Center for Public Company Audit Firms
AICPA
Committed to Audit Quality

American Institute of Certified Public Accountants • Harborside Financial Center, 201 Plaza Three • Jersey City, NJ 07311–3881
201.938.3030 • 888.817.3277 • fax 201.521.5436 • www.aicpa.org/cpcaf

February 13, 2005

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

File No.: S7-38-04
Proposed Rule: Securities Offering Reform
Release Nos. 33-8501; 34-50624; IC-26649

Dear Mr. Katz:

The Center for Public Company Audit Firms (the "Center") of the American Institute of Certified Public Accountants ("AICPA") respectfully submits the following written comments on the Securities and Exchange Commission's (the "SEC" or the "Commission") proposal, Securities Offering Reform (the "Release" or "Proposal").

The Center was established by the AICPA to, among other things, provide a focal point of commitment to the quality of public company audits and provide the Commission and the Public Company Accounting Oversight Board (PCAOB), when appropriate, with comments on its proposals on behalf of Center member firms. There are approximately 1,000 firms that are members of the Center. All of the Center's member firms are U.S. domiciled accounting firms. The AICPA is the largest professional association of certified public accountants in the United States, with more than 340,000 members in business, industry, public practice, government, and education.

We support the Commission's efforts to significantly streamline the registration, communications, and offering processes under the Securities Act of 1933 (the "Securities Act"). The Release raises many important issues. Our letter comments on those issues related to financial reporting and the involvement of independent auditors in the securities offering process. Our specific comments are organized into the following broad categories:

- Auditor Association with Prospectus Supplements
- Automatic Shelf Registration by "Well-Known Seasoned Issuers"
- Unresolved SEC Staff Comments
- Risk Factors
- Forward-Looking Information in Initial Public Offerings

AUDITOR ASSOCIATION WITH PROSPECTUS SUPPLEMENTS

As proposed, a prospectus supplement relating to a takedown of securities off of a shelf registration statement would (a) be considered to be part of the registration statement for Securities Act Section 11 liability purposes, and (b) establish a new effective date, for liability purposes only, for the shelf registration statement. The proposed rule states that the new effective date in those circumstances would be for liability purposes only and would not, by itself, require the filing of additional consents of experts.

We support the Commission's goal of streamlining the offering process. We also believe that it is important that such reforms not create liability to offering participants where such participants are not permitted to vet documents for which they are deemed to have statutory responsibility. If the SEC adopts the Proposal such that a prospectus supplement establishes a new effective date for the shelf registration statement for purposes of Section 11 liability, we would strongly object if the filing of a prospectus supplement did not also require an updated consent of named experts unless the adopted rules eliminate the potential liability an expert has under the prospectus supplement in such situations when no consent is obtained. There are several reasons for our objection:

- First, we are concerned about the auditor's ability to protect investors by fulfilling its traditional gatekeeper role if a written consent is not provided.
- Second, we believe that Section 11 does not permit an audit firm or other expert to be held liable under Section 11(a) for misstatements or omissions in a registration statement as of an effective date where the audit firm or other expert has not consented to be named in the registration statement as of such effective date.
- Third, we believe that Securities Act Section 7(a) requires each registration statement to contain the written consent of any expert named in the registration statement; that the limited exception in Section 7(a), allowing the

SEC to dispense with the consent requirement for impracticability or undue hardship, does not apply under the circumstances contemplated by proposed Rule 430B; and that, in any event, proposed Rule 430B makes no provision to dispense with the requirement of a consent.

- Fourth, we believe that, without adherence to the consent requirement of Section 7(a), the liability exposure of audit firms under Section 11(a)(4) may be unclear to investors and other participants in the offering process, notwithstanding the unambiguous language of Section 11(a)(4), particularly in light of the SEC's recent requirement that issuers who were previously audited by Arthur Andersen LLP disclose to investors the limitations on liability that result from the absence of an expert's consent.

- Finally, we believe that the potential for confusion among investors, offering participants, professionals and the courts with respect to the proper application of Section 11(a)(4) to experts who have not consented to be named in the registration statement could result in improper extensions of Section 11 liability to audit firms that have not had the opportunity to consent and, more importantly, perform the post-report review procedures that are required before auditors can provide such consent.

