

# **CHAPTER 1**

## *The Why and How of Acceptance and Continuance*

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Client acceptance and continuance may be the most important step in an audit, but it's one that gets little attention. A prospective client calls saying, "Will you audit my company?" and we respond, "sure." While new business *can* be a good thing, we need to evaluate the relationship. Not doing so can lead to significant problems.

### **New Relationships**

My daughter recently met a young man on Instagram. Not unusual these days. Now the relationship is entering into its third month. They talk every day for two or three hours. So far, they have not been in the same room and not even in the same state. Skype, yes. In the presence of each other, no. That's happening at the end of this month. (He lives ten hours away.)

What do Mom and Dad think about all of this? Well, it's fine. My wife checked him out on Facebook (I know you've never done this). And my daughter has told us all about her "fella" and his family. We like what we're hearing. He has a similar family background and beliefs. He has a job (yay!) and a college degree.

Why do we want to know all the details about the young man? Because relationships matter. My wife and I want what is best for our daughter. Why? Because we want her to be happy.

## **Client Acceptance**

And that's what good relationships create: happiness. The same is true with clients. As Steven Covey said, "think win, win." When the customer wins and your CPA firm wins, everyone succeeds and mutual needs are met.

Careless CPAs accept business with only one criteria: the ability to pay.

While getting paid is important, other factors are also critical.

Here are a few:

- Is the potential client ethical?
- Are you independent?
- Do you have the technical ability to serve them?
- Do you have the capacity to serve them?

## **Are They Ethical?**

I want my daughter to marry a guy with beliefs that correspond with who she is. Is he honest? Would he steal? Is he transparent? Who are his associates? What do others think of him?

We ask similar questions in accepting a new client. Audit standards require us to consider whether the prospective client has integrity. If the company is not morally straight, then there's no need to move forward—regardless of the audit fee.

## **Are You Independent?**

The time to determine your firm's independence is the beginning, not at the conclusion of the audit. As a peer reviewer, I can tell you that firms don't always fully vet their independence. Consider what happens during a peer review when a firm is not independent, and it has issued an audit opinion. The original audit report will be recalled, and I'll bet the company asks for and receives a full refund of the audit fee. And there's that impact on the peer review report.

Pay attention to nonattest services such as preparation of financial statements. If the client has no one with sufficient skill, knowledge, and experience to accept responsibility for such services, you are not independent.

### **Do You Have the Technical Ability to Serve Them?**

If you can pick up a client in an industry in which you have no experience, should you? Possibly, but it depends on whether you can gain an understanding of the client and their industry. Some new customers are not complicated. With those, you can move forward. But with others, it may be better to pass on the opportunity. Or maybe you can partner with another firm that has the requisite knowledge and experience.

### **Do You Have the Capacity to Serve Them?**

A prospective client calls saying, “Can you audit my company? We have a December 31 year-end, and we need the audit report by March 31.” After some discussion, I think the fee will be around \$75,000. But my employees are already working sixty hours a week. Should I take the engagement?

My answer is no unless I can create the capacity. How? I can hire additional personnel, or maybe I can contract with another firm to assist. If I can't create the capacity, then I'll let the opportunity go.

Far too many firms accept work without sufficient capacity. When this happens, corners are cut and firm members suffer. Stuffing even more work into busiest time of the year is not the wise thing to do. You'll lose people, and if the engagement is deficient, peer review results will suffer.

When you don't have the capacity to accept new clients, consider whether you should discontinue service to some existing customers (those who are difficult to work with or who don't pay).

## **The Continuance Decision**

Quality control standards call for continuance protocols. I previously said some CPAs don't give proper attention to acceptance. So, how about continuance? Even worse. It's as though we think there's a permanent relationship.

Each year, we should ask, "Would I accept this client now?" If the answer is no, then why do we continue to serve them?

**Here are a few questions to ponder:**

- Has the client paid their prior year fees?
- Am I still independent?
- Does the client demand more time than the fee merits?
- Do I enjoy working with the client?
- Is the client's financial condition creating additional risk?
- Is the client acting in an ethical manner?

Each year, well before the audit starts, ask yourself these questions. And then consider, "Is the bottom 5% of my book of business keeping me from accepting better clients?" My experience has been that when I have the capacity, new business appears. But when the capacity is lacking, I don't. The decision to hold on to bad clients is a decision to close the door to new ones. Don't be afraid to let go.

## **Risk Assessment Starts Now**

When should you start thinking about risk assessment? Now.

Whether you are going through the initial acceptance procedures or you are making your continuance decision, think about risk now. Assuming you accept the client, you'll be a step ahead as you begin your audit. Ask questions of the potential client such as:

- How is your cash flow?
- Do you have any debt with covenants?
- Who receives the financial statements?

- Has the company experienced any fraud losses?
- How experienced is management?
- Why are you changing auditors?

Retain this acceptance documentation and use it in your audit planning after you become the auditor. That way, you're not asking the same questions a second time.

### **Acceptance and Continuance - A Simple Summary**

- Acceptance and continuance may be the most important audit step
- Don't accept unethical clients
- Independence is necessary for acceptance of and continuance with an audit client
- Ask yourself if you have the technical ability to perform the audit
- In accepting and continuing to serve an audit client, consider your capacity (how busy are you when the audit is to be performed?)
- Conditions change from year to year, so make your continuance decision early (you may have been independent last year, but not this year)
- Risk assessment should start in the acceptance phase of the audit