

The Partnership 'Prenup': Responsibly Managing Dissolutions

By Malcolm D'Souza, MBA, CA, and Kaitlin D'Silva

The dissolution of a partnership brings with it a myriad of related risk management concerns, each of which is compounded by the emotions and circumstances surrounding the separation. The ease with which this separation occurs depends on the preparation by involved stakeholders at the outset of the partnership itself. Smart preparation is the only means for smooth separation. Most claim and insurance pitfalls resulting from partnership dissolutions can be avoided, so long as a firm is willing to use diligence and foresight when drafting the partnership agreement at the time the partnership is created.

In an accounting firm, partners must have confidence that they will each consistently provide the same quality of service. This is facilitated by clear documentation of standards, policies, and practices within a firm. The rationale for clearly documented policies is straightforward: failure to meet standards of the profession can lead to significant problems, including lawsuits. The same principles should be applied to the development of the partnership agreement.

The easiest time to determine and document the roles and responsibilities of each partner is when the partnership is created, and thereafter each time a new partner is introduced. These responsibilities should include the ongoing obligations that a partner has to their former partner(s) and firm, and the ongoing cooperation that is expected between all parties. The failure to detail these obligations in writing can open the door to uncertainty and needless disputes amongst former partners down the road, exposing one or more of the partners to unnecessary risk, liability and expense, and the possible loss of insurance coverage.

This article provides tips in a number of areas regarding precautionary measures that can be taken by firms in the development of partnership agreements to prevent or mitigate the impact of problems, as well as some best practices once the separation has taken place.

Client issues

One longstanding reality is that a partner(s) who leaves a firm will often take his or her clients and client files (permanent and working paper files) with them. In terms of managing risk, the existing firm should take great care when

orchestrating this transition period.

Recommendation #1: The partnership agreement must require the leaving partner to keep the files that he or she takes for the length of the time that is consistent with the retention policy followed by the departed firm. This is key for all parties, because the firm or the leaving partner could be liable for any important documents that are inadvertently destroyed. It is not uncommon for a claim to arise as much as ten years after a service is provided. It is essential that documents are retained and made available as evidence for the service in question to assist in resolving the claim.



Insurance coverage issues

When a two or three-person partnership dissolves, either the leaving partner or remaining partners will typically take carriage of 'prior acts coverage' for their former firm. This is done through the use of an endorsement to their current policy, which will provide coverage for any claim for services prior to separation. This is where avoidable problems can arise, because if a claim falls under an innocent partner's policy that is carrying 'prior acts coverage' for the former

partnership, then any deductible becomes the responsibility of that innocent partner.

Recommendation #2: Proper foresight when drafting the partnership agreement will ensure that partners agree to pay their own deductibles for services they have provided that lead to a claim, regardless of whether or not they still work with the firm.

Recommendation #3: Another option is the use of a 'discovery policy' endorsement to cover the services provided by the former partnership. This protects both the leaving partner(s) and their former partner(s) from being negatively impacted by reported claims for incidents taking place prior to separation. Ideally, the discovery policy would not include a deductible so as to avoid dispute over who is responsible for said deductible. Also this option may have an additional cost, as it involves an extra policy being purchased for prior acts.

Claims and issues of cooperation

Dealing with a negligence claim on behalf of a client can become increasingly complicated when it involves services provided by a former partner of the firm. Communication and cooperation between former partners is the key to

(Please see page 14)

(From page 13)

navigating said claims successfully. Errors and omissions insurance is a 'claims made policy', meaning that the policy responding to the claim is the one in existence when the claim is advanced, as opposed to the one that was in existence when service was provided. For dissolved partnerships, this could prove problematic.

Recommendation #4: It is imperative that the reporting of a claim or potential claim on a timely basis after dissolution be included as a clause in the partnership agreement, as well as any other minimum disclosure requirements. These disclosure requirements should include at least the following two parts: first, that the leaving partner(s) must notify their former firm should they become aware of written or verbal allegations against them with respect to services provided prior to separation; and second, the leaving partner(s) should also make their former partners aware of any errors or omissions that arise in regards to services to clients of the firm. Adhering to these requirements also ensures that insurers can be promptly informed when a claim arises. The possible repercussions of late reporting to insurers include a denial of coverage.

Recommendation #5: An accused partner who has left the firm should be required to cooperate and integrate his or her efforts with the former firm to put forward the best defence against a claim. This includes reporting the claim, being available to be interviewed by the lawyer defending the case, and remaining available for court procedures, including mediations and examinations for discovery,

pre-trials and trials. In exchange, the former partners may agree, in some cases, that the leaving partner(s) will be reimbursed for their time.

Conflict resolution

Taking care in the formation of the agreement can serve the best interests of the partners and the firm in the event of conflict as well.

Recommendation #6: The partnership agreement can provide an arbitration or dispute mechanism process so that any disputes between practices are resolved privately and quickly – and not in a public court system.

Legal advice

A partnership agreement is a legal contract.

Recommendation #7: It is imperative that legal advice be sought and a lawyer be used to prepare the partnership agreement. During this process, individuals should get independent legal advice to ensure their interests are protected.

Recommendation #8: One final word of advice - once the terms have been finalized, the partners need to sign the agreement, and each should keep their own copy in a safe place.

Conclusion

While handling partnership dissolutions will inevitably pose new challenges to an accounting firm, issues involving files, claims and insurance needn't be a nightmare. A little advance preparation can go a long way. The issues discussed here are difficult to address after partners have decided to go their separate ways. Animosity and disagreement can be minimized by mapping out obligations at the beginning of the partnership – your business 'prenup' of sorts.

Guest contributors Malcolm D'Souza, MBA, CA and Kaitlin D'Silva are with AICA Services Inc.

Connect to the best in tax and accounting at the new BeansTalk Career Site.

- **Search** and apply for relevant, targeted jobs with employers across Canada
- **Post** your resume in confidence and receive alerts each time a job in your category is posted
- **Post** jobs, search resumes and contact candidates online
- **Reach** key professionals and firms in a confidential setting, in real time

www.beansTalk.ca

0983

Connect to better health and well-being

Your CA-ASSIST Member Assistance Program
A confidential counselling service offering individual and family support for day-to-day issues and major life challenges.

Call your CA-ASSIST Member Assistance Program, 24 hours a day, seven days a week:
1 800 387 4765
Or visit online resources at:
<http://www.icao.on.ca/CA/MemberAssistance/CAassist/>