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SAS 72 Comfort Letters for first quarter 2019 capital markets deals

From 12 November, H1 2018 interim financial statements of issuers with calendar year ends went 'stale' for purposes of receiving negative assurance in a SAS 72 letter[1]. If your offering has been delayed due to ongoing market turbulence, or for other reasons you are targeting a first quarter 2019 launch, an auditor's review of financial statements for a period ending prior to 135 days of your contemplated completion date (eg the nine months to 30 September) can extend the negative assurance period.

You should, however, be aware of a potential issue presented by the AICPA's 2005 white paper '*Comfort Letter Procedures Relating to Capsule Financial Information Presented in a Registration Statement Prior to the Issuance of Year-End Financial Statements*' (the ***White Paper***)[2].

The White Paper sharply restricts the period covered by negative assurance in a SAS 72 letter delivered after year end if the audit fieldwork for that year is not substantially complete. Annex A of this note provides fuller details of the specific restrictions; in summary, underwriters are likely to find themselves faced with a lengthy gap between the end of the period for which an issuer's accountants can provide negative assurance (typically 30 November, and sometimes earlier) and the completion of an offering.

In considering early first quarter transactions for calendar year-end issuers, underwriters should move quickly to establish:

- the extent to which the accountants in question are likely to apply the White Paper's restrictions;
- when the issuer and its auditors expect audit fieldwork to be 'substantially complete' and the issuer's financial statements to be in 'substantially final form' and whether these can be accelerated and
- the quality and type of financial and operational information available during the affected period to allow underwriters to undertake additional financial due diligence in lieu of negative assurance.

Please get in touch with your usual Freshfields capital markets contact if you would like to discuss any of the issues raised in this note.

[1] A 'SAS 72' letter is the accounting comfort letter delivered by an issuer's auditors to the underwriters in a capital markets transaction using an offering circular, prospectus or registration statement with a distribution to investors in the United States. 'Negative assurance' for these purposes constitutes a statement by the accountant that nothing has come to its attention to cause it to believe certain line items in an issuer's financial statements have changed for the worse since the date of the issuer's last audited or reviewed financial statements.

[1] Although the White Paper was prepared in a US SEC-registered context, the European accounting profession increasingly treats the White Paper's prescriptions as mandatory in the non-US context when its members are asked to provide SAS 72 or SAS 72-lookalike comfort letters.

ANNEX A

AICPA White Paper Restrictions

The White Paper imposes substantial restrictions on the ability of accountants to undertake various procedures, including providing comfort letters, which relate to financial information which is the subject of ongoing audit procedures. As a result, obtaining "stub period" negative assurance covering the period from the date of the last audited or reviewed financial statements (eg 30 September 2018) to a date *on or after* an issuer's financial year end but *before* the publication of an issuer's audited full year financial statements can be difficult.

Two concepts are important to note in understanding these restrictions:

- **The date on which audit fieldwork is 'substantially complete'**. 'Substantially complete' is usually taken to mean that the auditor has delivered its audit report to the issuer's board of directors; although the White Paper allows that some accountants may consider audit fieldwork to be substantially complete when they are satisfied there are no significant matters outstanding which would be likely to cause a change to the line items being commented upon.
- **The date on which year end financial statements are in 'substantially final form'**. There is no consensus on what constitutes 'substantially final form'. Some accountants consider this to be synonymous with the financial statements being actually issued. Others require that the financial statements be through the full internal review process (eg senior management, disclosure committee, audit committee and full board sign off). Others require only that key footnote disclosures be completed and some level of internal review having occurred, but not necessarily the full process.