Section 11 of the Securities Act provides for liability if any part of a registration statement contains material omissions or misstatements. Section 11 liability applies not only to underwriters, directors, and those who sign the registration statement on behalf of the issuer, but also to named experts, such as the issuer's independent registered public accounting firm and any auditors of other financial statements that may be required in the registration statement (e.g., significant acquired businesses, significant equity investees). Specifically, Section 11(a) of the Act provides that such persons may be sued by anyone acquiring that security if any part of the registration statement contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

Liability under Section 11 is subject to several limitations, two of which are fundamentally important to independent registered public accounting firms. First, Section 11 liability is measured from the time of effectiveness due to the express requirement in Section 11(a) that the misstatement or omission must have been part of the registration statement at the time the registration statement "became effective." Thus, the SEC has previously stated that "Section 11 ordinarily does not apply to statements omitted from an effective registration statement and subsequently disclosed in a prospectus or prospectus supplement, rather than a post-effective amendment." Release No. 33-6672 (Oct. 27, 1986). Second, independent registered public accounting firms and other experts cannot be held liable under Section 11 unless they affirmatively consent to be named in the registration statement. Section 11(a)(4) authorizes plaintiffs to sue an expert only if the expert "has with his consent been named as having prepared or certified" part of the registration statement.

Given the scope and basis of Section 11 liability, and given the fact that Section 11(a)(4) makes the expert's consent a prerequisite to such liability, it is not clear to us how a prospectus supplement could be considered to create a new effective date "for liability purposes only" without also requiring consents from the experts named in the registration statement. We respectfully request that the Commission clarify the proposed rules so that it is clear that auditors will not have Section 11 liability for documents where no consent was obtained. We understand that, as a policy matter, there may be situations where the Commission may conclude that requiring consents would unduly delay the offering process. In these situations, however, it must be made clear where Section 11 liability will – and will *not* – apply.

We also continue to believe that the consent requirement serves the essential purpose of putting the expert on notice and thereby requiring the expert, as well as the issuer and others subject to Section 11 liability, to consider the adequacy and accuracy of disclosures as of the effective date. Unlike other offering participants, auditors and other experts have little assurance that they will be consulted to an appropriate extent unless they are required to consent to being named in the registration statement. The consent requirement thereby serves an important function in ensuring the adequacy and accuracy of disclosures with which such experts are associated.

Section 7(a) of the Securities Act, which operates in tandem with Section 11 with respect to expert consents, states that if "any person whose profession gives authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement." Thus, Section 7(a) requires the registrant to file the expert's written consent with the registration statement. Section 7(a) does not allow the SEC to dispense with the consent requirement except in cases where filing a written consent would be "impracticable" or would involve "undue hardship." Historically, such cases have been limited to truly extraordinary circumstances. In any event, where the SEC dispenses with the requirement for a consent, the lack of a consent removes the expert from the reach of Section 11 liability due to the consent requirement contained in Section 11(a)(4). Recently, the SEC underscored this straightforward consequence with the adoption of Rule 437a, which dispensed with the requirement for registrants to file the written consent of Arthur Andersen LLP, provided that the registrant satisfies the requirement contained in paragraph (b)(3) of Rule 437a to "disclose clearly any limitations on recovery by investors posed by the lack of consent." In contrast, the current proposal contains no such disclosure requirement. As a result, if implemented, the proposal will result either in the failure of investors to appreciate the consequences under Section 11(a)(4) of an omitted consent or in the unfair and inappropriate imposition of liability upon an auditor or other expert who was not sufficiently involved in creating the disclosure with which such auditor or expert was associated.

Moreover, the due diligence defense under Section 11(b)(3) would not be available to an auditor who had not engaged in the appropriate review procedures, notwithstanding the fact that the auditor had lacked sufficient, or any, notice of an offering necessitating such procedures. Section 11(b)(3) provides that a named expert would not be liable if he sustains the burden of proof that he had, after reasonable investigation, reasonable ground to believe and did believe, at the time the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading. Section 11(c) provides that the standard of reasonableness for purposes of determining what constitutes a reasonable investigation and a reasonable ground for belief under Section 11(b)(3) "shall be that required of a prudent man in the management of his own property," which forms the basis of the due diligence defense and, in the case of an a registered independent registered public accounting firm, requires performance of a number of detailed review procedures as required by the auditing standards.

