Risks and Opportunities for the CPA in Client Bankruptcies

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Economists warn that a fiscal storm is brewing, with prolonged recession the likely result. Bankruptcy filings seem imminent, and there will be a growing need for CPAs to assist their clients in financial distress. CPAs should be aware of the following key issues and opportunities when their clients face Chapter 11.

RISKS TO CPAs DURING BANKRUPTCY PROCEEDINGS

During a Chapter 11 proceeding, CPAs can seek to be retained and paid for services rendered to their client during bankruptcy. Allowed professional fees must be provided for in a debtor's confirmed plan of reorganization (11 U.S.C. § 1129(a)(9)). Despite this requirement, the risk of non-payment must be considered before servicing a bankrupt client.

- For CPAs who work with clients prior to bankruptcy, the **automatic stay** (11 U.S.C. § 362) must be considered. The filing of a bankruptcy petition automatically stays creditors' actions to collect debts. Accordingly, it is critical that CPAs' invoices be paid prior to bankruptcy, otherwise, any amounts owed as of the bankruptcy filing could be paid pennies on the dollar or discharged.

- A company in bankruptcy (or party acting on its behalf) may seek to "claw back" payments made prior to bankruptcy. These are called **avoidance actions** and include fraudulent transfers and preferences.

- **Fraudulent transfer actions** seek recovery of money or property transferred by debtors in the two years prior to bankruptcy. Debtors may also invoke state laws, which include longer look-back periods. Plaintiffs must establish that the debtor: (a) made a transfer with actual intent to hinder, delay or defraud any entity; or (b) received less than reasonably equivalent value in exchange for such transfer or transaction, and at the time of the transfer (i) was insolvent, (ii) was rendered insolvent as a result, (iii) incurred or intended to incur debts it would be unable to repay or (iv) made the transfer to benefit an insider (11 U.S.C. § 548).

- **Preference actions** seek to "claw back" payments made on preexisting debt by an insolvent debtor within the 90 days prior to bankruptcy (one year if an insider). Targets of these actions may assert defenses by arguing that such payments (i) were not for an "existing debt," (ii) were made in a "contemporaneous exchange" for the existing debt, (iii) were made in the "ordinary course of business" or (iv) that liability should be reduced by "new value" provided to the debtor following such payments (11 U.S.C. § 547).

TIPS TO MITIGATE RISKS OF NONPAYMENT

CPAs can minimize risk of nonpayment by:

- **Utilizing and strictly adhering to engagement agreements** that either require payment in advance (the best defense to avoidance) or ensure a steady payment schedule to support an "ordinary course of business" defense. Avoid "dunning" clients for payment, as dunning can undermine this defense.

- **Carefully maintaining billing records** and ensuring billing terms are stringently followed. To minimize exposure, cease work and require current payment if clients fall in arrears. When a client is in arrears, insist on current payment for new services performed, to argue that such payment represents new payment for new work.

- **Filing an affidavit of "disinterestedness"** (to be retained and paid for services following bankruptcy) to prove they do not have any disqualifying conflicts and allow for their retention to be approved by court order. CPAs owed money at the time of a bankruptcy, or who were paid within 90 days prior to commencement of bankruptcy, may face challenges to their retention.

OPPORTUNITIES FOR CPAs WITH DISTRESSED CLIENTS

CPAs add tremendous value in bankruptcy, as debtors and their attorneys need accounting advice. But CPAs should be careful, as the rules are complex and present traps for the unwary. CPAs would be wise to consult their own bankruptcy counsel when faced with a client in distress. As the potential for an economic downturn increases, proceeding with counsel's advice should greatly reduce the risk of costly lawsuits and related liability, while allowing CPAs to capitalize on continued retention during bankruptcy.

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