Risk Management and how to Avoid Claims before they Arise

Sarah Conroy and Mary Smith outline steps Practices can take to assist in minimising the risk of exposure to professional negligence claims from clients.

Disputes with clients and/or third parties can arise for a number of reasons and at any time. Claims against professional advisors such as auditors, accountants and tax advisors tend to increase particularly following a recession.

Any size of claim, whether it is small or large can have a significant adverse effect on a Practice in terms of management time and resources. Furthermore the level of premium payable in respect of professional indemnity may increase following a claim. It is more important than ever for professional advisors to ensure that appropriate risk management procedures are in place to assist reducing the risk of claims arising.

While it is not possible to guard against every circumstance arising there are clearly steps Practices can take to assist in minimising the risk of exposure to professional negligence claims from clients.  

**Engagement Letters**

A properly drafted engagement letter can serve as a helpful risk management tool. It is important to define the scope of your retainers and the parameters of your responsibilities to your client in an engagement letter. The importance of your engagement letter cannot be overemphasised. An engagement letter will serve as one of the first important lines of defence should a claim arise. An engagement letter can also reduce the risk of being in dispute with a client over fees.

An engagement letter should be tailored to suit each particular client and transaction in order to reduce the scope for any misunderstandings. While the engagement letter itself may vary with the level of service or type of engagement to be provided, the letter should be clear, certain and informative or else any ambiguity could be construed against the practice. The engagement letter should be countersigned by the client to ensure that it is contractually binding and enforceable and the final signed version placed on the file.

Common provisions in most engagement letters include the following:

1. Clear identification of the client and the main point of contact (e.g. individual, a group, an entity, or a portion of an entity);
2. The scope, duration/timing (for example, identify the specific tax year subject to the service) and purpose of the work, specific tasks to be undertaken, staffing of the engagement and any confined limitations on that work;
3. The fee arrangements;
4. The client’s tasks and responsibilities (e.g. collect certain information and applicable deadlines should be clearly set out) along with an explanation of the consequences of non-compliance;
5. Identification of intended users and recipients of the work product (this provision often contains language prohibiting the client from distributing the work product to any party other than specified users without consent);
6. Termination rights (e.g. to suspend work or cancel the engagement for fees not paid) and outline the complaints procedure available. It may be wise to issue a ‘disengagement’ letter, particularly in relation to tax matters so that it is clear what work has been carried out and which adviser will be responsible for any remaining work;
7. Limitations on liability and appropriate caveats (see below) tailored to the scope of service to be provided and;
8. Client signature (this provision should request the client to sign and return an executed copy of the engagement letter).

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**Introduction**

In the normal course of events, an accountant will perform services for clients as requested by them. These services are completed to the client’s satisfaction and the accountant’s fees are discharged accordingly. Unfortunately, it has become a feature of professional services that a professional has to be cognizant of the risk that a claim may ensue as a result of the provision of such services.

Such a claim may be entirely without merit but considerable time can be spent in ascertaining this and disposing of such a claim. We have set out some headline points below which should assist you in staving off such claims before they arise.
The above list is not exhaustive but merely an outline of the general provisions that will assist in protecting a Practice against claims. Any additional tasks or variations to the terms agreed are best documented and counter-signed to help protect against misunderstandings. The engagement letter can help guard against the client developing unreasonable expectations about the nature and the scope of the services to be provided.

**Limitation of liability and disclaimers**

Accountants and financial advisors should limit their liability where possible. These clauses should be included in the engagement letter and drawn specifically to the attention of the client.

Common examples of clauses limiting liability to a client are as follows:
- Excluding liability for consequential loss and/or loss of profits – those specific losses which are to be excluded should be clearly described. If your professional indemnity insurance policy does not provide cover for these losses then the clause may be considered reasonable in the circumstances if challenged.
- Monetary caps on liability – the amount of any cap is a matter for commercial judgment but obviously it should be set at a level no higher than the amount of a firm’s professional indemnity insurance cover.
- Exclusion of liability where information has been misrepresented or concealed by the client.

It is advisable to refer the client to the limitations of liability clauses in a covering letter enclosing the engagement to avoid any arguments that the client was not advised of them specifically. Limitations and exclusions should also be included as far as possible in reports and other documents.

You should recognise the limits of your own expertise and know when specialist advice (e.g. legal advice) is required.

If you are asked to provide advice on a query within a very short timeframe, it is advisable to outline the fact that the timeline is short and qualify that your advice could change if further time and/or information were available.

It is always advisable to seek legal advice when formulating limitation of liability clauses as the above points are for guidance purposes only.

**Third Parties**

As engagement letters are not binding on third parties the protections afforded in those letters will be of little avail if a claim is instigated by the third party. Examples of such recipients could be a lender, purchaser or investor who relied on the accounts and/or advice which you produced for the purposes of deciding on a particular transaction. Therefore, it is always advisable to put in place additional safeguards. The use of disclaimers in the actual work product can assist in protecting against an assumption of responsibility to third parties. Common provisions to insert in the work product (which could help minimise exposure to third parties):

- Stipulate that your work is not intended for any other purpose or recipient other than the specific purpose and recipient for which it was prepared;

- Disclaim responsibility to any third party and list any third parties that may seek to rely on your work without your agreement;
- State that insofar as any third party might seek to rely on your work, then they do so at their own risk.

Take care not to override the effectiveness of disclaimers with actual words or assurances which are inconsistent with them. A simple verbal assurance that you stand over a company’s accounts could render you liable should that company fail and render invalid the use of any disclaimer in existence.

You should respond to any direct correspondence from third parties in the normal way. You should seek to disclaim liability to these third parties. Alternatively, otherwise if you do agree to provide any representations or assurances to third parties it is advisable that you enter into a separate arrangement with them.

**Conclusion**

When work is carried out in accordance with the current professional standards expected in the industry you reduce the possibility of being held negligent whether to your client or, third parties, known or unknown.

Disclaimers are only precautionary in nature and one cannot eliminate risk, only manage it. In the event that a claim is threatened or made you should notify your professional indemnity insurers immediately.