

Risk Minimisation Strategies for Accountants and Auditors – Being Claim Aware

Since the economic crash of 2008, there has been a marked increase in litigation against professionals and accountants have not been immune from this trend. The nature and scope of the expansion of the accountancy sector means that risks can arise from ever more diverse areas of practice: accountancy now covers extensive advisory, reporting, investigatory, regulatory and administrative services. Accountants need to be increasingly claims conscious in the provision of their services.

We will summarise some of the risk minimisation strategies that accountants would be best served to implement or where such measures are already in place, to review and/or renew in order to best protect their interests in the event of a claim arising. Having such procedures in place, updated as necessary and followed consistently could be the difference between successfully defending a claim or facing an exposure which can have a significant impact upon policy premium for years ahead.

1. The Importance of Maintaining Effective Letters of Engagement

One of the prerequisites of a successful claim against an accountant will be the existence of a duty of care being owed by the accountant to the claimant concerned. This duty of care will typically arise from the retainer that comes into existence between an accountant and their client. A claimant will seek to construe the duties owed by the accountant to them in order to demonstrate the purported breach which the client maintains has given rise to actionable loss. Accountants will typically owe contractual duties, duties in tort and fiduciary duties to clients and in certain circumstances, could also owe duties to third parties. The standard of skill and care expected of an accountant in carrying out an engagement is that of the reasonable skill and care of an ordinary skilled person carrying out the same engagement.

Against this backdrop, accountants can seek to protect themselves and ensure absolute certainty with their clients as to the services being provided through a well-drafted letter of engagement. Such a letter of engagement should be issued at the outset of every instruction and serves the important purpose of defining the scope of the accountant's retainer. The letter should reflect the precise instruction and address issues such as the particular service being provided (and where relevant, those services which are not being provided where some other professional's input may be required), the point of contact for receipt of instructions, the timeframe within which the work is to be completed (where applicable) and the fee arrangements for such work. Such letters should be discussed with the client and counter-signed as this can help to avoid potentially unnecessary disputes that might otherwise arise where parties may inadvertently be at crossed purposes.

If there is any possibility that the service being provided by the accountant to the client will be relied upon by a third party (such as a lender or investor), that issue should ideally be addressed in the letter of engagement. If the accountant does not wish for their services or work product to be relied upon by a third party, the letter of engagement should properly contain such a stipulation. On each occasion that an accountant is retained in respect of a new engagement (and even for multiple engagements by the same client, such as



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annual audits or returns), a fresh letter of engagement should issue and indeed should be retained with the file for the appropriate period in accordance with the accountant's data retention policy (often recommended as being seven years post completion of work).

2. Contractual Limitations on Liability

Accountants may seek to use their letters of engagement to provide for contractual limitations on liability to protect themselves. Certain clients will not be prepared to accept such limitations as a matter of principle so it is an issue that needs to be carefully broached for commercial reasons. Similarly, if such terms are agreed between the parties and a claim subsequently arises and liability is established against the accountant, the court will look very closely at the manner in which such a clause was negotiated when assessing the level of such potential awards. A well-drawn limitation of liability clause could potentially survive a challenge based on an unfair contract term, however much depends on the circumstances of each particular case. Much will turn upon the construction of the clause so accountants should tread carefully so as to strike the correct balance between, on the one hand, taking all reasonable steps to protect their interests and on the other hand, avoid undermining the client relationship.

However, auditors are largely prevented from contractually limiting their liability to the companies they audit. Section 235 of the Companies Act 2014 effectively prohibits a company from limiting the liability of an auditor in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company. Section 235(3) (a) of the Companies Act 2014 provides that a company may indemnify an auditor of the company against any liability incurred in defending proceedings, whether civil or criminal, in which judgment is given in their favour or in which they are acquitted. Accordingly, the indemnity will not apply if the auditor has been found guilty of negligence, for example.

3. Remember the Retainer in Practice

Where there are multiple parties involved in a transaction, such as an investment scheme, it is always important to maintain clear parameters in relation to channels of communication and to be aware of the risk that lines might become blurred. Whilst it is important that progress is made in relation to such matters – often under significant time pressures – where there is a multiplicity of advisors, it is important to differentiate the roles and respective areas of expertise of each of the advisors. Otherwise, there is a risk that an accountant could inadvertently embrace a more onerous scope of duties which, if difficulties arose in connection with the transaction, could expose the accountant to liability that might not otherwise have accrued if the accountant had acted strictly in accordance with their retainer under the letter of engagement.

