

# PROFESSIONAL RISK MANAGEMENT BULLETIN

Technical Bulletin  
Managing the professional liability of accountants <sup>(N1)</sup>  
(Issued July 1999)

## PART I - Introduction

### Preamble

1. This Bulletin draws the attention of members to the principal areas in which actions for negligence may be brought against them by clients or third parties and suggests steps which they may properly be able to take to reduce the risk of such claims.
2. A discussion of the legal considerations applicable to this subject is included in two Appendices.
3. The expressions of law included in this Bulletin and its Appendices, having the approval of the Society's lawyer, are made in general terms for general guidance only and should not be taken as comprehensive. Nor does this Bulletin constitute legal advice. Members should seek their own legal advice in relation to the issues discussed herein and any other legal matters.
4. This Bulletin is not intended to provide means whereby members can avoid or escape their professional responsibilities and legal liabilities. It is intended, however, to make them aware of and to reduce their exposure to unnecessary and unreasonable liabilities and claims.

### The risk environment

5. In recent years the incidence of cases where substantial sums have been claimed as damages for negligence against accountants around the world has increased significantly.
6. In Hong Kong, the major corporate collapses of the 1980's led to some large lawsuits against auditors. Such claims, set against the total size of the audit industry, caused Hong Kong to have one of the highest professional indemnity insurance risk ratings at one stage. The potential liability exposure of accountants is a major concern of the profession so much so that the Council has established a standing committee to seek legal reform.
7. Progress since the stock market crash of the late 80's has seen the successful implementation of a strong regulatory system to govern the securities and financial markets and corporate governance, which significantly enhances the environment in which the accounting profession works.
8. The business environment, however, has also changed dramatically during the same period. The economic buoyancy of the last decade has created tremendous opportunities for the profession, but also brought new laws and regulations and new business situations, and the audit profession is faced with increased responsibilities, expectations and hence exposure.
9. The reform in Mainland China has also expanded the scope of the business of the profession because of substantial cross investment and business activities between Hong Kong and the Mainland. The social and legal climate is changing too. Legislative and regulatory developments in recent years have tended to place increased reliance on professionals.
10. All of these changes tend not to produce a problem in a period of economic buoyancy. However, in a recession when companies collapse and aggrieved parties look for somebody to recompense them for their loss, accounting firms may become subject to an onslaught of litigation. Hong Kong is particularly vulnerable in this respect as the economic downturn of the 80's has demonstrated the impact of large claims on the profession.
11. Against this background, members need to be vigilant and ensure that they manage the extent of their liability when providing professional services, particularly when in many cases claims arise not because of any inherent defect in the professional work performed but due to misunderstandings regarding the scope of or responsibility for that work or parts of it.

### Purpose of this Bulletin

12. The purpose of this Bulletin is in part to provide guidance to members on ways to reduce misunderstandings as to the extent of the liability which they assume in giving advice or expressing an opinion - **reducing the expectation gap**. It is also aimed at assisting members to identify the nature of their potential liability in respect of professional work and to give guidance on managing this liability - **reducing the risk of liability**.

### Scope of this Bulletin

13. This Bulletin is concerned only with the potential liability for professional negligence which a member may incur because of an alleged act or default by him or by one of his employees or associates which results in financial loss to a person to whom a duty of care is owed. It does not deal with liability arising from other causes (for example criminal acts, breaches of trust, breaches of statutory duty or breaches of contract other than the negligent performance of its terms).
14. Professional negligence in this Bulletin therefore means some act or omission which occurs because the member concerned has failed to exercise the standard of care expected of a reasonably competent member of his profession.
15. The duties of a member will primarily depend upon the terms of the contract between the member and his client and the nature of the work undertaken.
16. It is an implied term of the contract between the accountant and his client, that the accountant will exercise reasonable care and skill when undertaking the work (Section 5 of the Supply of Services (Implied Terms) Ordinance (CAP 457)). A member owes a similar duty of care to his client in tort, notwithstanding any duties he may owe to his client, whether express or implied, under the contract with his client. The duty of care in tort may extend to a third party with whom the accountant has no contract. Liability to third parties is dealt with in more detail in paragraphs 7 to 10 of Appendix I.

17. Guidance on the general legal basis for the liability of a corporate practice and the personal liability of the audit directors and authorised persons of a corporate practice is given in Appendix II.
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N1: This statement is based on similar guidance issued by The Institute of Chartered Accountants in England and Wales (ICAEW) appropriately adapted to the local context. The Society gratefully acknowledges the permission given by the ICAEW in this respect.

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