# MANAGING YOUR PROFESSIONAL RISKS WITH INSURANCE

## A GUIDE FOR PUBLIC PRACTITIONERS

## INTRODUCTION

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 accountant.

The most common financial instrument used to manage these risks is a Professional Indemnity Insurance (PII) policy. PII is mandatory for all CPA Australia 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 Australia's By-Laws.

Members should undertake an individual risk assessment prior to determining which policy and policy limits best meet their needs.

CPA Australia's By-Law 9.8 prescribes the minimum standards of cover and policy wording for any member holding a Public Practice Certificate. Members must ensure that their policy meets these minimum requirements. Members are required to provide CPA Australia with a copy of their certificate of currency or policy schedule. CPA Australia 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:

- undertaking an initial assessment of your business
- having a process of ongoing assessment.

## INITIAL ASSESSMENT

Before buying an insurance policy you need to:

- identify the risks associated with your practice

- ensure that the insurance is adequate to satisfy your risk and meet your obligations. CPA Australia provides a checklist to assist you with this.

(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 this assessment process to assist in this determination.

## Assess the business

Review your business, taking into account any proposed changes to the business.

Review your claims history (if any) and risk management.

## Assess potential liability

Determine 'the maximum liability that, realistically, has some potential to arise'. Do this by making a reasonable estimate of the following factors:

- the maximum exposure to a single client ('worst loss scenario' per client)
- 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)
- 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).

## Approach insurers and/or brokers

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.

## Assess amount of cover

Consider whether the amount of cover is adequate. It must, at least, meet the minimum requirements of CPA Australia's By-Law 9.8.

## Assess scope of cover

Consider whether the scope of cover is sufficient to cover all 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).

## Review policy terms and exclusions

Review the policy features using "What the policy should cover" below. Identify any gaps in cover.

## Assess the suitability of insurers

Generally, the cover needs to have been provided by an insurer regulated by the Australian Prudential Regulation Authority (APRA), or operating under an exemption, under the Insurance Act 1973.

## Consider your financial resources

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 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.

# ONGOING ASSESSMENT

CPA Australia 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 Australia's 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.

## Authorised insurer

### Minimum requirement under CPA Australia By-Law 9.8(c)(iii)

The policy must be underwritten by an APRA-Authorised General Insurer or Insurers unless otherwise approved in writing by CPA Australia having regard to any regulatory guidance published by the Professional Standards Council in respect of Professional Indemnity Insurance and in accordance with the applicable Professional Standards Act and any relevant subordinate legislation.

### Factors to consider

APRA is the Australian Government regulating body which oversees the Australian insurance industry. The importance of an APRA insurer is that they are regulated from a financial strength perspective and a client purchasing perspective to ensure that there is claim certainty and that there is protection for treating the customer fairly.

The CPA Australia PII Scheme policy is underwritten by an APRA-Authorised General Insurer.

## Amount of cover

### Minimum requirement under CPA Australia By-Law 9.8(c)(i)

The minimum sum insured shall be the greater of:

a. the sum of $NZ1,000,000 for New Zealand based members;
b. for Australian based members:

| | For Australian based members not providing audit, assurance services | For Australian based members providing audit, assurance services |
|---|---|---|
| If the member is in an Approved Practice Entity of less than 20 principals and their practice fee income for the prior year is less than $10 million. | $2 million | $2 million |
| If the member is in an Approved Practice Entity with 20 – 59 principals or their practice fee income for the prior year is between $10m- $20m | $10 million | $10 million |
| If the member is in an Approved Practice Entity with 60 or more principals or their practice fee income for the prior year is more than $20m | $20 million | $75 million |

c. any sum from time to time prescribed by a professional standards scheme or an otherwise prescribed adequate cover for compensation claims under any legislative enactment for the provision of a particular Public Accounting Services activity having effect in the Division to which the Member is attached; and
d. any sum from time to time prescribed by the Board either generally or in any particular instance.

### Factors to consider

Does the business carry a higher risk of claims (e.g. does it give advice in higher risk areas) which might mean a higher level of cover is required?

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?

The CPA Australia PII Scheme policy meets these minimum requirements.

## Scope of cover

### Run-off cover

Minimum requirement under CPA Australia By-Law 9.8(d)

After a Member ceases to provide Public Accounting Services, or ceases to practice or retires or the Member's Approved Practice Entity merges with another Entity, the Member must ensure they maintain a policy of professional indemnity insurance for a period of no less than seven years where the Member's liability for the provision of Public Accounting Services previously provided will not otherwise be covered by a future policy.

Factors to consider

PI insurance is underwritten on a "claims made" basis, which means that the insurer provides cover for when the claim is made, regardless of when the work was done. As a result, a practice needs to maintain insurance even after the business is no longer operating. This insurance is called run-off cover.

Run-off cover is only necessary for a business that is no longer operating, in order 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.

The CPA Australia PII Scheme policy offers the option to extend the insurance for seven years of run-off cover for entities when required. The premium for run-off cover under this policy is free if you have been continuously and consecutively insured with Fenton Green for two years or more prior to ceasing to trade.

Registered liquidators are required to have automatic run-off cover written into their policies. This is also offered in the CPA Australia PII Scheme policy.

## Excess / Deductibles

Minimum requirement under CPA Australia By-Law 9.8(c)(iv)(B)

There must be terms (save only to the extent the Board in any particular case otherwise allows) providing for an excess for each and every claim not exceeding the greater of:

i. 3% of the gross income of the insured in the immediately prior year; and
ii. 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 if you believe there is no merit to the allegation. 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 or if there is a negligent outcome.

The CPA Australia PII Scheme policy meets these minimum requirements.

