

Who Would Run Your Firm?

Practice continuation agreements help plan for the worst.

by Joel Sinkin and Ira Rosenbloom, CPA



There comes a time when every sole practitioner or small firm owner needs to consider the consequences of a disruption in leadership of his or her CPA practice. Illness, disability, family obligation or death can be devastating for the CPA's clients, family and employees. Proper planning, however, can mitigate the consequences.

Several powerful planning options are available. This article addresses practice continuation agreements as a first step for protecting a practice.

PRACTICE CONTINUATION AGREEMENTS

A practice continuation agreement is a contract between a practitioner (or firm) and another CPA firm or trusted employee, to take over a practice permanently or temporarily depending on the circumstances.

Practice continuation agreements (PCAs) spell out the terms and conditions for the takeover. The core business elements of a formal PCA include:

1. A definition of the circumstances that will trigger the activation of assistance.
2. The financial terms for the assistance process or the purchase of the practice in the event of the death or permanent disability of the practitioner.
3. Noncompete and restrictive covenant provisions for the period of coverage and subsequent to the coverage relative to clients and staff.
4. Specific professional responsibilities to be performed by the covering party and how a party can terminate the agreement.
5. Billing and collection protocols and procedures to be followed during the coverage period.
6. Record retention and return of record provisions.
7. Definition of permanent disability, temporary disability or leave of absence.
8. Notification of activation of coverage and transfer back of practice.
9. Approved agent to act on behalf of the party requiring coverage.
10. Staff and client retention obligations.

The agreement should spell out not only a permanent replacement but also a temporary replacement. If an owner is expected to miss an extended period, he or she must know that the PCA partner can step in and keep the ship sailing. PCAs are not substitutes for disability or life insurance but are considered supplementary to insurance.

There is no payment to the other firm for setting up a PCA. Typically, for a PCA to work, the temporarily disabled (or deceased) owner should have previously agreed on terms that would make it worth the time for another firm to step in. If the firm that is backing you up is not properly compensat-

ed to maintain your firm, this solution may not work well. Compensation to the PCA partner taking on the responsibility of the practice may include pay based on collections received, his or her chargeable hours (frequently at a small discount) or the like. "Sometimes money is not the motivating factor, however, if practitioners are close friends or are part of a local practice continuation group whose motivation is to keep the CPA brand strong in their region," said Heidi Brundage, a technical manager in the Private Companies Practice Section at the AICPA. Brundage educates firms throughout the country about the importance of a practice continuation agreement.

Practice continuation agreements are rarely established as a reciprocal relationship wherein two parties are each covering the other. A critical criterion for a partner in a PCA firm is that the CPA has the excess capacity to take on the workload of the firm that has suffered a catastrophe. Unless both firms are small firms with substantial excess capacity, it is not typical that the two parties entering a PCA will be able to make it reciprocal.

TURNING TO AN INTERNAL TRUSTED EMPLOYEE

Sole owners with CPA staff who opt to turn to a trusted employee or employees to take over the practice will be driven by several factors. The first issue will be familiarity with the clients and the staff. In many cases trusted employees have already serviced the clients, and there is some familiarity and, hopefully, confidence as well. Furthermore, they are accustomed to the priorities and preferences of the firm owner so that the possibility of service change and disruption is minimized. The surprise factor is much more contained, and the concern about unknowns is dramatically reduced. In the event of a temporary or permanent disability or leave for personal/family reasons, a turnover to an appropriate staff professional can be a practical and expedient choice.

In a small multipartner firm, when a partner can no longer continue due to death or permanent disability, the option

of turning to a trusted employee cuts both ways. The concern about lack of previous experience is mitigated by the continuing involvement of the other owners. The continuing owners may not want the stress of training and monitoring the new potential owner so there may be push-back from the other owners on any type of internal program. As a result, turning to another firm may be the solution if the original firm's continuing owners don't have the capacity and/or interest in dealing with the trusted employee in this manner.

The biggest advantages of turning to an internal person for a practice continuation agreement (PCA partner) include greater continuity for the clients and staff and a means of securing a key staff person's future with the firm. Ideally, the trusted team member should undertake the leadership role for a trial period prior to becoming your PCA partner. This may increase the likelihood of success or allow you to investigate external solutions.

TURNING TO ANOTHER FIRM OR PROFESSIONAL AS A PCA PARTNER

Practitioners who opt to turn to another firm to take over their practice, whether temporarily or permanently, will typically do so because there is more talent of the type required in the competitor's firm than in their own practice. In this circumstance, a greater sense of financial security is achieved by turning to the competitor.

When evaluating a competitor for a practice continuation agreement, it is important to conduct due diligence. Focus on technical and professional compatibility; billing rates and philosophies; capacity to handle the required work and supervise personnel; areas of expertise and competency; employee turnover; client turnover; financial commitment; partner demographics; and overall reputation. Conditions may change between the time the practice continuation agreement is executed and the time it is actually put into effect.

