Planning for the worst: Who needs a practice continuation agreement?

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CPA firm owners face a never-ending stream of challenges. For owners of smaller firms, especially, it can be difficult to take a step back from day-to-day affairs to think about long-term questions — what happens to my firm, my clients and my family if something happens to me? How do I plan for retirement in a way that protects my clients and my staff?

Few people relish facing these issues. But a sound methodology for addressing these questions exists: practice continuation agreements (PCAs). Unfortunately, AICPA surveys have consistently found that only a small percentage of firms have PCAs in place, meaning that many firms are not protected in the event of an emergency affecting a key owner.

What is a practice continuation agreement?

A PCA is a contract that sets forth the terms under which another CPA firm would assume your firm's practice in the event of a serious incident. There are two general types of PCAs: short term and permanent.

A short-term agreement would apply to a situation involving a disability or accident that jeopardizes your firm's ability to provide client service on a temporary basis. In that case, the PCA would allow for another firm or individual to meet your firm's obligations to clients under a predetermined fee structure.

A permanent agreement would apply to a situation involving a long-term illness, death or other disability or accident that jeopardizes your firm's ability to serve clients on a permanent basis. In such cases, the PCA would allow another firm or individual to purchase your practice for a predetermined price.

A PCA can also be used for a planned permanent transfer of your practice to another individual or firm and — in that sense — a PCA can be a form of retirement planning.

Why are PCAs important?

All CPA firm owners have at least three key constituents: clients, the firm's other partners and staff, and family. A well-crafted PCA can protect the interests of all three groups.

For *clients*, a PCA provides continuity of service in the event of an incident. This would be especially important if the incident were to happen at a critical time in the calendar.[1]

For *partners and staff*, the continuity of client service provided by a well-crafted PCA will also help protect the stability of the firm if something happens to a key partner.

For *family* members, a PCA ensures that your spouse or other family members will not have to scramble to keep your practice going in the event of a sudden accident. The PCA also can provide an income stream during a stressful time.

[1] The existence of a PCA could help to address questions from clients who wonder about the implications of working with a small firm.

[2] This is not intended to be a comprehensive list of all matters that a PCA would address.

What are the elements of an effective PCA?

An effective PCA is not a DIY project and is not a cookie-cutter document to be prepared using ChatGPT. While there are key terms that should be addressed in any PCA, the details of those terms matter and will vary from case to case.

An effective PCA addresses the following:[2]

- How are key events defined?
- What process will be used to determine when the obligations of the PCA come into effect, when those obligations will end or when a short-term practice assumption should transition into a permanent transfer?
- How will clients be notified and how will their confidentiality interests be protected?
- What are the financial terms and how will both parties be compensated?
- How will the parties account for work-in-progress or partial payments?
- How will the firm's accounts payable or vendor obligations (such as the office lease and insurance coverage) be handled?
- How will actual or potential liabilities for clients be addressed?
- What warranties, if any, will be given?
- How will the assuming CPA deal with the firm's other partners and staff?

Firm owners should consult with qualified and experienced legal counsel to tailor the agreement to the specific circumstances and goals of each situation. In the event of a permanent assumption of the practice, some overriding additional factors come into play, including: What is the long-term value of the practice, how is that value determined and how will that value be paid?

What should be done to prepare for a PCA?

The effectiveness of a PCA will depend largely upon the quality of your planning and preparation. This preparation must include a realistic assessment of your practice and its value. Possible successors will expect a high degree of transparency, including sound historical data regarding your practice.

The assessment will require a clear-eyed look at matters such as:

- Your client base, including the length, strength and depth of client relationships.
- The expertise you and your firm provide.
- Financial matters such as overall profitability, staff utilization, accounts receivable, obligations to vendors and related matters.

Who should the successor be?

Another element in an effective PCA is to identify the right successor. This can be a challenging task, especially in some geographic areas. You need to do your own due diligence to find a successor whom you trust will perform the obligations under the PCA and serve all three constituents effectively. The successor should be a person or firm with a sound character and reputation. The successor ideally should serve a similar clientele for similar rates, have appropriate expertise and quality staff, and have the ability and capacity to step in and absorb work in on short notice in an emergency.

In planning for a short-term arrangement, it could be that the person you identify as a successor is also looking for a successor in cases of emergency, and conceivably the PCA could be made reciprocal. Note that the ideal candidate for a permanent transfer of the practice might be different than the ideal candidate for a temporary assumption.

It is also possible to structure an arrangement in which a group — two or more individuals or firms — will assume the practice, especially in the case of temporary disabilities. This can lead to other complications that should be considered under the advice of legal counsel, such as how to allocate clients, liabilities and staff among the various individuals or firms. You will also need to ensure that no clients go unclaimed.

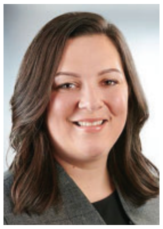
What happens after the PCA is signed?

The PCA should not simply be put on the shelf after it is signed — as your practice evolves, the PCA should evolve along with it. You and your successor should revisit the agreement annually to consider whether any changes to key terms are warranted. These changes could include updating the client list, reconsidering the valuation and payment provisions and assessing whether other terms remain appropriate.

Also, do not make the mistake of assuming the PCA will be self-executing. People you trust — your attorney, partner(s) (if you have them), key staff member(s) and spouse — should be kept up to speed on the details of the PCA. These individuals should be informed of the identity of the successor, the location of key information (such as a client list) and should be empowered to put the PCA into motion if and when that time comes.

Questions?

We recommend you consult with a competent and experienced legal adviser regarding drafting and implementing a PCA, as well as any questions that may arise as you prepare for, consider and implement the PCA. ■



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