverage.</p>	<p>12.16c In order for your risk to be minimized, the engagement letter needs to be specific as to the responsibility of the client.</p>
		<p><b>12.17</b> If you advise us to make a change in coverage which is already in force, be advised that the change is not effective until it is confirmed by the insurance company.</p>	

Suggested Wording	Comments
12.18 We are not insurance experts. We will not advise you on the adequacy of limits or interpret policy provisions for you.	
12.19 Because a detailed examination of all transactions is not a part of our engagement, there is a risk that material errors, irregularities, or illegal acts (including fraud or defalcation) may exist and not be detected by us.	
<b>INVESTMENT ADVICE</b>	
12.20 In our relationship, we are often advisors, not advocates, with regard to investment advice. We will advise you on the implications, if any, of specific matters you bring to our attention.	12.20c and 12.21c There are two types of investment advice: general and specific. General investment advice includes tax planning and advising on the timing of sales of residences. Specific investment advice is given when a client brings a specific investment proposal to a CPA for advice. Remember to warn your clients about investment risks. Do not be tempted to tell them only what they want to hear.
12.21 We are not <choose appropriate title: investment counselors, brokers, stock agents>. We can only advise you on the implications of this investment in light of today's tax laws and economy.	<i>It is important to document communication about investment advice with your client.</i>
	Give your clients a written statement about the tax implications of a specific investment and a disclaimer regarding due diligence. Avoid giving advice as to whether to invest or not. Warn them about the risks inherent in all tax advice, the risks in the particular situation and any absence of judicial authority, conflict in the courts, absence of clear regulation, or other factors that make their outcome uncertain.
	Promoting investments or accepting commissions or any other compensation from a group underwriting or sponsoring the investment is generally illegal in most states. Check your own state laws for the legality of accepting commissions and contingent fees. Accepting such fees may create a clear conflict of interest in rendering advice to a client. And if the investment vehicle is a security, the situation may expose the firm to claims involving securities law violations.

Suggested Wording	Comments
12.22 You have asked us to receive in our office and file your monthly broker statements from <list> for the purpose of preparing your federal and state individual tax returns. By your signature below, you understand that we are not investment advisors. As such, our services related to maintaining the brokerage statements in our files are not designed to review the broker statements or verify the accuracy of the statements, nor will we track the information for purposes of rendering any investment advice to you. Accordingly, we will not advise you regarding the economic viability or consequences of an investment and/or transaction or whether you should or should not make a particular investment and/or transaction.	
You will, of course, be free to follow or to disregard, in whole or in part, any recommendations we may make. You will be responsible for any and all decisions regarding implementation of the recommendations. At your request, we will be happy to coordinate implementation with any insurance agent, investment broker, or attorney of your choosing.	

