

THE BOTTOM LINE

Vol. 25, No, 11 Mid-September 2009

Be vigilant as others seek scapegoats

By Donalee Moulton

People are looking for someone to blame as the punishing recession saps their wealth, and often they look no further than financial professionals with whom they have dealt.

According to the Investment Industry Regulatory Organization of Canada (IIROC), complaints filed this year with brokerage firms alone are up 35 per cent, and up 90 per cent since 2007. On average, 225 complaints are being filed each month. A year ago, that figure was only 118.

Accounting firms are no less vulnerable. "Accountants are, unfortunately, a target in tough times," said Eric Hoffstein, a litigation partner with the law firm Fraser Milner Casgrain LLP in Toronto.

One noticeably difficult — and potentially divisive — situation is winding up an estate. "There's a real possibility that there could be more (legal) claims simply because there is less money to go around," said Roger Lee, a partner with the law firm Davis LLP in Vancouver.

It's not that financial experts, including accountants are doing anything differently, or anything wrong, said Hoffstein. "There is a greater scrutiny by beneficiaries, and there is more pressure on the estate trustee to wind up as quickly as possible."

Both situations can convince clients to take legal action. There are a number of potential pitfalls — and protections — accountants need to be aware of, noted Michael McCleave, a partner with Stern Cohen LLP, a chartered accounting firm in Toronto.

Topping the list of potential pitfalls, he said, are concerns that funds were used for a personal benefit by the executor, that the different interests of capital beneficiaries and income beneficiaries were not considered, and that the sale of assets, especially to friends, family or colleagues, was not at market prices.

The latter is particularly troublesome in a down market, said Robert Doran, a partner with KPMG LLP and a chartered business valuator in Calgary. "The biggest problem in this particular market is the lack of comparables."

When there hasn't been a lot of buying and selling, it can make valuing an asset more difficult, he noted. "We look to similar companies that have been sold but if the market is flat ..."

Interestingly, the best way to avoid a claim of what is often referred to as imprudent realization of assets, said Hoffstein, is to engage professionals such as accountants.

"In this market, it's fairly volatile. You need to monitor the markets."

In addition to doing your own due diligence, it is sound practice to turn to others, said Lee. "I would get a second opinion to show you didn't rely solely on your own opinion.

"The potential hassle it could save you is worth it, and there is no cost to you (as executor). It comes out of the estate," he added

There is a clear onus on the executor and the experts the executor hires to settle an estate. Accountants could fall into both groups – and are expected to be knowledgeable.

In most provinces, noted Lee, investments, for example, fall under the equivalent of British Columbia's 'reasonable and prudent investor rule.'

"Inherently by saying 'reasonable', there is an element of subjectivity."

That gray area is less gray for accountants, he added. "There is a separate standard for professionals. The estate could sue you if you do not meet that higher standard."

Executor compensation is a thorny area at the best of times, and concerns are more pointed in a recession, noted Hoffstein. "Beneficiaries may want the executor to take a (compensation) cut, especially if they are not satisfied.

"Communicating well with beneficiaries is critical," he added. "Things can snowball as people get more polarized in their views."

Indeed, said Lee, accountants need to take that extra step and make that extra effort when involved with winding up an estate. "You need the ability and the knowledge to ensure you understand the person's estate. The more you know the more you can help. You need to know the skeletons in the closet."

And you need to document them – as well as everything else, said McCleave.

"If complete and accurate records are maintained, it will be possible to respond quickly and accurately."

Equally important, he noted, "If there are concerns raised but accurate records are maintained and the payments are all consistent with the intended purpose, this will reduce the benefit to pursuing litigation."

Little things can make a big difference, noted Hoffstein. Auditing and interest penalties from the Canada Revenue Agency, for example, can be a sore spot.

"Beneficiaries are more sensitive in this market to any losses to the estate. They want to maximize the amount retained in the estate.

"You have to be really diligent and think far in advance," he added.

Ultimately, accountants will protect themselves by simply doing what they do best, said Lee. "You can never really bulletproof yourself. The best defence is to do your job well."