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Texas Law and Ethics Considerations Regarding Accountants Withholding Work Product and Documents to Enforce Fee Collection

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Abstract

Like other business people, accountants sometimes find themselves having difficulty in getting paid. Many times they have been engaged and been provided documents and records by the client, to use these to prepare financial statements, tax returns or other work product for the client. When the accountant learns before delivering the work product, or before returning the client's documents, that the client is refusing or failing to pay the fee, a natural question might be whether the accountant has the right to either withhold the finished work product (possibly urgently needed by the client) or even to hold onto the client's own documents and records, as a means of attempting to induce the client to pay. Is this allowable in whole or in part? This paper explores this issue from both legal and an ethical viewpoint, as answered under Texas law and accountant's ethics rules. It attempts to give guidance on what work product or records can be retained, and which cannot be, and on what circumstances such retention will be permitted considering both legal and ethical requirements.

Introduction

In terms of the right to retain client-related workpapers and client documents to enforce fee payment, accountants are generally left in a difficult position.

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In most jurisdictions, accountants are generally not treated as having a lien on client workpapers or client-supplied documents, and are generally not permitted much leeway to retain these for purposes of enforcing payment of the accountant's fees.

At the same time, court cases fairly consistently require that accountants turn over tax workpapers and documents in their possession when these are demanded by government authorities. Thus in most states accountants seem to have the worst of all worlds as regards retaining client-related documents and papers.

As will be seen, while Texas statutes appear at first glance to put accountants in at least a little better position than most other jurisdictions, the Texas Administrative Code appears to take away with one hand what the statutes provide with the other. This article will explore Texas law regarding what the accountant's rights and responsibilities are with respect to both client-supplied documents and tax workpapers, and also items prepared by the accountant for or on behalf of the client.

1. Retention of Tax Workpapers to Secure Fee Payment

In terms of an accountant's right to retain client-related workpapers to help to secure fee collection, Texas appears to treat accountants better than many other states. Statutory provisions appear to provide that where the accountant has not been paid, the accountant will have a lien on anything of value owned or controlled by his or her employer, if such item was either partially or entirely created by, or necessarily connected with, the accounting services provided.

In analyzing the accountant's rights to retain records, it is thus first necessary to distinguish between those documents and records supplied by the client ("client documents") and the workpapers, schedules and other work product prepared by the accountant from, or using, the client documents.

In the case of client-supplied documents, there appears to be little or no support for an accountant to retain the client's own documents under any circumstances under Texas' or any other state's law. Interestingly, there appears to be little case law on the topic.

What case law there is has not been supportive of accountants being permitted to retain client documents. A number of years ago a legal annotation was published that analyzed the rights of accountants to a lien interest in client-supplied documents to enforce fee payment, and concluded the weight of authority under the common law appeared to grant the accountant a lien interest only in his or her own work product prepared using the client's documents, and not in the client's documents themselves.

(2) This is contrasted to the situation of the common law "artisan's lien" which grants a lien to a business such as an auto repair service in the personal property (i.e., the automobile) that the business has repaired, permitting the business to retain the personal property, such as the automobile, until payment has been made. The courts have historically been unwilling to extend the same sort of lien interest to accountants regarding client-supplied documents.

In one fairly recent case dealing with this issue, Blum vs. Blum (3) arising in Florida, a woman had hired an accountant to do work for her pursuant to a divorce action.

The accountant withheld documents from the client on the basis of an engagement contract that specifically granted the accountant the right to a "retaining lien" on all documents delivered to his firm by the client, until such time as full payment had been made. The Florida court of appeals overruled a trial court verdict that had upheld the accountant's lien interest. It did soon the basis of a Florida administrative rule which, apparently much the same as the Texas Administrative Rule discussed below, allows an accountant to retain only his or her own workpapers, but not "records which are part of the client's records".

The right of an accountant to retain his or her work product, prepared from client-supplied documents, is another story however. The Texas Property Code supports an accountant's lien rights over work product prepared for a client. Texas Prop. Code Sec. 58.002 provides that a "worker" who performs a service in an office has a lien interest in the product produced for his or her employer via such services.

Code Sec. 58.001 specifically defines "worker" to include an accountant, and defines "employer" for purposes of the statute to include a person with whom the worker contracts for the performance of services. Not all states are so generous in allowing such a lien interest to accountants.

