

Practice Protection

This presentation is not intended to provide a detailed analysis of law and authorities. Rather, it aims to provide a personal, and fairly broad-brush, assessment of the current litigation climate, an extremely brief refresher on how accountants can become liable in legal proceedings and to whom, and some practical suggestions, drawn from personal experience, for policies and procedures which can help prevent that happening.

1. The Litigation Culture

- 1.1. For the last 10 years or more (the phenomenon can probably be dated to even earlier than the introduction, in England, of the Access to Justice Act 1999) there has been mounting concern about what press and politicians call the “litigation culture”. These concerns usually manifest themselves in mildly indignant – or not so mildly indignant - reports of the latest bizarre set of facts which has resulted in a substantial pay-out to somebody who is perceived to be wholly undeserving. Occasionally, more serious concerns have been expressed about mounting pressures on the court system, the increased cost of insurance cover, and improper practices amongst some sectors of the “claims management industry”.
- 1.2. There is no doubt that the litigation culture is real, in the sense that there are many more suits before the courts than there have ever been before, and the traditional deference which courts and clients previously showed towards the professions has been whittled away. The financial climate has had an impact, too, on claims against professional service providers. According to *Accountancy Magazine* (23 August 2010):

High Court claims filed against accountants, lawyers and estate agents increased from 147 to 332 – a rise of 125% - mainly from investors and lenders who have suffered losses resulting from the recession . . . In 2009, there were 13 major professional negligence claims against accountancy firms in the High Court, compared with none in 2008. In fact, over the previous five years (2004 to 2008) there were only four in total.

- 1.3. Senior professional figures have criticised this trend. As reported in the *Telegraph*, on 14 July this year, Bill Michael (UK head of financial services at KPMG) used an address to senior bankers to attack what he described as “unfair”, “deep pocket” lawsuits which pay “little or no attention to the balance of responsibility between auditor and management”. He went on:

We operate in a highly litigious environment where the balance of risk and reward has driven us to a world of caveats. Any corporate failure or financial loss invariably carries with it the risk of suing the auditor.

- 1.4. There are in fact a number of key factors which, it is suggested, have driven an increase in serious lawsuits against accountants (and others) in recent years, at least as far as the UK is concerned. As we will see, however, many of those factors are actually of fairly limited, or even no, relevance in Guernsey.

2. Key Drivers

- 2.1. We now live in a “consumer society”, with all that that brings. People are now more aware than ever before of their rights as “consumers”, and less inclined to defer to the professions. Without attempting any form of quantitative analysis, it is obvious from the sheer number of pending actions before UK courts that society has become more litigious.
- 2.2. In England, alternative funding arrangements (especially conditional fee arrangements and after-the-event legal expenses insurance) have revolutionised the way in which litigation can be funded, and the ways in which claimants can protect themselves from financial risk. However, even in England:

the use of CFAs and ATE for professional negligence remains surprisingly low, especially when compared to their usage in clinical negligence. (The Lawyer, 16 February 2009.)

- 2.3. In many jurisdictions, and notably the USA, the possibility of class actions is another way for complainants to insulate themselves against the costs and financial risk of litigation. The result is increased levels of large-scale litigation.
- 2.4. By virtue of their minimum professional indemnity insurance requirements, members of the professions are often viewed as having “deep pockets” and, especially after a recession in which a number of alternative defendants may have disappeared, they are liable to find themselves as the “last men standing”. Both factors serve to attract claims which might otherwise have been directed elsewhere.
- 2.5. Finally, it is a fact of life that hard economic times engender claims. This was as true in the early 1990s and after the dot.com crash as it is today. However, there is always a time lag between the low point of the economic cycle and the high-point of claims commenced. We may not have reached the high point yet.
- 2.6. The crumb of comfort for a Guernsey professional is that not many of the above factors are directly relevant here. Guernseymen have always been a litigious bunch, as the records of the Royal Court attest, but although the courts are certainly busier in civil matters than ever before, there does not seem to have been any appreciable upturn in the number of actions for damages brought against professionals generally, or accountants in particular. In part, this may be because would-be plaintiffs are deterred by the costs of the exercise. Litigation in Guernsey is a very expensive (and potentially very drawn out) process and the availability of legal aid is limited. The creative methods

of litigation funding which are available in the UK and elsewhere do not work here, either because they are specifically prohibited (contingency fees) or because they would not work in practice without legislative changes (conditional fees) or because the market is so small that insurers may have little interest (ATE insurance).

