



REQUESTS FOR REFERENCES ON CLIENTS' FINANCIAL STATUS AND THEIR ABILITY TO SERVICE LOANS

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This guidance was issued by the Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales in September 2001 to assist reporting accountants when asked to provide references on clients' financial status and their ability to service loans and was revised in December 2019. The guidance does not constitute an auditing standard. Professional judgement should be used in its application.

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CONTENTS

Introduction 3

The principal considerations involved..... 3

Meeting lenders' needs for individuals and other small borrowers..... 4

Forms of reporting..... 5

Example of accountants' references 6

APPENDIX A

Example of an accountants' reference in connection with a lending application made by an individual or other small borrower 7

APPENDIX B

Example of an accountants' reference in connection with a lending application made by an individual who is a director of a client company.....8

INTRODUCTION

1. Banks, building societies, insurance companies, letting agents and others (henceforth referred to as 'lenders and other third parties') may seek references from accountants regarding the financial status of intending borrowers or of those undertaking other obligations. The request may be to report on a borrower's present financial position, on ability to pay debts as they fall due, or on ability to service or repay a loan.
2. In many circumstances, the type of reference by accountants as to the financial status of their client, as outlined in this guidance, will meet a lender or other third party's needs. Such a reference may be particularly appropriate in relation to individuals or small businesses where lenders would not normally wish borrowers to be obliged to incur the time and expense of an investigation. However, such references might also be needed for larger businesses and the principles in this guidance will be equally applicable in these situations.
3. This guidance is for reporting accountants seeking to manage their risks effectively, when they receive requests for references. The type of reference covered by this guidance is only appropriate where there is no need for the accountants to perform any work, research or investigation to produce the reference. Where this is not the case, accountants agree a specific formal engagement, following the guidance in ICAEW Technical Release TECH 10/12 AAF '*Reporting to third parties*' (see paragraphs 11 and 12 below). In these situations, they are also aware of the duty of care implications of entering into such engagements and take account of the guidance in TECH 4/00 AAF '*Firms' reports and duties to lenders in connection with loans and other facilities to clients and related covenants*'.
4. This guidance was issued in September 2001 and revised in November 2019. The revisions were to:
 - align the guidance with updated auditing standards; and
 - further clarify the distinction between the purpose of this guidance and that of TECH 4/00 AAF

THE PRINCIPAL CONSIDERATIONS INVOLVED

5. Future income and expenditure is inherently uncertain. No amount of enquiry can provide accountants with the assurance needed to enable them to confirm that a client will have sufficient income to service a loan or other obligation. Accountants are, therefore, unable to report in positive terms on future income or future solvency.
6. Reporting on the present solvency of a client presents difficulties for accountants unless they are engaged (in accordance with full and proper terms reflecting the limits in the scope of the engagement, see paragraphs 11 and 12 below) to report on financial statements, computations and projections as at a stated date. It is likely that in many cases the time and expense of such an exercise would be out of proportion to the nature of the assurance being sought.
7. Lenders and other third parties may use audited financial statements to assess a client's approach to the fulfilment of past obligations, but the audited financial statements do not give any certainty in relation to going concern (see paragraph 7 of ISA (UK) 570¹).
8. Auditors would not normally expect to owe duties of care in respect of their audit report to anyone other than the members of the company as a body, to whom the audit report is addressed, to enable them to exercise their rights in general meeting. For the avoidance of doubt, auditors issue a disclaimer of responsibility to third parties, further to guidance in TECH 01/03 AAF (Revised) '*The audit report and auditors' duty of care to third parties*'. Generally, auditors do not send audited financial statements direct to third parties.

¹ Paragraph 7 of ISA (UK) 570 clarifies that the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

