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Proposed statement on auditing standards : amendments to SAS no. 38, Letters for underwriters ;Amendments to SAS no. 38, Letters for underwriters;Letters for underwriters

American Institute of Certified Public Accountants. Auditing Standards Executive Committee

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EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

Amendments to SAS No. 38: Letters for Underwriters

NOVEMBER 4, 1983

**Prepared by the AICPA Auditing Standards Board
For comment from persons interested in auditing and reporting**

**Comments should be received by February 6, 1984, and addressed to
AICPA Auditing Standards Division, File 2312
1211 Avenue of the Americas, New York, N.Y. 10036-8775**

SUMMARY

This Statement consists of amendments to SAS No. 38, *Letters for Underwriters*. The amendments are in response to recent changes in SEC financial reporting requirements and other developments in auditing and reporting practices. The following amendments are proposed:

- Guidance is added regarding shelf registrations relating to requests for a comfort letter before the managing underwriter has been named and references to comments in previously issued comfort letters.
- A change is made in the recommended wording of the accountants' statement on independence due to changes in SEC disclosure requirements regarding certain relationships with the registrant.
- A change is made to specify that accountants should comment on compliance as to form with published SEC accounting requirements only with regard to those requirements dealing with the form and content of financial statements.
- A change is made to permit comments on pro forma financial information, and an example of comments on pro forma information is added.
- Guidance is added on references in a comfort letter to previously issued reports on condensed financial statements, selected financial data, or pro forma financial information.
- Guidance is added permitting comments on unaudited condensed financial statements that are not included in the registration statement.
- A change is made to permit the accountant to comment on changes or decreases in financial statement items regardless of whether they are disclosed in the registration statement.
- An example is added of summarized descriptions of procedures and findings regarding tables, statistics, and other financial information.

Various miscellaneous technical changes are also proposed.

This exposure draft has been sent to

- *practice offices of CPA firms*
 - *members of AICPA Council and technical committees*
 - *state society and chapter presidents, directors, and committee chairmen*
 - *organizations concerned with regulatory, supervisory, or other public disclosure of financial activities*
 - *persons who have requested copies*
-



American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

November 4, 1983

Accompanying this letter is an exposure draft of a proposed Statement on Auditing Standards entitled Amendments to SAS No. 38; Letters for Underwriters. A summary of the proposed SAS also accompanies this letter.

Comments or suggestions on any aspect of this exposure draft will be appreciated. The AICPA Auditing Standards Board's consideration of responses will be helped if the comments refer to specific amendments and include supporting reasons for any suggestions or comments.

In developing guidance, the AICPA Auditing Standards Board considers the relationship between the cost imposed and the benefits reasonably expected to be derived from audits. Thus, the board would particularly appreciate comments on those matters.

Written comments on the exposure draft will become part of the public record of the AICPA Auditing Standards Division and will be available for public inspection at the offices of the American Institute of Certified Public Accountants after March 5, 1984, for one year.

Responses should be sent to the AICPA Auditing Standards Division, File 2312, in time to be received by February 6, 1984. For convenience in responding, a postpaid mailer is attached to this exposure draft.

Sincerely,

David L. Landsittel
Chairman
Auditing Standards Board

Dan M. Guy
Vice President, Auditing

Proposed Statement on Auditing Standards

Amendments to SAS No. 38

Letters for Underwriters

This Statement consists of amendments to Statement on Auditing Standards No. 38, *Letters for Underwriters*. The amendments are in response to recent changes in financial reporting requirements of the Securities and Exchange Commission and other developments in Statements on Auditing Standards and current auditing and reporting practices.

Note: Roman type indicates wording from the original statement. *Italics* indicate wording to be added by the amendments, and strike-throughs indicate wording to be deleted.

Shelf Registration Statements

These amendments provide guidance on responding to a request by the client, or the legal counsel designated by the client to represent the underwriting group, to issue a comfort letter in connection with a shelf registration statement before the managing underwriter for any part of the securities offering has been designated. The amendment also provides guidance on referring to comments in previous comfort letters regarding financial information incorporated by reference into a shelf registration statement.