2.7. Nevertheless, a number of claims are brought before the courts every year, and modern professional standards are always evolving. It is vital to keep up to date with standards of good practice, and to know what to do (and what not to do) when things go wrong.

3. Principles of Civil Liability for Accountants: In Outline

3.1. Accountants can be vulnerable to complaints and claims from a number of persons, including the client, third parties, liquidators, trustees and executors.

3.2. The most important sources of potential liability are in the law of contract (breach of retainer) and the law of tort (usually, but not always, based in negligence). Occasionally, trustee and other fiduciary duties may be owed, depending on the accountant's activities. Neither these types of duty nor the potential, in certain circumstances, for criminal liability to arise will be considered here.

3.3. Contractual liability requires:

- **Breach of an express or implied term** (express terms are set out in the letter of engagement; other terms may be implied including a requirement to exercise appropriate skill and care)
- Loss arising from that breach, being loss which was either specifically envisaged at the time of the contract or which flowed naturally from it.
- As a general rule, damages are assessed so as to put the plaintiff in the position he would have been in *if the contract had been correctly performed*.
- The Guernsey prescription period for claims in contract is generally 6 years *from the date of breach*

3.4. Liability to the client in negligence requires:

- **A negligent act or omission** (i.e. one which falls below the standards expected of a reasonably skilled practitioner in the accountant's field, appropriate to the circumstances of the case). Bear in mind that, just because a piece of advice turns out to be wrong, does not necessarily mean that the adviser has been negligent.
- **Loss caused by that act or omission**, which would not have occurred "but for" the accountant's negligence.

- Damages are generally assessed so as to put the plaintiff in the position he would have been in *if the negligent act or omission had not occurred*.
 - The Guernsey prescription period for negligence claims is generally 6 years *from the date loss occurs*
- 3.5. Liability may arise to a third party (i.e. someone who is not the client) where it is reasonably foreseeable that that person may be affected by an accountant's negligence. For example, liability can be imposed on auditors preparing accounts for a company to be shown to a would-be buyer of the business. Similarly, accountants who advise a company that a proposed transaction with the directors is lawful may be held liable to the directors if it subsequently transpires that the arrangement is unlawful and the directors are disqualified as a result. The key tests are whether the professional knows, or ought to know, that a third party might rely on the advice and, if the advice is negligent, might suffer loss.
- 3.6. Liability may be concurrent with another person: for example, auditors who fail to spot a fraud may be held liable to the company along with the directors who made the same mistake. The court can apportion liability between co-defendants, according to its views of the extent to which they were respectively "to blame", or reduce an award of damages to take into account any contributory negligence on the part of the claimant themselves.

4. Some Risk Management Techniques

(1) Professional Indemnity Insurance

- 4.1. Various professional associations prescribe minimum PII requirements, which may include minimum cover levels, maximum excess, obligatory terms and a list of qualified insurers.
- 4.2. Even where it is not a regulatory requirement, insurance provides peace of mind and financial protection for clients as well as professionals. As well as checking your PII cover satisfies all relevant regulatory requirements, it is important to review conditions and level of cover regularly to ensure the policy provides suitable protection. In larger operations, ensure somebody with appropriate seniority is delegated to deal with all PI issues.
- 4.3. All relevant risks must be covered (negligent errors and omissions, employee dishonesty, etc) and you should ensure the geographic reach of the policy is suitable to cover all jurisdictions in which you carry on business.
- 4.4. If in any doubt, discuss with your broker.
- 4.5. The same applies to D&O cover, or any other insurance arrangements which you may have in place.

