



# SHOULD YOU GIVE THAT REFERENCE? AN ACCOUNTANT'S GUIDE TO PREPARING A REFERENCE TO SERVE THE NEEDS OF YOUR CLIENT WHILST PROTECTING YOUR OWN INTERESTS.



## INTRODUCTION

A reference given by an accountant will usually meet the needs of lenders, letting companies and insurers and summarise the financial viability of their clients who intend to borrow money or undertake other obligations that are contingent on their earning capacity.

It is in both lawyers' and accountants' interests to understand how much weight will be placed upon the words of the reference. This note intends to cover the issues accountants should consider when preparing a reference, to accurately reflect the financial position of their client.

## TRUTHFULNESS

The amount of information upon which an accountant can base their reference will depend on the length of time they have acted for their client and the quality of the accounting information they have access to. Accountants may decline to provide a reference due to a limited amount of experience of the client, insufficient information, or doubt regarding the client's ability to fulfil the commitment. In a society where income streams are now so diverse, the Institute of Chartered Accountants of England and Wales' ("ICAEW") recent advice is that if accountants cannot be certain of the validity of the information from their client, they are encouraged to decline to produce any view<sup>1</sup>.

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<sup>1</sup> Institute of Chartered Accountants of England and Wales, Mortgage References: why accountants should stick to the facts, 25 February 2020

# RELIANCE

What is the point of the reference if it cannot be relied upon?

Accountants should clarify the extent of the responsibility they agree to undertake regarding the reference and specify what information will form the basis of their work.

Likewise, it is important to consider who might rely upon the words of the reference.

The decisions of the courts maintain that 'persons professing a special skill' could be liable in negligence for whom they owed a duty of care, this includes third parties. This might arise when the professional carries knows or ought to know<sup>2</sup>:

- a) The work is liable to be relied upon by a third party; and
- b) The third party may suffer financial loss if the work in question is negligent.

To determine the catchment for third parties, the three-fold criteria introduced in *Caparo Industries plc v Dickman and others (1990)*<sup>3</sup> and endorsed in *Law Society v KPMG Peat Marwick (2000)*<sup>4</sup> is applied:

1. It must be reasonably foreseeable by the defendant that the statements will be relied upon;
2. There has to be a relevant degree of proximity' between the parties;
3. It must be just and reasonable to impose a duty of care on the party of the defendant

Whilst accountants may not be able to avoid liability to third parties, there are steps to reduce exposure to claims by third parties.

## Purpose

Usually, a reference is provided for a specific purpose, which the accountant should be aware of. Likewise, the accountant should be aware that a third party has an interest in the words of the reference and so, has a right to rely upon it for said purpose. Nevertheless, it could be argued that a reference for a commitment of £10,000pm will not be suitable or reasonable to rely upon for a commitment of £100,000pm.

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<sup>2</sup> Association of Chartered Certified Accountants, Professional Liability of Accountants and Auditors, January 2009

<sup>3</sup> *Caparo Industries plc v Dickman and others (1990) 2 AC 605*

<sup>4</sup> *Law Society v KPMG Peat Marwick (2000) 4 All ER 540*

References should not be so general that they could be circulated to any third party for any purpose. To avoid this 'catch-all' nature, current practice suggests a rubric similar to:

***“This reference dated X has been prepared for the private use of X (the client / Requestor) only, and on condition that it must not be disclosed to any person without the written consent of Y (the accountant). This reference is produced for the purposes of...”***

## **Disclaimers**

Usually, disclaimers are regarded as inappropriate or ineffective as they can discredit the work undertaken by the accountant.

The reception to a disclaimer may depend on whether a reference is requested directly from a client to be passed on to a third party or, from a third party directly.

The former may risk imposing a dual duty of care. This is when a reference is expected to be relied upon by a third party, but the disclaimer only seeks to apply against the third party. This is unlikely to succeed since the third party will rely on the reference in assumption that the accountant has satisfied its duty to its client, rendering the disclaimer ineffective.

However, if a reference is given directly to the third party, no dual duty of care is established. Normal commercial practice is to state that, although the reference is given in good faith, the accountant accepts no financial responsibility for the opinion. These disclaimers are usually effective because references are not based upon extensive research by the accountant.

References prepared by accountants do not intend to absorb losses suffered by third parties on their client's behalf. Accountants are not party to contract/s, and it would be unfair to hold them to such a standard. Instead, a reference is prepared to allow a commercial decision to progress.

# CONFIDENTIALITY

In the unfortunate situation where the legitimacy of a reference is challenged, accountants should feel confident that they can defend their professional judgement.

Accountants will unlikely specify the documents that have informed the reference. Not supporting a reference with evidence does not prove, by default, that the reference was inaccurate and / or negligent.

Firstly, legal advice privilege does not apply to accountants.

Yet, similarly to lawyers, the Association of Chartered Certified Accountants' ("ACCA") rulebook imposes upon its members a professional duty of confidence and confidentiality to current and past clients. Rule 114.1 states an accountant is not to disclose confidential information without proper authority of its client, or after that relationship has ended<sup>5</sup>. Supplementary guidance outlines accountants may produce documents under voluntary disclosure to protect professional's interests. Yet, this only applies to 'proper authorities', such as HMRC<sup>6</sup>.

Granted, if a client authorises the release of documents, then accountants can proceed as they wish. However, it poses a difficulty for accountants who cannot obtain consent, for example if a client's venture has collapsed and is no longer contactable.

ACCA indicates it might be appropriate to disclose information to protect the professional interests of the accountant in legal proceedings<sup>7</sup>, and that the principal of confidentiality may threaten an accountant's compliance with other principals. This includes the professional duty or the right to disclose (when not prohibited by law) to protect the professional interests of an accountant in legal proceedings<sup>8</sup>. Although legal proceedings are not defined in ACCA's rulebook, it is difficult to see how the principle of confidentiality would supersede an order for disclosure from the courts.

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<sup>5</sup>Association of Chartered Certified Accountants, ACCA 2019 Rulebook, Rule 114.1 (f) & (d), January 2019

<sup>6</sup>Association of Chartered Certified Accountants, ACCA 2019 Rulebook Supplementary Requirements and Guidance, Section B1, para 34, January 2019

<sup>7</sup> Association of Chartered Certified Accountants, ACCA 2019 Rulebook, Rule 114.1 A1, January 2019

<sup>8</sup> Association of Chartered Certified Accountants, ACCA 2019 Rulebook, Section C1 (2)(e)(ii), January 2019

## CONCLUSION

Overall, references are a useful tool for insight into an individual or company. On occasions when accountants feel they cannot comment, they should feel able to politely decline.

When accountants do provide a reference, they should do so with confidence in themselves that they can make use of the information they relied upon, if required.

*This article has appeared in the ACCA In-Practice Ezine*

### Further Information

Given the generality of the note it should not be treated as specific advice in relation to a particular matter as other considerations may apply.

Therefore, no liability is accepted for reliance on this note. If specific advice is required, please contact one of the Partners at Caytons who will be happy to help.

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**Caytons**  
Changing  
Perceptions

**Megan Walton**

Solicitor

Direct: +44 (0)20 7398 7627

[walton@caytonslaw.com](mailto:walton@caytonslaw.com)