1. The following paragraph is added after paragraph 7.

Regulations under the 1933 Act permit, in certain circumstances, companies to register a designated amount of securities for continuous or delayed offerings during an extended period by filing one "shelf" registration statement. At the effective date of a shelf registration statement, the registrant may not have selected a managing underwriter (see note 4). A client or the legal counsel designated by the client to represent the underwriting group might, however, ask the accountants to issue a comfort letter at the effective date of a shelf registration statement to expedite the due diligence duties of the managing underwriter when he is subsequently designated and to avoid later corrections of financial information included in an effective prospectus. However, as stated in paragraph 2, only the underwriter can determine the procedures that will be sufficient for his purposes. In these circumstances, therefore, the accountants should not agree to furnish a comfort letter addressed to the client or legal counsel or to a nonspecific addressee such as to "any or all underwriters to be selected." The accountants may agree to furnish the client or the legal counsel for the underwriting group with a draft comfort letter (with no addressee indicated) describing procedures that the accountants have performed and comments the accountants are willing to express as a result of those procedures. The draft comfort letter should include a legend describing its purposes and limitations such as the following:

This draft represents a letter we would be prepared to sign as of the effective date of the registration statement if the managing underwriter had been chosen at that date and requested such a letter. The procedures set forth are similar to those that our experience indicates underwriters often request in such circumstances. The text of the final letter will depend, of course, on whether the managing underwriter who is selected requests that these or other procedures be performed to meet his needs and whether the managing underwriter requests that any of the procedures be updated to the date of issuance of the signed letter.

A signed comfort letter may be issued at each closing date to the managing underwriter selected for the portion of the issue then being offered.

2. Paragraph 46 is amended as follows:

46. The contents of letters for underwriters vary, depending on the extent of the information in the registration statement and the wishes of the underwriter. *This section provides The following are examples of letters for underwriters, or portions of such letters. Shelf registration statements may have several closing dates and different managing underwriters. Descriptions of procedures and findings regarding interim financial statements, tables, statistics, or other financial information that is incorporated by reference from previous 1934 Act filings may have to be repeated in several comfort letters if the underwriter does not request that the procedures and findings be updated. To avoid restating these descriptions in each comfort letter, accountants may initially issue the comments in a format (such as an appendix) that can be referred to in, and attached to, subsequently issued comfort letters.*

Independence

The following amendments are in response to Item 509 of SEC Regulation S-K, which revised disclosure requirements of named experts, including independent auditors, regarding their interests in the registrant.

3. Paragraph 12 is amended as follows:

12. It is customary for the underwriting agreement to provide for the accountants to make a statement concerning their independence in the letter. This may be done substantially as follows:

We are independent certified public accountants with respect to The Blank Company, Inc., within the meaning of the Act and the applicable published rules and regulations thereunder. ~~and the answer to [identify the item number that refers to the relationship with registrant of experts named in the registration statement, e.g., item 23 of Form S-1] of the registration statement is correct insofar as it relates to us.~~

Regulation S-K requires disclosure in the prospectus and registration statement of interests of named experts (including independent accountants) in the registrant. Regulation S-X precludes an accountant who reports on financial statements in a registration statement from having interests of the type requiring disclosure in the prospectus or registration statement. Therefore, if an accountant makes a statement in a comfort letter that he is independent within the meaning of the Act and the applicable published rules and regulations thereunder, any additional comments on independence would be unnecessary. (See paragraph 34 regarding instances wherein the accountants' client is not the registrant.)

4. The example comfort letter wording in paragraph 34 is amended as follows:

As of [insert date of the accountants' most recent report on the financial statements of their client] and during the period covered by the financial statements on which we reported, we were independent certified public accountants with respect to [insert the name of their client] within the meaning of the Act and the applicable published rules and regulations thereunder. ~~and the answer to item 23 of the registration statement is correct insofar as it relates to us.~~

5. Paragraph 47, example A, paragraph 1, is amended as follows:

1. We are independent certified public accountants with respect to The Blank Company, Inc., within the meaning of the Act and the applicable published rules and regulations thereunder. ~~and the answer to item 23 of the registration statement is correct insofar as it relates to us.~~

6. Paragraph 56, example J, paragraph 1, is amended as follows:

1. We are independent public accountants with respect to the company within the meaning of the Act and the applicable published rules and regulations thereunder. ~~and the answer to item 10 of the registration statement is correct insofar as it relates to us.~~

Compliance With SEC Requirements

The following amendment provides guidance on the types of information with respect to which the accountant may comment regarding compliance as to form with published accounting requirements of the SEC.