REQUESTS FOR REFERENCES ON CLIENTS' FINANCIAL STATUS AND THEIR ABILITY TO SERVICE LOANS

9. Where the financial statements are not publicly available, auditors may require, as a condition of the audited entity providing a copy of its audited financial statements to a lender or other third party, a release letter, signed by the recipient, releasing the auditor from any duty of care to that recipient.
10. Accountants do not carry out any specific procedures in order to make the type of reference covered in this guidance and this is made clear in the reference. To avoid the possibility of an implied contract, accountants do not charge any additional fees for the reference and they disclaim, in writing, any liability for providing the reference. It should be noted that it is legitimate for accountants to decline to provide a reference if the risks of so doing are judged to be unreasonably high. For example, this could occur if the amounts involved are judged by the accountants to be too large.
11. Where no specific assurance is to be provided but third parties still request specific procedures to be carried out, accountants usually negotiate an agreed upon procedures engagement in accordance with TECH 10/12 AAF.
12. In the specific circumstances where lenders are seeking assurance beyond that given by the type of reference considered in this guidance, a specific engagement is agreed between the accountants, the borrower and the lender. The terms of such an engagement set out the precise scope of the work to be carried out, the type of report that will be produced and a reasonable limitation of liability. Accountants refer to the guidance on this in TECH 4/00 AAF *'Firms' reports and duties to lenders in connection with loans and other facilities to clients and related covenants'*.
13. Any reference made in accordance with this guidance should be made in writing so as to avoid any misunderstanding.

MEETING LENDERS' NEEDS FOR INDIVIDUALS AND OTHER SMALL BORROWERS

14. When lenders consider lending applications from individuals or other small borrowers, they are likely to seek assurance on the potential borrower's financial status. However, there is unlikely to be financial data of the kind that may exist in the case, for example, of a borrower that is incorporated.
15. Nevertheless, for individuals and other small borrowers (in particular borrowers that are not required to prepare audited financial statements) there is likely to be information that accountants can supply that might be useful to a lender. Examples are:
 - a) the length of time during which the accountants have acted on behalf of the client;
 - b) the net income or profits of the client as declared by the client to HM Revenue & Customs in the latest tax return (where this is not publicly available information, for example in financial statements (audited or unaudited) filed at Companies House);
 - c) based on the reporting accountants' experience and having exercised judgement, a statement that the accountants have no reason to suppose that the client would be likely to enter into a commitment, such as that proposed, that the client did not expect to be able to fulfil.
16. A combination of paragraphs 15a) and b) above will often provide the lender with the sort of information required. However, sometimes the lender will receive additional benefit from the accountants' judgement that is provided in connection with 15c). That judgement is formed in the light of the accountants' professional experience of the client's attitude to the assumption of obligations. Any view formed by the accountants is based on their experience of the client's attitude towards commercial obligations generally. It is limited in line with their experience of the client and in recognition that they can only act in relation to information which they have the client's authority to disclose. In some cases accountants decline to express a view due to their limited amount of experience, for example, if they have insufficient information or if they have only recently started acting for the client. They also decline to comment where there is any doubt regarding a judgement, or where the client

asks the accountants to give overly selective information merely provided by the client. It should be noted that accountants are not obliged to express a view.

17. The accountants' knowledge of the client is often not up to date and this fact is stated in the written report.
18. The considerations outlined in this section are also relevant when dealing with requests for references from other third parties, for example, requests from letting agents seeking to arrange a rental agreement involving the accountants' client.
19. Accountants may be asked to provide references relating to directors or key employees of a client company. In most situations the client company will be better placed to respond to the request. The accountant would not be best placed, for example, to provide comment on how an individual has performed in their capacity as a director of the company, nor on their financial status or probity.
20. A reference should only be provided where the accountant has an established professional relationship with the director or employee in question and the reference relates to a matter on which the accountant has substantive and objective knowledge on which to base the reference. For example, how long the accountant has known the individual, and in what capacities they have dealt with them. Every effort should be made to ensure that the contents of the reference provided are factual in nature and relate only to matters that are within their firm's knowledge. The accountant should decline to give a reference where they are being asked to comment on a matter that is outside their firm's knowledge. An example of an accountants' reference for a director of a client company is provided in Appendix B.
21. Accountants may also be asked to sign statements of high net worth under articles 60H(1) and 60Q(c) of the Regulated Activities Order. We would recommend consulting ICAEW's Technical Advisory Service technical helpsheet, *Statement of high net worth*, before making such a statement.

