Professional negligence claims

One unexpected consequence of the recession is the upsurge in claims against accountants, many without merit, writes Sarah Conroy and Mary Smith.

Many professional negligence claims against accountants are entirely without merit, but considerable time and expense is spent in dealing with them. There are other steps that accountants can take to pre-empt or avoid such claims.

Claim components
To succeed in a claim for professional negligence against an accountant, the claimant must prove three essential elements:

- That the accountant owed them a duty of care
- That the accountant acted in breach of that duty
- That the accountant’s breach was the cause of their loss.

Furthermore, if a claimant waits more than six years to bring a claim from the date of the alleged negligence or damage, then the accountant may have a strong defence to argue that the time allowed for bringing a claim has expired.

Duty of care
The starting point for a professional negligence claim is for the party claiming to establish that the accountant owed them a duty of care. Usually a client would have no difficulty establishing a duty of care as the relationship between the accountant and the client is a contractual one where there is a written retainer in place. Even in the absence of a retainer, the client is usually close enough to be owed this duty of care. In such cases, the accountant must answer to the client for any material mistakes made in the course of the engagement.

However, the person claiming can often be someone other than the client, for example a lender or investor, who relied on financial statements and suffered a loss as a result. It tends to be more difficult for a non-client complainant to successfully establish that the accountant owed them a duty of care in the absence of a direct contract between the claimant and the accountants.

Accountants need to be aware that in certain scenarios, for example, audits or representations of credit assurances, a duty of care can indeed arise to third parties without the accountant having intended this to occur. This can arise where an accountant makes representations as having a particular expertise and having assumed duties to a third party. Measures should be implemented to minimise the chances of this happening unless otherwise agreed in the first instance.

Breach of duty
The provision of an inadequate service may not necessarily constitute negligence. A professional does not promise that the services or the results will be perfect, and delay or a mistake, may not always result in a loss.

However, certain minimum standards of skill and care are required of the accountant and such standards are usually set and required by the
Examples of typical claim scenarios include the following:

* Failing to identify situations when specialist advice (for example legal advice), is required, which is beyond the accountant’s expertise, and failing to advise the client to engage such a specialist where appropriate.

* Failing to advise the client of changes in the law so that the client can review the impact of the charges on their tax affairs/schemes if the accountant had promised to do so.

* Representing to a client’s prospective investor/lender that financial accounts, which were prepared for a client at an earlier stage, were accurate when in fact they were not and thereby caused the investing party a loss as a result. Claims against financial advisers have increased in recent times because financial products have not performed as well as expected.

* Missing deadlines to claim tax credits or property-related tax allowances. Claims for tax-related negligence usually increase in times of recession as tax-related schemes attract greater scrutiny. The party claiming needs to prove that the accountant performed the services to a standard below what would be expected from his professional peers in the same circumstances.

In assessing if the standard had been breached, a court would normally have regard to the nature of the work undertaken, the standards expected in the industry (eg the ACCA Rulebook) and if the governing professional body (eg ACCA) would regard the performance of the accountant as competent and reasonable in the circumstances. When defending a claim of this nature, an expert would be retained to give an opinion as to whether there has been negligence in this regard.

Causation and loss
A party claiming must establish that they suffered loss as a result of the negligence. If the negligence did not cause the loss then there is no claim. A loss could have occurred in any event due to other outside causes such as the risk inherent in a transaction. Also the party claiming has a duty to mitigate its loss. It cannot recover damages for losses, which could otherwise have been avoided.

Useful risk measures

* Know your client and identify any factual circumstances relating to your client that could impact upon the advice you give, eg non-domiciliary status for tax purposes.

* Maintain well-drafted letters of engagement and review regularly.

* Consider appropriate disclaimers and limitations on liability in documents intended for circulation to third parties.

* Recognise the limits of your own expertise and know when specialist advice is required.

If a claim is made
In the event that a claim is made or threatened, an accountant should adhere to the following guidelines:

* Contact your professional indemnity insurer as soon as possible. Bear in mind that your insurance policy may provide for a strict time limit for notifying claims – do not delay in doing this.

* Contact your insurers before incurring any legal costs on your own account in order to ascertain if your insurers will discharge these costs or if they have their own legal representation that they wish to appoint.

* Send all correspondence received in relation to the claim to your insurers. Do not respond to it without the insurer’s permission.

* If you have a broker contact them as they may be in a position to provide guidance and assistance in dealing with the claim.

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