Measuring the key areas noted above might be very difficult for the family or agents (anyone representing the former owner) of the practitioner requiring coverage—especially when they are emotionally invested in the conditions that merited the takeover. Frequently, the agreement will provide for an annual or semiannual confirmation of the conditions and commitment so there is less risk when the agreement needs to be activated.

When seeking an external firm to be your PCA partner, consider the following guidelines:

1. **Capacity.** As the owner of your firm, what time are you dedicating and on what level? How much time is mandatory for the role of partner, and how much responsibility can be passed down in a larger firm with more levels of talent? If your potential PCA partner cannot invest the time needed and perform the role you did as

partner, he or she is not a good candidate.

2. **Culture/chemistry.** Your staff and clients are with you and your firm not just because you are a good accountant but also because they are comfortable with you, your personality and your philosophies. If your potential PCA partner operates differently, will he or she be able to retain your staff and clients while you are not available?

3. **Fee structure and rates.** Can your PCA partner work within your current billing rates and billing procedures? Clients will have to adjust to working without you, and will also be greatly impacted by fees and procedures. Retaining fees and procedures will be critical to ensure client retention.

4. **Niches.** If your practice has certain niches or practice specialties, your PCA partner must have similar core competencies, and sometimes this includes special licenses.

TEMPORARY DISABILITY VS. PERMANENT DISABILITY/DEATH

A definition in your PCA of when a temporary disability becomes a permanent disability and how to handle death and permanent disability is critical and must be crafted by a qualified attorney. (A sample statement may be viewed with the online version of this article at journalofaccountancy.com. Enter 20103179 in the search box.)

EXECUTIVE SUMMARY

■ **Just as you need to have insurance to protect** your health, car and life, you need an insurance policy to protect your practice. A practice continuation agreement (PCA) can do just that.

■ **It is important to have a practice continuation agreement** if you are a small firm, but that is not where the process ends. Keeping your PCA partner apprised of what is going on in

your practice and where information is kept, and maintaining a realistic plan for him or her to step in to manage your practice while you are unable to is an ongoing event that should be reviewed semiannually.

■ **The PCA needs to address** what circumstances would activate the agreement and how dollars and responsibilities are divided.

■ **Your PCA partner needs to**

have the excess capacity to replace you in an emergency, the skill set to handle the work and the culture, and operational philosophies close enough to yours to avoid wholesale changes to the operation of your practice while you are unavailable. Otherwise, client retention may be at risk.

■ **A PCA is not a succession plan** but rather a method of addressing emergencies only.

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Once the owner is deemed permanently disabled or dies, the PCA should indicate the next step. In most situations, there is a buyout made by the PCA partner with the former owner or the deceased owner's estate. This is typically a purchase

price predicated on collections since having a fixed price when there is not time for an appropriate transition is the fairest method of going forward (for example, payments based on 20% of the gross collections over the subsequent five years as

billed and collected). Sometimes a practitioner enters into a PCA with someone who will only cover the practice for a temporary disability and, in the event of death or permanent disability, becomes the agent representing the former owner and/or

CPAs SHARE CONTINUATION STRATEGIES

by **Loanna Overcash**

In August 1988, 48-year-old CPA Jim Feigel was in an accident that left him in a coma for 23 days.

"If anything ever happens to me, the first thing you should do is sell the practice," he recalled telling his wife, Janice, well before the accident. "At that time it was our biggest asset." His wife, who was unsure of whether he would live or die, quickly made arrangements for a larger firm in the Tulsa, Okla., area to take over his practice. Seventeen months later, after a long hospital stay and rehabilitation, Feigel began the process of re-establishing his former firm.

"While what happened to Feigel may seem unlikely circumstances to some," said Heidi Brundage, a technical manager in the Private Companies Practice Section at the AICPA, "the point is that it did happen and the situation would have been better for his family had there been a formal PCA in place."

"Nobody wants to talk about death and disability," said Allen Nahrwold, CPA, a sole practitioner in Phoenix who has a formal practice continuation agreement with six other sole practitioners in his area. "However, if you view it as an exit strategy and ask yourself: how do I want my practice to be five to 10 years from now, and what's my strategy going to be when I part ways with the firm? It doesn't have to be a negative thing but instead: what can I do to make positive things happen?"

Cynthia LeBreton and Gigi

Matthews of New Orleans are sole practitioners with no employees. They have an informal agreement. They meet every year after busy season to go over office procedures, billing records, passwords and other pertinent information. "If something happens to me, Gigi can come in and help my clients on a temporary basis. In a worst-case scenario, she would [act as an agent for my business and] help my husband negotiate what to do with my practice and vice versa," LeBreton said.

LeBreton had an instant connection when she first met Matthews because their husbands had known each other from childhood. That sort of instant rapport and trust isn't easy to come by, however.

Nahrwold's group has been working at it for 20 years. The group meets regularly to discuss their businesses and situations that might have a significant impact on another member's practice, and to strategize for the next five years. If a member has a need, the group can assess which practice is best suited to help.

"We know each other's firms very well and have developed a level of trust with each firm's employees so if I have to go over to a firm and step in, I already know most of the people there and they know me," Nahrwold said.

