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Assessing the Liability Risks of Review Engagements

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Overview

In a review engagement, no external verification of the client's financial information is normally required. A review engagement is distinguished from an audit engagement in that the accountant provides a "negative opinion." The accountant verifies only that the financial statement has been prepared in accordance with accepted accounting standards and that no known material changes need to be made. The resulting unaudited financial statement is considered the representation of management. The accountant expresses no affirmative opinion as to whether the underlying financial information has withstood testing pursuant to audit standards.

Accordingly, liability claims based on review engagements commonly are subject to what is known as the "limited engagement" defense under professional liability law. Nevertheless, limited liability is not equivalent to blanket immunity. If appropriate disclaimers are made, liability for material errors in the underlying financial information should lie exclusively with management. However, the courts have been inconsistent in recognizing that the standard of care should be constrained by the scope of the engagement.

Further, professional standards have changed considerably over the years. Most reported cases were decided before the enhanced self-regulatory standards that now apply to non-audit engagements were in place. In 2000, the U.S. Securities and Exchange Commission (SEC) mandated that each public company's interim quarterly financial statements be independently reviewed by an independent auditor as a precondition to the filing of each respective Form 10-Q. This SEC rule was designed to return integrity to financial reporting in an era of accounting tricks euphemistically referred to as "earnings management" that led to the collapse of Enron in 2001. Public accountants were conscripted to abide by enhanced standards as to all public companies, big and small. After the enactment of the Sarbanes-Oxley Act of 2002, quasi-audit guidelines were proposed and adopted for such engagements pursuant to Statement of Auditing Standards No. 100 (SAS 100).

The mandate that the company's auditor review interim financial statements under such standards raises questions as to whether existing precedent on limited liability is reliable. As one example, a public company's auditor will have a detailed understanding of the client's internal control structure. Such an understanding would not ordinarily be required for a stand-alone review engagement. However, a basic familiarity with internal controls is required under SAS 100 to facilitate the task of identifying possible material errors in a public company's quarterly financial statement. This conforms with precedent holding an accountant to a higher standard on a non-audit engagement when the firm has also previously served as auditor. *Bonhiver v. Graff*, 248 N.W.2d 291, 297-98 (Minn. 1976).

Moreover, self-governing bodies such as the American Institute of Certified Public Accountants (AICPA) have repeatedly revised review service standards applicable to all engagements since the enactment of the Sarbanes-Oxley Act. The guidance on review procedures is more expansive and detailed. For example, in 2004, the AICPA released a Statement on Standards for Accounting and Review Services (SSARS) 10 establishing performance standards, and recommended inquiries to identify possible fraudulent business practices. At the end of 2010, review standards were amplified and enhanced once again by SSARS 19. Since AICPA guidance is routinely consulted by expert witnesses and the courts in accounting malpractice litigation, these higher levels of recommended analysis will likely impact the standard of care in future cases. *E.g.*, *Cast Art Indus. LLC v. KPMG LLP*, 38 A.3d 562, 570-71 (N.J. App. 2010); *Abrams & Wofsy v. Renaissance Inv. Corp.*, 820 F. Supp. 1519, 1532-33 (N.D. Ga. 1993) (extensive reliance on AICPA Advisory Services Guidelines in federal securities fraud action).

As noted, much of the case law on non-audit engagements predates the various restatements of review standards and procedures adopted since 2000. Adherence to these clarified standards should serve to bolster the limited engagement defense in one respect. Poor definition of an accountant's responsibilities in non-audit engagements was often itself a source of exposure in the past. Thus, less detailed standards provide leeway for hired experts to adopt subjective and hindsight-driven opinions on the standard of care.

However, to the extent industry standards have been enhanced, the standard of care has moved up a notch. As with all major changes to professional standards, the unpredictable risk of change itself has to be considered until the dust settles.

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Review Engagement Standards

Review engagements are generally recognized as the middle-tier financial statement evaluations between the higher audit level engagement and the lower compilation engagement. *See Otto v. Pennsylvania State Educ. Ass'n*, 330 F.3d 125, 133-34 (3d Cir. 2003). Standards for non-audit engagements lagged behind those applicable to audits. A so-called unaudited "write-up" was typically utilized by smaller and closely held nonpublic companies in connection with transactions such as applications for financing. *E.g.*, *Ryan v. Kanne*, 170 N.W.2d 395, 397 (Iowa 1969). Thus, before the late 1970s, the scope of a non-audit engagement was generally not determined with reference to industry standards. Instead, the standard of care was determined based on the terms of the written engagement and disclaimers within the report. *E.g.*, *Ryan*, 170 N.W.2d at 397-98; *MacNerland v. Barnes*, 199 S.E.2d 564, 566 (Ga. Ct. App. 1973).

