

Standard of Care

The Professional Standard of Care

Professional negligence claims (and judgements) have grown larger and more common in the latter part of this century. This trend reflects the high expectations that the public and the courts have of professionals providing services to members of the public. In common law countries, the fundamental legal test applied to determine whether a professional has met the minimum standard of care has been constant for over a hundred years. However, with the increasing sophistication of professional practice in recent years, that test has been applied with greater stringency.

In a lawsuit for damages relating to a complaint about professional services, the claimant must show that the professional did not exercise the care and skill possessed by his professional peers at the time the services were provided. A professional who makes a mistake in the course of providing professional services is not liable to the person who suffers a resulting loss provided that the professional has exercised reasonable judgement, diligence and competence. The test is supposed to be applied without using hindsight available by the time a claim proceeds to trial. Generally speaking, a professional does not promise that the services, or the results, will be perfect. However, the minimum standards that professional bodies require their members to meet are generally quite high and are steadily rising. As a result, the standard of "ordinary" or "reasonable" competence applied by the courts is a rigorous one.

One factor that the courts have emphasized when assessing the services of an individual professional is the practice standards approved by the professional's governing body. Unfortunately though, the courts have sent mixed messages on the question of whether a professional can be found negligent, or otherwise liable, for services which complied with the applicable professional standards but still proved to be deficient. Professionals have sometimes been held liable despite having conformed to the approved practice of their profession. Our courts have insisted on retaining a discretion to find that a practice is not prudent and reasonable, or that it involves a foreseeable risk of harm.

The standard of care can vary depending on the legal basis of the claim advanced. Claims against professionals can be brought on the basis of negligence, breach of contract (such as a retainer agreement), deliberate wrongdoing (such as fraud), or on equitable grounds (the most common being breach of a fiduciary duty owed by the professional). For example, a professional can be found not to have been negligent, but may still be held liable if the services provided did not conform to the terms set out in a retainer letter.

Auditors & Accountants

The standard of care that an auditor is required to meet depends to a large extent on the type of engagement entered into. Different engagements involve different degrees

of attestation by the accountant. The three most common types of engagement are audits, review engagements and compilation or non-review engagements conducted on a notice-to-reader basis. The highest degree of attestation, and consequently the highest standard of care, applies to an audit. Audits usually involve review of a client's financial statements, but may also relate to investigation of a specific aspect of the client's business. Audits can only be conducted by accountants who are qualified as Chartered Accountants.

Most lawsuits against accountants arise from the audit function. Typically, such suits are based on allegations of negligent misstatement regarding the financial position of an audit client as reflected in the client's audited financial statements. One recurring complaint arising from audits relates to the auditor's failure to detect fraud by employees or by management of the audit client. Audits are not designed to detect fraud, but that does not prevent claimants from arguing that they should. As a result, complicated issues often arise regarding whether an auditor should have detected a fraud and whether a failure to do so resulted from the auditor's failure to comply with proper auditing procedures.

Auditors are required to comply with the extensive, detailed standards set out in the Handbook of the Canadian Institute of Chartered Accountants (CICA). The Generally Accepting Accounting Standards (GAAS) and Generally Accepting Accounting Practices (GAAP) set out in the CICA Handbook provide evidence, although not necessarily conclusive evidence, of the standard of care that auditors are required to meet by law.

The general standard contained in the CICA Handbook applicable to auditors states that an auditor "performs the audit with an attitude of professional scepticism, and seeks reasonable assurance whether the financial statements are free of material misstatement." There are many practical limitations inherent in the audit process. The auditor is expected to exercise professional judgement regarding the sort of testing to be conducted and other audit procedures to follow on a given audit. Judgement is also required to evaluate the results of whatever procedures are conducted. When approaching an audit, the auditor must assume that the client's management is acting in good faith unless there is reason to believe otherwise. The CICA Handbook observes that "much of the evidence available to the auditor is persuasive rather than conclusive in nature". Therefore, an auditor cannot be expected to obtain "absolute assurance" in the course of an audit review.

