CPA
Practice Advisor

period insurance coverage, commonly known as "tail coverage," is highly recommended. With this coverage in place, the risk to the former and continuing partners ...

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When partners at public accounting firms plan the terms of their departure strategy, they don't usually think about the possibility of getting sued after they leave – whether in retirement or otherwise. The terms of their exit should include the obligation for their former partners both to indemnify them (exempt and/or protect them from liability), *and* to carry liability coverage for some period of years that

representation in a case. It's obviously bad news when a former partner is named in a lawsuit, but worse if the tail policy has been altered or cancelled, or the indemnity is no longer in place.

Lawsuits happen – it's the nature of the profession. Departed partners can be sued for work they performed prior to their departure. The question is: Are they covered if it happens, and how does it all work? Departing partners should make sure that their firm carries a minimum of $1 million in tail coverage for a period of five years. These figures are based on the timing and size of average U.S. accounting industry liability claims.

This might seem costly to some firms, and they may be tempted to reduce the level of coverage or cancel it within the first five years. But, the reality is, the longer it takes for a liability claim to develop, the bigger it usually is. The good news: after five years, the risk of a lawsuit diminishes fairly rapidly.

Tail Coverage, Former Partners and the Acquiring Firm

Buyers of an accounting firm often require the seller to obtain a tail policy. Not only does a tail policy help protect the selling firm and its selling and retiring partners, it should give the acquiring firm a lot of comfort. The acquiring firm's risk of successor liability is minimized for future claims on work performed by the selling firm and its active and retired partners. Even though the acquiring firm may not have legal responsibility for work performed prior to the acquisition, experience has shown that successors are often drawn into the legal proceedings. Being named in a lawsuit still requires time and money to assert the firm's defense. Insurance helps.

Extended reporting period insurance (tail coverage) is an investment in risk management for the new owners. If the selling firm can't obtain tail coverage, the buyer can add the seller to their existing policy through an endorsement. Retired

indemnification and cooperation provisions in their partnership agreements, as well as minimum insurance coverage requirements. Otherwise, disputes may ensue later. Make sure that the terms and limitations of an agreement between the firm and its former partners prevails rather than the uncertain and broad legal principles of indemnification.

After many years of hard work and dedication to the firm, a departing or retiring partner should be able to focus on the next stage of life. Consider these simple risk management practices to support that future.

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