## Fraud and dishonesty

Minimum requirement under CPA Australia By-Law 9.8(c)(iv)(C)

There must be terms (save only to the extent the Board in any particular case otherwise allows) providing for cover with respect to losses arising out of the dishonesty of:

1. all employees of the Member; and
2. all contractors engaged by the Member who are directly involved in the provision of Public Accounting Services by the relevant Approved Practice Entity;
3. all employees of any Approved Practice Entity with which the Member is Affiliated;
4. 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
5. all natural persons (other than the Member themselves) who are:

i. Affiliated with any Approved Practice Entity with which the Member is Affiliated;
ii. partners of any Approved Practice Entity (which is a partnership) with which the Member is Affiliated;
iii. directors and officers of any Approved Practice Entity with which the Member is affiliated;
iv. a trustee of any Approved Practice Entity (which is a trust) with which the Member is Affiliated.

### Factors to consider

PI insurance policies generally indemnify an innocent member of the practice for the dishonest, fraudulent, malicious act or omission of another.

Be aware of the exclusions and limitations that are specifically relevant to this cover. In particular, be careful about how the excess may be applied. Some policies apply the excess to each act of misappropriation, which could reduce the cover to nothing.

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

Be aware to look for policies which have a clause protecting the innocent members of the practice from non-disclosure issues, such as a severability and non-imputation clause.

The CPA Australia PII Scheme policy includes cover for losses arising out of fraud and dishonesty.

## Reinstatements

### Minimum requirement under CPA Australia By-Law 9.8(c)(iv)(D)

There must be terms (save only to the extent the Board in any particular case otherwise allows) providing for one or more automatic reinstatements following a claim.

### Factors to consider

Under a standard PII policy, the limit of indemnity will be reduced for the remainder of the policy period by the amount required to settle any claim made against the insured.

An automatic reinstatement clause will reinstate the full level of cover for the balance of the period to cover any new claims that might arise. This is important as public practice certificate holders must ensure that their PI insurance cover is adequate at all times. It is also of particular importance to anyone who unfortunately experiences a claim soon after starting or replacing their insurance as they might otherwise have no cover for the rest of their policy.

Different polices offer a different number of reinstatements. Some may only offer one reinstatement, which doubles the aggregate limit for all claims made against the insured. Other options include multiple reinstatements i.e. two or three or unlimited. 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”.

CPA Australia’s By-Laws stipulate that one or more reinstatements is required.

The CPA Australia PII Scheme policy offers unlimited reinstatements.

A number of policies do not provide for any reinstatements, which would be insufficient to satisfy CPA Australia’s By-Law requirements.

## Activities

Minimum requirement under CPA Australia By-Law 9.8(c)(iv)(E)

There must be terms (save only to the extent the Board in any particular case otherwise allows) providing for except as otherwise provided for by By-Law 4.5, indemnity to attach to any civil liability arising out of or in any way related to the provision of Public Accounting Services by the insured.

Factors to consider

Check policy wordings very carefully to satisfy yourself that all of your Public Accounting Services are being covered. If you are still in any doubt then get confirmation in writing. Each time you take on a new client consider whether you are covered for that work before proceeding.

Some policies offered to accountants have exclusions for certain activities, such as insolvency work.

Other 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. Audit work is an example of this.

The CPA Australia PII Scheme policy covers all accounting activities that might be undertaken by a CPA Australia member, including insolvency work and activities provided by Limited AFS licence holders.

## Exclusions

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.

Apart from excluding certain activities some policies will also amend or limit the cover that is provided for example, by imposing a higher excess or by only offering cover as an optional extension. Some policies limit the cover offered for the loss of documents. Some policies only offer cover for the cost of inquiries as an optional extension.

## Persons covered

Minimum requirement under CPA Australia By-Law 9.8(c)(ii)

The insured must be the relevant Member, any Approved Practice Entity with which the Member is Affiliated, all employees of the Member, all Directors and officers of any Approved Practice Entity with which the Member is Affiliated, 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.

Factors to consider

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.

The CPA Australia PII Scheme policy provides cover for employees, contractors and consultants of the practice.

### Retroactive cover

Minimum requirement under CPA Australia By-Law 9.8(c)(iv)(A)

There must be terms (save only to the extent the Board in any particular case otherwise allows) providing for a retroactive date no later than seven years before the beginning of the period of insurance.

Factors to consider

The retroactive date shown in the Policy Schedule may limit your cover for acts, errors or omissions that arise from work done by your practice.

Where a specific date is shown you need to consider how this may affect your business as claims made against you which relate to work done prior to the retroactive date will not be covered by your insurance.

Ideally, your insurance policy should have a retroactive date as being "unlimited".

The CPA Australia PII Scheme policy has an unlimited retroactive date.

### Company appointments

There are no minimum requirements set down about company appointments.

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.

### Defence costs

Minimum requirement under CPA Australia By-Law 9.8(c)(iv)(F)

There must be terms (save only to the extent the Board in any particular case otherwise allows) providing for, any policy issued from and after 8 October 2017, defence costs must be 'in addition' to the minimum limit or the level of cover must be sufficiently increased to no less than 50% of the minimum limit to take into account these costs.

Factors to consider

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 $2 million will not be available to pay the claim.

The CPA Australia PII Scheme policy has a limit of indemnity which is exclusive of defence costs.

*The above material is only general in nature and not intended to be specific to the reader's circumstances. The reader should therefore seek independent advice from a broker or solicitor before making any decisions or relying on the information provided.*

## FURTHER INFORMATION

For more information access the guidance on CPA Australia's Public Accounting Insurance portal.

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