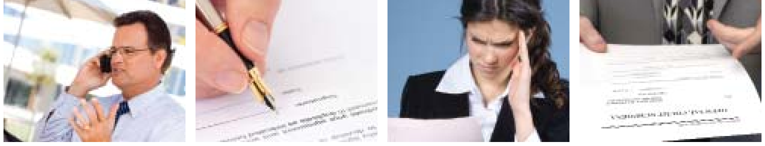

Liability Lessons

When Moonlighting Becomes Your Problem

By Jonathan S. Ziss, JD

Managing partners and other practitioners give a great deal of thought to risk management within their firms. From caution with regard to new engagements, to the implementation of best practices, to the purchase of a sufficient amount of professional liability insurance, professional risk has high visibility and gets hands-on treatment. Even in the most prudent and conservative of workplaces, however, there is a professional risk that lies beyond management's field of vision: moonlighting.

It is not uncommon for CPAs to become involved in outside business ventures. These include real estate development, start-ups, boards of directors, tax return preparation, and trustee appointments, to name a few. Given the CPA's role in the community and in the business lives of clients, a practitioner frequently encounters opportunities to cross over from advisor to participant. Such opportunities can diversify and enrich one's work experience, generate additional income, and open the door to additional opportunities for both the practice and the practitioner.

In a weak economy, moonlighting can be more than a dalliance or hobby; it can be a fundamental block of one's income base. Moonlighting is thus a prominent, if little discussed, element of the professional lives of CPAs. By intent, it is a haven for a practitioner to do his or her own thing outside of the gaze, the judgment, and the responsibility of the firm. Perhaps it comes as a surprise then that from a professional liability perspective, moonlighting poses significant risks to the firm.

Before exploring these risks, consider how firms typically address moonlighting by their professionals. A common approach is to require all professionals, whether partners or not, to disclose outside business interests. This requirement may be found in an employment handbook, a partnership agreement, or, less formally, in a firm's custom and culture. Disclosure provides rudimentary control against conflicts of interest, provides an opportunity to understand the time commitments of the staff, and provides an opportunity to reject an outside endeavor as incompatible with employment for whatever reason. Being realistic, this is a very low threshold. The moonlighter is then free to go off and running, sometimes for years on end, with effectively zero oversight by the firm.

The problem with a CPA moonlighting is that a practitioner is first and foremost thought of in his or her capacity as an employee of a firm. Should problems arise, forces adverse to the moonlighter will almost invariably look for a way to involve the firm, with its presumably greater financial strength backed up by insurance. Nearly any perceived connection can be enough to embroil the firm in a claim – whether as a party or as a nonparty participant in discovery. This can lead to unanticipated and unplanned-for exposure – exposure that might fall outside insurance coverage.

Consider a real estate development scenario. The moonlighting practitioner prepares the real estate partnership's returns using the firm's tax software, and casually makes notes on firm letterhead or notepads. Despite there being no engagement of the firm, there is tangible evidence of the firm's involvement. What if files are backed up on the company's IT systems, or a client number is assigned to run the tax software for this return? There might even be an e-mail or two between the moonlighter and a colleague discussing an issue related to the outside entity's return.

This can be stickier than flypaper for the firm if something goes wrong. Proving that the firm was never hired and that the work was done by an employee in a solo capacity will take time and money to establish. Also, the fact that the complainant was never a client might lead the insurance company to disclaim coverage for the moonlighter as well as the firm, which usually only extends to errors and omissions committed in the service of an engagement.

Another pitfall could emerge on a professional liability insurance application. If all pertinent extracurricular activities are not disclosed, a misrepresentation could be perceived. Also, if there is any financial tether between the practice and the outside venture, such as a loan to the practitioner that could be perceived as an investment, the firm stands closer to the flames than it would have ever anticipated.

A mere subpoena served on the firm in connection with an employee's moonlighting can be costly and problematic. These days, business of all kinds (professional, extracurricular, personal, financial) is often entered into and sent out of a single laptop or workstation owned by the firm. Its data is stored on, and backed up within, the firm's IT infrastructure. The time, effort, and expense involved in responding to a subpoena for electronically stored information can be enormous.

The problem is not moonlighting per se. It is a healthy, and certainly inevitable, part of life in the CPA community. The focus from the standpoint of professional risk is that the lines must not be blurred between one's day job and one's outside ventures. To keep those lines straight and clear, firms should make and enforce rules about the use of firm property in connection with outside ventures. Also, firms should require that a communication in writing be on file with the outside venture describing the firm's relationship (or lack thereof) for the sake of clarity and managing expectations. Something brief and to the point, an anti-engagement letter, should suffice – provided that it is backed up by compliance with the firm's guidelines for outside ventures.

As always, it is a good idea to talk to your insurance broker about outside ventures so there are no unpleasant surprises and so you understand the options available for coverage.

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