

Accountability

Issue II

Changing professional liability insurance -- important claims issues to consider

At each policy anniversary many accountants take the opportunity to review coverage and evaluate alternative terms offered by competing insurers. If a successful bid is received and the accountant decides to make the move and replace coverage with a different insurer, there are a number of issues in regard to claims or incidents that might give rise to a claim, that are known (or should be known) but not reported to the expiring insurer.

Accountants' professional liability insurance policies are written on a Claims Made and Reported basis. That is, the claim should be made against the firm and reported to the insurer, while the concerned insurer's policy is in effect. There are certain modifications to this rule, for example, where an extended reported period is automatically or optional provided by the insurer. However, generally speaking once a policy has reached the end of its' term (usually 12 months) if the policy has not been renewed or extended, then any claims reported to the insurer after the termination date are not the insurer's responsibility.

Let's look at an example that uses fairly standard language which states:

YOUR ACCOUNTANTS PROFESSIONAL LIABILITY INSURANCE IS WRITTEN ON A "CLAIMS MADE" BASIS. IT PROVIDES COVERAGE FOR THOSE CLAIMS WHICH ARE BOTH FIRST MADE AGAINST YOU AND REPORTED TO US DURING THE POLICY PERIOD.

and

II. COVERAGE AGREEMENTS

- A. We will pay on **your** behalf all sums in excess of the deductible, up to our limit of liability, that **you** become legally obligated to pay as **damages and claims expenses** because of a claim that is both first made against you and reported in writing to us during the policy period by reason of an act or omission in the performance of **professional services by you**, or by

any person for whom you are legally liable provided that....

and

V. POLICY CONDITIONS

C. Duties In The Event Of A Claim

1. **You must give us** written notice as soon as reasonably possible during the policy period of any **claim** made against **you**. We agree that **you** may have up to, but not exceeding, 60 days after the policy expiration to report to **us** a **claim** made against **you** during the policy period if the reporting of such **claim** is as soon as reasonably possible.

and

V. POLICY CONDITIONS

D. Duties In The Event Of A Potential Claim

*If, during the policy period you become aware that an act or omission that may reasonably be expected to be the basis of a **claim** against **you**, you must give written notice to us as soon as reasonably possible during the policy period.*

So, it's pretty plain to see that if you don't report a claim or incident during the policy period, there no coverage.

Conversely, a new insurer's policy will contain a clause that states there is no coverage for any claims or incidents known to an accountant that were reported, or should have been reported, to the former insurer. For example, CNA states this as follows:

The succeeding wording of Clause II. COVERAGE AGREEMENTS, A (above) states:

....any person for whom you are legally liable provided that:

1. **you did not give notice to a prior insurer** of any such act or omission or **interrelated act or omission**;
2. prior to the inception date of this Policy, **none of you** had a basis to believe that any such act or omission or **interrelated act or omission**, might reasonably be expected to be the basis of a **claim**;
3. such act or omission happened subsequent to the prior acts date, if any;
4. **you did not give notice to a prior insurer** of an **interrelated claim**.

Failure to comply with any of the clauses mentioned above may result in a late notification dispute or worse, a denial of coverage, often by BOTH the expiring and the new insurer. Consequently, when executing a decision to change insurers it is vital before expiry of coverage (the last date of the policy) that you advise the expiring insurer of any claims and incidents that might reasonably be believed to give rise to a claim.

Additionally, it is important to have a sense of what might be considered a potential claim. Neither CNA nor any of the other leading accountants' professional liability insurers offers a clear definition. However, a broad overview is offered in *Accountability XIV*, which states the following.

No list can be all-inclusive, but the following may be considered grounds for notifying your insurer that something may arise from a situation:

- *A fee dispute – not all fee disputes result in a counter-claim for negligence, but many do. Consequently, if you choose to litigate, make sure your files are absolutely perfect and that you are completely confident in the work.*
- *A telephone call from a client alleging negligence and threatening litigation. Don't wait for it in writing. Where there's smoke, there's fire.*
- *A client files for bankruptcy or is suffering long-term financial problems. If the client is having financial difficulties, then it is likely that the shareholders and creditors may start looking for a deep pocket to make good their losses.*
- *Senior executives or officers of a client are the subject of a criminal investigation.*
- *Notwithstanding your suggestions to the contrary, a client continues to operate their business in a manner that may cause future exposure to tax liabilities and/or fines and penalties.*
- *You receive a call from another accounting firm or your client's attorney, requesting copies of work papers or files.*
- *If you have any substantial ownership interest in a client or a relationship with*

an owner that goes beyond the usual CPA-client situation, your role as an independent adviser may be prejudiced and have the potential for an allegation of a conflict of interest.

There are, of course, a multitude of other hypothetical scenarios that you might consider to be an incident, occurrence or offense, which may reasonably be expected to result in a Claim.

Additionally, the individual specifics of any situation may dictate how seriously you believe there is a potential for a claim. The most conservative approach is to report every incident to your insurer, because your loss record will not necessarily be prejudiced. In fact, many insurers actively encourage early reporting as this provides an opportunity to mitigate the possible consequences.

If you are considering changing insurers at renewal, you have a duty to ensure that all claims and any incidents that might give rise to a claim are reported to the expiring insurer before the coverage termination date.

Often the decision as to whether or not to notify a particular incident is subjective. However, a saving grace is that the doctrine of *reasonable foreseeability* is well tested in the courts and governed by various judicial precedents.

Nevertheless, the most conservative approach may be to undertake a thorough sweep of the accountant's files to reveal any incidents that might give rise to a claim. If anything is discovered this must be advised to the expiring insurer, before the policy ends and prior to changing insurers. Any resultant claims are then the responsibility of the expiring insurer.