Historically, the SEC staff has required auditors to update their consent whenever a company files a post-effective amendment or, in the case of a shelf registration using Form S-3, an annual report that creates a new effective date. As noted above, an essential purpose of obtaining a written updated consent is to assure that the auditor is aware of the use of its report and the context in which that report is used. Independent registered public accounting firms, whether or not registered with the PCAOB, are required to comply with the respective auditing standards of the PCAOB and the AICPA. Those standards require the auditor to perform post-report review procedures up to the effective date or as close thereto as is reasonable and practicable in the circumstances. Unless the auditor has completed the procedures specified by Section AU 711 of the auditing standards adopted by the PCAOB (*Filings Under Federal Securities Statutes*), and resolved any concerns identified as a result of those procedures, the auditor would withhold its consent.

Section AU 711 requires the auditor to perform certain procedures in connection with an offering of securities under the Act. The purpose of the auditor performing these procedures is to sustain the burden of proof that the auditor has made a "reasonable investigation" under Section 11(b)(3) of the Act (i.e., the procedures represent the auditor's due diligence). The procedures clearly require the auditor to anticipate the effective date of the registration statement and to commence the procedures sufficiently in advance of that date to assure their timely completion. At or near the effective date of a registration statement, AU 711 requires the auditor to perform procedures, as specified in AU 560.12, with respect to subsequent events that may require adjustment or disclosure in the financial statements in order for them to be fairly stated in conformity with generally accepted accounting principles.

For all of these reasons, we firmly believe that in most cases, at any effective date of a registration statement, a currently dated, signed consent from any auditor whose report is part of that registration statement should be obtained by a company.

Moreover, this would need to be explicitly included as a formal requirement if the auditors are to have Section 11 liability for the registration statement at that effective date. We believe that such consent requirement should apply equally at the initial effective date of the registration statement, upon any post-effective amendment, upon the filing of the issuer's annual report that creates a new effective date, and, if adopted, upon the filing of any prospectus supplement that creates a new effective date. The requirement for such a consent from the auditor would continue to ensure that the auditor has had the opportunity to perform the post-report review procedures required by the relevant auditing standards. Consents also ensure that auditors are allowed to protect investors by fulfilling their traditional gatekeeper role in connection with registered securities offerings. We do not believe that requiring an auditor's consent upon the filing of a prospectus supplement would adversely delay capital formation, provided that the issuer gives adequate notice to the auditor and cooperates as necessary for the auditor to comply with AU 711. If this is believed to present the potential for undue delay in the capital formation process, the SEC should consider altering its proposal accordingly to clarify that the Section 11 liability of experts would not extend to the time of the new effective date under proposed Rule 430B, unless the expert had provided its consent as part of the shelf takedown.

Similarly, with respect to free-writing prospectuses, we believe the Commission should require the consent of the independent registered public accounting firm with respect to any financial information contained in any free writing prospectus that is filed and incorporated by reference into a registration statement where such financial information purports to appear on the authority of the independent registered public accounting firm. With respect to free-writing prospectuses, that are not incorporated by reference into a registration statement, we understand that they would be filed and subject to Section 12 prospectus liability, but would not be part of the registration statement subject to Section 11 liability. Accordingly, we understand that auditors would have no liability with respect to these documents. We suggest that the Commission make its views on this point clear in the release accompanying the final rules. We also suggest that the Commission consider the potential investor harm that may result if free-writing prospectuses contain inappropriate references to experts. This risk may be greatest in free-writing prospectuses prepared by an offering participant other than the issuer. We suggest that the Commission consider whether such documents that refer to third parties should be required to state that such statements have been made without their acknowledgment.

We would expect that others who are subject to Section 11 liability, especially other experts and outside directors, would share our concern about having sufficient opportunity to perform their own "reasonable investigation" under Section 11(b)(3) of the Act prior to the filing date of any prospectus supplement that creates a new effective date for the registration statement. For example, all directors of an issuer are subject to Section 11 liability, but only a majority of directors are required to sign a registration statement. Accordingly, the SEC should consider requiring an issuer to obtain, in advance of the filing date of a prospectus supplement, an explicit, currently dated acknowledgment (or a waiver thereof) from persons with Section 11 liability, other than named experts from whom a written consent is required, that they are aware of the issuer's proposed filing. In contrast to experts from whom Section 7(a) of the Act clearly requires the filing of a written consent, such an acknowledgement from other persons with Section 11 liability would not necessarily require filing. But for similar reasons, others with Section 11 liability need to be provided adequate notice of any filing that creates a new effective date for a registration statement and be given sufficient opportunity to perform their reasonable investigation under Section 11(b)(3).

