NEW YORK CITY BAR

COMMITTEE ON FINANCIAL REPORTING

October 25, 2005

Center for Public Company Audit Firms
American Institute of Certified Public Accountants
Harborside Financial Center
201 Plaza Three
Jersey City, New Jersey 07311-3881
Attention: Lillian Ceynowa

Ladies and Gentlemen:

We wish to thank you for having provided to the Financial Reporting Committee of the Association of the Bar of the City of New York (the "Committee") the opportunity to express our views and participate in the discussion on your draft White Paper on Auditor Attendance at Due Diligence Meetings with Underwriters (the "White Paper") at the meeting held on October 11, 2005 at the New York office of the American Institute of Certified Public Accountants (the "Meeting").

As you know, the Committee is composed of lawyers with diverse perspectives on the securities offering process, including counsel to corporations and investment banks, academics and members of law firms representing issuers, underwriters and investors. A list of the members of the Committee is attached as Annex A.

Although we found the Meeting to be a useful forum for better understanding the views of the Center in drafting the White Paper, we continue to be extremely concerned with the approach to due diligence advocated by the White Paper as we believe it would undermine the quality of financial disclosure and is therefore inconsistent with the goal of investor protection. The purpose of this letter is to:

memorialize our views of the highlights of the discussion at the Meeting,

explain why the expressed underpinnings for the White Paper described by members of the Center at the Meeting fail to justify the White Paper's approach, and

reaffirm our recommendation that the Center publicly withdraw the White Paper, confirm that existing auditing standards do not require auditors to curtail their participation in due diligence and advise auditors that the draft is not to be relied upon in public or private securities offerings in which due diligence is conducted.

We Continue to Have Serious Concerns With the White Paper

At the Meeting, we articulated our serious concerns, as set out in more detail in our letter of September 30, 2005, with the recommendations to auditors contained in the White Paper. We also presented to you our view that the process associated with the White Paper needs to include all key constituencies—particularly issuers and investors. In view of the fundamental flaws affecting the White Paper, we urged you to withdraw the White Paper, advise auditors that the draft is not to be relied upon in public or private securities offerings in which due diligence is conducted and pursue any further initiatives on this topic only after appropriate consultation with all affected participants in the capital markets and oversight by the Public Company Accounting Oversight Board and the Securities and Exchange Commission. Representatives of the Securities Industry Association and The Bond Market Association and their counsel present at the Meeting, as well as several representatives from the many investment banks and law firms that attended, expressed similar concerns and made the same recommendations.

In response to questions, members of the Center articulated several purported justifications for proposing the White Paper. In our view, none of these considerations justifies the retreat from the traditional role played by auditors in the due diligence process advocated by the White Paper. In particular:

> Several members of the Center argued that the White Paper is needed to ensure that audit firm representatives participating in due diligence discussions do not, in formulating their responses to underwriters' and counsel's questions, stray outside the bounds of what is deemed acceptable by the AICPA. These members stated that they believed existing auditing standards relating to attestation reports, comfort letters and other formal written reports apply with equal force to oral due diligence sessions and require auditors to limit their participation in the manner suggested by the White Paper. As noted at the Meeting and in our September 30 letter, we believe this is a novel and unjustified interpretation of the auditing literature that flatly contradicts decades of established practice. Moreover, the Center is not the appropriate body to interpret existing auditing standards in this novel manner, for the PCAOB, and not the AICPA, has been charged by Congress with standard setting in this area.
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> One Center member expressed the view that the sole role of auditors in the capital formation process is to perform specific procedures relating to the issuer's financial statements in response to specific requests, and that it is not appropriate for auditors to provide any comment to underwriters beyond what is contained in the audit report and comfort letter. As we noted at the Meeting, this narrow view of the auditor's role is at odds with decades of established practice, and would significantly undermine the effectiveness of the due diligence process in protecting investors.
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> Center members also asserted that the White Paper is needed to bring consistency and efficiency to a process that, in the words of several of the members of the Center, is inefficient and allows for variability in practice by individual audit partners. These goals cannot justify the significant harm to investor protection posed by the White Paper. Efficiency has never been the objective of the due diligence process. Instead, the due diligence process is designed to protect investors by helping to promote complete and accurate disclosure. Moreover,

although Center members expressed a desire for greater efficiency, the White Paper's approach in fact would be counterproductive by encouraging auditors to deny offering participants access to much of the accumulated insight and knowledge gained by the auditors through the audit process. Similarly, while all due diligence efforts are consistent in that they share the common objective of complete and accurate disclosure, the precise course an investigation takes will, of necessity, vary depending on the particular facts and circumstances of each offering. Moreover, even if greater consistency were needed, the Center would not be the appropriate body to impose it, for standard setting in this area is a responsibility assigned by the Sarbanes-Oxley Act to the PCAOB, not the AICPA.

