

Notice to Reader: Limited Responsibility with Potentially High Risk

by Malcolm D'Souza, CA

Between 1999 and 2002, over nine per cent of all claims made to the profession's liability insurance program, offered by AICA Services Inc., related to non review engagements, with the majority of these claims arising from lenders who relied on financial statements with a Notice to Reader.

Surprising?

The financial statements are compiled from information supplied by management. The Notice to Reader explicitly states that the Chartered Accountant "has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information" and further cautions readers that the statements may not be appropriate for their purposes.

Whether it appears on each page or each page is conspicuously marked "Unaudited – see Notice to Reader", the Notice clearly informs readers of the nature of the work. But can you assume that investors and lenders are sophisticated users who understand the accountant's limited involvement in the preparation of the statements? If the statements are subsequently used to procure financing, these users *should* know that they were not prepared with them in mind. Indeed, these users *should* demand an audit or review for their purposes.

So Why Do These Claims Arise?

At first blush, one would think the accountant is protected with the Notice to Reader disclaimer. Not necessarily.

A typical situation is one where a banker calls the accountant to discuss the information on the statements and he or she engages in a discussion. When the claim later ensues, the bank takes the position that since the accountant knew the banker should not be relying on the statements for a lending decision, the accountant should not have been willing to discuss them. In a sense, the banker views the conversation as a waiver on the notice. In these situations, the accountant may be found to have failed to warn the bank that it is using the statements for a purpose for which they were not prepared.

The observations of practice inspectors validate another trend that is giving rise to claims: practitioners are doing extra work in compilation engagements, thinking this might afford additional protection. However, be aware that the courts will consider *what you ought to have done* and *what you actually did*. If you did extra work beyond the scope of the engagement and failed to detect a problem, you cannot hide behind the Notice to Reader claiming that your further procedures were not warranted.

Notice to Reader: Loss Prevention

If a bank or other user contacts you, do not engage in a discussion about the financial statements. Clearly warn the caller that the statements were not prepared for that purpose. Communicate the limitations of the Notice to Reader of the financial statements. If you are aware that the client plans to use the financial statements for financing purposes, encourage the client to have a review performed. Put this advice in writing. Clients appreciate that the compilation engagement is a low cost service; however, the work must be appropriate for the purposes. If the service is not appropriate for the intended use, do not provide it. As the new independence rules require that you assess independence *de facto*, this fact must be disclosed in the Notice to Reader communication where independence is impaired. Make sure you and your staff clearly understand the requirements of these new rules. Document the independence assessment for the engagement.

Litigation is an adversarial process. Even if the claim is eventually found in your favour, the time demands and stress of the claims process are enormous. Protect yourself. Take preventative steps.

The above article was prepared by Malcolm D'Souza, CA of AICA Services Inc. For further loss prevention tips and guidance on other areas of risk exposure, refer to the AICA Services' Loss Control Manual available at <http://www.aica.ca/pdf/Loss%20Control%20Manual.pdf> and the archived issues of the CARM newsletter at www.aica.ca/carm_newsletters.aspx.