If the shoe fits

Who's going to step into your shoes when disaster strikes?

By Joel Sinkin and Terrence Putney, CPA

For some years now, PCAs or Practice Continuation Agreements have been recommended as a way for small accounting firms to insure against sudden, unforeseen calamities. That said, very few firms have this type of agreement in place. And those that do, have found the results somewhat inadequate.

As a small practitioner, should you have a PCA, and if so, how can you guarantee its success?

What is a PCA? It's an agreement between two firms stating that, in the event that the owner of one firm is disabled or dies, the other firm will take over the practice either permanently or temporarily. Particularly in the event of short-term disability, where the practitioner is unable to return to the practice immediately, a PCA can act as an effective back-up plan or temporary bridge.

Some PCAs are bilateral in that both firms commit to the other to be the successor. Some are unilateral, usually where only one of the firms is realistically capable of becoming the successor. The terms of the PCA usually contain at least:

> A definition of the circumstances that will trigger the succession.
> The successor's obligations (usually this covers managing client relationships and providing ongoing client services).
> The terms of the acquisition if the successor is expected to buy the practice.
> The compensation to be paid to the successor firm if the support is temporary.

Also, the agreement sometimes allows for support without succession, meaning that the firms agree to client cross-referrals or support during staff shortages.

How useful are PCAs? For many small practitioners, they're extremely useful. When a practitioner suddenly passes away or becomes disabled, the value of the practice diminishes dramatically. Many clients, especially those that are served frequently, will quickly find a new accountant. Furthermore, when a PCA is in place, the practitioner's family is not obligated to manage a difficult company transition, or to sell the practice.

Do you need a PCA? The vast majority of firms that use PCAs are those with less than three partners. For these practices, there aren't enough partners to spare, and current staff may not have the experience necessary to take over client relationships or practice management.

That said, a PCA should not be used as a succession plan in the traditional sense. There are much more effective methods to use when a practitioner is trying to create an exit strategy for retirement. For example, if you're 5 or fewer years from retiring or substantially slowing down your work pace, you can find a successor firm and negotiate a binding succession plan that covers the practice's orderly transition. If properly constructed, this type of solution—known as a Two Stage Deal—will also allow for the need to transition the practice suddenly. (For more on this topic, see the article "Two Stage Deals" at the author's website, www.transitionadvisors.com, or in the March 2006 issue of *the Journal of Accountancy.*)

PCA challenges Finding a firm willing to make the commitment to take over a practice with little or no notice can be difficult. And for good reason.

First, a firm that has made that commitment must expect to have excess capacity in place to handle what can amount to hundreds or thousands of new clients all at once. Second, a properly structured PCA needs to address the same issues in the same detail as a purchase agreement. This might mean a lot of time spent dealing with a matter that is contingent on a set of specific

circumstances. What's more, many of us find it difficult to address mortality issues and risks that don't seem at all pressing.

PCA pointers

If you've decided a PCA is for you, and you've found a firm willing to make the commitment, you'll need to explore strategies to ensure the agreement's success. Here are some pointers.

Choose the right successor firm. Critical factors include, but are not limited to:

> Chemistry—If you're not comfortable having lunch with this person, don't expect your clients to be comfortable doing business with them.

> Excess capacity—Does the successor firm have the resources necessary to replace you in either the short term or the long term?

> Continuity—Does the firm's fee structure, practice philosophies, location and appearance mesh with yours? Does the practice offer the same niches, industry expertise and certifications?

> Longevity—If some or all of the successor firm's partners are nearing retirement, they may not be available when you need them.

Structure the deal. Like any agreement, the right documentation has to be in place. Make sure your PCA addresses these areas:

> A definition of temporary disability versus permanent disability. If an owner is temporarily disabled, when is the other firm required to jump in? How will the firm be compensated for supplying this back up? When and how do you determine that the disability is permanent?

> Upon permanent disability or death, what are the terms of the buy-out payments from the successor firm to the previous owner or his/her heirs, assigns or estate? What is the value? How long is the payout period? Will there be a down payment? How is the deal to be treated for tax purposes?

> How is the collection of accounts receivable and work in progress to be handled? To what extent are these assets included in the purchase terms?

> What are the liability issues and indemnification?

> What are the restrictions on competition?

> How will staff, leases and other operational matters be handled?

Share information. It's a good idea to provide the successor firm with your client list, a biannual update of the list, and pertinent client files, software and other information needed for a quick and effective transition. Also, check in with the firm annually to make sure it's still willing and able to carry out its obligations.

PCAs, when structured correctly, are an effective solution to the need for sudden practice succession. While these agreements shouldn't be used in lieu of life and disability insurance, they can be a successful means to keep a practice going until the owner recuperates or a successor is found.

What's more, these agreements can help to ensure that the owner's heirs receive appropriate compensation for the years of sweat equity they may have put into building the practice. □

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