By the late 1970s, the need to establish industry standards became apparent. On the audit front, the traditional rule disallowing claims by non-client investors and other third parties was increasingly being challenged and rejected. *E.g.*, *Rusch Factors Inc. v. Levin*, 284 F. Supp. 85, 91 (D.R.I. 1968) (challenging so-called *Ultramares* strict privity doctrine). This trend soon spilled over to liability claims involving non-audit engagements. *Ryan*, 170 N.W.2d at 404; *Bonhiver v. Graff*, 284 N.W.2d 291, 297-98 (Minn. 1976). Moreover, courts began entertaining even client claims that often conflicted with broad disclaimers on reliability

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and use in the engagement letter and work product. *1136 Tenants' Corp. v. Max Rothenberg & Co.*, 30 N.Y.S.2d 1007, 1008 (1972). Thus, in *1136 Tenants' Corp.*, the court held that general disclaimers would not insulate a firm from discovering embezzlement in the context of a write-up engagement where the work undertaken revealed suspicious circumstances that would have uncovered the fraud. Similarly, in *Ryan*, 170 N.W.2d 395, the court held that disclaimers as to unaudited services would not immunize a CPA from liability where the actual work undertaken entailed certain confirmation procedures.

The *Ryan* court actually used the term "uncertified audit," a contradiction in terms, to describe the write-up. With courts entertaining claims that arguably improperly applied audit standards to non-audit engagements, the industry finally acted in 1978 when SSARS 1 was promulgated by the AICPA.

The basic definition and analytical tasks entailed in a review engagement have not changed since that time. As noted, the evaluation in a review progresses backwards to a negative assurance. Thus, in SSARS 1, a review was defined to mean the performance of investigation and analytical procedures providing a reasonable basis for expressing limited assurance that no material modifications should be made to the financial statement to conform with accounting standards.

Contemporary standards are similar. SSARS 19 carries over the same limited assurance definition but clarifies the precise meaning of an assurance engagement in an effort to draw a brighter line between compilation and review engagements. Thus, under AR Section 60.04, an "Assurance engagement" is defined as:

> An engagement in which an accountant issues a report designed to enhance the degree of confidence of third parties and management about the outcome of an evaluation or measurement of financial statements (subject matter) against an applicable financial reporting framework (criteria).

"Attest engagement" is defined to mean:

> An engagement that requires independence, as defined in AICPA *Professional Standards*.

Detailed descriptions of the differences between compilation, review, and audit engagements are set forth in the current AICPA standards. The current definition of review is a two-part one that includes a definition which distinguishes the engagement from an audit. A review engagement is both an assurance and an attest engagement. In AR Section 60.07, the AICPA defined a review engagement by distinguishing it from an audit:

> A review differs significantly from an audit of financial statements in which the auditor obtains a high level of assurance (expressed in the auditor's report as obtaining reasonable assurance) that the financial statements are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. . . .

Other elements of review engagements have remained consistent since the time standards were first developed in the late 1970s. Those elements include the requirement that the CPA gain sufficient familiarity with the client's management to reasonably perform the engagement. The identical basic analytical procedures also continue to apply. First, a comparative evaluation is made in which historical financial data is evaluated against current financial information with an eye toward identifying changes that warrant explanation or comment. Second, there is an initial and follow-up management inquiry protocol through the completion of the engagement. This culminates with a final management representation letter in which management assumes responsibility for and signs off on the accuracy of the financial statement.

Notwithstanding the general consistency of these standards, as previously noted, additional industry guidance over the past decade not only clarifies an accountant's duties but in several areas, raises the performance bar. As to public companies, CPAs performing reviews of interim financial information must follow SAS 100. Though nominally an auditing standard, SAS 100, issued in November 2002, incorporated most of the traditional standards applicable to review engagements. However, it also added a fraud inquiry protocol and detailed illustrations of analytical procedures to be followed before issuing standard representation letters. Although there is no requirement that the accountant issue a review report, management must be in a position to confirm in writing that a review was completed in conformity with SAS 100. SAS 100 also includes responsibilities to investigate subjects such as corrected misstatements, uncorrected misstatements, and weaknesses in internal controls. An accountant who identifies such issues cannot consent to releasing the quarterly financial statement for filing with Form 10-Q unless management provides satisfactory responses on these subjects. The resulting financial statement, though still the representation of management and without independent certification, is ultimately the product of a collaborative inquiry and response process. It is similar to an audited financial statement included within the company's Form 10-K registration statement in that sense.

