



CNA, 333 S. Wabash Ave., 39 South, Chicago, IL 60604

Third Party Verification Letters

Increasingly, CPAs are receiving requests from clients, lenders, loan brokers, health insurance providers, adoption agencies, regulators and various other agencies to confirm client information. In most cases, CPAs are asked to sign a confirmation letter containing specific language, a verification statement or a certification form.

The information may relate to a pending loan, employee medical insurance, child adoption application or use-tax certification. The most common type of requests is associated with mortgage loan applications of tax return preparation clients who are self-employed.

Examples of information requested by lenders and loan brokers include:

- Confirmation of a client's self-employment status;
- Verification of income from self-employment;
- Profitability or sustainability of a client's business; and
- The impact on a client's business if money is withdrawn to fund the down payment on a real estate purchase.

The means available to obtain financial information from a self-employed borrower may be limited. Lenders or brokers are required to assess a borrower's creditworthiness and verify the accuracy of information provided to them by the borrower. By obtaining a comfort letter, lenders or brokers attempt to shift responsibility for confirming the accuracy of the information -- and possibly the risk of non-repayment of the loan -- to the borrower's CPA. If the borrower later defaults on the loan, the lender will be able to establish that the confirmation came from the CPA prior to funding the loan, and can take the position that the letter was at least a substantial factor in its decision to extend credit.

As a result, the lender may be in a better position to sue the firm to recover the loan losses, alleging a negligent misrepresentation by the accountant which was relied upon by the lender. This could be used in some instances to establish the lender's standing to sue the accountant where it may not otherwise exist.



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Self-employed borrowers often use business assets from their sole proprietorship, partnership or corporation to fund down payments and closing costs for a home mortgage. Such mortgages often are resold to Freddie Mac, a secondary market for residential mortgages.

Sec 37.13 of the *Single Family Seller/Servicer Guide* issued by Freddie Mac lists loan requirements for self-employed borrowers who use business assets to fund a down payment and closing costs. It stipulates that the lender use one of two methods to analyze whether the withdrawal of funds from a business may have a negative impact on its ability to continue operations. One method requires that the lender obtain a letter from an accountant stating that, “[T]he Borrower has access to the funds and the withdrawal of the funds for the down payment and closing costs will not have a detrimental effect on the business.” Sec 37.13 also provides that, “[I]f the borrower does not, or is unable to obtain such a letter from an accountant, the seller must document a cash flow analysis for the borrower’s business using the individual and/or business tax returns, as applicable.” Clients should be advised to provide the necessary information to the lender or mortgage broker for the purpose of preparing a cash flow analysis.

Lenders and brokers are responsible for conducting their own due diligence using other supporting documents or performing alternative procedures to meet loan requirements. While self-employed borrowers may be informed that they will not qualify for a mortgage unless their accountant provides a comfort letter, alternative procedures can be performed by the lender or broker that allow the mortgage to qualify for sale in the secondary market.

CPAs providing written assurance must comply with the AICPA Statements on Standards for Attestation Engagements (SSAE). Attesting to client information without performing attestation services in accordance with the SSAE constitutes a violation of professional standards and has licensure implications.

Recently, other types of third-party information requests have emerged. Examples include:

- Requests from adoption agencies and foreign countries for a CPA letter confirming the client’s self-employment, citizenship status and the financial stability of the client’s business;



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- Requests from health insurance providers for a business verification statement from a CPA, CMA, licensed tax consultant or attorney attesting that the listed, eligible employees worked the minimum hours required under state law, and that the business is a bona fide business qualifying as a small employer under state law and health plan underwriting guidelines; and
- Requests from state taxing authorities for a letter from a CPA, enrolled agent or attorney certifying that the taxpayer and the “authorized representative” have reviewed the books and records of the taxpayer and determined that there is no use tax due or to report.

In response to such requests, CPAs should remind clients that tax returns are prepared based on their information and representations which are neither audited nor verified. Inform clients that assurances cannot be provided to a third party about information in tax returns or with regard to any other client matters.

