



GUIDANCE ON REASONABLE STEPS TO BE TAKEN FOR PII PURPOSES

INTRODUCTION

1. Part 4 of the Institute's Public Practice Regulations apply to practising certificate holders and to members who have carried on public practice within the last two years. They also apply to firms which are registered as auditors by the Institute, or hold a DPB licence. Practising certificate holders and firms must comply with the Regulations, those members who cease to engage in public practice must use their *best endeavours* to ensure they are covered by arrangements which meet the requirements of Regulation 4.15 for at least twenty-four months after they cease to practice.
[Paragraph 9 refers.]
2. This guidance must be taken into account by those firms wishing to demonstrate to the Institutes that they satisfy the requirements of Part 4 of the Public Practice Regulations, and in particular Regulation 4.5, to "take such steps as may reasonably be expected of it to ensure that it is able to meet the claims against it arising out of its professional business". For convenience, this guidance refers to "firms", but it applies equally to relevant members. The nature and size of the firm will influence the degree of attention paid to the various aspects of this guidance but it is intended to be of use and relevance to all firms in respect of all their practice work.

ASSESSMENT OF RISK

3. Before considering the nature of the protection which is required to cover potential liabilities, a logical approach to risk assessment should be adopted. A firm should carry out such an assessment and take any appropriate action, at least annually in the context of an impending renewal of PII cover, and at any other time when the composition of the firm or its client base changes significantly, giving consideration to the following:
 - a. The possibility of being sued should anything go wrong and the possible quantum of such a claim;
 - (1) client by client, having regard to whether the work is ongoing or one-off;
 - (2) client by client, having regard to the maximum potential exposure to stakeholders in the client;
 - (3) generally, talk through your conjectures, worries and problems with your partners or colleagues or with the Member Services Department at the Institute.
 - b. Evaluation of new and existing clients in terms of:
 - (1) instructions received, nature of work to be carried out and co-operation necessary to complete tasks in a timely and accurate manner;
 - (2) credibility of management;
 - (3) quality of accounting, financial and management controls;
 - (4) type of business;
 - (5) continued viability of company;
 - (6) the effect of the fee on the quality of the work.

- c. Awareness of general economic climate;
 - (1) rate of company insolvency;
 - (2) types of business experiencing difficulty.

Translate general impression of climate into specific understanding of clients.

- d. In the case of partnerships, delegation of risk assessment matters to responsible partner.

MITIGATION OF RISK

- 4. Upon identification of a client as creating a potentially higher than average risk:
 - a. Evaluate ability to mitigate risk in terms of procedures;
 - b. Decide whether to retain client;
 - c. Institute safety procedures, eg second partner review.

Generally, consider your quality control and assurance procedures, the problems these throw up and how you have dealt with these.

OTHER FACTORS

- 5. a. Bear in mind the need to cover:
 - (1) all firms current staff, including sub-contractors and consultants;
 - (2) all firm's activities, including, for example, joint audit appointments;
 - (3) past and new partners and predecessors in business.
- b. Bear in mind the firm's claims history and the need for regular analysis of prime causes of any failure experienced by the firm.

Further advice on the factors which should be taken into account under this heading is to be found in the Auditing Practices Committee Brief "Risk Management for Auditors" by E H Woolf.

AMOUNT AND BREADTH OF PROTECTION

- 6. Having carried out the above assessment, the firm will next need to decide how much protection it needs. In making this decision it should:
 - a. Consider and attempt to quantify the exposure of the firm, taking into account assessment of risk;
 - b. Assess whether current measures of protection are sufficient to meet potential claims and are relatively consistent with those of similar firms using available sources, eg Interfirm Comparison, information held by insurance broker, information held jointly with other firms in mutual arrangement;
 - c. Take expert advice as to how much cover is available and its cost;
 - d. Determine sufficiency of firm's own resources to meet claims - availability of both personal and the firm's assets and reserves made to meet known claims;
 - e. Exercise judgement as to requisite levels of insurance to meet claims and associated costs and

interest.

FORM OF PROTECTION

7. Having decided how much protection it needs, the firm will need to consider the most appropriate way of meeting its requirements:
 - a. Professional Indemnity Insurance

Use of broker with experience in this field to arrange appropriate terms of offering sufficient limits at acceptable price with sound insurance companies.
 - b. Self-Insured Excess

Selection of appropriate level of excess based on partners' resources including their borrowing capacity and the firm's resources. Consider past incidence of claims and ability to meet multiple losses.
 - c. Captive/Mutual Arrangements

Reference to expert advice and sound management procedures to ensure continued ability to meet claims.

PROCEDURES FOR IDENTIFYING AND MONITORING CLAIMS

8. In addition to taking steps to cover liabilities, the firm should look for ways of limiting the damage from existing and potential claims and ensuring that the likelihood of such matters arising again is reduced as far as possible:
 - a. Regular circularisation of and open discussion between partners and senior employees in order to identify matters which may lead to a claim;
 - b. Establishment of procedures for notifying claims to insurers and otherwise ensuring that insurance arrangements remain valid;
 - c. Regular assessment of claims progress;
 - d. Use of expert advisers - insurance and legal;
 - e. Learning from experience.

RUN-OFF COVER

9. As noted above, the terms of Regulation 4.15 of the Public Practice Regulations require members who ceased to engage in public practice to use their *best endeavours* to ensure they are covered by arrangements which meet the requirements of Regulation 4.5 for at least twenty-four months after they cease to practice. The terms and extent of any cover must be equivalent to any previous Qualifying Insurance. Run-off cover may be provided under the policy of a continuing practice, otherwise an individual run-off policy may be effected.