



Most accounting firms carry professional liability insurance. The CPA firm's policy

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statutory indemnification arises under an ancient legal principle that makes an employer responsible for the acts or omissions of its employees.

## **Why Indemnification Benefits the Accounting Firm**

The statutory requirement for indemnification notwithstanding, many accounting firm partnership agreements have an indemnification provision — often coupled with a cooperation requirement — that covers both active and former partners. The indemnification clause usually sets forth the prerequisites, parameters and limitations on the underlying statutory general indemnification obligation.

Accounting firms should eagerly give current and former partners an indemnification, subject to certain conditions and time limits. The reasons are very simple. First and foremost, it's a good partner relations practice. Partners are more likely to act in the best interests of the firm — and possibly sleep better at night — knowing the firm protects them. Additionally, so long as the firm is covering the partners' defense costs and liabilities, the partners are much more likely to cooperate and assist in the defense. The firm can use the lawyers of their choosing to represent the partner, advance a common defense strategy and control what happens, including a settlement.

## **Indemnification Conditions and Terms**

Here are the common characteristics and conditions that accounting firms include in the indemnification of partners.

- The indemnification usually includes a duty to defend. If a partner gets drawn into a lawsuit, the firm is required to either assume the legal defense of the partner or pay the defense costs on behalf of the partner. This is in addition to coverage of any of the partner's liability for damages that might result.

- A partner named in a lawsuit needs to give the firm prompt notice. In most cases,

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- the demands of assisting with the defense may be significant. Former partners may or may not get compensation for helping, but should at least have any out-of-pocket expenses covered.
- While fairly unusual, partners who are defendants in a lawsuit may voluntarily (and surreptitiously) cooperate with the other side in an attempt to get themselves dismissed from the case. This effort should cancel the firm's indemnification obligation.
- In order to secure the indemnification, the partner must have acted properly, and within the scope of employment and authority. The partner needs to have operated in good faith and for the benefit of the firm (rather than for personal benefit). The partner cannot have committed any gross negligence, intentional misconduct, fraud, or knowingly any criminal act. Whether a partner has acted appropriately is occasionally an area of considerable ambiguity. In addition to an indemnification provision, accounting firm partnership agreements should include clear guidelines for partner performance.
- The partner cannot be indemnified twice for the same claim. For example, say that a partner leaves a firm with some clients. One of those clients sues the partner for work performed *before and after* leaving the former firm. That partner cannot be indemnified by two firms. In other words, the partner cannot "double dip." Whenever there is a "crossover claim," the old and new firms — and their respective insurance carriers — need to collaborate on both the defense of the firms and the partner, as well as the apportionment of expenses.
- If the partner does not comply with the foregoing requirements, the firm's obligation to defend and indemnify the partner may go away. In addition, the partner may be required to repay any amounts the firm advanced for the partner's defense or settlement.

An indemnification is only as good as the party that gives it. Accordingly, both active and former partners should insist that the firm carry professional liability insurance

with deductible/retention amounts, policy limits and exclusions that are consistent

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active and former partners should be able to sleep well at night.

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