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M&A checklist for CPA Firms

For CPA firms, a key driver of claims can be traced back to a merger, acquisition, or even an asset purchase. Acquiring all or part of another practice can present liability exposures. Below are some recommendations, considerations, and preventive measures your firm can employ to help minimize risk exposures associated with a merger or acquisition.

☐ Structuring the deal

When conducting a risk assessment related to structuring a merger or acquisition. Here are some recommended safeguards you can employ.

- Recommend that the firm being acquired purchase an Extended Reporting Period on its professional liability coverage to minimize risk to the acquiring firm.
- Structure the transaction in such a way to create minimal risk for the firm (e.g., asset purchase or merger).
- Include a contract provision that the firm being acquired would be responsible to pay for the deductible if a claim arises from their prior acts.
- Ask if there is work in process that needs to be considered before the acquired firm purchases an Extended Reporting Period?
- Consider including indemnification language in the purchase agreement whereby the target firm agrees to defend and indemnify the acquiring firm for any and all claims related to the prior acts of the target firm.
- Consider holding back some portion of the purchase price to fund any indemnification obligations triggered under the purchase agreement.
- Be careful not to mis-characterize an asset purchase as a "merger" in any internal or external communications.

☐ Review of client acceptance and continuance procedures

To help ensure your firm is taking appropriate steps to safeguard the transition of client acceptance and continuance procedures consider the following.

- Review the acceptance and continuance process for the acquired firm.
- Put all clients through your acceptance processes and procedures, then determine whether you want to continue with the client or disengage.
- Institute your acceptance and continuance procedures for the acquired firm.

☐ Client Screening

It's important to pay careful attention to clients' work history and activities that may leave you vulnerable to risk exposures. Following are some red flags to watch out for.

General

- Delinquent accounts receivable
- Unresponsive or uncooperative clients
- Business disputes or litigation with third parties
- A significant planned or proposed transaction (e.g., merger, acquisition, divestiture, public or private offering, etc.)
- Poor credit history
- Criminal history
- Bankruptcy and litigation history
- Judgments or regulatory licensing issues
- Review of work in progress
- Conflicts of interest
- Clients that have not received or signed engagement letters

Audit and Attest Engagements

- Independence concerns
- Evidence of fraud or misappropriation
- Report issuance delayed 60 days or more
- Pending or prior disagreements with management on tax and accounting treatments, going concern issues, or report issuance
- Requested information is untimely, inaccurate, or incomplete
- Pending ownership litigation
- Pending inquiries from regulators or taxing authorities
- Pending criminal investigation regarding management or firm

Tax Engagements

- Clients with delinquent tax filings or payments
- Clients under audit or with matter on appeal
- Divorcing clients
- Estate planning or estate tax return preparation for high-net-worth clients
- Review of prior tax returns

Consulting Engagements

- Services with management responsibilities
- Family office services
- Client accounting services
- Merger and acquisition services
- General consulting

☐ Engagement letter recommendations

It's important to conduct a thorough review of the policies and procedures around engagement letters. Consider employing the following safeguards:

- Put a written policy in place for use of engagement letters
- Allow necessary changes to engagement letters to cover additional services
- Employ a process for requesting changes to current engagement letters
- Move the acquired firm's clients to your firm's engagement letter format and require them to be signed
- Institute your engagement letter policy and procedures with the acquired firm

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Information technology (IT)

Following are some general areas to consider when it comes to continuity and protecting IT assets:

- What is the compatibility of IT platforms and analytics software
- What data security and response plans are in place?
- What are the data retrieval and storage methods?

Culture

By employing internal communication methods you can help their employees understand and feel more comfortable with a transition associated with a merger or acquisition. Here are some questions to consider:

- Will there be any new offices?
- Will there be a partner/firm representative from the acquiring firm visiting the new or acquired offices on a regular basis?
- Will there be any service area or industry not within your firm's expertise (i.e., dabbling)?
- Who is overseeing integration?
- What will the strategy be to make sure the integration of the acquired firm is a priority?
- What is the plan for oversight of entities that may continue to run more independently?
- Do you need to appoint a change liaison?

Employment and ownership agreements

It's a wise practice to review the firm's:

- Pre-employment and post-employment agreements
- Agreements with non-equity partners
- Ownership agreements

Claims and potential claims

In the acquisition process, the acquiring firm may be taking on unknown or unwanted claims exposures. Request the following information for both the firm and its predecessors in interest, and review it with your legal counsel:

- All claims and potential claims reported to insurers over the past 5-10 years under professional, cyber, employment practices, and/or directors and officers liability (management liability) policies (loss run)
- All claims and potential claims not reported to insurers under these policies
- All pending complaints or disputes (both oral and written) with employees, owners, or former owners regarding employment or ownership that were not reported to insurers under these policies

Insurance coverage

Conduct a comprehensive review of all risks consider purchasing insurance coverage to help safeguard against exposures, including:

- Professional liability
- Cyber liability
- Employment practices liability
- Directors and officers (Management Liability)
- Crime coverage

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