

# N7 – Arrangements to Cover the Incapacity or Death of a Sole Practitioner

---

## GUIDANCE NOTES

Updated February 2017

### Table of Contents

[7.1 General considerations](#)

[7.2 Ethical considerations](#)

[7.3 Professional registration considerations](#)

### Disclaimer

This Guidance Note has been prepared for use by members of Chartered Accountants Australia and New Zealand (CA ANZ) in Australia only. It is not intended for use by any person who is not a CA ANZ member and/or does not have appropriate expertise in the Guide's subject matter.

Laws, practices and regulations may have changed since publication of this Guidance Note. Users should make their own inquiries as to the currency of relevant laws, practices and regulations.

No warranty is given as to the correctness of the information contained in this Guidance Note, or of its suitability for use by you. To the fullest extent permitted by law, CA ANZ is not liable for any statement or opinion, or for any error or omission contained in this publication and disclaims all warranties with regard to the information contained in it, including, without limitation, all implied warranties of merchantability and fitness for a particular purpose. CA ANZ is not liable for any direct, indirect, special or consequential losses or damages of any kind, or loss of profit, loss or corruption of data, business interruption or indirect costs, arising out of or in connection with the use of this publication or the information contained in it, whether such loss or damage arises in contract, negligence, tort, under statute, or otherwise.

### Copyright

© 2017 Chartered Accountants Australia and New Zealand ABN 50 084 642 571. All rights reserved. Other than for the purposes of and in accordance with the *Copyright Act 1968* (Cth), this Guidance Note may not be reproduced, adapted, published, stored in a retrieval system or communicated in whole or in part by any means without express prior written permission.

### charteredaccountantsanz.com

Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ).  
Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.



## 7.1 General Considerations

### Short term and long term absence from the practice

All members in public practice have a duty to ensure that their practices are at all times properly supervised and conducted, including implementing arrangements to cover holidays and sickness of the practitioner. The problems which will inevitably arise where a sole practitioner ceases to be able to conduct the practice, because of continuing incapacity or death, are much more serious. The interruption of services resulting, in particular, from mental incapacity or death, will cause considerable difficulty and inconvenience to the member's clients, additional anxiety for his or her family, and reduction in the value of the practice or even its disintegration.

It is therefore vital for a sole practitioner to confront these problems and difficulties and to make arrangements appropriate to minimise the disruption to their clients and business and to continue to provide clients with the professional support and advice they require. Practitioners should address business continuity when first commencing practice and should regularly review such arrangements over time.

Having a plan that can be executed when one of the following events occurs is important to enable clients to be serviced with a minimum of disruption:

- (a) short-term absence due to holiday or sickness;
- (b) continuing physical incapacity;
- (c) mental incapacity;
- (d) death.

These arrangements should provide for the practice to continue as a going concern by having an appointed "alternate" accountant as a short-term caretaker or locum (see below) who can assist clients and run the business. This can be for pre-arranged short-term absences, like extended holidays or planned surgery or emergency short-term absences.

Practitioners should consider long term succession planning options for their business to protect their clients' interests and their practice (from premature closure or reduction in its value) due to events such as physical incapacity, mental incapacity or death.

### Professional supervision arrangements

Where a sole practitioner is mentoring a provisional Chartered Accountant (**CA**) member, any arrangements for short term periods away from the practice should include provision for appropriate supervision and in the event of physical or mental incapacity or death, the 'caretaker' practitioner or locum should notify CA ANZ so that provision can be made to ensure that the provisional CA member's future admission eligibility status is not placed in jeopardy.

### Key objectives for planning

In managing short term and long term absence from the business, practitioners need to:

- Identify one or more colleagues or another firm who can act as a 'caretaker' practitioner/s and agree the basis on which assistance will be provided including remuneration.

- Identify the trigger events that would call upon the 'caretaker' practitioner stepping in to the business.
- Prepare and confirm a formal agreement with the 'caretaker' practitioner, including key terms such as resources, responsibilities, authorities, services, fees, expenses and ownership of the servicing rights for the clients and operational considerations.
- Obtain legal advice and assistance to prepare a power of attorney or other arrangements allowing the 'caretaker' practitioner to make business decisions.
- Include under what circumstances the business may be sold in the event of extended period or permanent absence from the business. This will need to include how the business will be valued, timing of valuation and sale and purchase options.
- Consider under what circumstances the 'caretaker' practitioner will have an interest in or the right to acquire the clients if a short term absence becomes a more serious event that prevents the practitioner returning to work.
- Seek advice from a financial adviser or life insurance broker who can advise on appropriate insurances to protect the practitioner, their family members and the business, including key person cover, income protection, personal accident and sickness insurance and life insurance.

In exploring whether there is an interest in the other caretaker acquiring the business, financing the purchase of that business is an important consideration. Insurance policies which cover temporary or permanent incapacity and death may assist family members, employees or a 'caretaker' practitioner to fund the succession planning options.