7. The following paragraph is added after paragraph 13:

Accountants may comment on compliance as to form with requirements under published SEC rules and regulations only with respect to those rules and regulations applicable to the form and content of financial statements. Accountants should not comment on compliance as to form of other information included in the registration statement, for example, the ratio of earnings to fixed charges, selected financial data, management remuneration, and industry statistical data. (See paragraph 19 regarding unaudited condensed interim financial statements and paragraph 18g regarding pro forma financial information.)

Pro Forma Financial Information

Article 11 of Regulation S-X requires the presentation of a pro forma condensed balance sheet and either a pro forma condensed income statement or financial forecast to show the effects of significant business combinations, dispositions, and certain other transactions. The following amendments relate to the requirements of Regulation S-X and provide guidance on the accountant's comments in a comfort letter on pro forma financial information.

8. Paragraph 14 is deleted:

14. Since published SEC requirements do not deal with the form of pro forma financial statements or pro forma adjustments applied to historical financial statements, there is no basis for accountants to comment on whether such pro forma information complies in form with SEC requirements (see also paragraph 18g).

9. Paragraph 18g is amended as follows:

g. The accountants should not give negative assurance on *the application of pro forma adjustments applied to historical financial statements or the compilation of pro forma financial information and should not give negative assurance that the pro forma financial information complies as to form with published SEC rules and regulations* unless (1) they have made an examination of the entity's historical financial statements (or, in the case of business combinations, of a significant constituent part of the combined financial statements) (a) for the period presented or (b) in the case of interim periods for the latest fiscal period that includes or precedes the interim period, or (2) they have otherwise obtained knowledge of the client's accounting and financial reporting practices and its system of internal accounting control as provided for in f above.¹ (See example K.)

¹Regulation S-X permits a financial forecast to be filed in lieu of the required pro forma condensed income statement. Because of the unique responsibilities of the accountants regarding financial forecasts, the accountants should not include in a comfort letter any description of procedures or any assurance based on those procedures regarding a financial forecast. (See paragraph 17 regarding reference in a comfort letter to an accountant's report on a financial forecast.)

10. The following example is added as paragraph 57.

Example K: Comments on Pro Forma Financial Information

57. Example K is applicable when the accountants are asked to comment on compliance as to form of pro forma financial information in a registration statement (see paragraph 18g).²

²The accountants may be requested by the underwriter to apply additional procedures to pro forma financial information and comment on the application of pro forma adjustments to historical financial information or the compilation of pro forma financial information, and the accountants may perform the procedures and agree to comment on those matters.

The material in this example is intended to follow numbered paragraph 6 in example A. The example assumes that the accountants have not previously reported on the pro forma financial information. If the accountants did previously report on the pro forma financial information, they may refer in the introductory paragraphs of the comfort letter to the fact that they had reported, and the report may be attached to the comfort letter (see paragraph 17).

7. For purposes of this letter and at your request we have

- a. Read the unaudited pro forma condensed balance sheet as of March 31, 19X6, and the unaudited pro forma condensed statements of income for the year ended December 31, 19X5, and the three-month period ended March 31, 19X6, included [incorporated by reference] in the registration statement; and*
- b. Made inquiries of certain officials of the company and of XYZ Company (the company being acquired) who have responsibility for financial and accounting matters concerning whether the unaudited pro forma consolidated financial statements referred to in 7a comply as to form in all material respects with the applicable requirements of Rule 11-02 of Regulation S-X.*

The foregoing procedures would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representation about the sufficiency of such procedures for your purposes, and we are also unable to and do not express any opinion on such unaudited pro forma consolidated financial statements or on the pro forma adjustments applied to the historical amounts included in those statements.

8. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that the unaudited pro forma financial statements referred to in 7a included [incorporated by reference] in the registration statement do not comply as to form in all material respects with the applicable requirements of Rule 11-02 of Regulation S-X.

Accountants' Reports

The following amendments are to provide guidance on comments in a comfort letter when the accountants have previously issued reports on certain financial information, other than the financial statements, included in a registration statement.