Suggested Wording	Comments	Suggested Wording	Comments
<b>RECORD RETENTION</b>			
<p>12.23 It is our policy to keep records related to this engagement for &lt;number&gt; years. However, &lt;Firm Name&gt; does not keep any original client records, so we will return those to you at the completion of the services rendered under this engagement. When records are returned to you, it is your responsibility to retain and protect your records for possible future use, including potential examination by any government or regulatory agencies.</p>	<p>12.23c If you think there is even a remote chance of a claim with a current client, keep copies of the client's records and your workpapers. If you are asked to return client records, make copies for your files and return the originals. Get a signed, itemized receipt when you turn them over to your client.</p>	<p>12.25 Statements for our services will be sent on a &lt;weekly/biweekly/monthly&gt; basis. Currently, billing rates for our staff are: &lt;rates&gt;.</p>	<p>12.25c It is unethical to base a fee for preparing a tax return on the amount saved in taxes, because a properly prepared tax return results in proper tax liability and there is no basis for computing a savings. Consider progress billings, especially in the case of audits. Without such a provision the "entire" contract is tied to the audit, so that payment cannot be enforced until after full performance by the auditor. Consider billing every other week for significant engagements and first-year audit clients.</p>
<p>By your signature below, you acknowledge and agree that upon the expiration of the &lt;number&gt;-year period &lt;Firm Name&gt; shall be free to destroy our records related to this engagement.</p>	<p>Your firm should establish its own record retention policy.</p>		
	<p>Before you destroy records, consider taking the following steps: (1) send a letter to the last known address of the client, (2) inform the client that you intend to destroy the records unless you hear from them by a specific date, and (3) if a client picks up his or her records, get a signed, itemized receipt.</p>	<p>12.26 Billings become delinquent if not paid within &lt;number&gt; days of the invoice date. If billings are not paid within &lt;number&gt; days of the invoice date, at our election, we may stop all work until your account is brought current, or we may withdraw from this engagement. &lt;Client&gt; acknowledges and agrees that we are not required to continue work in the event of &lt;Client&gt;'s failure to pay on a timely basis for services rendered as required by this engagement letter. &lt;Client&gt; further acknowledges and agrees that in the event we stop work or withdraw from this engagement as a result of &lt;Client&gt;'s failure to pay on a timely basis for services rendered as required by this engagement letter, we shall not be liable for any damages that occur as a result of our ceasing to render services.</p>	<p>12.26c Late charges are legal. They are not subject to usury. However, they should be in a reasonable amount, such as 1% per month or 10% per annum. The number of days set forth in this section should mirror those used in the section describing when payment is due. Thus, if payment is due within 30 days of the invoice date, then late charges begin to accrue after 30 days.</p>
	<p>You may wish to provide copies (not originals) of your workpapers if the client requests them. If you give your client copies of your workpapers, number each of the pages copied consecutively and get a signed, itemized receipt. If you have questions or concerns about whether papers belong to you or to the client, or about whether you should give your client copies, call your risk advisor.</p>		<p><i>Caveat:</i> A penalty for not paying an invoice must be denominated as a late charge. This cannot be called interest without full compliance with federal and state truth-in-lending and other laws.</p>
<b>FEES &amp; BILLINGS—GENERAL</b>			
<p>12.24 Our fees for this work will be at our regular hourly rates for the individuals involved plus direct out-of-pocket expenses. Payment for services is due when rendered, and interim billings may be submitted as work progresses and expenses are incurred.</p>		<p>In the event any statement or invoice rendered by us to &lt;Client&gt; is not paid within &lt;number&gt; days of the date of the invoice, then a late charge shall be accrued on the unpaid amount at the rate of &lt;number&gt;% per month from that date until paid.</p>	
		<p>12.27 Progress billings will be presented every two weeks or upon completion of a project, whichever is earlier.</p>	

Suggested Wording	Comments	Suggested Wording	Comments
<b>FEES—RETAINERS</b>			
<p>12.28 We require a retainer prior to starting work. This retainer is applied to the final billing. Any retainer in excess of the final billing will be refunded. A retainer of \$&lt;amount&gt; is necessary to begin work on this engagement.</p>	<p>12.28c Most ongoing engagements lend themselves well to the use of retainers. This method is especially important if a client's payment habits have been a problem or if his or her ability to pay is questionable. In order to avoid fee disputes be sure the client knows that the amount of the retainer is not an estimate of the total fee for the engagement.</p>	<p>12.31 In the event that these bills are not paid in a timely manner, we will apply the retainer to pay the amounts owing. We will stop our work until the retainer balance is replenished to the full amount required. If this is not done within &lt;number&gt; days after the application of the retainer to the unpaid balance, we reserve the right to withdraw from this engagement and return any unused portion of the retainer.</p>	<p>12.31c Use this paragraph with difficult clients or clients with recurring payment problems.</p>
<p>12.29 This retainer is not intended to be an estimate of the total cost of the engagement. Your retainer will not earn interest while held by our firm.</p>	<p>12.29c <i>This paragraph is optional.</i> Consider keeping retainers in a client trust account. Among other things, if kept in a client trust account, the retainer is not subject to claims of the firm's general creditors in the event of insolvency or bankruptcy. Accordingly, it provides the clients with an element of protection.</p>	<p>12.32 A retainer of \$&lt;amount&gt; is due after the first week of work is completed, with regular &lt;weekly/biweekly/monthly&gt; billings as the work progresses.</p>	
<p>This retainer is not an estimate of the total cost of the engagement. The retainer will be deposited into our general account and may be commingled with our other funds. No interest shall accrue or be paid on the funds held as a retainer.</p>	<p>However, for ease of administration, you may prefer to deposit the retainer into your general account. Use this paragraph in such cases.</p>	<p>12.33 We will bill you prior to each quarter for an advance retainer of &lt;number&gt;% with your first quarterly payment of \$&lt;amount&gt; to be made upon signing this agreement. Final billing of any balance will follow completion of the work.</p>	<p>12.33c Establish a firm policy as to percentage requested for retainers.</p>
<p>12.30 We will require a retainer of \$&lt;amount&gt;, which will be applied to current billings as registered.</p>	<p>12.30c <i>This paragraph is optional.</i> A replenishing retainer is very useful where dealing with a problem client or one who has a poor payment performance history.</p>		
<p>In the event the retainer is exhausted during the engagement, we will require one or more additional advance retainer fee deposits. The amount of the additional retainer will depend on the amount of the work remaining. In the event that the work is in progress when the initial retainer or additional retainers are exhausted, there will be no obligation on our part to continue with this engagement until additional retainer fee deposits have been received.</p>		<b>FEES—CHANGE IN CIRCUMSTANCES</b>	
		<p>12.34 In our engagement letter of &lt;date&gt;, we said that unforeseen or changed circumstances might affect our original fee estimate of \$&lt;amount&gt;. It now seems likely that they will, and we want to bring this matter to your attention.</p>	<p>12.34c Document a change in circumstances as an addendum to the engagement letter.</p>
		<p>12.35 Both unforeseen and changed circumstances have occurred during the course of the engagement. We did not anticipate the problems we have encountered with your accounting procedures. These include certain shortcuts and irregular practices. Also, we did not make allowance for: &lt;list circumstances&gt;.</p>	

