The Association of the Bar of the City of New York

Committee on Financial Reporting

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

September 30, 2005

Ladies and Gentlemen:

We appreciate the opportunity to respond to the request of the SEC Audit Practices Task Force of the Center for Public Company Audit Firms (the "Center") for comments on the Center's draft White Paper on Auditor Attendance at Due Diligence Meetings with Underwriters (the "White Paper").

The Financial Reporting Committee of the Association of the Bar of the City of New York (the "Committee") consists 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. Each of these constituencies shares a common goal – full and accurate disclosure to investors.

The Committee would like to emphasize at the outset that our goal in this process is not to create new liability for auditors, or to increase liabilities that currently exist. In particular, our letter should not be misconstrued as supporting an effort to convert all statements made by an auditor in the due diligence context into a formal opinion or to "expertise" every topic touched upon by the auditors in the due diligence process. Instead, we seek to minimize the risk of liability faced by all participants in the offering process, including auditors, by preserving a process designed to facilitate full and accurate disclosure. An open and collaborative due diligence process is the means contemplated by the Securities Act of 1933 to achieve this result. Artificial constraints imposed on this process only serve to increase the liability risk of all participants and to undermine investor protection.

In the Committee's view, the draft White Paper adopts an approach that inappropriately marginalizes the auditor's role as one of the key participants in the due diligence process. This draft would reduce, or even prevent, the meaningful and cooperative dialogue that long has been customary as issuers, auditors, underwriters and counsel prepare a disclosure document intended to provide prospective investors with complete and accurate

information regarding the issuer and its financial statements. We note there is no discussion in the draft of how the proposals would affect the goal of investor protection. Simply put, it is the Committee's view that the proposals could seriously compromise this goal and undermine the quality of financial disclosure. Given the fundamental public policy issues involved, we believe it is of paramount importance that all interested constituencies have the opportunity to participate meaningfully in the discussion of the White Paper.

When Congress enacted the Securities Act, it created a regulatory structure designed to encourage the provision to investors of full and accurate disclosure. An important component of this structure is the independent investigation of the completeness and accuracy of the issuer's disclosure by distribution participants. That this system has been effective is evidenced by the unparalleled depth and breadth of the United States capital markets. However, as recent events have demonstrated, if investors do not believe they can rely on the disclosure provided to them, their willingness to invest, and the very vitality of our capital markets, may be impaired.

Courts and regulators frequently point to the importance of the auditors' role in the disclosure process. PCAOB Member Daniel Goelzer observed in an August 2, 2005 speech that "it has always been recognized . . . that the auditor has important obligations to the investing public" and that "[f]undamentally, the Sarbanes-Oxley Act seeks to refocus auditors on [those] obligations." Similarly, SEC Chief Accountant Donald Nicolaisen observed in a 2004 speech that "[t]he audit profession is unique – serving the public interest first and foremost. That is a significant responsibility, and it's important that the auditor understand the needs of investors."

As a key participant in the securities offering process, auditors hold an important public trust. The auditor's role as expert is a fundamental component of the Securities Act regulatory scheme, and a company cannot offer its securities to the public without first obtaining an auditor's report on its financial statements. Also critically important in promoting full and accurate disclosure, however, is the role auditors historically have performed as professionals sharing their judgment, experience and knowledge with other participants, including management, boards of directors and underwriters, in the offering process. As recognized both in existing auditing standards (e.g., SAS 60, 61 and 90) and the Sarbanes-Oxley Act, the audit process gives auditors an invaluable vantage point from which to form judgments about the quality of the issuer's accounting practices, financial statements and internal controls and to identify sensitive accounting estimates and other management judgments relating to financial reporting. Auditing and accounting literature recognizes that the sharing of these insights with those responsible for oversight of the company's financial reporting is an important component of accurate financial reporting. These insights are no less valuable to those involved in the independent investigation of the accuracy and completeness of an issuer's disclosure and, indirectly, to the investors who rely upon those disclosures.

Although we do not intend at this juncture to engage in a line-by-line analysis of the draft, we highlight below for illustrative purposes several of the issues that give us cause for concern.

- Perhaps the provision that most clearly evidences the Committee's concern is the White Paper's suggestion that it is inappropriate for an auditor to share with the underwriters its perspective on the matters required to be discussed with the audit committee under AU 380, Auditing Standard No. 2 and the Sarbanes-Oxley Act. These matters include important issues such as the quality of the issuer's accounting principles, the use of critical accounting estimates and significant deficiencies and material weaknesses identified during an integrated audit. The White Paper seeks to justify silence on these vital subjects by citing auditing literature, particularly the restrictions on use of these "by-product" reports in AU 380 and Auditing Standard No. 2. But, as described in AU 532.09, the purpose of restricting the use of reports on matters coming to the auditor's attention during the course of an audit is to guard against the potential for misinterpretation or misunderstanding of the limited degree of assurance associated with such reports. We believe that this legitimate concern can be addressed through appropriate disclaimers and disclosure to the underwriters, such as are customarily included in auditor comfort letters. Similarly, to the extent the Center's unease with auditors discussing matters raised with the audit committee is based on concerns regarding client confidentiality, issuer consent to disclosure of such matters should be sufficient to address such concerns.

- We also find particularly troubling the draft White Paper's recommended response to inquiries of auditors who may have become aware of fraud or illegal acts by the issuer. We believe the White Paper inappropriately circumscribes auditor participation in what should be a collaborative effort to protect investors in such instances. Instead of sharing relevant information with the underwriters, auditors are advised not to comment on these matters. And, once again, client confidentiality cannot be the Center's concern, because disclosure will be with the issuer's consent.