Although, from a risk control perspective, it is preferable to avoid confirming any client information to a third party, refusing to provide any information may alienate clients. As an alternative, CPAs could send a letter to the third party confirming only that the firm prepared the applicable income tax returns for clients to meet their tax-filing obligations. If the individual income tax returns were filed electronically on the client’s behalf, the letter also could state that the client provided the CPA with a signed copy of IRS Form 8879, which includes a declaration that the taxpayers have examined a copy of their electronic individual income tax return and accompanying schedules and statements for that tax year and declared that it is true, correct and complete to the best of their knowledge.¹

Ideally, clients should provide any requested information directly to third parties. If a client asks the CPA to send a copy of his or her tax return to a third party, the CPA must obtain the client’s signed written consent prior to doing so. Protecting the confidentiality of client information is required under professional ethics standards, the Gramm-Leach-Bliley Act, the Internal Revenue Code, state board of accountancy rules or regulations, and federal and state privacy statutes and regulations. The following is a sample letter that could be used to respond to a comfort letter request from a lender or broker, and may be modified for other similar requests:

¹ If electronic tax returns are prepared, signed copies of IRS Forms 8878 and 8879 (as applicable) must be retained for CPA’s records and as part of the working paper file for the client engagement.



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Date

ABC Company

Address

City, State ZIP

Dear _____:

I am writing to you at the request of Mr. & Mrs. _____.

The purpose of this letter is to confirm that I prepared the 20XX federal individual income tax return of Mr. & Mrs. _____ and delivered this return to them for review and approval before filing it electronically with the Internal Revenue Service (IRS) and [state tax authority]. Mr. & Mrs. _____ provided the firm with a signed and dated copy of IRS Form 8879, which includes a declaration that they examined a copy of their electronic individual income tax return and accompanying schedules and statements for that tax year and declared that it is true, correct and complete to the best of their knowledge.

This return was prepared from information furnished to me by Mr. & Mrs. _____. This information was neither audited nor verified by me, and I make no representation nor provide any assurance regarding the accuracy and completeness of this information, or the sufficiency of this tax return, as it relates to your decision to extend credit to, or make any other determination regarding, Mr. and Mrs. _____ or any other persons or entities.

I prepared Mr. & Mrs. _____ tax return in accordance with applicable tax law and regulations, and guidance by IRS and [state tax authority], solely for filing with the tax authorities. As a result, the tax return does not represent any assessment on my part as to their creditworthiness, and does not include any statement of their financial position or income and expense for the year 20XX in accordance with generally accepted accounting principles, and should not be construed to do so.



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As you know, a credit decision, or any other determination that this information might be used for, should be based on the exercise of due diligence in obtaining and considering multiple factors and information. Any use by you of Mr. & Mrs. _____ 20XX federal individual income tax return and this letter is solely a matter of your responsibility and judgment. This letter is not intended to establish a client relationship with you, nor is it intended to establish any obligation on my part to provide any future information to you with regard to Mr. & Mrs. _____.

Sincerely,

(Firm Name)

cc: Mr. & Mrs. _____ (Client)

In addition, if a CPA is aware that the purpose of a client's request for copies of tax returns is to provide them to third parties, the CPA should consider adding the following language in the transmittal letter that accompanies the copies of tax returns:

"We prepared the tax returns solely for filing with the Internal Revenue Service (IRS) and state and local tax authorities. They are not intended to benefit or influence any third party, either to obtain credit or for any other purpose.

As a result, you agree to indemnify and hold our firm and any of its partners, principals, shareholders, officers, directors, members, employees, agents or assigns harmless from any and all claims arising from the use of the tax returns for any purpose other than filing with the IRS and state and local tax authorities, regardless of the nature of the claim, including the negligence of any party."

Even after offering this practical solution, clients may continue to press you to provide the specific representation that a lender, broker or other third party is seeking. The third party may assert that the client will not be approved for a loan or may otherwise fail to meet their requirements if the CPA does not provide the requested letter, verification or certification. When this occurs, remind the client about the limited nature of the scope of services provided, and why it is inconsistent with such representations. Third parties are



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responsible for performing their own due diligence rather than relying on a representation or verification of information by a CPA. This is especially true when the requested representations are outside the scope of the CPA's engagement and the requested verification relates to information that comes from the client, for which the CPA has no first-hand knowledge. Additionally, while clients desire the flexibility to obtain credit in the marketplace, the responsibility for underwriting a loan and determining the creditworthiness of the borrower lies with the lender — not the client's CPA.

Additional Resources

- “How CPAs Should Handle Comfort Letter Requests From Lenders, Mortgage Brokers,” *The CPA Letter*, February 2007, AICPA
- [AICPA Information Technology Center: Federal, State and Other Professional Regulations](#)

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