AUTOMATIC SHELF REGISTRATION BY "WELL-KNOWN SEASONED ISSUERS"

A. Eligibility Criteria

The Proposal would permit issuers that meet the criteria to be a "well-known seasoned issuer" to register an unspecified amount of securities on a registration statement that would be automatically effective upon filing. A well-known seasoned issuer would control when it registers its securities and the SEC staff would not have the opportunity to review the registration statement prior to effectiveness. Acknowledging both advances in technology and recent regulatory actions that seek to improve the delivery of timely, quality information to the markets, the Commission's proposed eligibility criteria for well-known seasoned issuers focus on those issuers whose reports "not only are reliable but also are broadly scrutinized by investors and the markets." The premise is that certain issuers are widely followed by many market participants who actively seek and scrutinize new information on a continual basis. Accordingly, whether an issuer qualifies as a well-known seasoned issuer depends on, among other things, (a) how long it has been an Exchange Act registrant, (b) whether it has timely filed its Exchange Act reports, and (c) its market capitalization or volume of registered debt.

The Commission seeks comment on its proposed eligibility criteria for automatic shelf registration.

We commend the SEC staff's efforts to study how market capitalization and volume of registered debt securities relate to market following and default risk. We also agree that advances in technology and the changes in the periodic reporting requirements (e.g., accelerated filing requirements and expanded Form 8-K reporting) significantly enhance the market's ability to obtain and analyze relevant information. We suggest that the Commission consider modifying the criteria to address the matters outlined below.

History of Public Reporting

We question whether an issuer that has been a public company for as little as twelve months has developed a sufficient market following to provide the high level of market scrutiny that is the basis for the privilege of automatic shelf registration.

Consider the explosive market conditions of the late 1990s (i.e., record numbers of IPOs, dramatic increases in stock prices and incredibly high P/E ratios). Should the market again experience similar conditions, it could be flooded with new “well-known seasoned issuers” whose public reporting track record would consist of an initial registration statement, one Form 10-K and a few Form 10-Qs. Consider, for example, the number of technology start up companies that had significant market capitalization in 1999-2000 but significantly lower market capitalization two years later. We encourage the Commission to consider whether requiring a longer reporting history would provide investors with greater assurance that well-known seasoned issuers are not only well known, but also sufficiently seasoned.

We suggest that the Commission consider requiring a well-known seasoned issuer to have a three-year history of reporting as an Exchange Act registrant. In addition to allowing more time for the market to scrutinize a company, this period would be long enough to ensure that at least one SEC staff review of an issuer’s Exchange Act reports pursuant to Section 408 of the Sarbanes-Oxley Act had occurred.

Loss of Eligibility Under the Float Test

We suggest that the Commission consider whether the criteria for automatic shelf registration should allow for relatively small changes in market and economic conditions that may have no substantive effect on the issuer’s market following. Under the Proposal, a decline in market capitalization that is the product of a general downturn in the market could cause an otherwise widely followed, highly seasoned issuer to become disqualified. An alternative model that the Commission could consider is the current framework for exiting the small business disclosure system. By providing a two-year period for the market capitalization test, short-lived declines in market capitalization would not cause an existing well-known seasoned issuer to automatically lose its eligibility. Acknowledging that extreme decreases in market capitalization might lead to a significant decrease in market following or raise other concerns, the Commission could construct this two-year test so that an issuer would become ineligible if its market cap fell below a certain dollar amount and remained at that level for a defined period.

B. “Ineligible Issuers”

The Proposal provides that an “ineligible issuer” would not meet the definition of a well-known seasoned issuer. As proposed, ineligible issuers are:

a. reporting issuers who are not current in their Exchange Act reports;
b. blank check issuers;
c. shell companies;
d. penny stock issuers;
e. issuers who are limited partnerships offering and selling their securities other than in a firm commitment underwriting;
f. issuers who have received a "going concern" opinion from their auditors for the most recent fiscal year;
g. issuers who have filed for bankruptcy or insolvency during the past three years;
h. issuers who have been or are the subject of refusal or stop orders under the Securities Act;
i. issuers who, or whose subsidiaries, have been found to have violated the federal securities laws, have entered into a settlement with any government agency involving allegations of violations of federal securities laws, or have been made the subject of a judicial or administrative decree or order prohibiting certain conduct or activities regarding the federal securities laws during the past three years; or
j. registered investment companies, business development companies, or issuers registering an offering relating to a business combination transaction.

