Mitigating Risk During Succession

With change comes the potential for professional liability risk, and CPA firm succession is no different. While the claims databases of professional liability insurance carriers are not teeming with these types of claims, there will be an increase in claims as a result of the succession issues – as well as the explosion of merger and acquisition activity – in the CPA profession.

By John F. Raspante, CPA
North American Professional Liability Insurance Association

Three major categories of risk that have evolved over the last few years due to firm succession are (1) firm culture and personalities; (2) firm applications and processes; and (3) employee benefits and retirement plans.

Firm Culture and Personalities

Firm culture issues – leadership style, ethics, open door policies, education and staff assimilation – can pose risks.

Example: Senior partners at firm XYZ are forced to retire based on the firm's mandatory retirement guidelines, and new leadership plans to visit clients less frequently or not at all. Instead, the leaders will use advanced technological applications to service clients. The result could be a loss of clients or a professional liability lawsuit alleging breach of contract by firm XYZ.

Example: Prior to a merge, the firm periodically met as a group and viewed the latest American Institute of CPAs webinars that focused on compilation and review updates. After the merge, the education training center at the firm could not accommodate the practice growth, and the educational programs were discontinued. As such, the firm's most recent compilation engagement letter failed to have the latest and required language. The firm consequently received a letter of comment on its peer review.

Firm Applications and Processes

Use of engagement letters, client portals, cloud computing, document management and destruction, client selection committees and client terminations all pose risks before, during and after succession.

Example: Firm XYZ recently recruited a new quality control (QC) partner from a large regional firm. That QC partner recommends that any partner who brings in new business should not be part of the client selection committee. This new process is met with opposition by the existing partners who feel this is unnecessary and will lead to less growth.

Example: Firm A acquires a much smaller firm, firm B. Firm A has a strict policy requiring the use of engagement letters on all engagements. Prior to the merge, firm B used engagement letters only for attest engagements and never for tax services. Firm B feels if engagement letters are used on all tax services, it will lead to a significant loss of clients. It is worth noting that firm B will ultimately be paid for the clients who have been merged into firm A, based on collections.

Employee Benefits and Retirement Plans

Employee benefits include, but are not limited to, paid time off, reimbursement for CPA Exam costs, health savings accounts, continuing education and tuition reimbursement, health insurance and group-term life insurance. The discussion of retirement plans will be limited to 401(k)s, but applies equally to all retirement plans. Many of the exposures discussed in this section have historically had their genesis in employment practice claims against CPA firms, as opposed to professional liability claims.

1. Employees of smaller firms that combine with larger firms may experience tremendous differences in employee benefits. The array of benefits will often be greater and more valuable after the merger or sale. However, it's the loss of benefits that people will focus on. If the successor firm had a policy of 100-percent employer coverage for medical and now it's 50/50, this will probably be met with staff resistance. Firm management needs to clearly and comprehensively articulate any reductions in benefits early in the transition. Further, human resource personnel should meet with staff individually or in small groups to discuss benefits changes. Employment practice insurance carriers have reported these types of issues as common causes of actions faced by CPA firms.
2. Retirement plan claims occur less frequently, but complications and related exposures exist nevertheless. Changes in the type of plans instituted by the firm will always subject it to exposure, as the dollar amount of the pension benefit may change. Plan loans, plan termination and the resulting income tax consequences need to be analyzed. The nuances of the Employee Retirement Income Security Act need to be analyzed and applied properly. Also, the same-desk rule needs to be examined to determine whether the responsibilities of the staff prior to and after a merger or sale are effectively the same. The same-desk rule will have the effect of treating the employees that have joined the new firm as not being considered to have a separation of service and, consequently, no distribution of pension account balances. Internal Revenue Service Ruling 2000-27 provides guidance regarding the same-desk rule.

Best Practices

With Baby Boomers retiring at unprecedented levels, as well as the dramatic increase in accounting firm mergers and sales, professional liability and employment practice liability exposures are sure to increase. Careful attention to best practices and a review of the related professional standards will help keep these exposures to a minimum. For the above reasons and beyond, there are several things you can do to help mitigate your risk:

- Choose a successor firm that will not have to implement changes that place your firm at risk for client and staff loss and liability reasons.
- Make sure that the mergee/seller maintains its tail policy and the successor firm is covered.
- Add proper hold-harmless and indemnification clauses into your agreement that protect both parties.

John F. Raspante, CPA, M.S.T., CDFA, is the director of risk management for the North American Professional Liability Insurance Association. He is a member of the New Jersey Society of CPAs Accounting & Auditing Standards Interest Group and the Editorial Advisory Board of New Jersey CPA *magazine. Contact him at johnr@naplia.com or 508-656-1318.*