### **Potential trigger events**

There can be a number of life-changing events that can impact the practice including:

- *Temporary incapacity*, e.g. a physical or mental illness that is treatable over the course of time but requires an extended period away from the business for recovery. These types of events can be crippling to a business. While the practitioner may be able to function to some extent, taking time out of the business facilitates recovery and reduces a greater or sustained impact on the practitioner and business;
- *Permanent incapacity*, e.g.:
  - An accident or illness that leaves the practitioner disabled to the extent that it affects the person's capacity to carry out the normal function of daily living, such as eating, dressing, and general mobility; and
  - An accident or illness that leaves the practitioner mentally incapable of exercising professional judgement and competence;
- *Death*.

### *Considerations for 'caretaker' practitioner agreements*

The following matters should be included in an agreement with a 'caretaker' practitioner:

- A licence permitting the 'caretaker' practitioner to service the clients for a short term / specified period.

- The period for when the 'caretaker' arrangements will be in place and the trigger events commencing and concluding the arrangement, including the circumstances which trigger a review of the practitioner's condition to evaluate whether the practitioner is likely to be able to return to operate the business and service the clients.
- Appropriate professional indemnity insurance requirements.
- Details of the resources and additional assistance available to the 'caretaker' practitioner.
- Details of how the business can meet the costs and expenses of running the business and how revenue will be shared during the 'caretaker' period (e.g. the need for key person revenue and capital insurance).
- Any role the 'caretaker' practitioner or others must perform to sell the business and the circumstances of when those rights apply. This might include an understanding at the outset of how the business is to be valued and how any purchase price would be calculated.

If the temporary incapacity of the practitioner turns into permanent incapacity or the practitioner dies, the parties might decide to use put and call options which can be exercised to allow the 'caretaker' practitioner to exercise the right to purchase the business – this is known as a buy/sell agreement. It must be formally documented and must include a pre-agreed purchase price and a pre-agreed funding mechanism so that the transaction is reasonably seamless at a time when the practitioner will be under considerable stress.

The buy/sell agreement can also provide a process for a staggered sale of the client books of business and other business assets and document any vendor finance arrangements which can be supported by an insurance policy.

#### *Arrangements following the death of a practitioner*

On the death of a sole practitioner, it is unlikely that a family member will be able to take over the practice unless they have the professional qualifications of an accountant.

Any agreement for temporary arrangements can also include instructions for how the practitioner's business must be dealt with upon death. The executor will then have responsibility for managing the situation. The 'caretaker' practitioner may continue to service the clients and work in the business whilst the executor makes permanent decisions or arrangements about the future of the practice.

Practitioners making a will should consider advice from a lawyer regarding their arrangements for the business beyond estate planning, including any powers of attorney or other instruments which may assist to facilitate the operation of the business.

Formal documents, such as a power of attorney required to give a 'caretaker' practitioner authority to operate the business should be prepared as part of the process to cover a short term absence or succession planning. Such documents cannot be prepared if the practitioner is mentally incapacitated. This is particularly the case if the executor of the practitioner's estate is someone who does not have the business acumen or time to be involved in the day to day management of the practice.

Formal documents may include:

- the appointment of the 'caretaker' practitioner as an attorney under a protected power of attorney (known as an enduring power of attorney) to enable that person to act during the sole practitioner's lifetime in the event of the practitioner's physical or mental incapacity; and
- the appointment of the 'caretaker' practitioner as a special executor under the sole practitioner's will to attend the affairs of the practice until it is sold, transferred or otherwise disposed of.

Other key questions to deal with during the planning stage for these arrangements include:

1. Who will buy the business? How will that sale occur? Is a business broker useful?

2. How will any debts of the business be repaid? Is there working capital or income to meet expenses?
3. How will the sale be funded? Is vendor finance possible? Can the sale be funded from borrowings?
4. How can the estate get the value of the practice? Will the estate have enough in the way of assets to meet the ongoing cost of living for remaining family members? How reliant is the estate on the equity in the practice?
5. Can insurance be used to address some of these exposures for family members? Can insurance be used to assist a 'caretaker' practitioner to acquire the business from the beneficiaries of the estate?

Sole practitioners should consider including wording in their client engagement letters to address the issue of business continuity.

### **Forms of insurance protection and funding**

Some of the options for funding the purchase of the business by a 'caretaker' practitioner using insurance are explained below. Members should seek advice from a:

- financial adviser
- lawyer
- tax advisor
- insurance broker

when considering appropriate structures and insurance options.

#### *Death and Total and Permanent Disability (TPD) arrangements*

The sole practitioner will take out a policy over their life for the amount of the value of the practice at that time. The sum insured can be increased as the business grows (subject to the insurer's underwriting requirements). The policy is self-owned by a formal agreement with the 'caretaker' practitioner, which documents the understanding that if the sole practitioner dies the proceeds of the policy will be paid into their estate to fund the transfer of the business to the 'caretaker' practitioner.