The modifications to AICPA guidance in SSARS 10, applicable to all review engagements, picked up many elements from SAS 100. Unlike SAS 100, beginning in 2005, analytical procedures that included fraud inquiries were recommended though not required. However, like SAS 100, SSARS 10 requires the CPA to obtain a specific written acknowledgment from management regarding fraud, including management's responsibility to prevent and detect fraud. The 2005 review standards also contained an appendix of illustrative templates to be used in completing an engagement similar to those developed by the Public Company Accounting Oversight Board (PCAOB) under SAS 100.

The changes effective from December 2010 forward under SSARS 19 will likely have a mixed impact on legal liability claims. On the one hand, the additional detail in the standards leaves less room for expert witnesses to make arbitrary subjective assertions as to the minimum standard of care. Engagement letters, for example, are now clearly mandatory. An accountant who follows the guidelines and illustrative examples can create a defensive shield against liability claims that implicitly attempt to change the engagement after the fact. The definitional lines among various engagements are more precise. The manner in which the assurances must be communicated is better defined in the new guidelines. Clear communication can often eliminate opportunities for dispute and litigation.

However, several guidelines essentially add audit standards to review engagements. Based on the definitions of "review risk," "review evidence," and "materiality," the quantum of documentation and proof needed to establish that a review analysis was properly completed is not to be left to the accountant's professional judgment. As in the case of an audit, the review file must be self-proving. The work papers must show that there was a reasonable basis for the limited assurances provided in a review engagement. Thus, in addition to including the standard review evidence, such as questionnaires in the file, reviews must include documentation of significant findings.

Again, the increased detail in the guidance is a double-edged sword. Strict compliance with the guidelines may support a strong defense in litigation. However, inadvertent failures to follow and document every element of a review plan could create exposure where none might have existed under prior more general and judgmental standards.

The Limited Engagement Defense Under Contemporary Review Standards

The liability exposure for errors in the preparation of a review report differs under existing law depending on whether the claimant is the client or a third party that forseeably relies upon the report.

Client Claims

Generally, courts have rejected client claims at odds with the scope of the non-audit engagement and relevant disclaimers that the financial statement has not been audited. However, a substantial number of reported decisions have allowed client claims irrespective of such disclaimers. A common basis for claims arising out of non-audit engagements is the failure of the accountant to detect employee embezzlement or insider self-dealing.

Several recurrent rationales have been offered by the courts that declined to limit liability to clients based on disclaimers. First, the failure to conduct further investigation in light of obvious red flags of potential fraud has often led to exposure. In *1136 Tenants' Corp.*, 30 N.Y.S.2d 1007 (1972), the accountants encountered missing invoices and other suspicious circumstances that allegedly would have uncovered a large embezzlement had there been a follow-up investigation. The accountants failed to comment on these suspicious circumstances in preparing an unaudited financial statement. The court held that the accountants had a professional duty to alert the client of these circumstances.

Second, accountants who have maintained a longstanding professional relationship with a client have been denied the shelter of the limited engagement defense when information known from other engagements revealed the need to modify the financial statement. In *Bonhiver v. Graff*, 248 N.W.2d 291 (Minn. 1976), an accountant was found liable for failing to discover embezzlement in the course of a non-audit engagement. The immediate engagement did not require an evaluation of possible embezzlement. However, the same firm had audited the company in prior years and was aware of its poor financial condition and serious questions as to the reliability of the company's books. The court held that, with this knowledge, the accountant could not perform the non-audit engagement and provide a negative assurance with blinders on. The accountant had a duty to alert the client to the reliability problems spotted in the earlier audit and suggest a broader independent verification than that called for in the write-up.

This duty to volunteer additional advice and services in the client's interests is a rare phenomenon in accountant liability jurisprudence. However, it is well-established in fields such as legal malpractice. The courts have reasoned that a lawyer's professional fiduciary responsibilities require the attorney to advise in cases where, without such guidance, the

lesser sophisticated client will fail to recognize the peril of the "limited engagement." *Nichols v. Keller*, 15 Cal. App. 4th 1672, 1684 (1993). However, auditors, unlike attorneys, are not generally considered fiduciaries and the client in the case of a review engagement is rarely unsophisticated. *See Franklin Supply Co. v. Tolman*, 454 F.2d 1059, 1069 (9th Cir. 1991) (regarding potential exposure of accountants as fiduciaries).