Ultimately, the practitioner's choice for a practice continuation plan may be heavily influenced by the nature of the practice and the practitioners' risk tolerance.

"Trust, compatibility, size and culture are the hardest and biggest obstacles," said Craig Morris, CPA of Long Island. "I have struggled in forming a formal practice continuation agreement because it's hard to find the right firm." As a result, Morris has an informal arrangement with a larger firm in his area, but he is a strong advocate for practice continuation agreements, and works for education and networking on this topic at the local level.

Brundage believes that even an informal agreement is a step in the right direction for small firms and sole practitioners. "I encourage firms to have a formal agreement, yes, but for sole and small practitioners who aren't even thinking about full-blown succession plans, it is very important to have something in place, even if it is informal," she said. Results from the 2010 PCPS/TSCPA National MAP Survey seem to support the claim that few small firms are planning ahead in this sense. Of the 2,937 firms surveyed, only 6% have a practice continuation agreement with another firm in place, and 25% have a succession plan.

"The next person may not be as fortunate as I was," Feigel said. "Today I have another pretty solid practice, and I don't think my wife would have any trouble selling it again. The only problem is that I put the responsibility on her the first time, and that is not something you ever want to put on your spouse."

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the deceased owner's estate and sells the practice.

SUCCESS FACTORS

Practice continuation agreements can be very comprehensive and easily workable. Covering the right bases while drafting and negotiating is important, but success will require other steps. The successor needs to be well-prepared for the responsibility. In the best of all possible worlds, the practitioner requiring coverage should have a policy and procedures manual that is updated annually and reviewed with the parties of the continuation agreement.

In many instances there are no manuals—but there are always codes, passwords and security procedures. An agent must be entrusted with this critical information. This agent will only transfer the information when authorized by a party or parties named in the agreement, but the agent must receive any updates in concert with the updates taking effect. We also suggest semiannually reviewing client lists, where things are, and other vital information so that, when an emergency does occur, there is less for the PCA partner to track down; he or she will know where most of the needed information exists.

KEEPING CLIENTS HAPPY

Keeping the clients happy is the key to a successful practice. Clients will need to deal with the absence of their trusted adviser in their own way. The fact that their trusted adviser selected a particular professional or professional organization to take over should carry significant clout. The clients will, however, need to see for themselves whether the fit is right. The fit will be determined by many factors. Communication and organization of any transition are crucial barometers.

Develop a business plan for both a temporary and a permanent takeover in tandem with drafting the agreement or before you draft one. The plan will help all parties anticipate the kinks and properly plan for the date of activation. As part of the plan, the notifications to the clients and

referral sources should be prearranged and agreed upon. The worst time to craft a notification and announcement is during a crisis. The business plan should be reviewed at least annually and made a part of the periodic confirmation of the agreement noted above. The practitioner must regularly share information so that, if a horrific event triggers a PCA, the party who needs to step in has as much information as possible, since it is likely the original owner of that firm is not available for guidance.

Other items in the business plan should include, but not be limited to: how the billings, collections, work processing and governance issues will be addressed; how staff will be notified, paid and retained; how bills will be covered; and how day-to-day operations will be handled.

The main kinks to avoid are losses of clients and staff. The message to clients must include allaying their fears about change of service, fee increases, and changes in the practice operations. The communication must make clear whether the issue is temporary or permanent; that the parties prepared for this event to protect the clients; and that services will be provided in a similar manner with similar fees until the owner returns. Staff must also be informed of continuity, similar roles, compensation and other information to put them at ease.

Mergers

Merger, especially the type described in the *JofA* article "Two-Stage Deals," (March 2006, page 43) can be a stronger method of protecting a client base, especially for practitioners who are five years or less from reducing their time commitment to the firm.

CONCLUSION

There is great merit to planning for a leadership interruption in your practice.

Whatever option you pursue to protect

your practice, it will be in your best interest to continue to strive for excellence and to secure the best possible talent. Excellence and talent will attract the right kind of successor. Whether it is internal or external, it will maximize the value of your practice, enhance the caliber of your clients, and keep you motivated and well positioned to be the trusted adviser to your clients that they expect you to be. ❖

AICPA RESOURCES

JofA articles

- "A 2009 Tuneup for Your Firm's Succession Planning," March 2009, page 42
- "Two-Stage Deals," March 2006, page 43

Use journalofaccountancy.com to find past articles. In the search box, click "Open Advanced Search" and then search by title.

Publications

- *Management of an Accounting Practice Handbook* (#090407)
- PCPS Human Capital Center (HCC) Toolbox Series—white papers that introduce the tools included in the 11 sections of the HCC, such as *Team Recruitment, Orientation/Acculturation, Performance Management, Reward & Compensation, Incentives and Owner Development*, tinyurl.com/36al43f
- *Practice Continuation Agreements: A Practice Survival Kit*, second edition (#090211PDF)
- *Securing the Future: Building a Succession Plan for Your Firm* (#090520)

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Website

Succession Planning Resource Center, tinyurl.com/2vndhzw (requires PCPS membership for access)

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