SAS 72 Auditor Representation Letters

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A SAS 72 auditor representation letter (also called, among other things, a SAS 72 letter, an underwriter representation letter or auditor representation letter) may be delivered by the underwriters or certain other parties to an issuer’s independent accountants (referred to herein as auditors) in connection with that party’s request for a SAS 72 comfort letter from the auditors, typically in connection with private and certain public equity and debt offerings, both domestic and international, including underwritten Rule 144A and Regulation S debt and equity offerings. For further information on SAS 72 letter requests in the context of international offerings, see Foreign Private Issuer Practice Guide.

Brief Overview of SAS 72 Comfort Letters

In connection with an offering of securities, underwriters (and other financial intermediaries) will typically require the issuer to cause the auditors to deliver a comfort letter as a condition of the underwriting agreement (or other transaction agreement, e.g., a placement agreement). Comfort letters provide additional assurance to the requesting party regarding the accuracy and completeness of certain financial information disclosed by the issuer in connection with an offering and constitute an important part of the underwriters’ due diligence review of the issuer’s financial condition and the accuracy of the financial information contained in the offering document.

The requirements for a SAS 72 comfort letter originate from U.S. accounting professional standards, as first articulated in Statement on Auditing Standards No. 72 and superseded by Auditing Standards 6101 (AS 6101). The relevant auditing standard may be found at https://pcaobus.org/Standards/Auditing/Pages/AS6101.aspx. In common practice, the term SAS 72 is still often used when referring to the standards. AS 6101 provides guidance to auditors on their preparation of comfort letters, including the form and content of such comfort letters, and is the most commonly requested form of comfort letter for any offering of securities in the United States or involving sales into the United States. This practice note does not apply to the requirements for other forms of comfort letters, such as a SAS 76 comfort letter or a comfort letter issued under the International Capital Markets Association (ICMA) standard.

In a registered offering, receipt of a SAS 72 comfort letter is a key part in establishing the underwriters’ statutory due diligence defense under Section 11 of the Securities Act of 1933, as amended (the Securities Act), with respect to the financial information included in a registration statement. Additionally, audited financial statements are considered an expertized portion of the offering document. Underwriters can establish their due diligence defense and therefore avoid Section 11 liability with respect to such expertized portions, through reasonable reliance on them without having to conduct an independent investigation.

In an unregistered offering, underwriters and other financial intermediaries are not subject to liability under Section 11 of the Securities Act and therefore have no statutory due diligence defense. However, underwriters and other financial intermediaries are still subject to other forms of liability for material misstatements or omissions in an offering document (such as liability under Rule 10b-5 under the Securities Exchange Act of 1934, as amended) and will nearly universally require a SAS 72 comfort letter with respect to all of the audited or reviewed financial information contained in the offering document.

For more information on comfort letters, see Reviewing the Comfort Letter and Comfort Letter Review and Negotiation Checklist.

Why Auditor Representation Letters Are Necessary

Paragraphs .03 and .04 of AS 6101 provide guidance to auditors regarding (1) which parties may receive a SAS 72 comfort letter, and (2) whether those parties need to provide a signed auditor representation letter (as described below) in order to receive one.
In a registered offering, an auditor may provide a SAS 72 comfort letter to a named underwriter in the offering. In addition, an auditor may provide a SAS 72 comfort letter to any other parties to the registered offering that have a statutory due diligence defense under Section 11 of the Securities Act (such as a sales agent or a selling shareholder), but only if:

- A law firm or attorney for the requesting party issues a written opinion to the auditor that states that such party has a due diligence defense under Section 11 of the Securities Act—or–

- Such party provides a signed auditor representation letter that states:
  - It will conduct a due diligence review substantially consistent with the inquiry that would be made in an SEC-registered offering of securities—and–
  - It is knowledgeable about the due diligence process that would be performed if the placement of securities were registered under the Securities Act

In certain types of unregistered offerings, an auditor may provide a comfort letter to a broker-dealer or other financial intermediary (such as an initial purchaser or placement agent), acting either as principal or agent, but only if the requesting party has provided a signed auditor representation letter making the same statements as are required for a registered offering.

A named underwriter in a registered offering does not need to provide an auditor representation letter in order to receive a SAS 72 comfort letter.

This practice note does not address auditor representation letters or SAS 72 comfort letters requested in the context of acquisition transactions, which are covered by paragraph .05 of AS 6101.

**Content of an Auditor Representation Letter**

The required elements of an auditor representation letter, as set out under paragraph .06 of AS 6101, are as follows:

- The letter should be addressed to the auditors.

- The letter should contain the following language, which will often include the corresponding footnote if requested by the auditors:

  This review process, applied to the information relating to the issuer, is (will be) substantially consistent with the due diligence review process that we would perform if this placement of securities (or issuance of securities in an acquisition transaction) were being registered pursuant to the Securities Act of 1933 (the Act). We are knowledgeable with respect to the due diligence review process that would be performed if this placement of securities were being registered pursuant to the Act.

  It is recognized that what is “substantially consistent” may vary from situation to situation and may not be the same as that done in a registered offering of the same securities for the same issuer; whether the procedures being, or to be, followed will be substantially consistent will be determined by the requesting party on a case-by-case basis.

- The letter should be signed by the requesting party, which would include each sales agent, placement agent, initial purchaser, selling shareholder, or other addressee of the comfort letter.

For a form of auditor representation letter, see SAS 72 Auditor Representation Letter.

**Practice Tips**

- As counsel, you should confirm with your client(s) early on in the transaction whether they expect to receive a SAS 72 comfort letter. You should then communicate this with the auditors and confirm as early as possible whether they will expect an auditor representation letter from your client. If there are multiple auditors, each accounting firm delivering a comfort letter will require a representation letter from each of the requesting parties. Generally, any party requesting a comfort letter, other than a named underwriter in a registered offering, will need to deliver an auditor representation letter.

- In a typical underwritten offering, the latest an auditor representation letter can be dated and delivered is the date of delivery of the first comfort letter, which is usually on pricing of the securities. This is usually a very busy time for all parties to the offering. Best practice is to get the auditor representation letter in agreed form prior to pricing, and if agreeable to the auditors and the requesting party, deliver the executed letter on or prior to pricing.

- An example representation letter with the minimum requirements under AS 6101 is available under paragraph .07 of AS 6101. Please note that in practice, many auditors will provide their own standard form of auditor representation letter, which should ideally not deviate from the form language. For a form of auditor representation letter, see SAS 72 Auditor Representation Letter.
Regardless of which language is used, early communication between the requesting party and the auditors is vital to ensure that the language and form of the representations made are acceptable to both parties and that the comfort letter can be delivered in a timely manner.