4. Internal Risk Minimisation Strategies

Accountancy practices can best serve their clients' interests whilst also protecting their own position by operating a documented supervision system, particularly in a larger accountancy practice. There should be a defined supervision structure with clear reporting lines involving suitably qualified supervisors based on their technical competence, experience and ability. New work should be allocated and subject to early review by a supervisor so as to maintain effective and timely checks. Regular scheduled reviews should take place to monitor workloads, check for progress and inactivity, prioritise work and to deal with problem cases or particular challenges that have been identified internally. Practices should also consider operating an agreed system for reviewing incoming and outgoing correspondence, including post, faxes and emails. Practices may wish to disclose appropriate details of these arrangements to clients in their engagement letters so as to align the respective parties' expectations from the outset.

Frequent file audits should also be carried out, including the files of senior principals within the practice. High risk problem cases or cases where there has been undue delay should be identified through frequent file progress monitoring with supervisors making independent checks on file progress as appropriate. Client file management policies should also be in place so as to ensure that files are kept in an orderly fashion, correspondence filed in date order, the file kept up-to-date and stored securely, preserving client confidentiality and retained in accordance with a file retention policy. Any sensitive personal data should be identified on the file so that the practice can comply with its General Data Protection Regulation ("GDPR") obligations. Policies should also be maintained for long-term staff absenteeism so that files are actively progressed at all times. Upon the conclusion of a file, before it is archived, best practice would be for that file to be reviewed against a checklist of defined criteria as part of a practice's quality control procedures.

5. Allegations of Negligent Audits having been carried out

There is arguably more of a focus on the role of auditors when difficulties arise for companies than has ever been the case. This is largely as a result of the professional negligence action being maintained by Quinn Insurance Limited ('QIL') against PriceWaterhouseCoopers ('PWC') since 2012 arising from allegations (denied by PWC) that PWC should have known QIL's relevant financial statements and regulatory returns did not accurately reflect the state of QIL's financial position and the status of their reserves from 2005 to 2008.

Auditors in Ireland should accordingly be minded to ensure that appropriate standards of quality are maintained and all work on an audit properly documented on the basis that it could be scrutinised in ever greater depth if a claim is contemplated.

6. Documenting of Significant Interactions on File

As accountants and auditors have become more claims conscious, they have also become more aware of the importance of having detailed attendance notes on their files, maintaining a clear record of instructions when matters are discussed verbally with clients and reducing such advices to writing. This can often seem an onerous task but where a claim arises, it can play a critical role in demonstrating that advices were, in fact, provided when the client might later seek to dispute the position. These notes should be legible, the originals kept and typed copies prepared.

In the absence of such notes, where claims arise and central 'facts' are the subject of a dispute, the court may not be prepared to accept the evidence of an accountant if it is not properly supported by documentary evidence on the file, particularly if the claimant can adduce contradictory documentary evidence. That is not to say that a claimant's evidence will inevitably be preferred simply because of an accountant's failure to create an attendance note, it is simply a question of an accountant looking to take every opportunity to protect their position.

In particular, where accountants are engaged in advisory work and if the client wishes to ignore that advice in respect of a particular transaction or in any other such context, the accountant may wish to protect their position by requesting the client in question to sign a waiver to acknowledge that they have been provided with the particular advice and understood same but that they are nonetheless not following such advice.

7. Liability for Data Breaches

As and from 25th May 2018, accountants will face increased risk of civil compensation claims arising from data breaches when the GDPR comes into effect. Accountants are also at risk in relation to potential regulatory fines. All practices should accordingly ensure that they have updated their terms and conditions, data sharing agreements, privacy notices, data breach notification policy, data subject right access policy and data retention policy in accordance with a GDPR Action Plan. Accountants who process significant volumes of personal data should also consider the benefit of having policies of cyber/crime and D&O insurance in place as part of their strategic response. Those firms that operate the most effective data protection strategies are likely to minimise the scope for data breaches but it nonetheless presents a further risk for accountants, in particular, those acting as receivers who are processing the personal data of distressed borrowers.

Conclusion

Proper and effective governance is a critical feature of any accountant's risk minimisation strategy. It is impossible to guarantee that a claim will not arise but accountants and auditors can take a number of steps when providing services on a day to day basis which should put them in the best position to robustly defend and minimise the scope of any claims that may arise.



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