The Proposal also provides that the Commission may, for good cause, determine that an issuer (other than a registered investment company or a business development company) is not an ineligible issuer.

With respect to these ineligibility criteria, the Commission notes, "The categories of ineligible issuers include issuers that are not compliant with their Exchange Act reporting obligations, issuers that may raise greater potential for abuse, and issuers that have violated the federal securities laws previously."

The Commission seeks comment on its proposed definition of an "ineligible issuer."

We support the Commission's proposal to disqualify an issuer from being considered a well-known seasoned issuer if it is an "ineligible issuer," and except as outlined below, we support the criteria proposed. We also agree with the proposal to include a provision to allow the Commission to waive an issuer's ineligibility if it finds good cause for doing so. We believe the Commission, through its staff, should have the ability to waive the disqualifying criteria in appropriate situations.

We have the following comments regarding the proposed ineligibility criteria:

Going Concern Opinions

It was not clear to us whether the Commission included issuers with significant liquidity problems on the list of disqualifying criteria because it believes they are not as broadly scrutinized by investors and the markets, because their reports may have a greater risk of being less reliable, or because the existence of liquidity problems may raise greater potential for abuse and thus merit possible SEC staff review of their registration statements prior to effectiveness. If the concern is reduced investor scrutiny, we question the basis for this. If an issuer with the requisite market capitalization has liquidity problems, won't investor scrutiny increase?

Regardless of the Commission's rationale, if issuers with liquidity problems are to be ineligible, we believe alternative criteria such as those suggested by the Commission in its request for comments (i.e., whether an issuer had (1) net losses or negative cash flows from operations for two or more of the past three annual fiscal periods or (2) a deficit in net worth at the date of the most recent balance sheet) would better identify such issuers.

We believe attempting to set a uniform standard that will correctly identify liquidity issues will be difficult. In many cases, the proposed market capitalization test will catch many of these companies since these companies will be required to disclose any financial difficulties they are experiencing and the markets would take these difficulties into account in establishing a price for the company's stock. If the market capitalization test requires some form of updating, most situations where liquidity is a significant concern will be addressed.

In the Release, the Commission asked whether disqualification based on a going concern opinion would cause undue pressure on auditors to not issue those opinions. Our concern is not about undue pressure on auditors to not issue such opinions. Rather, we believe the going concern opinion criterion would not be as effective in promptly identifying issuers with significant liquidity problems for the following reasons. It is important to recognize that "going concern" opinions were not established to determine whether a company is more or less suitable to raise money in the capital markets.

- Given the conditions under PCAOB standards for issuing a going concern opinion, that criterion will identify a relatively limited group of companies that have potentially significant liquidity problems. We believe it would be preferable to establish criteria that would cast a net that is wide enough to catch substantially all issuers whose liquidity problems warrant disqualification.

- In particular, we note that operating and liquidity problems can arise (or worsen) subsequent to the date of the auditor's report on the latest annual financial statements. If the issuer received a "clean" opinion on its latest annual financial statements but its financial condition has deteriorated, the issuer may need to be disqualified. However, under the proposed going concern criterion it would not be disqualified.

- The auditing standards require an auditor to use significant judgment in deciding whether a company warrants a going concern opinion. We believe that using objective criteria is a better way to determine which issuers should be disqualified. Those issuers that fail the objective criteria because of unique circumstances that are not indications of liquidity problems can always seek a waiver.

Material Weaknesses in Internal Control

The Commission also asked whether an issuer's disclosure of a material weakness in its internal control over financial reporting should make it an ineligible issuer. We presume that the Commission's concern is that a material weakness may be an indicator that an issuer's securities may be more likely to be the subject of abusive activities, as has been the case with other types of issuers included in the definition.

At this time, no one knows how frequently issuers will report material weaknesses. However, we would not be surprised to find that numerous issuers that have historically produced reliable financial statements and have never been associated with abusive activities will report material weaknesses. In addition, when issuers that would qualify as well-known seasoned issuers report material weaknesses, we expect that they will generally work vigorously to remediate them. Accordingly, we do not expect a high correlation between such issuers reporting material weaknesses and abusive activity. In addition, we do not expect the level of an issuer's market following to decrease if it reports a material weakness.