Cases such as *Bonhiver* can be reconciled with contemporary review standards and the guidance that dates from the late 1970s. There has long been a requirement to evaluate the results of a review engagement for known misstatements or omissions. Moreover, there has been a standing requirement that such errors be communicated to management in order to obtain appropriate modifications or qualifications.

A third category of decisions centers around basic due diligence in gaining familiarity with the client. In *Robert Wooler Co. v. Fidelity Bank*, 479 A.2d 1027 (1984), the accounting firm was retained to perform unaudited accounting services. Based on the limitations of the engagement, the firm contended it had no responsibility for its failure to detect an embezzlement scheme. In particular, the firm claimed it had no obligation to familiarize itself with a company's internal controls. Apparently, the company's internal controls were so poor that even a superficial examination would have revealed the open opportunities for embezzlement. The court rejected the accountant's claim that it had no obligation to delve into these issues based on expert witness testimony on the subject and the firm's own internal guidelines. This holding can also be reconciled with the longstanding requirement that an accountant obtain a sufficient understanding of the client's business and accounting systems to competently perform a review engagement.

Because accountants have never enjoyed blanket immunity to clients in the performance of review engagements, an argument can be made that the clarifications and enhancements set forth in contemporary standards should not affect liability exposure substantially. In fact, a case can be made that exposure may be lower in some respects.

As noted, the most common source of client claims arises out of insider fraud. Under contemporary standards, fraud detection as part of a review engagement is not merely implied. It is a subject that is both on the table and subject to specific inquiry that is well-documented in the ordinary course of the engagement. Moreover, the opportunities for shifting blame from management to the CPA should be fewer in light of the explicit assumption of primary responsibility for fraud detection in the mandatory management representation letter. Further, the template of illustrative engagement letters and representation letters are far more detailed under AR Section 90 than disclaimers discussed in many published cases. These relatively newer elements of review engagements should actually bolster the ability of accountants to rely on the limited engagement defense in the future in keeping with the spirit of a negative assurance engagement.

Further, a well-performed review engagement should reduce opportunities for insider fraud and self-dealing, potentially reducing liability risk. Although more burdensome, the review evidence requirements in many cases could make client liability claims more defensible because inquiries and findings will be well documented. In short, it will be difficult for a client to complain in instances where it provided the wrong answer to the right question when that fact is documented.

On the other hand, contemporary standards have more mandatory items and substantially more recommended procedures. Even if liability claims are more readily defensible, the undertaking will be more complex. The case of *Abrams & Wofsy v. Renaissance Inv. Corp.*, 820 F. Supp. 1519 (N.D. Ga. 1993), illustrates the burdens created by detailed professional standards. In that case, accountants that performed review services in connection with a real estate syndication were vindicated from liability for malpractice in connection with preparing a financial forecast. However, in reaching that result, the court applied anything but a simple and mechanical limited engagement defense analysis. More than 50 pages of the opinion were devoted to a host of criticisms, an exhaustively detailed review of the work product involved, and an extremely detailed evaluation of the AICPA guidance and literature applicable to financial forecasts. Moreover, the work in controversy was conducted in the early 1980s, when AICPA guidance was much more basic. Indeed, no specific mandatory guidelines applied to an accountant's review of financial projections when the work at issue was conducted.

Whereas current standards may bring certainty, they are also more complex and require higher levels of investigation. This creates opportunities for dispute in a professional liability case. Thus, where the level of investigation was previously a matter of professional judgment, more detailed guidelines could increase liability exposure in some instances. A review engagement is now a more complex and thorough undertaking. Broader engagements generally carry broader liability risk.

Third-Party Claims

Disclaimers as to limited engagements have traditionally been more effective as to third-party claims. Thus, even where investors or other non-clients are expected and intended beneficiaries of the work product, they face hurdles in establishing justifiable reliance as to claims that cannot be harmonized with disclaimers in the work product. This tendency to hold third parties to the letter of disclaimers is most pronounced in securities litigation. There courts have consistently disallowed claims based on unaudited financial statements not expressly attributed to the firm as audited work product. *Pacific Inv. Mgmt. Co. LLC v. PIMCO Funds*, 603 F.3d 144, 152 (2d Cir. 2010); *Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147, 155 (2d Cir. 2007). However, investors have been allowed to assert common law claims in instances in which the work product was allegedly not prepared in conformity with professional standards.

