

# MANAGING YOUR PROFESSIONAL RISKS WITH INSURANCE

## A guide for practice certificate holders

As professionals and business people you are subjected to many risks. The risks you can eliminate tend to be the smaller operational risks. Most however, need to be managed and, over time, reduced.

One of the risks you identify will involve the responsibility and liability you have to your clients to complete your work for them in the professional manner becoming of a CPA Australia (CPA) Accountant.

The most common financial instruments used to manage these risks is a Professional Indemnity Insurance (PII) policy. PII is mandatory for all CPA Public Practice Certificate and Limited Public Practice Certificate holders, as well as other members providing public, honorary or private accounting services, whether paid or unpaid, and should be treated as an integral part of your risk management strategy.

### Assessing adequacy of PI insurance

Whether a particular PII policy is adequate for you depends on a number of facts and circumstances, including the nature, scale and complexity of your business, and your other financial resources.

It is up to you to determine whether your PII is adequate to meet your obligations under CPA's By-Laws. Members should undertake an individual risk assessment prior to determining which policy and policy limits best meet your needs. CPA's By-Law 9.8 prescribes the minimum standards of cover and policy wording for any member holding a Public Practice or Limited Practice Certificate. Members must ensure that their policy meets the minimum requirements. Members are required to provide CPA with a copy of their certificate of currency or policy schedule. CPA will not however, provide an assessment of your individual risks or review your individual policy wording.

Even if you already have PII cover in place, you should regularly review your operations to assess whether the insurance continues to be suitable. This should involve you in:

- a) undertaking an initial assessment of your business; and
- b) having a process of ongoing assessment.

#### **a) Initial assessment**

Before buying an insurance policy you need to:

1. identify the risks associated with your practice, and
2. ensure that the insurance is adequate to satisfy your risk management.  
(*Buying the wrong insurance policy could be as bad as not buying any insurance at all.*)

Firstly, you need to understand what your risk is. Use the assessment process below to assist in this determination.

<b>Assess the business</b>	<p>Review your business, taking into account any proposed changes to the business.</p> <p>Review your claims history (if any) and risk management</p>
<b>Assess potential liability</b>	<p>Determine ‘the maximum liability that, realistically, has some potential to arise’. Do this by making a reasonable estimate of the following factors:</p> <ul style="list-style-type: none"><li>• the maximum exposure to a single client (‘worst loss scenario’ per client);</li><li>• the number of claims that could arise from a single client (potential for multiple claims – one audit client could suffer a loss but not realise it for several years and each audit year could then be a separate claim); and</li><li>• the number of claims that might be expected during the policy period (on average, one practice will suffer a claim out of every 30 practices in business and each practice will incur one claim from every 30 years of operation).</li></ul>
<b>Approach insurers and/or brokers</b>	<p>Ask insurers or insurance brokers for a list of key policy features, exclusions and available extensions and to confirm that the insurance will satisfy the needs you have identified after a full disclosure of your assessment in the previous steps.</p>
<b>Assess amount of cover</b>	<p>Consider whether the amount of cover is adequate. It must, at least, meet the minimum requirements of CPA’s By-Law 9.8.</p>
<b>Assess scope of cover</b>	<p>Consider whether the scope of cover is sufficient to cover <b>all</b> of the work you might undertake or have ever undertaken (remember that PII is underwritten on a claims made basis which means that your current insurance needs to cover all past work done).</p>
<b>Review policy terms and exclusions</b>	<p>Review the policy features using “What the policy should cover” below.</p> <p>Identify any gaps in cover.</p>
<b>Assess the suitability of insurers</b>	<p>Generally, the cover needs to have been provided by an insurer regulated by APRA, or operating under an exemption, under the <i>Insurance Act 1973</i>.</p>
<b>Consider your financial resources</b>	<p>Check that you have the financial resources to pay the excess on the estimated number of claims and cover any gaps and legal costs (if necessary). Consider how you will cover these</p>

claims and retain records of the assessment (e.g. through capital, cash flow, overdraft, support).

Remember that your excess is payable on each and every claim. Multiple claims = multiple excesses.