Therefore, rather than establishing a disqualifying criterion based on unremediated internal control weaknesses now, we suggest that the Commission monitor this issue and consider whether controls based criteria would be appropriate at some future date. Perhaps future study will indicate that certain types of material weaknesses or failing to remediate material weaknesses are good indicators of abusive behavior. If so, these types of material weaknesses might be suitable disqualifying criteria.

C. Accelerated Filer Definition

In the Commission's September 2002 release accelerating the reporting deadlines for certain registrants, the Commission stated that it had designed the public float and reporting history requirements reflected in the accelerated filer definition "to include the companies that are least likely to find such a change overly burdensome and *where investor interest in accelerated filing is likely to be highest*" (emphasis added). The Commission indicated that investor interest in accelerated filing is likely to be highest for companies followed by analysts and institutional investors because "[t]he more extensive information in periodic reports is evaluated by investors and particularly analysts and institutional investors as a baseline for the incremental disclosures made by a company." In addition, "investors, institutional investors and financial analysts" comprised the group of 20 commenters who supported acceleration as proposed.

The SEC staff's study of market following and seasoned offerings indicates that the market capitalization level at which issuers are widely followed by investors whose interest in accelerated filing is likely to be the highest (based on "[h]igh levels of analyst coverage [and] institutional ownership," among other criteria) is $700 million (not the $75 million reflected in the current accelerated filer definition). Therefore, we believe the Commission should change the public float threshold (currently $75 million) in the accelerated filer definition to correspond to that adopted as the threshold for qualification as a well-known seasoned issuer (which is proposed to be $700 million). If an issuer is not widely followed, we believe the cost of meeting the accelerated filing deadlines is "overly burdensome" and exceeds the benefit. While issuers that would not qualify as a well-known seasoned issuer should be permitted and encouraged to voluntarily file on an accelerated basis, we believe that the information gained in the study of market following strongly supports adjusting the level of market capitalization at which issuers should be required to file periodic reports on an accelerated basis.

Notwithstanding the view expressed above, in order to qualify as a well-known seasoned issuer and have the privilege of automatic shelf registration, we believe that all well-known seasoned issuers should be required to file on an accelerated basis. This would ensure that the extent and timing of information available to investors at the time an automatically-effective shelf registration statement is filed would be the same for all well-known seasoned issuers. Therefore:

- If the Commission adopts our prior recommendation and modifies the well-known seasoned issuer definition so that an issuer's market capitalization temporarily falling below $700 million would not disqualify it from well-known seasoned issuer status, we believe that issuer should continue to be an accelerated filer.

- We believe that an issuer that meets the definition of a well-known seasoned issuer because it has issued the requisite amount of debt securities in registered offerings should also be required to file on an accelerated basis to be able to take advantage of automatic shelf registration. However, we believe that these issuers (who would not otherwise meet the definition of an accelerated filer) should be given the option to file periodic reports in accordance with the non-accelerated timetable if they are willing to forgo the privilege of automatic shelf registration.

If the Commission is unwilling to revert to the 45/90 days due dates for quarterly and annual reports filed by issuers with market capitalizations in the $75-700 million range as we have recommended, we believe the results of the study of market following at least warrant retaining the current due dates for these issuers' periodic reports (40/75 days) and not accelerating them further (to 35/60 days).

UNRESOLVED SEC STAFF COMMENTS

In the Release, the SEC seeks comment on whether automatic effectiveness of automatic shelf registration statements should be conditioned on resolution of SEC staff comments.

We believe that the current process has sufficient checks and balances such that SEC staff comments for accelerated filers are not likely to remain unresolved for significant periods of time. Our experience is that SEC staff comments are monitored and discussed internally in a robust manner among the executive officers that certify issuers' financial filings, issuers' disclosure review committees, audit committees, legal counsel, and independent auditors. Due to the heightened sense of scrutiny for all financial reporting matters, and particularly in light of the significance of Securities Act liability for errors and omissions in new registration statements, we do not believe that it is necessary to condition automatic effectiveness on resolution of SEC staff comments.

In the Release, the SEC asks whether accelerated filers should be required to disclose unresolved SEC staff comments in Exchange Act filings as an incentive for those issuers to timely resolve comments.

