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A Professional Association

## VIOLATIONS OF PROFESSIONAL ETHICS IN MALPRACTICE LITIGATION

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Aggressive and sophisticated plaintiff's attorneys (and their "independent" expert witnesses) frequently attempt to introduce claimed violations of professional ethics into malpractice lawsuits. They do so because:

- Ethics rules are often intuitive and easier than technical professional standards for lay judges and juries to understand.
- Rules of ethics can often be applied with flexibility and discretion by testifying experts.
- An ethics violation can motivate (inflammate) the fact finder, leading to a finding of aggravated liability or enhanced damages.

In short, a plaintiff with a plausible claim for conflict of interest or lack of integrity may have an easier time persuading the jury to find a technical violation and damages than would otherwise often be the case.

### **AICPA Code of Professional Conduct**

The source of professional ethics is the Code of Professional Conduct, promulgated by the American Institute of Certified Public Accountants ("Code"). The Code has been enacted into the substantive law governing CPAs by the accounting boards of many states. In Minnesota, for example, the Minnesota Board of Accountancy has incorporated the Code into state law by reference, in Minn. R. 1105.0250.

The lofty aspirations of the Code are introduced with a call for “unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.” (ET § 51.02.) Unlike other professions, accountants have made it a “distinguishing mark” of the profession to don the mantle of “responsibility to the public.” (ET § 53.) Thus:

The accounting profession’s public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective wellbeing of the community of people and institutions the profession serves.

In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients’ and employers’ interests are best served.

Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public.

\* \* \*

All who accept membership in the American Institute of Certified Public Accounts commit themselves to honor the public trust.

(ET § 53.01-04.)

The duty of integrity is the cornerstone of the professional ethics owed by a CPA. The Code expresses this as follows:

Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality.

\* \* \*

Integrity is measured in terms of what is right and just. In the absence of specific rules, standards or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

Integrity also requires a member to observe the principles of objectivity and independence and of due care.

(ET § 54.)

As has been frequently noted, most ethics issues concerning accountants arise from alleged violations of objectivity or independence. These are separate, but closely related concepts:

- Objectivity is "a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

- Independence, though closely related, takes a different tack by “precluding relationships that may appear to impair a member’s objectivity in rendering attestation services.”

(ET § 55.)

Another hallmark of ethical behavior for a CPA is the exercise of “due care.” This duty obliges each CPA to discharge professional responsibilities with “competence and diligence.” (ET § 56.01.) The elements of due care are:

- ❖ “Mastery of the common body of knowledge required for designation” as a CPA.
- ❖ Non-ending commitment to learning and professional improvement.
- ❖ Competence to handle all client engagements accepted by the CPA.
- ❖ Rendering services with diligence, *i.e.* -- promptly, carefully, thoroughly and with full observance of all technical and ethical standards.
- ❖ Adequately planning and supervising each professional activity within the CPA’s responsibility.

Finally, each CPA is required to be “free from conflicts of interest in discharging [their] professional responsibilities.” (ET § 57.01.)

### **Standard of Care**

As this brief summary of the rules of ethics shows, it is often quite easy for a plaintiff’s expert witness to apply such broadly worded aspirations to the facts and circumstances of individual malpractice claims. Thus, plaintiffs seek to leverage violations of generally accepted auditing standards into violations of the duty to comply with the ethical requirement to exercise due care. In other

words, a lapse in tax return preparation is double counted as a violation of the public trust -- or a lapse of professional integrity. Clever lawyers and their "hired gun" experts weave these words and concepts into the very fabric of their evidence and summations to the jury.

### **Conflicts of Interest**

No doubt the leading candidate for inclusion in any lawsuit is a claim of conflict of interest. Conflicts of interest are easily understood and are universally abhorred. For proof, check this morning's daily newspaper -- the odds are that it has at least one article alleging or discussing a conflict of interest by a politician, government official, business or business owner.

It is, therefore, worthwhile to recite the rule on conflicts of interest:

A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his firm or her firm has a relationship with another person, entity, product or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rules shall not operate to prohibit the performance of the professional service.