There could be reciprocal arrangements between the sole practitioner and the 'caretaker' practitioner to mitigate the consequences for death events involving either of them. The practitioners must self-fund the premiums and cannot fund each other's premiums for the policies.

On the practitioner's death, the insurance policy proceeds are paid to the deceased's estate as consideration for the transfer of the business assets to the 'caretaker' practitioner. The transfer of the business assets occurs as soon as possible after the policy proceeds have been paid. No cash is actually paid by the 'caretaker' practitioner.

Sole practitioners could also insure for total and permanent incapacity in a similar way (as above) using a self-ownership strategy. Practitioners should seek professional advice from a financial adviser and a lawyer as to how best to structure the use of insurance policies.

#### *Other alternatives*

Another way of facilitating a sale of the sole practitioner's business if insurance is not available is through vendor finance. The practitioner will loan the funds to the 'caretaker' practitioner to purchase the business. The 'caretaker' practitioner might contribute a deposit for the purchase price, but the balance is loaned by the practitioner with interest repaid over the term at a pre-determined rate in the agreement.

This may be a more expensive option than borrowings funds from a financier depending on the interest rate.

### **Other types of protection for the practitioner**

*Key person insurance* - This type of insurance will cover the expenses of the business whilst the practitioner is unable to generate the necessary revenue to meet them. It may include business expenses, such as fees that are paid to the 'caretaker' practitioner.

*Key person capital cover* – This cover provides a lump sum payout to pay down debt or fund a capital item in the business.

*Business overhead / business continuity / business interruption insurance* – This insurance covers the regular fixed operating expenses of a business if the practitioner is unable to work.

*Income protection for the individual practitioner* – The sole practitioner's income protection policy would be used to fund income necessary for the ordinary costs of living as a result of the unanticipated early "retirement" from the practice, along with any necessary capital expenses that may have arisen out of the permanent incapacity.

*Succession planning* - Developing a robust succession plan for the business which considers long-term succession planning options (such as merger with another a practice) will not necessarily change the risks for the practice in losing a key person but it may provide more options as to who could purchase the business in the event of temporary or permanent illness or disablement or death.

## **7.2 Ethical considerations**

Members are required to keep client information confidential. In the event of a practitioner's death or incapacity, another practitioner (the caretaker) may step in to cover the business, whether at the request of an executor or by arrangement with the practitioner. That 'caretaker' should contact clients to inform them of the situation and provide a new engagement letter in accordance with APES 305 - *Terms of Engagement*. This should be done before the caretaker performs any work upon a client's files, and should allow a client the option to move their business to another accountant of the client's choosing.

The caretaker accountant should consider his own professional indemnity insurance.

## **7.3 Professional registration considerations**

### **1. Audit**

The Australian *Corporations Act 2001* (Cth) sets the requirements for the appointment of a firm or an individual to act as an auditor of a company. In the case of a sole practitioner who has been appointed as an auditor of a company, the individual must oversee and sign off the audit. It is not permissible for another person who has not been appointed to sign an audit report.

There may be a situation where the sole practitioner has become physically (but not mentally) ill, and has completed the audit work save for the final review and signing of the audit report. In this instance another practitioner who has been properly appointed by a power of attorney could, if satisfied with the audit work, carry out the review in consultation with the practitioner and sign the report on the authority of the practitioner. Temporary incapacity, mental or physical, would not necessarily

terminate the appointment. In this situation the caretaker (or sole practitioner where appropriate) should seek legal advice on the specific circumstances.

Where a sole practitioner who is an auditor dies or is mentally incapable, the audit appointment will be terminated and it will not be possible for another practitioner to sign off an audit on their behalf. The audit would have to be commenced again and the Australian Securities and Investments Commission must be notified of the new appointment.

## **2. Trustee in Bankruptcy/Liquidator**

A sole practitioner who acts as trustee in bankruptcy, or liquidator, will be appointed in a personal capacity. In the event of incapacity or death of the appointee, a new appointee will need to be appointed. If an appointee dies, the appointment is automatically vacated.

Specific procedures apply when appointing a new appointee. The procedures vary depending on the nature of the administration. Another practitioner is not automatically entitled to act in place of the sole practitioner. The appointment may need to be sanctioned by the court, creditors or a relevant committee. In certain circumstances it may be possible for an alternate practitioner to deal with a sole practitioner's resignation or vacation of office particularly when the alternate is acting as the representative of the sole practitioner's estate. If presented with these circumstances the alternate should seek legal advice.

## **3. Tax Registrations**

Where a sole practitioner acts as a tax agent, BAS agent or a tax (financial) advisor (collectively referred to as 'tax practitioners') there may be other employees in the firm who can continue to act for clients in this capacity during the period of the practitioner's incapacity.

However, it is not possible for another practitioner to sign a tax or BAS return on behalf of the sole practitioner. Tax practitioners must notify the Tax Practitioners Board of any changes to nominees. If the caretaker practitioner is a tax practitioner they can sign off in their own capacity.