

**AUDIT AND ASSURANCE FACULTY  
TECHNICAL RELEASE**

*This guidance is 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. The guidance does not constitute an auditing standard. Professional judgement should be used in its application.*

**AUDIT 2/01  
REQUESTS FOR REFERENCES ON CLIENTS'  
FINANCIAL STATUS AND THEIR ABILITY  
TO SERVICE LOANS**

	<b>Paragraph Numbers</b>
<b>Introduction</b>	<b>1-4</b>
<b>The principal considerations involved</b>	<b>5-12</b>
<b>Meeting lenders' needs for individuals and other small borrowers</b>	<b>13-17</b>
<b>Forms of reporting</b>	<b>18-22</b>
<b>Example of accountants' reference</b>	<b>23</b>
	<b>Page Number</b>
<b>Appendix:</b>	
<b>Example of an accountants' reference in connection with a lending application made by an individual or other small borrower</b>	<b>5</b>

# Requests for References on Clients' Financial Status and their Ability to Service Loans

---

## Introduction

1. Banks, building societies, insurance companies, letting agents and others 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 statement, 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 statement will be equally applicable in these situations.
3. This statement provides guidance to reporting accountants seeking to manage their risks effectively, when they receive requests for references. The type of reference covered by this statement 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 Audit 1/01 '*Reporting to Third Parties*' (see paragraphs 10 and 11 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 Audit 4/00 '*Firms' reports and duties to lenders in connection with loans and other facilities to clients and related covenants*'.
4. This statement replaces the Institute statements TR 698 'Requests for confirmation of clients' ability to service loans' (issued in May 1988) and TR 846 'Accountants' references on clients' financial status' (issued in October 1991).

## 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. The Audit and Assurance Faculty of the Institute expects to issue further guidance on requests from third parties for solvency statements or similar reports.
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 10 and 11 below) to report on accounts, 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.

## **Requests for References on Clients' Financial Status and their Ability to Service Loans**

---

7. Lenders and other third parties may use audited accounts to assess a client's approach to the fulfilment of past obligations, but the audited accounts do not give any certainty in relation to going concern (see paragraphs 11 and 12 of SAS 130<sup>1</sup>).
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 client 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 where a request for reference or confirmation is received, particularly in situations where they send the audited accounts direct to the third party. Generally, auditors do *not* send audited accounts direct to third parties. Accountants refer to the guidance on this subject in Audit 4/00 '*Firms' reports and duties to lenders in connection with loans and other facilities to clients and related covenants*'.
9. Accountants do not carry out any specific procedures in order to make the type of reference covered in this statement 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.
10. 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 Audit 1/01 '*Reporting to Third Parties*'.
11. In the specific circumstances where lenders are seeking assurance beyond that given by the type of reference considered in this statement, 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 Audit 4/00 '*Firms' reports and duties to lenders in connection with loans and other facilities to clients and related covenants*'.
12. Any reference made in accordance with this statement should be made in writing so as to avoid any misunderstanding.

### **Meeting lenders' needs for individuals and other small borrowers**

13. When lenders consider lending applications from individuals or other small borrowers, they are likely to seek assurance on the potential borrower's financial

---

<sup>1</sup> Paragraph 12 of SAS 130 concludes that any judgement made on going concern, although reasonable at the time, can be valid only at that time and can be overturned by subsequent events.

## **Requests for References on Clients' Financial Status and their Ability to Service Loans**

---

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.

14. Nevertheless, for individuals and other small borrowers 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 the Inland Revenue in the latest tax return;
  - 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.
15. A combination of paragraphs 14a) 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 14c). 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.
16. The accountants' knowledge of the client is often not up to date and this fact is stated in the written report.
17. 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.

### **Forms of reporting**

18. 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.
19. 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

## Requests for References on Clients' Financial Status and their Ability to Service Loans

---

arrangement. However, such prescribed forms may not always reflect the considerations referred to in this statement. 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.

20. 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.
21. 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.
22. 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.

### Example of accountants' reference

23. An example of an accountants' reference for a lender is provided in the attached Appendix. It 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 statement*). The example is designed to cater for the more usual cases and is 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 statement.

**APPENDIX**

**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 Sirs

**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 ... . 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 income<sup>2</sup> declared by our client to the Inland Revenue as at 5 April 20.. amounted to £... *[To be adapted as appropriate for borrowers who are not individuals]*.

*[Income / profits for previous years and identification of those agreed with the Inland Revenue 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.

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]*

---

<sup>2</sup> Define 'net income' – see paragraph 21