Center members expressed the view that the increasingly compressed time-frames in which offerings occur under the shelf registration regime justify a reduced role for auditors in the due diligence process. As noted at the Meeting, the shelf registration regime is hardly new, and the approach suggested by the White Paper departs considerably from the more than two decades of custom and practice that has developed in this area. Indeed, the limited time available to conduct due diligence at the time of the offering heightens, rather than lessens, the value to investors of meaningful participation by auditors in the due diligence process. The approach suggested by the White Paper would undermine the ability of offering participants to identify and respond appropriately to financial disclosure issues in the short time-frames imposed by contemporary shelf offering practice, a concern that promises to increase under the forthcoming automatic shelf registration regime.

Center members also expressed the view that the White Paper could be interpreted so as not to limit the ability of auditors to continue to participate in drafting sessions in capital formation transactions, but instead to apply only to formal due diligence sessions involving the auditors and underwriters. As we noted at the Meeting, we do not believe that it is possible to draw a meaningful distinction between these fundamentally interrelated parts of the process of preparing for an offering. The due diligence objective permeates the drafting process. Participants in a drafting session often uncover substantive issues during the drafting process and engage in on-the-spot inquiry and analysis relating to the underlying facts to develop appropriate disclosure. Against this backdrop, the White Paper threatens to have a chilling effect on meaningful participation by auditors in drafting sessions. This could seriously undermine investor protection.

In sum, none of the purported justifications for the White Paper's suggested approach can be accepted if investor protection is the primary goal. Despite recent court decisions that make clearer than ever that inquiries regarding financial matters are a fundamental part of the due diligence process, the White Paper would have the effect of encouraging auditors to retreat from active participation in a manner that could seriously undermine the ability of offering participants to adequately address such matters. As noted at the Meeting and in our September 30 letter, investors are served best by an open and collaborative process aimed at preparing complete and accurate disclosure. Deprived of meaningful auditor participation in the process, offering participants could be severely hampered in their efforts to achieve that objective.

We Reiterate Our Recommendations

In light of the above concerns, the Committee reiterates the three recommendations it made at the Meeting:

1. Advise auditors that the draft White Paper is not to be relied upon in public or private securities offerings in which due diligence is conducted.

2. The Center has said that it has not widely distributed the White Paper, and has not advised its member firms to begin to implement it. Unfortunately, we can confirm, based on reports from many of our members, that public accounting firms have begun to implement the White Paper on a *de facto* and inconsistent basis in recent weeks. Therefore, it is extremely important that the Center issue a clear and unambiguous statement instructing member firms not to implement any aspect of the White Paper and confirming that existing auditing standards do not require auditors to curtail their traditional role in the due diligence process. Failure to accomplish this result will only increase the risk that investor protection will suffer from the continued decline in auditors' participation in due diligence sessions with underwriters, and as we stated in our initial comment letter, we believe this will increase, not decrease, potential liability risk to all participants, including auditing firms.

3. If the Center believes that continued dialogue on this topic is warranted, we reiterate our recommendation made in our initial comment letter that a public roundtable conducted under the auspices of the SEC and the PCAOB be convened. We believe an open forum with all interested constituencies, including the regulators, is the only means by which a discussion of this topic could occur in a productive way.

Respectfully submitted,

The Financial Reporting Committee of the
Association of the Bar of the City of New York

cc

Hon. William J. McDonough, Chairman
Hon. Kayla J. Gillan, Member
Hon. Daniel L. Goelzer, Member
Hon. Bill Gradison, Member
Hon. Charles D. Niemeier, Member
Mr. Douglas R. Carmichael, Chief Auditor and Director of Professional Standards
(Public Company Accounting Oversight Board)

Hon. Christopher Cox, Chairman
Hon. Paul S. Atkins, Commissioner
Hon. Roel C. Campos, Commissioner
Hon. Cynthia A. Glassman, Commissioner
Hon. Annette L. Nazareth, Commissioner
Mr. Donald T. Nicolaisen, Chief Accountant
Mr. Alan L. Beller, Director, Division of Corporation Finance
Ms. Carol A. Stacey, Chief Accountant, Division of Corporation Finance
(Securities and Exchange Commission)

Annex A

Financial Reporting Committee Members*

Barbara Alexander
Bruce Bennett
Robert Buckholz
Martin Cohen
Jill Darrow
Richard Drucker
Steven Gartner
Caroline Gentile
Salvatore Graziano
William Hartnett
Adele Hogan**
Andrew Hutcher
Kenneth Josselyn.
Frederick Knecht
Richard Kosnik
Richard Langan
Raymond Lin
Cara Londin
Peter Loughran
Michael Lubowitz
Aileen Meehan
Adam Meshel.
Jeanne Mininall
Rise Norman
Stephen Older
Christopher Paci
Vincent Pisano
Neila Radin.
Charles Raeburn
Bruce Rosenthal
Knute Salhus**
Kathleen Shannon
Leslie Silverman
Norman Slonaker
Jill Wallach
John White**
Thomas Yang
Michael Zuckert

* The Committee acknowledges the assistance of Mark Adams in the preparation of the letter.

** Abstained