- 4.6. When renewing your policy, make sure you disclose all material facts, especially relating to claims and complaint history. Keeping an accurate complaints ledger will help. Insurance proposals require full disclosure (so the insurers can price their policies), and cover may be declined in circumstances where anything material has been kept back.

(2) Review Letters of Engagement

- 4.7. Ensure your letters of engagement and terms of business comply with any relevant professional guidelines or requirements.
- 4.8. Set out in detail the actual services to be performed, the fees to be charged and the basis upon which fees are calculated. Except in urgent cases where it really is impractical, ensure the letter is received by the client before work commences. Get the client to evidence acceptance of terms, perhaps by signing and returning a copy of the letter. Ensure that a fresh letter of engagement is sent out whenever the scope of work changes materially.
- 4.9. Minimise the scope for misunderstandings between accountant and client as to who is responsible for what. The letter of engagement needs to be clear about the division of responsibilities and the scope of your retainer. For example, where this is appropriate, you should make it clear from the outset that the client is responsible for the accuracy of any information they supply. When preparing tax returns, remind the client that they are responsible (at least, as far as the Income Tax Office is concerned) for checking that the return is fair and accurate before it is signed. If there are any significant matters which are not included in the retainer, set these out.
- 4.10. Consider, to the extent your professional rules permit this, whether your terms of business should include a limitation clause, so as to cap any potential liability. Even though there is no Guernsey equivalent of the UK Unfair Contract Terms Act 1977, any limitation provisions should still be fair and reasonable. Limitation clauses are interpreted strictly against the professional and, if your clause is in any way unreasonable, you can expect the court to do its best to find a way to strike it down. There is no hard and fast guidance as to what types of limitation clause may be reasonable, but it is suggested that any clause which purports to exclude liability completely or which aims to limit liability for fraud is extremely likely to be struck down. If, owing to the nature of the individual business, it would be difficult to obtain insurance cover above a certain limit, it may be reasonable to limit your exposure to that amount. Any limitation clause should be fairly prominent: do not bury it in the small print.

(3) Supervision and Training

- 4.11. Ensure that your internal arrangements for supervising staff are adequate. Ask yourself: do you know what your staff are doing, and are you sure they know what they are doing?

- 4.12. Consider internal or external training programmes to ensure all staff are kept up-to-date with the latest relevant developments in their field (law, tax, professional standards, etc). Subscribe to appropriate journals and update services.
- 4.13. Make sure that staff stick to their fields, and have arrangements in place for access to different specialists if the need arises. If the client requests work which is not appropriate for your field of practice or expertise, it is better to decline the instruction.
- 4.14. Promote effective time management, so that pressures of last-minute deadlines are minimised. This is when mistakes occur.
- 4.15. Regularly review your files, and those of any staff for whom you are responsible. Is WIP building up on a file, with no obvious explanation? Are any deadlines looming? Look out for obvious red flags which indicate that something may be going wrong.
- 4.16. Provide an opportunity for members of staff to raise any issues of potential concern internally, so they can be investigated and addressed at the earliest possible stage. For example, if there are regular fee earner meetings, consider including “concerns” as a standing agenda item.

