

## LIABILITY LESSONS



**“If you respond to a comfort letter request, remain mindful of the applicable professional standards.”**

### “Comfort Letters” Offer No Comfort to CPAs

By Jonathan S. Ziss, JD

*Insightful lessons can be learned by reviewing professional liability issues. With this in mind, Mather & Co., a division of Bollinger Inc., provides this column. For more information, contact Mather at robert.connolly@bollingerinsurance.com.*

Lenders or brokers of certain classes of mortgage loans may ask the borrower’s CPA to confirm client information relating to a pending loan application. These requests for “comfort letters” must be handled with care, if you are going to provide the letter at all. Anything less than a cautious approach can result in a violation of professional standards and exposure to a third-party lawsuit.

Requests for comfort letters have increased as lenders looked to close loans on mortgages that do not require borrowers to document their income, so-called stated-income loans. These borrowers typically derive income from sources that are difficult to verify or vary widely from one year to the next. The self-employed often find themselves in this category.

To gain sufficient comfort to extend the loan, some lenders and brokers will turn to the borrower’s CPA. Without it, the loan might not close. This is why comfort letter requests are often accompanied by high drama.

The information sought typically includes confirmation of a client’s self-employed status; verification of income from self-employment or otherwise; actual

or expected profitability of a client’s business; and the client’s ability to survive the down payment and service the debt. If you choose to respond, remain mindful of the applicable professional standards. Also, know that if you vouch for your client’s creditworthiness, you will be exposing yourself to risk if any of the information turns out to be false.

Attestation Interpretation No. 2 speaks to situations where a CPA is requested to report on matters relating to solvency. This interpretation states that “a practitioner should not provide any form of assurance, through examination, review, or agreed-upon procedures engagements, that an entity” is not insolvent, or is not undercapitalized, or has the ability to pay its debts as they come due. This is not to say that CPAs cannot author comfort letters. Rather, if a comfort letter is to take the form of an attest report, then you should comply with professional standards by auditing, reviewing, or compiling the personal financial statements of the borrower. You may perform an agreed-upon procedures report, but the agreed-upon procedures should not provide any assurance on matters relating to solvency.

Since professional standards preclude written assurance regarding solvency outside of the scope of attest engagements, a frank discussion of the work involved and the cost may kill the request or cause the lender to scale back its requirements, such as acknowledging that the income reported

by the borrower is the amount that has been reported to the IRS on the tax return. Of course, you would need to have your client’s consent to do so.

Assuming that the comfort letter is limited to the confirmation of a discrete fact such as reported income, care is still required with the presentation. A statement as to the source of the information, accompanied by a clear disclaimer that the information was neither audited nor otherwise verified, would be prudent. Likewise, a statement that the CPA is providing the information at the request of, and for the benefit of, the client and that no relationship is, or is intended, to be formed with the lender, would be appropriate.

Bear in mind that the notion of privity – or, in this instance, the lack thereof between the lender and the borrower’s CPA – would not reliably shield you from third-party liability were the borrower to default and the lender to seek recompense. Courts have found that CPA communications to third parties can serve as actionable misrepresentations, even in the absence of privity.

The CPA community has, by and large, been prudent and professional in this area, as CPAs tend not to issue them. An unscientific sampling of CPA blogs on the topic suggests CPAs are wary of these requests. ■

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