Loan liability: Negative associations with an auditor can affect loan chances

June 4 2024, by Tess Malone

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How much does a loan officer's familiarity with an auditor affect their client's ability to receive a commercial loan? New research from Georgia Tech suggests that while knowing an auditor doesn't guarantee a commercial loan, loan officers are more likely to deny loans to companies that have auditors with poor reputations.

Arnold Schneider, a professor in the Scheller College of Business, found that loan officers who knew the borrower's audit firm were reassured the loan wasn't high-risk. However, familiarity with an audit firm didn't guarantee an approved loan. If anything, an audit firm's negative reputation for association with a defaulting client or a client needing regulatory enforcement meant a new client is more likely to lose out on a loan.

The research is titled "Do Familiarity With a Loan Applicant's Auditor and the Auditor's Associations With Past Borrowers Impact Lending Judgments?" and is published in the 2023 issue of *Advances in Accounting Behavioral Research*.

In his study, Schneider conducted an experiment with 64 loan officers from 49 banks across the eastern U.S. He examined two main variables: whether the loan officer was familiar or unfamiliar with an auditor and whether an auditor had a history with regulatory enforcement of a client or a defaulting client.

Each questionnaire used the same case scenario: a client applying for a $4 million commercial loan at a hypothetical loan company, along with their financial statements. Participants were asked to assess risk on a 10-point scale and provide the probability that they would extend the credit at a reasonable rate of interest. Then they rated the importance of the factors that helped them make their decisions.

"I found that the lenders did assess the risk higher in the case where the auditors were not familiar to them," Schneider said. "But to my surprise, that did not translate into a lower probability of granting credit to these borrowers."

Rather, if the loan officer only knew of an auditor because of their poor history with defaulting clients or clients having regulatory enforcement, this negative association would inhibit a loan.

Understanding the role of auditors in loan decisions is crucial for borrowers. While familiarity with a loan provider can reduce perceived risk, loan approval remains a complex process.

More information: Arnold Schneider, Do Familiarity With a Loan Applicant's Auditor and the Auditor's Associations With Past Borrowers Impact Lending Judgments?, *Advances in Accounting Behavioral Research* (2023). DOI: 10.1108/S1475-148820230000026009

Provided by Georgia Institute of Technology