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COVID-19

What to Do When Small Business Clients Go Out of Business

More than 100,000 small businesses have closed since the pandemic began. With no clear end in sight, one major question has come to the forefront for CPA firm leaders as both their own firms and their clients struggle financially: What happens when ...

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More than **100,000 small businesses** have closed since the pandemic began. With no clear end in sight, one major question has come to the forefront for CPA firm leaders

as both their own firms and their clients struggle financially: What happens when clients go out of business or can't pay their bills?

Liability Claims Rise

As businesses go under, firms typically see an increase in professional liability claims – stemming from issues like failing to advise or failure to detect fraud. For example, clients may argue that CPAs did not provide sufficient guidance that could have kept them afloat during the pandemic or that they should have seen the signs of internal fraud long before the economy took a downturn. CPAs need to be aware of both professional liability and financial risks that may impact their practice going forward and take the necessary steps to proactively mitigate these potential exposures.

Claims impacted by economic factors often appear about two years after the initial downturn. In most, if not all, cases a detailed record of the scope and limits of the work to be performed is truly the best defense CPAs have when faced with claims.

Engagement letters are mutually beneficial for CPAs and clients. These letters serve as a guide for the work that is expected to be completed, and must be agreed upon by both parties. These agreements must be updated on a regular basis – whether that's annually or as needed, based on changes to the engagement – and should specifically define the scope of work to make sure all bases are covered.

Billing Struggles Emerge

If a client is not paying the fees on time, CPAs have a few things to consider. First, they need to determine if the nonpayment stems from a perceived work quality issue. If so, CPAs need to consider if the work product falls within the defined scope of practice in the engagement letter. The refusal to pay for services is often a red flag that a claim is imminent, and firms should prepare accordingly.

Additionally, CPAs need to decide whether or not unbilled work in progress should continue and if so, for how long. Now may be a good time to take a close look at your firm's client list and identify those accounts that may pose problems, especially if the client is known to be litigious or has significant cash flow problems. In the midst of long-term uncertainty, it is helpful to determine if you want to continue to service the client to avoid future issues.

Of course, clients aren't the only ones feeling the financial strain caused by COVID-19. Firms can manage risks related to their own financial trouble by evaluating

billing and collection processes – including billing frequency – and implementing retainers for new clients and/or clients with a history of delayed payments.

Although it's important to remain empathetic to a client's financial struggles, CPA firms also rely on revenue and expect to be compensated fairly for the work they've performed. Firm leaders may be tempted to initiate a fee suit when clients do not pay their bills, but this is a business decision that should not be taken lightly. Keep in mind—the time and money a CPA firm will spend defending a malpractice claim will likely far exceed the balance owed.

Reviewing and enhancing your billing practices has another benefit beyond simply getting paid. It's actually harder to defend a malpractice claim when your firm has ineffective billing practices. Documentation and billing go hand-in-hand. Bills should be reflective of what was agreed upon in the engagement letter. Itemized billing that is detailed enough to explain the work that was completed with an attached engagement letter for reference can create a persuasive way to resolve claims in favor of a firm.

Firms rely on revenue just like any other company, and many are feeling the negative impacts of the pandemic. Advising clients and remaining sensitive to their needs during a difficult time is vital, but at the end of the day, it's important to remember that firms are businesses too.

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