



Activity Review

North Carolina State Board of Certified Public Accountant Examiners

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The Challenge of Providing “Comfort Letters” for Clients

North Carolina CPAs continue to face the challenge of how to respond to requests from clients, lenders, and other third parties for “comfort letters” or “solvency opinions.”

There are various reasons a client may request a comfort letter--a mortgage broker may be collecting information needed for a loan approval or a third party may be trying to verify that clients applying for a particular service have the resources and ability to pay for the service or items involved. In some cases, a foreign government may request financial information for adoption proceedings.

Usually, the letter at issue is associated with stated-income loans, which are mortgages that do not require borrowers to document their income. Such loans often are sought by self-employed people and individuals with investment income or with sales jobs of varying commissions.

Lenders, lacking documentation to support borrower’s income claims, take on the risk that borrower’s claims are inad-

equate. To gain more comfort in extending loans, some lenders look to the borrower’s CPA for assurance or comfort about certain information.

Most lenders will simply ask the CPA to write a letter indicating that the prospective borrower is self-employed or is employed in a certain profession. Others may attempt to shift the burden of responsibility for due diligence onto the borrower’s CPA and provide a script of what they want the letter to say.

Such a letter provides third-party verification of details in the application and could transfer some of the potential liability to the CPA in the event of default on the loan.

There are a few issues with this type of letter that should concern CPAs. First, the proposed letter asks the CPA to attest, when the CPA has not specifically been engaged for that purpose. The report would be issued to a third party that has not contracted with the preparer for that specific purpose.

According to Auditing Stan-

dards Board Statement on Standards for Attestation Engagements No. 10, *Attest Engagements*, an attestation engagement is called for if the client wants a written report providing assurance about a specific subject.

Of course, performing an attestation engagement is not prohibited in the case of a lender’s comfort letter request, but CPAs must follow the procedures required in an attestation engagement. The client will likely not want to incur the expense of a formal attestation engagement.

It is also important to know what is not permitted under the standards. AT Section 9101, *Attest Engagements: Attest Engagements Interpretations of Section 101*, No. 2, ¶ 25 states that practitioners should not provide any form of assurance that an entity is not insolvent or would not be rendered insolvent upon a proposed condition, or that an entity has the ability to pay debts as they mature.

A lender may want the CPA to make an assurance that the applicant’s withdrawal of the

funds for a down payment or other purposes would not put a financial strain on the applicant's self-employment business. Any representation to that effect could be construed to be a comment on solvency and would thus be prohibited under the standards.

The types of services permitted in a CPA attest report include an audit, a review, or a compilation of the applicant's personal financial statements. The CPA may also report on *pro forma* financial information or perform an agreed-upon procedures report, as long as those procedures do not provide any assurance on matters of solvency.

The important thing to consider is that this type of engagement requires many procedural steps, which take time and result in significant fees to the client.

If the CPA takes the time to explain to the lender what is involved in presenting a comfort letter in light of professional standards and the related cost to the applicant of issuing any attestation letter, the lender may be convinced to withdraw its request for a comfort letter.

As an alternative, the CPA may offer to send a copy (with the client's written authorization) of the client's tax forms directly to the lender with a simple cover page stating, "Please find attached the tax forms I prepared for Client for the past two years."

Sometimes the broker does not want the tax forms in the application file because the forms do not provide enough information or may provide information

that might cause the loan to be rejected.

Another option is to provide the lender with a CPA letter that basically makes no assurances, therefore limiting the CPA's liability. The letter merely says that the CPA prepared the tax forms and that the lender should not construe the letter to be an audited CPA representation.

Although from a risk management perspective it is preferable to avoid confirming any client information to a lender or broker, a CPA, not wanting to alienate or offend a client, may be tempted to send off a quick letter to the lender confirming that the client is self-employed, or retired, or earning a living from the activities addressed on the tax return.

The CPA may want to consult with his or her professional liability insurer (or legal counsel) regarding the issuance of comfort letters. One insurer has warned that attesting to client information outside of the scope of an audit or attestation services engagement may be construed as a violation of professional standards and have licensure implications. Another insurer offered an example of how a CPA was sued by a lender alleging negligent misrepresentation of a client's finances and loss prevention tips. Some insurers have standard letters that a CPA may use when responding to a request for a comfort letter.

The CPA should be careful about sending such a letter. Does the CPA really know everything that is occurring with that client?

Does the client have other activities on the side that the CPA is not aware of and that conflict with the information on the tax forms? A CPA is certain about what he or she puts on tax forms. Saying anything else in the letter advances the tax engagement to a new level.

When asked to provide a comfort letter for a client, a CPA can best avoid risk by sticking to the professional standards and not caving in to pressure from a client or lender. While clients need to have the flexibility to obtain credit, the responsibility for underwriting the loan lies with the lender, not the CPA.