

PRACTITIONER SUPPLEMENT

ENGAGEMENT CONTRACT WORDING

This Supplement seeks to assist audit firms in the Cayman Islands by suggesting wording for inclusion in engagement contracts for attest and non-attest engagements.

It is not intended to be prescriptive but rather to indicate what would generally be regarded by the accounting profession in the Cayman Islands as best practice. It should not be relied upon in respect of points of law.

Practitioners should note there are circumstances where an indemnification, liability cap or other limitation of liability may be prohibited, by the independence rules applicable to the engagement or by law or regulation (subject to legal advice the Firms may seek from time to time).

LIMITATION OF LIABILITY PROVISIONS

1. INDEMNIFICATION

It is important to seek limitation to the firm's potential liability to claims, liabilities, costs and expenses arising from the performance of the engagement under certain circumstances.

However, where permitted, indemnification should be obtained to protect the firm from claims and other losses where the potential liability is a consequence of fraudulent acts or omissions, misrepresentation, or wilful default by management.

Sample wording:

XYZ Company agrees to release and indemnify [Audit Firm] and its personnel from any claims, liability and costs relating to the services under this letter arising from or connected to any fraudulent acts or omissions, misrepresentations, or wilful default by management.

Firms should consider whether the indemnifications should be extended to subcontractors engaged by the firms to assist in the performance of the audit. In particular Firms should consider the *Contracts (Rights of Third Parties) Law 2014* of the Cayman Islands (as it relates to the granting of rights to third parties under the engagement contract) and should seek legal advice around proposed amendments to their engagement letters.

Firms should also consider obtaining indemnification for claims, liabilities and costs caused by actions brought by third parties against the Firm in connection with the engagement. This is reasonable and appropriate because the Firm's duty of care is generally to the party with whom it is contracting, and not any other party, and generally the only party that should have standing to bring a claim against the Firm would be the client as the party to the contract. However, third party claims are often brought (especially in connection with audit engagements) and the Firm will generally incur significant costs as a result.

Sample wording:

[Name of client] agrees to indemnify and hold harmless the Firm from any and all third party claims and other losses arising out of or in connection with this engagement.

2. CAP ON LIABILITY TO THE CLIENT

The seeking of reasonable limitation of liability by Firms is consistent with the division of responsibility involving the financial statements. Management is responsible for the content of the financial statements and the audit firm is responsible for rendering an opinion on those financial statements. The audit or non-attest engagement is not intended to be a risk shifting mechanism in which risks normally borne by the client are shifted to the audit firm.

A liability cap limitation creates a maximum amount for any client claim against the firm based on an allegation that the firm was negligent. The cap does not provide protection in the event the firm is determined to be wilfully or intentionally negligent or there has been wilful or intentional misconduct or fraudulent behaviour on the part of the Firm.

Sample wording:

[Firm]'s maximum liability to XYZ Company for any reason relating to the services under this letter shall be limited to three times the fees paid to [Firm] for the services or work product giving rise to liability, except to the extent finally determined to have resulted from the wilful or intentional neglect or misconduct, or fraudulent behaviour of [Firm].

Firms may also consider including language in their engagement letters regarding proportionate allocation of any liability. Such wording would normally state that, in respect of breach of contract or breach of duty or fault or negligence or any other liability whatsoever arising under the engagement, the proportion of the loss or damage (including interest and costs) suffered by the entity which is ascribed to the Firm by agreement with the entity (or failing such agreement by a Court of competent jurisdiction) should be allocated based on the proportionate responsibility to the Firm having regard to the contribution to the loss and damage in question of any other person. As joint tortfeasors are ordinarily jointly and severally liable for the full amount of any loss, this provision is intended to limit the liability of the Firm to the amount of that loss that is attributable to the Firm's contribution to the loss suffered by the entity, rather than the Firm being liable for the full amount of the client's loss, even though the Firm's actions may have only contributed to a small amount of any loss. This provision compels proportional allocation between the Firm and other joint tortfeasors and avoids the need for the Firm having to seek contribution from other parties that were also at fault or having to bear the full cost itself.

Sample wording:

[Firm]'s liability to the Company howsoever arising out of or in connection with this engagement shall be limited to that proportion of the loss or damage suffered by the Company which is ascribed to us by agreement with the Company or failing such agreement by a Court of competent jurisdiction, on the basis of an allocation of proportionate responsibility to us having regard to the contribution to the loss and damage in question of any other person, irrespective of whether the Company can or does actually obtain judgment against such other person or obtains satisfaction of any such judgment.

3. APPLICABLE LAW AND GOVERNING JURISDICTION

The engagement contract should set out unequivocally the law and courts that will be used to settle any claims arising from the engagement contract even where the agreement is between entities all of which are domiciled in the same jurisdiction.

Sample wording:

The agreement reflected in this letter shall be governed by Cayman Islands law and it is hereby agreed that the courts of the Cayman Islands shall have exclusive jurisdiction to settle any claim.