- The White Paper suggests that auditors should have discretion to respond to misleading or inaccurate management responses to underwriter questions by taking steps that would not result in disclosure of the misstatement or omission to the underwriters. This raises the possibility that the misstatement or omission could remain in the offering document uncorrected, and those independent of the

issuer charged with verifying this information would remain unaware of the misstatement, again to the detriment of investors.

- The White Paper instructs auditors not to comment on specific elements, accounts or items of the financial statements or risk assessments made in planning the audit. Public companies are complex entities. Their financial reports are similarly complex, far more so now than when the Securities Act was enacted in 1933. MD&A, which the SEC staff views as the most important component of an issuer's disclosure, provides investors with context for, and an interpretation of, the issuer's financial statements. Curtailing discussion by the auditors of specific elements, accounts or items of the financial statements, or of risks that may affect those matters, could significantly impede independent investigation of the accuracy and adequacy of the issuer's disclosures regarding the financial statements, whether they be contained in MD&A or elsewhere in the prospectus, and could well result in disclosure that provides less insight into the issuer's financial condition and results of operations. Also, the White Paper's guidance in many cases would prevent underwriters from discussing with auditors "red flags" related to the financial statements, since in most if not all cases the red flag will relate to a specific element, account or item. This creates an unnecessary obstacle to the additional due diligence with respect to red flags mandated by applicable judicial precedents.

- The White Paper suggests that it is inappropriate for auditors to offer their views on matters that are subjective in nature or require qualitative or judgmental assessments, even when those matters are within their area of professional expertise. As recognized in AU 380, the audit and review process provides the auditor with an incomparable perspective from which to offer an independent view of the quality of the issuer's financial reporting. Further, as noted by the SEC and PCAOB in May 2005 in connection with the internal control attestation process, exercising subjective judgment regarding risks of misstatement in the financial reporting context is at the heart of the auditor's professional competency. Depriving participants in the offering process of the auditor's views on such matters could seriously undermine efforts to identify and investigate potential financial disclosure issues, resulting in less meaningful disclosure to investors.

- The Committee is troubled by the insular approach the draft White Paper takes to discussions of auditor independence. Congress, the SEC and the PCAOB have each recognized the importance of auditor

independence and the potential conflicts associated with non-audit services. These issues are of clear concern to investors, and thus can be a necessary matter of inquiry for underwriters in the due diligence process. Rather than acknowledge these issues and encourage discussion, the draft White Paper suggests that it is inappropriate for an auditor to discuss the basis for its independence conclusions. Barring discussion of these issues creates an unnecessary obstacle to verifying the accuracy and adequacy of the issuer's disclosure regarding the independence of its auditors.

Fundamentally, the draft White Paper misconceives the auditor's role in the disclosure process as a limited exercise consisting primarily of delivery of an audit report and comfort letter, providing a general description of the audit and making reference to matters of public record. This narrowly circumscribed role is at odds with decades of practice under the federal securities laws for both public and certain private securities offerings and the level of due diligence mandated by applicable judicial precedents. It also runs counter to the ongoing efforts of Congress, the SEC and the PCAOB to improve the quality of issuer disclosure. Deprived of meaningful auditor participation in the process, offering participants could be severely hampered in their efforts to produce full and accurate disclosure, thereby undermining investor protection.

Despite these and other fundamental concerns for investor protection raised by the draft White Paper, the Committee notes that two key constituencies – issuers and investors - have not been afforded a meaningful opportunity to participate in its consideration. We anticipate that issuers will, for example, view with considerable unease the extensive changes the White Paper would impose on customary offering practice, particularly if audit committee members are asked to take on a new role as a second-hand source for information regarding matters discussed with them that fall squarely within the professional competence of the auditors. Accordingly, we do not believe the White Paper can or should be completed without the meaningful involvement of issuers and investors.

Further, in light of the adoption of the Sarbanes-Oxley Act and the creation of the Public Company Accounting Oversight Board, we believe the adoption by the Center of any document that addresses auditor conduct relating to such a fundamental public policy issue constitutes implicit standard setting, which has been reserved by Congress to the PCAOB and the SEC with the attendant procedural steps required by administrative law. Pending appropriate consideration by the PCAOB and SEC, the Committee therefore requests that the Center advise auditors that the draft is not to be relied upon in public or private securities offerings in which due diligence is conducted.

We believe an appropriate forum for facilitating a full discussion of the issues underlying the draft White Paper would be a public roundtable conducted under the auspices of the SEC and the PCAOB. As with the roundtable held by the SEC and the PCAOB in April 2005 regarding the implementation of internal control reporting provisions, such a

roundtable would provide all affected constituencies a meaningful opportunity to discuss issues in the presence of the regulatory bodies charged with the protection of investors. If discussions at the roundtable suggest that investor protection would be served by additional guidance or standard setting, that effort could then be undertaken by the PCAOB and SEC.

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The Committee believes that investors are best served when participants in the offering process can perform their roles effectively. The due diligence process should not be an adversarial one. On the contrary, cooperation among the independent parties interested in full and accurate disclosure – underwriters, counsel, auditors and board members – is the best way to ensure that each can be effective in confirming the accuracy and completeness of information on which investors rely in making their investment decisions. We encourage the Center to take into account the considerations outlined in this letter and to recognize that the only appropriate process is one that ensures that the views of all other interested parties are solicited and addressed in shaping procedures that touch so fundamentally on the capital formation process and the protection of investors.

Please note that this letter does not necessarily reflect the individual views of each member of the Committee, nor does it necessarily reflect the views of the institutions with which they are affiliated.

Members of the Committee would be pleased to answer any questions you might have regarding our comments.

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
(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
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

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** Abstained