Suggested Wording	Comments	Suggested Wording	Comments
<p>12.36 These changes are being dealt with on a continuing basis. We are spending nearly &lt;quantifiable multiple&gt; as many hours as indicated on our estimate. Therefore, the original fee must be revised, and our best estimate is that the total fee will be approximately \$&lt;amount&gt;. If you find this new estimate acceptable, please sign this letter and return it to us.</p>		<p><b>LIMITATION OF LIABILITY CLAUSE</b></p>	
<p><b>FEES—REIMBURSEMENT FOR LITIGATION</b></p>		<p>12.38 In recognition of the relative risks and benefits of this agreement to both the client and the accounting firm, the client and the accounting firm have discussed and have agreed on the fair allocation of risk between them. As such, the client agrees, to the fullest extent permitted by law, to limit the liability of the accounting firm to the client for any and all claims, losses, costs, and damages of any nature whatsoever, so that the total aggregate liability of the accounting firm to the client shall not exceed \$&lt;amount&gt; or &lt;Agreed Factor&gt; times the accounting firm's total fee for services rendered under this agreement, whichever is greater. The client and the accounting firm intend and agree that this limitation apply to any and all liability or cause of action against the accounting firm, however alleged or arising, unless otherwise prohibited by law.</p>	<p>12.38c Before automatically using the suggested limitation of liability language in your engagement letters we strongly encourage you to review this language with your risk advisor or legal counsel, as appropriate, for possible modification. Also, it is important to note that the SEC forbids the use of indemnity clauses in engagement letters with public companies.</p>
<p>12.37 In addition, you further agree that in the event our firm or any of its employees or agents is called as a witness or requested to provide any information whether oral, written, or electronic in any judicial, quasi-judicial, or administrative hearing or trial regarding information or communications that you have provided to this firm, or any documents and workpapers prepared by &lt;Firm&gt; in accordance with the terms of this agreement, you agree to pay any and all reasonable expenses, including fees and costs for our time at the rates specified in our engagement letter, as well as any legal or other fees that we incur as a result of such appearance or production of documents.</p>		<p><b>MEDIATION CLAUSE</b></p>	
		<p>12.39 If a dispute arises among the parties hereto, the parties agree to first try in good faith to settle the dispute by mediation administered by the &lt;Name of Association&gt; under its applicable rules for resolving professional accounting and related services disputes before resorting to litigation. Costs of any mediation proceeding shall be shared equally by all parties.</p>	<p>12.39c through 12.43c Read these comments carefully before deciding to use mediation and arbitration clauses and <i>seek legal counsel</i> before using these techniques.</p>