## **b) Ongoing assessment**

CPA expects you to review your PII or other compensation arrangements at least annually to ensure they continue to be adequate (e.g. when your existing policy is due for renewal). You should also review the adequacy of your compensation arrangements in light of any major changes in your business (e.g. if you acquire another practice, start providing new services or products, or engage more people).

## **What the policy should cover**

For a PII policy to be 'adequate', and to satisfy the minimum requirements of CPA By-Law 9.8, it should include the following features. Included below are the minimum requirements for each feature, and some factors you should consider when determining what is adequate depending on your business and individual circumstances.

### **a) Amount of cover**

#### ***Minimum requirement:***

*The minimum sum insured shall be the greater of:*

- a) the sum of A\$1,000,000;*
- b) any sum from time to time prescribed by any legislative enactment having effect in the Division to which the Member is attached; and*
- c) any sum from time to time prescribed by the Board either generally or in any particular instance;*

#### **Factors to consider:**

- Under Professional Standards Legislation (PSL), the minimum level of indemnity must be \$1,000,000 or 10 times the largest fee you generate. Check PSL requirements as other minimums can apply in certain circumstances.
- CPA has prescribed that the minimum level of indemnity must satisfy the PSL requirement.

#### **Notes:**

- Some insurance policies only offer cover which is “**costs inclusive**”. In such cases, any costs incurred by Insurers or their representatives will erode the available level of cover so that the full \$1,000,000 will not be available to pay the claim. CPA recommends that member stake out a policy which is costs exclusive, however, if a member purchases a policy which is costs inclusive then it is suggested that the policy limit should be increased by, at least, 25%. This additional cover will be required of registered Liquidators as set out by RG 194.
- Under Professional Standards Legislation your liability is limited provided:

- ✓ The work done which is the subject of the claim was done subsequent to the introduction of the Legislation, and
- ✓ You have the insurance required under the Act. If not then your liability may not be limited.
- Does the business carry a higher risk of claims (e.g. does it give advice in higher risk areas) or is it still exposed to higher claims for work done prior to the introduction of PSL?
- Have weaknesses been identified in your compliance systems, such as a high number of claims or high-risk practices, which might mean a higher level of cover is required?

## **b) Scope of cover**

### **(i) Run Off cover**

***Minimum requirement:***

*There shall be terms (save only to the extent the Board in any particular case otherwise allows) providing for:*

***A. run-off cover in respect of Members ceasing to provide Public Accounting Services;***

**Notes:**

- Run-off cover is only necessary for a business that has closed to ensure ongoing protection for the business.
- Most policies don't make any specific reference to run-off cover and where they do it is somewhat meaningless as such clauses tend to only provide the cover for the remainder of the policy period which the policy does anyway.
- The CPA Australia PII Scheme policy offers the option to extend the insurance for 7 years of run-off cover for sole practitioners when needed.
- Registered liquidators will be required to have automatic run-off cover written into their policies with effect from 1<sup>st</sup> August, 2010. This is also offered in the CPA Scheme policy.

### **(ii) Dishonesty**

***Minimum requirement:***

*There shall be terms (save only to the extent the Board in any particular case otherwise allows) providing for:*

***C. cover with respect to losses arising out of the dishonesty of:***

- *all employees of the Member; and*
- *all contractors engaged by the Member who are directly involved in the provision of Public Accounting Services by the relevant Approved Practice Entity;*
- *all employees of any Approved Practice Entity with which the Member is Affiliated;*
- *all contractors engaged by any Approved Practice Entity with which the Member is Affiliated who are directly involved in the provision of Public Accounting Services by the relevant Approved Practice Entity; and*
- *all natural persons (other than the Member themselves) who are:*

- *Affiliated with any Approved Practice Entity with which the Member is Affiliated;*
- *partners of any Approved Practice Entity (which is a partnership) with which the Member is Affiliated; or*
- *a trustee of any Approved Practice Entity (which is a trust) with which the Member is Affiliated;*

**Notes:**

- Some policies do not extend cover to the Directors and/or Partners of the practice, limiting cover only to acts committed by employees.