FORMS OF REPORTING

22. Accountants report in a way that is appropriate to the particular circumstances. Any limitation in the view being given is clearly stated, for example, in relation to future income and expenditure.
23. Lenders and other third parties may prescribe their own forms of report as a matter of administrative convenience to cater for the more usual types of loan or arrangement. However, such prescribed forms may not always reflect the considerations referred to in this guidance. If necessary, accountants amend the wording of the report to be given or provide explanatory wording so as to reflect the limited view that they are in a position to provide. In particular, this may be necessary if the accountants are invited to comment in indefinite terms which they are unable to do. For example, the accountants may be asked for general comments on the proposed transaction in relation to the client or for any information which the accountants consider should be brought to the third party's attention.
24. It will sometimes be necessary to refer the third party to information more appropriately provided direct by the client. An example would be a question about what part of the funding is coming from the client's business where, without the expense of an investigation, the accountants can only rely on the representations of their client.
25. Accountants avoid the possibility of misinterpretation, particularly regarding any technical terms used. For example, a reference to income might be interpreted as either *net income* or *gross income*. Accountants therefore define any terms used. These terms are normally interpreted as follows: *gross income* means sales, turnover or other revenues *before* costs are deducted; *net income* is the amount *after* costs have been deducted.
26. In circumstances where accountants are uncertain about whether they are able to provide either the requested report or a modified version of it, they do not do so.

EXAMPLES OF ACCOUNTANTS' REFERENCES

27. Examples of an accountants' reference for a lender are provided in Appendices A and B. They should be regarded as illustrative only but may assist accountants in assessing the form in which it may be appropriate to communicate to a third party (*NB: whilst the example is for a lender, the form of report may also be used for any reference provided to a third party covered by this guidance*). The examples are designed to cater for the more usual cases and are amended by accountants, as appropriate, to reflect the particular circumstances of the client. In certain cases accountants may be able to provide alternative or additional information to assist a third party, but in doing so they take into account the considerations set out in this guidance.

APPENDIX A

EXAMPLE OF AN ACCOUNTANTS' REFERENCE IN CONNECTION WITH A LENDING APPLICATION MADE BY AN INDIVIDUAL OR OTHER SMALL BORROWER

Without responsibility

To [Name and address of lender]

Dear Sir / Madam

REFERENCE IN CONNECTION WITH THE LENDING APPLICATION MADE BY [Name of client and application reference, as appropriate]

Our above named client has approached us for a reference in connection with the proposed loan by you of £... [repayable by monthly instalments of £... over ... years].

We have acted in connection with our client's [personal / business / corporate tax] affairs since [date]. However, it should be noted that our knowledge of our client's affairs may not be fully up to date. In addition, we have not carried out any specific work with regard to this statement.

[Our client's net income² declared by our client to HM Revenue & Customs as at 5 April 20.. amounted to £... [To be adapted as appropriate for borrowers who are not individuals, or deleted if the information is otherwise publicly available (for example in financial statements filed at Companies House).]

[Income / profits for previous years and identification of those agreed with HM Revenue & Customs may be added].

Whilst we have no reason to believe that our client would enter into a commitment such as that proposed which our client did not expect to be able to fulfil, we can make no assessment of our client's continuing income or future outgoings, or ability to fulfil their commitments to you.

Whilst the information provided above is believed to be true, it is provided without acceptance by [name of firm / signatory] of any responsibility whatsoever, and any use you wish to make of the information is, therefore, entirely at your own risk.

Yours faithfully

Signed

Dated

cc [Client name]

² Define 'net income' – see paragraph 25

APPENDIX B

EXAMPLE OF AN ACCOUNTANTS' REFERENCE IN CONNECTION WITH A LENDING APPLICATION MADE BY AN INDIVIDUAL WHO IS A DIRECTOR OF A CLIENT COMPANY

Without responsibility

To [Name and address of lender]

Dear Sir / Madam

REFERENCE IN CONNECTION WITH THE [LENDING] APPLICATION MADE BY [Name of director and application reference, as appropriate]

The above named individual, a director of our client [*name of client company*] ("the Company"), has approached us for a reference in connection with [his/her] application to you for a [*describe the subject matter of the application*].

We have acted in connection with the Company's [business] affairs since [date] and [*name of director*] has been a director of the Company since [date]. However, it should be noted that our knowledge of the Company's affairs and that of its directors may not be fully up to date. In addition, we have not carried out any specific work with regards to this statement.

Whilst we have no reason to believe that [*name of director*] would enter into [a position / a commitment] such as that proposed which [he/she] did not expect to be able to fulfil, we can make no assessment of [name of director]'s continuing [suitability / income or future outgoings, or ability to fulfil their commitments to you].

Whilst the information provided above is believed to be true, it is provided without acceptance by [*name of firm / signatory*] of any responsibility whatsoever, and any use you wish to make of the information is, therefore, entirely at your own risk.

Yours faithfully

Signed

Dated

cc [*Client name*]

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