Before 1997, the most authoritative pronouncement in Canada on the degree to which the courts should accept the CICA Handbook as determining the standard of care to be met by accountants was the Supreme Court of Canada's decision in *Hodgkinson v. Simms*. That decision stated that professional standards are of guiding importance in determining the nature of the duty owed by a member of the profession. However, in 1997, the B.C. Court of Appeal held in *Kripps v. Touche Ross* that the court was not bound to conclude that the CICA Handbook was determinative. Despite the existence in that case of a retainer letter stating that the audit opinion was given in accordance with GAAP, the court stated that the adherence to GAAP was not a defence where the GAAP standard fails to adopt obvious and reasonable precautions which are readily apparent to the judge. As a result of this decision, accountants in Canada cannot

assume that adherence to the provisions of the CICA Handbook will necessarily protect them from liability.

Notwithstanding this uncertainty, the CICA's detailed codification of standards and its structural process for the review of those standards remains highly relevant for the determination of liability. In most cases where accountants' work meets those standards they will not be found liable.

Cases involving sophisticated commercial fraud present an interesting opportunity to see how a Canadian court will typically establish a standard of care to govern liability in a particular case. As previously noted, auditors are normally entitled to assume the honesty and good faith of management. However, one of the most commonly encountered phrases in negligence case law is "knew or ought to have known." Many a standard of care dispute will focus on what the professional "ought to have known".

Among the questions which are likely to arise are:

1. Did the auditors obtain sufficient knowledge of the client's affairs to plan the audit?
2. Was the audit plan adequate?
3. If the auditors relied upon internal controls and limited their substantive testing, did they have appropriate evidence of the proper functioning of those controls?
4. Were all relevant audit assertions tested?
5. Was the intensity of inquiry adequate and were questions directed to appropriate individuals?
6. Are analytical procedures properly documented and were the results of those procedures given appropriate consideration?

It is because questions of this nature regularly arise that audit cases are often complicated and expensive to pursue.

It is also important to consider the flip side of the coin. What care does management owe and what are the legal consequences of management's failure to meet an appropriate standard of care? An issue commonly arises where both the auditor and the management of an audit client are at fault to some degree for failure to detect the existence of a problem. Under the legislation enacted in most provinces dealing with negligence, where two parties are at fault for a loss, the courts will apportion a degree of fault to each. If one of the parties is the plaintiff in the action, the liability of the other party as defendant will be reduced to the extent of the plaintiff's contributory negligence. If the fault is divided between two defendants, the plaintiff is entitled to recover its losses on a joint and several basis, meaning that the plaintiff can recover part or all of the loss from either defendant. This situation sometimes creates serious problems for auditors in circumstances where, for example, an auditor is found to be 5% at fault for a loss, but the party that is 95% at fault is insolvent. The auditor must then answer for the whole of the plaintiff's loss.

There is disagreement in the case law regarding how the law of contributory negligence should be applied to an action by an audit client against its auditor, where both the auditor and the client's management are at fault for failure to detect a problem. Canadian courts have generally concluded that an audit client cannot recover from its auditor to the extent that the client's own management is at fault for the loss. A few

decisions though have held that the client has retained the auditor to provide a check on management and, consequently, the auditor cannot defend itself by pointing to errors or wrongdoing by management of the sort that the auditor was paid to detect.

Engineers & Architects

A common standard of care applies both to engineers in the construction industry and to architects. An architect or engineer owes a duty to exercise the skill, care and diligence which may reasonably be expected of a person of ordinary competence, measured by the professional standards of the time. In the case of a claim based in contract rather than negligence, a higher standard will be applied if the contract terms expressly require that a higher standard be met. As well, architects and engineers who represent that they possess special skills may be held to an elevated standard. An architect or engineer is required to inform himself of current scientific or technical knowledge bearing on a project. If an architect or engineer is aware that the design of a project entails risk, that professional may owe the client a duty to warn of the risk.

However, architects and engineers generally are not taken to have guaranteed perfect, or even successful results, provided they have exercised reasonable judgement, competence and diligence. It will usually be a sufficient defence to establish that the work performed was consistent with generally accepted practice, or with formal standards established by industry and professional associations. However, if the court were to find that an accepted practice or a formal standard was inadequate, it could hold the professional liable even if the work was performed to a standard consistent with that of the professional's peers.

