

# PRACTITIONER SUPPLEMENT

## INDEPENDENCE: LIMITED RECOURSE LANGUAGE IN ENGAGEMENT CONTRACTS

### INTRODUCTION

The purpose of this Supplement is to assist members of the accounting profession in the Cayman Islands. It is not intended to be prescriptive but rather to indicate what would generally be regarded by the accounting profession in the Cayman Islands as best practice. It should not be relied upon in respect of points of law.

With respect to the use of limited recourse language in engagement contracts for audit engagements, with limited exceptions, as discussed below, auditors should not provide audit clients, their management or their governing entities with limitations of the auditors' recourse with regard to the auditor's fees, or damages, losses and costs arising from claims that relate directly or indirectly to management/governing entities' acts. Offering such terms for circumstances other than those discussed below may raise an appearance of an independence conflict.

Supporting professional guidance on such matters includes AICPA Code of Professional Conduct, Section 100 - Independence, Integrity, and Objectivity and the IFAC Code of Ethics, section 290.

Circumstances may exist where the reasons for such language would be rooted in principles that are specific to the legal structure and business nature of the audit client.

Examples of such circumstances which are relevant to certain Cayman Islands' entities include the following:

#### 1. LIMITED RECOURSE LANGUAGE FOR TRUSTS

The limited recourse language against trustees with respect to the trustee's Potential obligations to the Auditor may be included in the audit engagement contract to allow for differentiation between the trustee's liability in a personal capacity and the trustee's liability solely in its capacity as trustee, as unlike a corporation a trust does not have a distinct limitation of liability drawn between the trust and trustee.

Such language would generally be added to an engagement letter with a caveat, where the limitation on the trustees' personal liability to the auditor does not hold in the event of fraudulent acts, omissions, misrepresentation or wilful default committed by trustees and its personnel and agents.

#### SAMPLE WORDING:

*We acknowledge that the Trustee is acting solely in its capacity as trustee of the Trust and not in its individual capacity. Except to the extent the Trustee is personally liable under applicable law or the trust agreement governing its relationship with the Trust,*

*“the name of the audit firm” shall have no recourse against the Trustee in its personal capacity in respect of any obligations or liabilities of the Trust.*

## 2. LIMITED RECOURSE LANGUAGE FOR BANKRUPTCY REMOTE SPVS

Limited recourse language with respect to collection of service provider fees and other amounts, as well as rights of recourse to pursue such collection is usually included in all contractual documents of the SPV. The assets of the SPV are usually pledged to various funding providers and, the service providers are entitled to the residual proceeds upon liquidation, once the claims of the secured lenders are satisfied.

Language within the audit engagement letter which stipulates such an agreement by the auditor would not seem to result in a violation of the auditor’s independence. Such limited recourse language should be limited to the SPV itself and should not further extend to the management, directors, sponsor or other service providers for the SPV, unless the SPV entity is a trust in which case the unique circumstances of a trustee-trust relationship discussed in the previous section may apply.

Each auditor would need to assess the feasibility of any such language on a case by case basis in accordance with its own risk management policies.

### SAMPLE WORDING:

*Notwithstanding any provision in this Agreement to the contrary, the rights of recourse of “the name of the audit firm” against the Company shall be limited to remaining amounts from time to time available and comprising the assets of the Company having satisfied or provided for all other prior ranking liabilities of the Company. Accordingly, “the name of the audit firm” shall have no claim or recourse against the Company in respect of any amount which is or remains unsatisfied after the application of the funds comprising the assets of the Company and/or representing the proceeds of realisation thereof and any remaining obligation to pay any further unsatisfied amounts shall be extinguished.*

*“The name of the audit firm” hereby covenants and agrees that it will not at any time institute against the Company, or join in the institution against the Company of any bankruptcy, reorganisation, arrangement, insolvency or liquidation proceedings, or other proceedings under any bankruptcy or similar law in connection with any obligations relating to the Agreement. The provisions of this and the immediately preceding paragraph shall survive the termination of the Agreement.*

Auditors should not enter into any contract terms which limit their recourse without first considering the threats to their independence and the safeguards which might exist to preserve their objectivity.