We do not believe that the SEC should require that unresolved SEC staff comments be disclosed in Exchange Act reports (quarterly or annual). The Commission appears to be concerned that automatic effectiveness of registration statements for well-known seasoned issuers will eliminate some of the incentive that issuers have to respond timely to staff comments. We believe that this group of issuers has historically been responsive and will continue to be responsive as they seek to enhance their disclosures and improve the overall quality of their financial reporting. In addition, as previously noted, there is already a strong system of reporting checks and balances, with significant objective, outside involvement from independent audit committee members, underwriters, legal counsel and auditors. Each participant in the offering process is very sensitive to the assumption of Securities Act liability with each new registration statement, and recognizes that it is in the best interest of all participants to resolve SEC staff comments on a timely basis. For example, as named experts with respect to audited annual financial statements, auditors are reluctant to consent to the use of their report in a registration statement as long as material accounting comments from the SEC staff are outstanding. As such, we do not believe there is a need to require disclosure of material unresolved comments, regardless of how long they have been outstanding.

We recommend that the SEC staff provide notification to issuers when the staff commences a review in which they expect to issue comments on an issuer's previous periodic filings. This practice would give issuers contemplating a new offering or shelf takedown the opportunity to consider delaying filing a new registration statement in order to take into account any pending SEC staff comments. Notification of commencement of review is a logical adjunct to the SEC staff's June 2004 announcement that issuers will be formally advised when staff reviews are completed and would provide another means by which the quality of information contained in offering statements may be improved.

Further, we believe it is appropriate for the SEC to adopt a policy with the objective that its staff members adhere to a reasonably strict timeframe within which to reply to an issuer's response. We suggest that the SEC staff be required to respond within the same number of days taken by the issuer to respond to the SEC staff's comments, subject to a minimum of five business days for the staff.

In the event that the SEC continues to believe that issuers should be required to disclose material unresolved comments in annual reports, we believe that the requirement should apply only to well-known seasoned issuers. We also believe that any timeframe set for resolution of staff comments make allowance for the needs of issuers to adequately consult with their SEC counsel, auditor and in some cases, their audit committee members. We believe that 180 days, measured from the date that the initial specific comment that the issuer believes is material is received in writing from the staff, would be an adequate timeframe to allow for proper consultations while at the same time meeting the need for resolution of comment that the SEC is seeking, as long as the SEC adopts a policy ensuring that its staff responds within a specific timeframe as suggested above.

Further, if the Commission adopts a requirement to disclose material outstanding comments in periodic filings, we concur with the Commission that issuers should be permitted to paraphrase or summarize the comments. By the time 180 days has elapsed, we believe that issuers and the SEC staff will have appropriately framed any remaining matters such that there would be no need to repeat the comment verbatim. Also, we agree that only material comments should be required to be disclosed and that the assessment of materiality should be the responsibility of management. Given the amount of dialogue that would likely occur in the timeframes proposed, we believe that issuers would be able to distinguish those comments that are material from other unresolved comments and there is no need for all unresolved comments to be disclosed. We believe that issuers should maintain primary control over the disclosures in their periodic filings.

RISK FACTORS

The Release proposes extending risk factor disclosures to Exchange Act registration statements and periodic reports. The Commission asks for comments on whether any other risk factors, in addition to those in Item 503 of Regulation S-K, should be specified and whether there are ways to ensure that issuers include meaningful, rather than boilerplate, risk factor disclosures. The Commission also asks whether risk factor disclosures should be extended to Forms 10-KSB and 10-SB.

We support the proposal to extend risk factor disclosure to registration statements on Form 10 and annual reports on Form 10-K (with updates in Form 10-Q). We also agree that those risk factors should be written in plain English and that Item 503(c) of Regulation S-K provides an appropriate basis for those disclosures.

We also believe that the risk factor disclosures should be extended to registration statements on Form 10-SB and annual reports on Form 10-KSB (with updates in Form 10-QSB) because we believe that the benefit to be derived by investors and potential investors in smaller companies are the same as those that would be derived by investors (and potential investors) in larger companies. Indeed, the risks faced by smaller companies oftentimes exceed those of larger ones.

Disclosure of risk factors in Exchange Act reports would encourage regular communication of the significant risks facing issuers, would enhance the transparency of reported information available in the secondary market, and would further the Commission's efforts toward greater integration of Exchange Act and Securities Act filings. In fact, many public companies already disclose risk factors in their Exchange Act reports, and provide further embellishment and discussion of risks and uncertainties as part of the Management's Discussion and Analysis (MD&A) section of the filing as required by Item 303 of Regulation S-K. Since disclosure of risk factors in proposed Item 1A could result in duplicative disclosures with similar information presented elsewhere in the filing, such as MD&A, the Commission may want to consider issuing guidance regarding preferential placement within the filing.