(4) Paper Trails

- 4.17. Make sure your files and working papers are kept in good order, from initial client take-on right through to the final invoice. Bear in mind that, if a claim or complaint does arise, it may not arise until a number of years after the work was done. By then, memories will have faded and relevant members of staff may have moved on. Unless you have a record of a particular instruction or piece of advice, you may have no way of defending your position if the client subsequently queries the instruction or the advice they received. Even though this is always difficult in a busy office, you should ensure in every case that contemporaneous notes are kept of any material instructions received or advice communicated, whether during meetings or on the telephone.
- 4.18. When advising in writing, always take the time to set out the facts upon which the advice is based, and any assumptions which have been made.
- 4.19. Especially where urgent advice is required or the information provided by the client is limited, it can be helpful to include a suitable caveat in the advice so there can be no doubt that the advice was provided under difficult circumstances. If there is subsequently a claim, the court is able to take such circumstances into account in determining whether the appropriate standard of care has been achieved. Where you think you need to do this, there is no harm in stating that the advice has been supplied urgently, that the issue is complicated, and that the answer might have been different if you had had time for further consideration, or if you had received further information.

- 4.20. Be aware, however, that anything which is committed to writing in your offices may one day need to be disclosed in the context of legal or regulatory proceedings, or conceivably in response to a data protection subject access request. This applies especially to internal notes and emails. It is always embarrassing, and sometimes extremely damaging, to have to disclose documents which are disparaging of the client or which, perhaps inadvertently, contain admissions of poor service. You should work on the basis that any communications which are not held with external lawyers for the specific purpose of obtaining legal advice may one day have to be disclosed.
- 4.21. Select your document retention periods with care. Bear in mind that it is possible for claims to arise even after the standard 6-year prescription period appears to have expired. Unlike the position in the UK, prescription time limits cannot be extended by Guernsey courts outside the arena of personal injury claims. However, where there is a negligence claim, the clock will not start running against the claimant until a loss is actually sustained, which may be some time after the act or omission which caused the loss. For example, an accountant might give negligent advice about how a client's affairs will be treated for tax purposes if he moves to Guernsey: any loss will not occur until after the client moves to Guernsey and his tax position is prejudiced because the advice was wrong.
- 4.22. Similarly, where for some practical reason the client is effectively prevented from commencing legal proceedings (for example, where the client does not and could not know that he might have a claim, perhaps because he has no reason to think he might have suffered a loss), time may not begin to run until he is in a position to consider his options. In Guernsey, this doctrine is called *empêchement d'agir*.

(5) Avoid Difficult Clients

- 4.23. This is always easier to achieve in theory than in practice.
- 4.24. If you have a bad experience with a client, you are not obliged to accept future instructions from them. "Red flags" may be that the client was a poor payer; that important information was withheld; that the client's instructions changed repeatedly; or that the client was unusually demanding in terms of management time or had unrealistic expectations. Unless a client is really contributing to the success of your business, you really are better off without them.
- 4.25. Equally, prospective new clients can give off danger signals. Even where you do decide to take them on, do consider asking for a reasonable payment on account before you begin to act.

(6) Manage Client Expectations

- 4.26. Do not overpromise and under-deliver.
- 4.27. Keep clients fully up-to-date with progress on their work and the level of fees being incurred. Unexpected delays or bills cause ill-will and make the client relationship difficult to manage. If an invoice needs to be written down, do not be afraid to do this or to say that you have done so, and why, in a covering letter. If, for good reason, a bill is higher than the client may have been anticipating, explain this to the client at the time the invoice is sent. It is better to show the client that you take a proactive stance on billing than to invite complaints for perceived overcharging.
- 4.28. Take care that any claims made in your marketing and other publicity materials are fully justified. If you lay claim to a particular expertise, the courts will judge your acts and omissions against the standards to be expected of an expert in that field.

(7) Business Structure

- 4.29. Accountants know the advantages and disadvantages of different business structures better than any lawyer. Nevertheless, where permitted by professional rules, consider whether a corporate structure may be more appropriate than a classic partnership. Bear in mind that the Commerce and Employment Department is currently working on proposals to extend the LLP model to businesses generally.
- 4.30. Where you conduct business in partnership, ensure that there is a proper partnership deed in place which provides for respective rights and duties of the partners, and what is to happen to partnership property, both during the life of the partnership and when partners retire.