If an architect or engineer does not possess the specialized knowledge required to complete a particular aspect of the project, then he should obtain advice from a specialist. An architect or engineer who delegates work to a competent sub-consultant will generally not be liable for an error by the sub-consultant unless some contractual term imposes liability for the sub-consultant's work.

Lawyers

When a lawyer is retained by a client, misunderstandings often arise regarding the scope of the lawyer's involvement. It is therefore appropriate for the lawyer and client to discuss and decide upon the extent of the legal services to be provided and the degree of responsibility assumed. Even after these matters are determined at the outset of the retainer arrangement, the scope of the retainer may shrink or expand as the matter progresses. The variability of legal retainers has significant implications for the standard of care to be met by lawyers. Many negligence claims against lawyers relate not to the quality of the work performed, but rather to complaints about the lawyer's failure to complete tasks that the lawyer considered to be outside the scope of the engagement.

In assessing the standard of care to be met by a lawyer and the scope of the engagement, the court will be guided by the terms of a written retainer. If a written agreement clearly limits the scope of the retainer, then the lawyer will ordinarily not be liable for failing to undertake work beyond that scope. Where no written retainer exists, the courts will infer the nature of the retainer arrangement from the conduct of the parties. In the event of a disagreement, where there is no written retainer, the lawyer will be at a disadvantage in seeking to limit the scope of the retainer.

It is ordinarily expected that, when accepting a retainer, a lawyer assumes the following obligations:

1. to exercise reasonable skill, care and diligence;
2. to advise the client on all matters relevant to the retainer;
3. to protect the client's interests;
4. to carry out the client's instructions by all proper means;
5. to consult with the client regarding matters that are outside of the authority delegated to the lawyer to decide; and
6. to keep the client reasonably well informed.

With respect to the duty to advise, a lawyer is required, in particular, to warn client of risks associated with a proposed course of action. A lawyer's liability exposure for failure to provide an appropriate warning generally increases where the client is less sophisticated. If a client instructs his lawyer to proceed despite knowledge of a risk, the lawyer will usually not be liable in the event that outcome warned about actually occurs.

A lawyer will usually not be found negligent in the handling of a matter after complying with the prevailing practice of the profession regarding such matters, unless the practice is found to be unreasonable in the circumstances of the particular case. The practices and procedures that lawyers are required to follow in the conduct of individual engagements are defined with less specificity than that for many other professions. Lawyers perform a broad range of professional services. Some legal services are capable of being evaluated against relatively precise and objective criteria for work competently performed. A simple real estate conveyancing transaction is an example of a service of this sort. However, much of the professional judgement that lawyers are called upon to exercise is not capable of being reduced to a detailed or comprehensive set of written standards. This observation is more true of advocates than solicitors, in part because the decisions made by an advocate regarding matters of tactics and presentation can be highly subjective. In the case of advocates, the courts have been reluctant to fault judgements made regarding the manner of presentation of a client's case, even where the court considers that another approach would clearly have been preferable. However, liability usually will follow from egregious errors of judgement, or from failure to comply with a strict procedural requirement, such as a limitation period.

While the specific practices and procedures to be followed by Canadian lawyers have not been precisely defined for general application, some basic principals have been set down. Of greatest significance in this regard are the codes of professional conduct established by the provincial law societies – the bodies empowered to exercise governance of the legal profession. These codes of conduct tend to address prohibited practices and proper ethical conduct, rather than imposing guidelines for the proper conduct of specific legal functions. However, to the extent that a lawyer's conduct is found not to comply with the applicable code of professional conduct, such non-compliance is sometimes considered to be strong evidence of failure to satisfy the minimum standard of care.

A lawyer qualified to practice in a Canadian province is permitted to undertake any engagement that a lawyer may properly undertake, without being required to obtain specialist training or qualifications. All lawyers are required to have knowledge of matters of fundamental importance and to conduct research necessary to inform

themselves of the applicable law if the circumstances are such that a reasonably prudent solicitor would be alerted to the need for such research. Lawyers have been held liable for errors made as a consequence of lacking specialized knowledge required for a particular engagement undertaken. Some courts have held that a lawyer who specializes in a specific practice area may be held to a higher standard than a generalist undertaking an engagement in the same area. With the movement of some law societies towards certification of specialist qualifications to allow lawyers to market their specialities, the judicial recognition of a specialist standard of care may increase.

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