The case of *Anderson v. Deloitte & Touche*, 66 Cal. Rptr. 2d 512 (1997), provides an example. In that case, the accounting firm was sued for negligent misrepresentation based on its review of a limited partnership's financial forecast used in the offering memorandum. The accounting firm was granted summary judgment on the grounds that, under AICPA guidelines, the ultimate "responsible party" for the assumptions in a financial forecast was the client issuer. The firm had not been retained to audit the assumptions underlying the forecast. Because the accounting firm was retained only to confirm that the forecast was presented in conformity with AICPA guidelines, it successfully argued that there was neither a duty nor reasonable reliance.

The court of appeal reversed on the grounds that the investors had raised a triable issue of fact as to whether the engagement, though limited, had been performed in conformity with AICPA guidelines. That the issuer was the sole responsible party for the projections did not excuse the firm from familiarizing itself with the operations of the general partner. This potentially included a duty to confirm certain basic business relationships supporting the assumptions, such as relationships with third-party lenders. Negligent misrepresentation claims were allowed to proceed on the grounds that a review was completed without a sufficient basis to opine that the forecast was presented in conformity with AICPA guidelines.

This decision is consistent with both past and present requirements that the accountant obtain a sufficient understanding of the industry and the client. Thus, although a review engagement may be limited, some basic standards simply cannot be written out of the engagement by way of disclaimers. To achieve that result, the entire engagement must be lowered to that of a compilation level engagement.

Current standards actually may be more useful in defending third-party claims than those of the past. SSARS 19 contains the most detailed and clear articulation to date of the fact that the ultimate party responsible for the preparation and fair presentation of financial statements is management. To the extent illustrative management representation letters are used in conformity with current guidelines, it will be more difficult for investors and other third parties to make claims that implicitly attempt to convert a review engagement into an audit by claiming false or inaccurate information originated with the CPA.

In the securities litigation context, courts have generally refused to adopt a so-called "creator" standard of liability based on the accountants' mere involvement in the preparation of non-audited financial reports. *Pacific Inv. Mgmt. Co. LLC*, 603 F.3d at 154-55. There can be no liability unless the financial statement is directly attributed to the accountant as in the case of an audited financial statement. The federal courts have frequently based their rulings on the general prohibition under the securities law of imposing "secondary liability" for assisting securities fraud. *Lattanzio*, 476 F.3d at 154 (citing *Central Bank of Denver N.A. v. First Interstate Bank of Denver N.A.*, 501 U.S. 164 (1994)). However, this defense also has been sustained under principles of justifiable reliance. *Pacific Inv. Mgmt. Co. LLC*, 603 F.3d at 156-57 (reliance on uncertified reports not justifiable as a matter of law).

In cases such as *Anderson*, there was no clear articulation of the source of the information supporting management's forecasts. Nor was it clearly stated in the offering memorandum that management had exclusive responsibility for the accuracy of the information. To the extent review reports are clearer on this subject in the future, in conformity with existing guidance, it may actually be more difficult for third parties to bring malpractice claims against accountants who perform such limited review engagements.

Conclusion

There is a natural lag time between the development of new professional liability standards and decisions interpreting and applying those standards. One school of thought is that higher standards equal greater exposure. But that perspective builds on the bearish assumption that the profession will not rise to the challenge. As the profession known to be most cautious and conservative, the assumption is likely wrong in the case of accountants. The closer question is whether the legal profession and retained experts will understand and examine the standards well enough to differentiate between a legitimate and untenable claim for malpractice. Under any set of professional standards there are always good and bad claims.

Recent Court Rulings

Case Summaries & Conclusions

Insurance Agents

"Special Relationship" Between Insurance Agent and Insured Required to State Cause of Action for Failure to Procure Adequate Coverage

***McClammy v. Cole*, 243 P.3d 932 (Wash. Ct. App. 2010)**

The Court of Appeals of Washington recently held that an insurance agent owes no duty to advise an insured as to adequate coverage. The court further held that in order to state a cause of action against an insurance agent for failure to procure adequate coverage, an insured must establish a "special relationship."