We believe that the guidance provided in Item 503(c) of Regulation S-K is a good starting point for proposed Item 1A disclosures, but we believe that additional guidance regarding the nature and content of risk factor disclosures would be helpful. In order to avoid boilerplate disclosures, we believe that the Commission should provide clearly articulated objectives of the disclosure and guidance on identifying the most significant risk factors. We believe that this objectives-oriented approach will encourage issuers to focus on their business and to tailor their disclosures to their specific facts and circumstances. We believe that guidance similar to that provided in the various releases on MD&A would be helpful.

FORWARD-LOOKING INFORMATION IN INITIAL PUBLIC OFFERINGS

The SEC has requested comment on whether, for non-reporting issuers in their initial public offerings, it should consider extending a statutory safe harbor to forward looking statements made in a related registration statement, similar to the safe harbor contained in Securities Act Section 27A.

We encourage the SEC to reassess the scope of the statutory safe harbor for forward-looking statements (Section 27A of the Securities Act). We recommend that the SEC use its exemptive authority to extend the statutory safe harbor to forward-looking statements that are required by SEC regulations in the registration statement of an initial public offering (IPO) by a non-reporting issuer. For example, in our view, the statutory safe harbor should cover forward-looking statements about certain known trends and uncertainties, off-balance sheet arrangements, and aggregate contractual obligations, which must be provided in an IPO registration statement in response to the SEC's MD&A rules. However, we do not believe that any expansion of the statutory safe harbor for forward-looking statements should extend to an IPO by an ineligible issuer (but see our comments above regarding the proposed definition of an ineligible issuer).

Were the SEC to expand the statutory safe harbor in this manner, eligible non-reporting issuers would be provided equal and appropriate protection in their IPO registration statement with respect to SEC-mandated disclosures of forward-looking statements, which would qualify for safe harbor protection once the registration statement becomes effective and the company becomes a reporting issuer. However, such a limited expansion of the statutory safe harbor would respect the concerns about potential abuse that led Congress to exclude IPOs from the original scope of the statutory safe harbor. With sufficient experience under the statutory safe harbors, and given the SEC's emphasis on the quality and usefulness of MD&A (as expressed in FR-72, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*), we encourage the SEC to extend the statutory safe harbor to forward-looking statements required to be disclosed within an IPO registration statement.

The SEC also has requested comment on whether non-reporting issuers should be required to file projections as part of their IPO registration statement and, if so, whether the projection should (a) comply with Item 10 of Regulation S-K or S-B as applicable, and (b) be required to be accompanied by an accountant's report.

In connection with the IPO of any issuer, we do not believe that the SEC should require financial projections, whether or not accompanied by an attestation report from an independent auditor. Notwithstanding the Commission's view in Item 10(b) of Regulation S-K, which encourages the use of financial projections in registration statements and certain Exchange Act reports, we believe that, because there is no requirement for reporting issuers to file financial projections either in a registration statement or in an Exchange Act report, the Commission should not mandate such a requirement in an IPO registration statement by a non-reporting issuer.

In addition, in Release No. 33-5362, *Statement by the Commission on the Disclosure of Projections of Future Economic Performance*, the Commission expressed “strong reservations about the ability of issuers with limited resources or operational histories to make reasonably based projections.” We concur that non-reporting issuers are less likely to have a reasonable basis for making projections, and we question why mandatory projections in IPO registrations statements ever would be appropriate. However, if the SEC ever mandated projections by all issuers, we believe that any such projection in an IPO registration statement should be subject to the statutory safe harbor for the reasons expressed above.

If the Commission is inclined to proceed with a requirement to mandate projections, we would encourage it to do so as part of a separate rulemaking initiative to ensure that such a significant change would be subject to further analysis and adequate consideration.

* * * * *

The AICPA appreciates the opportunity to comment on the Release. We would be pleased to discuss these comments with you at your convenience.

Sincerely,

Robert J. Kueppers
Chair
Center for Public Company Audit Firms

Jay P. Hartig
Chair
SEC Regulations Committee

cc: Chairman William H. Donaldson
Commissioner Cynthia A Glassman
Commissioner Harvey J. Goldschmid
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Alan L. Beller
Donald T. Nicolaisen