However, the Texas Administrative Code also directly addresses this issue, and is less generous than the statue in terms of the accountant's right to retain his or her work product to secure fee payment. It is axiomatic that Texas accountants practice under the authority of the Texas State Board of Accountancy. The powers and rules of the Accountancy Board are prescribed in Texas Administrative Code Chapters 501-527.

Rule 501.76 contains more significant restrictions on an accountant's right to retain work product than those suggested by Property Code Sec. 58.002. It states in pertinent part as follows:

(a) Records

(1) A person shall return original client records to a client or former client within a reasonable time (promptly, not to exceed 10 business days) after the client or former client has made a request for those records…

(2) A person's work papers, to the extent that such work papers include records which would ordinarily constitute part of the client's or former client's books and records and are not otherwise available to the client or former client, shall also be furnished to the client within a reasonable time (promptly, not to exceed 20 business days) after the client has made a request for those records. The person can charge a reasonable fee for providing such work papers…

(b) Work papers. Work papers, regardless of format, are those documents developed by the person incident to the performance of his engagement which do not constitute records that must be returned to the client in accordance with subsection (a) of this section. Work papers developed by a person during the course of a professional engagement as a basis for, and in support of, an accounting, audit, consulting, tax, or other professional report prepared by the person for a client, shall be and remain the property of the person who developed the work papers.

(c) For a reasonable charge, a person shall furnish to his client or former client, upon request from his client made within a reasonable time after original issuance of the document in question:

(1) A copy of the client's tax return; or
(2) A copy of any report or other document previously issued by the person to or for such client or former client provided that furnishing such reports to or for a client or former client would not cause the person to be in violation of the portions of §501.60 of this chapter (relating to Auditing Standards) concerning subsequent events.

It is difficult to totally reconcile the above with the lien rights given by Texas Property Code Sec. 58.002. The Administrative Code section requires that the accountant supply the client with a wide number of items of his or her own work product, and that this be done whether or not the client has paid the accountant's fee. It is merely requires that the client pay "... a reasonable charge for personnel time and photocopying…", in other words, a minor amount for copying charges.

The items that are required to be furnished, whether or not payment has been made, include such common accountant work-product as the client's tax return, the working papers prepared by the accountant, and adjusting and journal entries. It does not appear to include, however, financial statements. Nevertheless the list is quite sweeping and appears to leave the accountant with little work product to withhold to enforce fee payment.

2. Ethics Considerations

The accountant must also consider, in addition to legal restrictions, the ethical requirements of his or her profession. The AICPA's Code of Professional Conduct, Rule 501, Acts Discreditable to the Profession, includes Interpretation .02501-1(4), relating to retention of client records .02501-1 provides as follows:

Retention of client records after a demand is made for them is an act discreditable to the profession in violation of rule 501 [ET section 501.01]. The fact that the statutes of the state in which a member practices may grant the member a lien on certain records in his or her possession does not change this ethical standard.

A client's records are any accounting or other records belonging to the client that were provided to the member by or on behalf of the client.

If an engagement is terminated prior to completion, the member is required to return only client records.

A member's workpapers, including, but not limited to analyses and schedules prepared by the client at the request of the member, are the member's property, not client records, and need not be made available.

In some instances a member's workpapers contain information that is not reflected in the client's books and records, with the result that the client's financial information is incomplete.

This would include for example, (1) adjusting, closing, combining, or consolidating journal entries, (2) information normally contained in books of original entry and general ledgers or subsidiary ledgers, and (3) tax and depreciation carry forward information. In those instances when an engagement has been completed, such information should also be made available to the client upon request. The information should be provided in the medium in which it is requested, provided it exists in that medium. The member is not required to convert information that is not in electronic format to an electronic form. The member may require that all fees due the member, including the fees for the above services, be paid before such information is provided.

Once the member has complied with the foregoing requirements, he or she need not comply with any subsequent requests to again provide such information.

The language of Interpretation .02501-1 appears to be less strict than that of Texas Administrative Code Section 501.76 discussed above. Thus, the AICPA Code of Professional Conduct does not appear to add any restraint above those already in place for Texas accountants under the Texas Administrative Code.

This is further supported by AICPA Code of Professional Conduct Rule 591: Ethics Rulings on Other Responsibilities and Practices.