(ET § 102.03 102-2.)

Examples of conflicts include:

- ✓ The accountant is asked to perform litigation services for a plaintiff suing a client of the CPA or his firm.

- ✓ The CPA has provided tax or personal financial planning services for a married couple undergoing divorce.
- ✓ In a financial planning engagement, the CPA suggests an investment in a business or product in which the CPA has a financial interest.
- ✓ The accountant provides tax services for several members of a family who may have opposing interests.
- ✓ The CPA is asked to provide services for a buyer of an asset from another client of the firm.
- ✓ The accountant receives an undisclosed commission or fee for making a referral to another professional or service provider.

(ET § 102.03.)

### **Case Law Example**

The interplay between a CPA's conflict of interest and a malpractice claim was presented in a case decided by the Montana Supreme Court, *Brevig v. McCormick*, 980 P.2d 603 (Mont. 1999). In this fascinating case, a sister and brother jointly inherited equal ownership of a family-owned ranch, but later had a falling out. An action was brought to dissolve their partnership, together with other claims. During the lawsuit, the brother issued a subpoena to the CPA who had worked on the underlying estate planning, with the siblings and their now deceased father, some 13 years earlier.

The subpoenaed documents included correspondence between the CPA and the sister concerning the father's initial interest in establishing an irrevocable trust granting the brother sole ownership of the entire ranch. In fact, the father

had gone so far as to have a lawyer draw up the trust agreement and had even signed it -- but he never signed the deed legally required to transfer title in the ranch to the trust. That was because the CPA quickly advised that the formation of the trust would have serious, adverse tax consequences for the father's estate (and hence, for the brother).

After receiving the accountant's advice, the father instead signed a will granting joint and equal ownership in the ranch to the children. The accountant learned of this decision in a communication from the sister -- who further admonished the CPA not to tell the brother that his father had ever contemplated giving him sole ownership because they did not want to upset him. The CPA honored this request for confidentiality from his client.

Upon learning of this via the subpoenaed documents, the brother sued the CPA claiming breach of a duty to have either made full disclosure to the brother of the father's abandonment of the unfunded trust or else to have withdrawn from all further representation of any family members or interests. By virtue of the CPA not having taken either step, the brother claimed he had been deprived of the opportunity to persuade his father to revert to his initial plan to transfer the entire ranch to him, either via trust or in a will.

On appeal, the Montana Supreme Court ruled as a matter of law that the CPA owed a fiduciary duty to the brother, even though the only service rendered by the accountant to the brother was the preparation of his annual tax returns.



In doing so, the Supreme Court rejected on its own motion the opinion of the accountant's expert witness that the CPA would have breached his professional duty to hold the father's wishes in confidence, under the rules established by the Montana Board of Accountancy, if he had made the disclosure. This court decision, therefore, exemplifies the flexibility with which ethical concepts can be applied in litigation and the proclivity of lay persons to make that application with their own, subjective moral compass.

### **Waiver of Conflicts**

One lesson for practitioners confronting potential conflicts of interest with clients is to consider the possibility of proceeding with a conflict waiver. The rule on conflicts expressly authorizes the use of a waiver to condone the CPA's contemplated involvement in the matter giving rise to the conflict:

If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client . . . the rules shall not operate to prohibit the performance of the professional service.

(ET § 102.03 1-102-2.)

In order to be effective, such a waiver should be comprised of these elements:

- ✓ It should be written.
- ✓ It should disclose in a meaningful and understandable way exactly what gives rise to the conflict for the CPA.

- ✓ It should disclose in a meaningful and understandable way how the conflict might jeopardize the interests of each client.
- ✓ It should be signed by each client.
- ✓ It should include a recommendation that each client seek independent legal advice before signing the waiver.
- ✓ It may include a release and hold harmless from any claim or complaint that the CPA has violated any applicable professional standard or rule of conduct.

### **Conclusion**

In the end, of course, faithful adherence to the highest standards of the profession are the ultimate safeguard against the embarrassment and harmful effects of being charged with a violation of professional ethics.

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