**(iii) Reinstatements**

***Minimum requirement:***

*There shall be terms (save only to the extent the Board in any particular case otherwise allows) providing for:*

*D. multiple automatic reinstatement following a claim; and*

**Recommendation:**

- The more reinstatements you can get written into your policy the better. The best option is to purchase a policy with unlimited reinstatements or which provides a Limit of Indemnity for “each and every claim”.
- The By-Law stipulates multiple reinstatements are required indicating two or more. A number of policies only offer one reinstatement or none at all which would be insufficient to satisfy this requirement.

**Notes:**

- Without automatic reinstatements the amount of available cover provided by your insurance will be eroded by any amount/s required to be paid to settle any previously notified claim.
- Automatic reinstatement means that if the limit of the policy is exhausted before the end of the policy period, the limit of indemnity is reinstated for the balance of the period to cover any new claims that might arise. This is important, as public practice holders must ensure their PI insurance cover is adequate at all times.
- Automatic reinstatement is available in different multiples up to “unlimited” but each insurer is different in their offering.

**(iv) Activities**

***Minimum requirement:***

*There shall be terms (save only to the extent the Board in any particular case otherwise allows) providing for:*

*E. indemnity to attach to any civil liability arising out of or in any way related to the provision of Public Accounting Services by the assured.*

**Recommendation:**

- Check policy wordings very carefully to satisfy yourself that all of your activities are being covered. If you are still in any doubt then get confirmation in writing.

**Notes:**

- Some policies specify only those activities that will be covered and, by default, are therefore not covering some Public Accounting Services. Such limitations could render the insurance in breach of this requirement.
- Other policies can exclude or limit the cover for certain activities either by endorsement or in exclusions contained within the policy wording.

## **b) Excess / deductibles**

***Minimum requirement:***

***There shall be terms (save only to the extent the Board in any particular case otherwise allows) providing for:***

***E. an excess for each and every claim not exceeding the greater of:***

- ***3% of the gross income of the assured in the immediately prior year; and***
- ***1% of the policy limit;***

**Factors to consider:**

- Is the excess at a level that the business can confidently sustain as an uninsured loss, taking into account the public practice holder's financial resources?
- The excess imposed by the insurer may be described as “**costs inclusive**”. If your excess is so described you will be required to pay your excess as soon as your insurer starts to spend money on investigating your claim even when the claim is spurious. The majority of claims notifications are spurious. When your excess is “**costs exclusive**” you only have to pay your excess when an amount is paid to the claimant to settle the dispute.

## **c) Exclusions**

**Recommendation:**

- There are no minimum requirements set down about the exclusions that are contained in your policy but you should be mindful that exclusions can't reduce the cover below other minimum requirements, i.e. they can't exclude cover for certain Public Accounting Services, such as certain audit work.

**Notes:**

- Apart from excluding certain activities some policies will also amend or limit the cover that is provided, i.e. by imposing a higher excess.

## **d) Persons covered**

***Minimum requirement:***

***The insured must be the relevant Member, any Approved Practice Entity with which the Member is Affiliated, all employees of the Member, all contractors of the Member who are involved in the provision of Public Accounting Services, all employees of any Approved Practice Entity with which the Member is Affiliated and all contractors of any Approved Practice Entity with which the Member is Affiliated who are involved in the provision of Public Accounting Services; and***

**Notes:**

- Apart from Contractors, a PII policy generally includes a definition of the Insured which is designed to include all members of the business.
- Most PII policies will not extend to cover a Contractor but some will cover the Insured practice for any work undertaken by the Contractor on its behalf.

**e) Retroactive cover**

**Recommendation:**

- Ideally, your insurance should not have a retroactive date or it should be stated as being “unlimited”.

**Notes:**

- Claims made against you which relate to work done prior to a retroactive date will not be covered by your insurance.
- Your liability on work done prior to the introduction on PSL is not limited. Such work still needs to be covered by your PII but you need to consider whether you have a sufficient amount of cover to adequately protect you for that work.

**f) Company appointments**

**Notes:**

- Your policy will not cover you for:
  - ✓ Work undertaken as a company director or member of a Board, or
  - ✓ Work undertaken by you as a committee member of an incorporated association, sporting club, not for profit, etc.

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