(8) Security of Client Data

- 4.31. Make sure your hard copy files are stored securely, and that any electronic records are adequately backed-up. Consider implementing a “clear desk” policy at work, to minimise the danger of breach of confidentiality and data loss.

(9) Avoid Conflicts

- 4.32. Ensure you have adequate internal procedures for identifying actual and perceived conflicts. Do not rely on memory alone: search client names and other key information against central records, and utilise internal email to make others aware of the proposed new business.

(10) Have a Complaints Procedure

- 4.33. A client complaints procedure can help identify areas of concern and manage issues raised by clients, before they escalate.

- 4.34. Consider designating a senior person within your firm to act as the “Client Care Partner” or similar, to be responsible for overseeing client complaints.
- 4.35. You will need an internal policy for the manner in which complaints are to be considered. This should be available for all your staff, so there is clarity about how complaints will be dealt with. It can also help to provide your clients with a document which sets out how they can make a complaint, who will deal with it, and how long the process will take.
- 4.36. No two complaints are alike, and it is not necessary to treat all complaints in the same way. Consider classifying complaints as “low level” or “high level”, depending on how serious they are. “Low level” complaints might be suitable to be dealt with by the staff member concerned, subject to being reported to the Client Care Partner. “High level” complaints are likely to require investigation and management at a senior level, and are more likely to need to be reported to insurers.
- 4.37. All complaints should be recorded in a ledger, and in due course reviewed by the partners or directors so that possible problem areas (which might include training needs or excessive workloads) are identified. The easiest way to achieve this is to provide staff with a complaint registration form, which must be completed with details of the complaint, specific issues complained of, action taken to date, and so on.
- 4.38. Inform yourself of the facts, and get both sides of the story.
- 4.39. If you think the complaint is justified, then apologise. Often, “Sorry” is all a client wants to hear. If you need to offer an additional remedy, discuss this with the client. Do be careful, however, to consider notifying PI insurers about the complaint and the proposals for remedying it *before* anything is put to the client. If the complaint is sufficiently serious that it requires to be notified to insurers, do not do anything further without insurers’ consent.

5. What to Do “When Things Go Wrong”

- 5.1. In most cases, a client will raise a complaint directly with you, and will only turn to lawyers if you are unable to resolve the complaint to their satisfaction. Therefore, implement your complaints policy. If it does become clear that a claim is in the offing, there are a number of steps which must be observed.
- 5.2. First, ensure that all appropriate notifications to insurers have been or are now made, and that insurers are kept apprised of any developments as and when they occur.
- 5.3. Notifications must be made in accordance with the terms of the particular policy. Generally, this will be whenever the client makes an expression of discontent to the insured, which might result in a remedy being expected from the insured. If in any doubt, discuss with your broker. If doubts persist, the only safe course is to make a notification.

6. Notification: Points to Watch

- Even a purely internal concern that a mistake might have been made, before any external complaint is received, can be a notifiable circumstance.
- Notifications should be sufficiently clear and unambiguous so that a reasonable recipient will understand that a notification is being made and what it relates to.
- The consequences of failing to notify can be extremely expensive. Do not be tempted to take any chances!

7. Other Steps

- 7.1. When legal proceedings are intimated, lawyers will need to be instructed. You may do this yourselves (for example, if the amount claimed is less than the amount of your deductible) or, if an insurer is acting, through insurers.
- 7.2. In the meantime, identify and collate all the relevant files and papers and keep them safe. There is a duty to preserve these pending disclosure, and in any event you should have easy access to them for the purpose of liaising with insurers and instructing lawyers.
- 7.3. Do not make any admissions or concessions in relation to the claim without insurers' explicit consent. A certain tension can sometimes arise between insured and insurer, because the insured may be anxious to manage the client relationship, whilst the insurer is strictly interested only in the overall financial impact of the claim. All policies will prohibit settlement without insurer consent, however, and if you do anything which might prejudice the insurer's position your cover is likely to be at risk.

Jon Barclay
Partner
AO Hall