With these concepts in mind, the White Paper restricts:

- **SAS 100/ISRE 2410 reviews of fourth quarter results**: The first limb of a SAS 72 letter typically comprises a review of interim financial information in accordance with SAS 100 or ISRE 2410. These reviews validate quarterly results included in offering circulars and serve to reset the 135-day deadline which governs when financial statements included in offering circulars go stale for purposes of receiving a SAS 72 letter with negative assurance. According to the White Paper, review reports of fourth quarter results should not be issued until the audit fieldwork is 'substantially complete' and year end financial statements are in 'substantially final form'. In practice, this requirement makes fourth quarter reviews redundant in first quarter transactions, as only a relatively short further delay would allow the issuer to go to market on the back of full-year results.
- **Reading December management accounts**: The second limb of a SAS 72 letter provides that the accountants have read monthly management accounts and (amongst other assurances) that nothing has come to their attention on the basis thereof indicating that certain specified line items have changed for the worse during that period. The White Paper restricts 'reading' management accounts and providing negative assurance on specified line items for the last month in a financial year (eg December) unless audit fieldwork for the year end is 'substantially complete', although the year-end financial statements do not need to be in final form.
- **Making enquiries of company officials for the period following the latest available management accounts**: The third limb of a SAS 72 letter provides that the accountants have made enquiries of management for the period from the last available management accounts to a given cut-off date and that nothing has come to their attention on the basis of such enquiries indicating that certain specified line items have changed for the worse during that period. The White Paper restricts making these enquiries and providing negative assurance with a cut off date on the last day of the financial year (eg 31 December) unless audit fieldwork for the year end is 'substantially complete', although the year-end financial statements do not need to be in final form. The White Paper suggests, but does not require, accountants to wait until audit fieldwork is 'substantially complete' prior to providing negative assurance on the basis of enquires with a cut off date after the last date of the financial year (eg 15 January). In the alternative, accountants may report the results of such enquiries rather than providing negative assurance prior to the substantial completion of audit fieldwork (a compromise often referred to as 'agreed-upon procedures' or, pejoratively, 'cold comfort').
- **Providing a circle-up of fourth quarter/full year financial information**. The final limb of a SAS 72 letter consists of agreeing certain information included in an offering circular to the issuer's accounting records. The White Paper restricts providing this circle-up comfort unless audit fieldwork for the year end is 'substantially complete', although the year-end financial statements do not need to be in final form. Given the difficulties in getting substantive comfort on fourth quarter or full year results, however, few market participants are willing to include such information in an offering circular until at least the publication of preliminary full-year accounts (in the case of already listed issuers) or the finalisation of full year financial statements.

Implications of the White Paper Restrictions

As a result of the White Paper, any SAS 72 letter an underwriter receives in the first quarter prior to the substantial completion of audit fieldwork is likely to have a cut-off date prior to 31 December, or alternatively, 'agreed-upon procedures' or 'cold comfort' for the period commencing on 30 November (if that is the date of the last set of management accounts that could be read and commented upon in accordance with the White Paper) or earlier and ending three to five days prior to the date of the SAS 72 letter. If, however, an issuer and its auditors are able to substantially complete audit fieldwork prior to the offering (and before the 135-day period expires) underwriters can receive a customary SAS 72.

The following indicative timetable details the type of comfort available at different periods for an issuer with a calendar year end, which has undertaken a SAS 100/ISRE 2410 review of its nine month results for the period ended 30 September 2018, substantially completed its audit fieldwork in early February and published its full year financial statements on 28 February 2019.

December				January				February				March		
10	17	24	31	7	14	21	28	4	11	18	25	4	11	18
Customary SAS 72 using third quarter accounts				Cut-off date prior to 31 Dec, or 'agreed-upon procedures'/'cold comfort' to a customary cut-off date				Customary cut-off date, no December management account review		**No SAS 72 comfort**		Customary SAS 72 using full year accounts		

If audit fieldwork is not substantially completed before 12 February (in the above example), the issuer and its underwriters will need to:

- consider delaying the transaction until full-year results are available;
- undertake a SAS 100/ISRE 2410 review of the ten months ended 31 October 2018 or eleven months ended 30 November 2018 using October or November monthly management accounts. The viability of this approach will depend greatly on the quality of the issuer's management accounts, but will extend the 135-day deadline to allow audit fieldwork to be completed; or
- do without negative assurance for the affected period and undertake additional financial due diligence, including, for example, requiring additional officer's certificates and reviewing management 'flash' or other internal financial and operating data reports.

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