Interpretation No. 182 (5) of that rule, titled “Termination of Engagement Prior to Completion” provides the following question and answer format guidance:

Question—Does rule 501 [ET section 501.01] require a member to furnish a tax return or supporting detail to a client if the engagement to prepare the tax return is terminated prior to its completion?

Answer—As provided in interpretation 501 1 [ET section 501.02], if an engagement is terminated by either the member or the client prior to completion, the member is required to return or furnish copies of only those records originally given to the member by the client.

Therefore, if a member has been engaged to prepare a tax return and the client or the member terminates the engagement before the tax return is delivered to the client, the member's responsibility is to return only those records originally provided to the member by the client. [Italics added]

Thus, Code of Professional Conduct Rule 591 also supports that the accountant is permitted to retain his own work product, and thus again appears to be less restrictive than the Texas Administrative Code. It appears that the Texas Administrative Code will tend to be the controlling document on the subject for Texas accountants.

3. Special Considerations for Tax Practice

In the case of tax practice, the accountant's rights are also circumscribed by government rules relating to tax practice. Circular 230 constitutes the Department of the Treasury's statement of regulations governing tax practice before the Internal Revenue Service. Section 10.28 of Circular 230 deals with the right of a tax practitioner to retain not only client records supplied to the practitioner for purpose of doing tax returns or other tax work, but also work papers and schedules prepared by the practitioner. Section 10.28 provides:

(a) In general, a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with his or her Federal tax obligations... The existence of a fee dispute generally does not relieve the practitioner of his or her responsibilities under this section.

Nevertheless, if applicable state law allows or permits the retention of a client's records by the practitioner (i.e., a member of the bar) in the case of a dispute over fees for services rendered, the practitioner need only return those records that must be attached to the taxpayer's return.

The practitioner, however, must provide the client with reasonable access to review and copy any additional records of the client retained by the practitioner under state law that are necessary for the client to comply with his or her federal tax obligations.

(b) For purposes of this section — Records of the client include all documents or written or electronic materials provided to the practitioner, or obtained by the practitioner in the course of the practitioner's representation of the client, that preexisted the retention of the practitioner by the client.

The term also includes materials that were prepared by the client or a third party (not including an employee or agent of the practitioner) at any time and provided to the practitioner with respect to the subject matter of the representation. The term also includes any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner, or his or her employee or agent, that was presented to the client with respect to a prior representation if such document is necessary for the taxpayer to comply with his or her Federal tax obligations. The term does not include any return,

Claim for refund, schedule, affidavit, appraisal or any other prepared by the practitioner or the practitioner's firm, employees or agents if the practitioner is withholding such document pending the client's performance of its contractual obligation to pay fees with respect to such document.

At first glance, Circular 230, and particularly paragraph (b) of Section 10.28, appears to state a stricter standard for retaining accountant-prepared tax workpapers than the previously discussed rules provided for other areas of practice. Paragraph (a) requires that, even where applicable state statutes or rules permit the accountant to retain client records, the accountant still at least permit the client to review and copy any such records that are needed by the client to comply with federal tax obligations.

Paragraph (b) then defines client records to include not only those provided by the client, but also any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner, or his or her employee or agent, if it had been previously presented to the client with respect to a prior representation, so long as such document is necessary for the taxpayer to comply with his or her Federal tax obligations.

This would seem to sweep into the definition of "client records" even working papers such as depreciation schedules, net operating loss schedules, and other schedules and worksheets prepared by the practitioner, if these had been presented for some reason to the client, as they may have been.

However, Circular 230 then goes on to clarify that the term "client records" does not include any return, claim for refund, schedule, affidavit, appraisal or any other item prepared by the practitioner or his employees or agents, if the practitioner is withholding such document pending fee payment.

These two statements appear to be contradictory. It is suggested that, so long as state statutes and administrative rules, along with ethics rules, are not violated by the retention of the accountant-prepared work papers, Circular 230 should not require their being returned or made available to the client where they are being withheld in an attempt to secure fee payment. The accountant should be able to rely on the final sentence of Section 10.28(b) as a basis for such withholding of records not violating IRS tax practice regulations.

Notes

See Texas Property Code Sec. 58.001-58.008.
76 AIr2d 1322, Right of Accountant to Lien upon Client's Books and Records in Former's Possession.
769 So.2d 1142 (Fla., 2000).
AICPA Code of Professional Responsibility, Rule 501
AICPA Code of Professional Responsibility, Rule 591, Inter. 182