In May 1995, the insureds purchased a home for $248,000 and a homeowner's policy through the agent that provided $200,000 in replacement value. Thereafter, the insureds made certain improvements to the home. The insureds informed the agent of the improvements and inquired about additional coverage for the home. However, they never directly asked the agent to increase the limits on the homeowner's policy. After their home was destroyed by a fire, the estimate to replace the home was more than $365,000.

The insureds sued the insurance agent, contending that he had negligently advised them that coverage for their home was adequate, when in fact coverage was not adequate to pay for reconstruction of their home. The agent moved for summary judgment, contending that no special relationship existed, and therefore, that he had no duty to advise the insureds to increase their insurance policy limits. The trial court agreed.

The court of appeals undertook an analysis of an insurance agent's duty to its client. The court observed that ordinarily, an insurance agent has no duty to advise an insured as to the adequacy of the applicable insurance policy coverage. Thus, to state a cause of action for failure to procure adequate coverage, the insured must establish a "special relationship."

The court held that a special relationship exists if (1) the agent holds himself out as an insurance specialist and receives additional compensation for consulting and advice; or (2) there is a long-standing relationship, some type of interaction on the question of coverage, and the insured relied on the agent's expertise to the insured's detriment.

The court found that the insured and agent had a long-standing relationship and that some sort of interaction existed on the question of coverage. However, the court stated that it was necessary to examine the nature of the interaction, because "in cases where the insured never consulted with the agent about the adequacy of coverage and the agent never gave any advice, courts have held that no special relationship exists."

The court's findings regarding the level of interaction are of note. The court found that there was interaction between the parties on the adequacy of coverage — face-to-face meetings in which the subject of improvements to the home and adequacy of coverage were discussed as well as electronic communications regarding coverage. However, the court concluded that it was not significant enough to establish a special relationship.

This case illustrates that the question of whether there is a "special relationship" is determined case by case, based on the specific interactions and relationships of the insured and the agent, and not generalized marketing tools and programs.

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Architects & Engineers

Texas Court Clarifies Certificate of Merit Requirements in Cases Against Professionals

***Nangia v. Taylor*, 338 S.W.3d 768 (Tex. Ct. App. 2011)**

A Texas appellate court affirmed the denial of an engineer defendant's motion to dismiss, finding that the trial court did not abuse its discretion in finding that the plaintiff met the statutory exception for the certificate of merit requirements of Section 150.002.

Section 150.002 of Texas's Civil Practice and Remedies Code provides that a "certificate of merit" must be attached to any complaint seeking an action for damages arising out of the provision of professional services by a licensed or registered professional (including licensed architects and engineers). A certificate of merit is an affidavit of a third-party with the same license or registration as the defendant that should explain the alleged error or omission and the factual basis for the claim.

Section 150.002 also contains an exception. The requirement to file a certificate of merit does not apply if the statute of limitations will expire within 10 days of the date of filing the complaint, and the plaintiff alleges that an affidavit of a professional could not be prepared because of such time constraints. In such cases, the plaintiff has 30 days after filing the complaint to supplement the pleadings with the required certificate of merit.

In this case, the plaintiff added an engineer as a defendant in a second amended complaint which was filed on June 16, 2010. The complaint contained neither a certificate of merit nor the required allegation that the statute of limitations was about to expire and that an affidavit from an engineer could not be prepared. The engineer filed a motion to dismiss on July 9, 2010. The plaintiff filed a third amended complaint on July 14, 2010. This time, the plaintiff's third amended complaint contained the statement required by Section 150.002 and a certificate of merit from a licensed engineer setting forth a factual basis for the claims. The trial court denied the engineer's motion to dismiss the complaint.

On appeal, the engineer argued that the plaintiff failed to attach a certificate of merit to the second amended complaint, and failed to allege that the statute of limitations would run in ten days and that it was unable to obtain an affidavit. The appellate court found that under Section 150.002, if a plaintiff does not file a certificate of merit with the initial complaint, the certificate of merit is timely only if within 30 days the plaintiff satisfies the statutory exception. The court found that the plaintiff satisfied the statutory exception by filing a third amended complaint with the required allegation and a certificate of merit from an engineer within 30 days of the second amended complaint. Accordingly, the appellate court affirmed the trial court's denial of the engineer's motion to dismiss.

This case serves as a reminder to practitioners to be aware of state requirements for filing a certificate of merit with a complaint against a licensed or registered professional. Although the appellate court in this case upheld the denial of the engineer's motion to dismiss (and may have given the plaintiff a break), a party must comply with certificate of merit requirements. Failure to comply with any such requirements subjects the complaint to dismissal.

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