11. Paragraph 17 is replaced by the following:

17. The accountants may refer in the introductory paragraphs of the comfort letter to the fact that they have issued reports on —

- a. Condensed financial statements that are derived from audited financial statements (see SAS No. 42).*
- b. Selected financial data (see SAS No. 42).*
- c. A review of interim financial information (see SAS No. 36).*
- d. Pro forma financial information (or a financial forecast filed in lieu of a pro forma condensed income statement).*

Such a reference should be to the accountants' reports that were previously issued, and, if not included in the registration statement, the reports may be attached to the comfort letter. In referring to previously issued reports, the accountants should not repeat their reports in the comfort letter or give negative assurance or make other comments regarding representations in the reports, for to do so might imply that the accountants are reporting as of the date of the comfort letter or that the accountants assume responsibility for the sufficiency of the procedures for the underwriter's purposes. However, for certain information on which they have reported, the accountants may agree to comment regarding compliance with published SEC requirements (see amendment number seven).

17. The accountants may refer in the introductory paragraphs of the comfort letter to the fact that a review had been performed of interim financial information. Such a reference should be to the accountants' report that was previously issued on the interim financial infor-

mation, and that report may be attached to the comfort letter. The accountants should not, however, repeat their report in the comfort letter or otherwise imply that they are reporting on the interim financial information as of the date of the comfort letter, for to do so might extend the accountants' responsibility for their report to the date of the comfort letter or imply that the accountants assume responsibility for the sufficiency of the procedures for the underwriter's purposes.

12. Footnote 19, for paragraph 47, example A, is amended as follows:

¹⁹As described in paragraph 17, the accountants may refer in the introductory paragraphs to the fact that they have issued reports on other financial information. For example, if the accountants refer to the fact that a review of interim financial information had been performed, an additional introductory paragraph, such as the following, may be added:

Also, we have made a review of the unaudited condensed interim financial statements for the three-month periods ended March 31, 19X6 and 19X5, as indicated in our report dated May 15, 19X6, which is included [incorporated by reference] in the registration statement.

13. Footnote 21, for paragraph 55, Example I, is amended as follows:

²¹In some cases the company or the underwriters may request that the independent accountants report on "selected financial data" as described in SAS No. 42. When the accountants report on this data and the report is included in the registration statement, separate comments should not be included in the comfort letter (see paragraph 17).

²¹In some cases the company or the underwriters may request that the independent accountants cover the "selected financial data" in their auditors' report. When the auditors' report specifically covers this data, separate comments should not be included in the comfort letter.

Comments on Unaudited Condensed Financial Statements That Are Not Included in the Registration Statement

The following amendment clarifies guidance on commenting on unaudited condensed financial statements that are not included in the registration statement.

14. Paragraph 22 is amended as follows:

22. The underwriter occasionally asks the accountants to give negative assurance with respect to the unaudited financial statements (or unaudited condensed financial statements) that underlie the capsule information and to state that the capsule information agrees with amounts set forth in such statements. If the underwriter requests it, and if it is practicable for the client to prepare such financial statements on a timely basis in conformity with generally accepted accounting principles, it is appropriate for the accountants to agree to the underwriter's request. Paragraphs 4b and 5b in example E provide an example of the accountants' comments in these circumstances. The underwriter might also ask the accountants to give negative assurance with respect to unaudited condensed financial statements for a period ending after the latest financial statements included in the registration statement. In those cases, the unaudited condensed financial statements should be attached to the comfort letter. Comments on subsequent changes, as discussed in paragraphs 23 through 28 below, should then be limited to those occurring after the date of the latest financial statements on which the accountants have commented.

Comments on Subsequent Changes and Decreases

The following amendments are intended to remove the prohibition against commenting on the occurrence of changes and decreases in financial-statement items that are disclosed in the registration statement.

15. Paragraph 29 is amended as follows:

29. Comments on the occurrence of changes in capital stock or long-term debt and decreases in other specified financial-statement items ordinarily are limited to changes or decreases not disclosed in the registration statement. Accordingly, the phrase, "except for

changes or decreases that the registration statement discloses have occurred or may occur,” should be included in the letter when it has come to the accountants’ attention that a change or decrease has occurred during the change period, and the change or decrease is disclosed in the registration statement. If the underwriter requests that the accountants comment on the occurrence of changes or decreases whether or not they are disclosed in the registration statement, the above phrase should not be included in the letter.

29. Comments on the occurrence of changes in capital stock or long-term debt and decreases in other specified financial-statement items are limited to changes or decreases not disclosed in the registration statement. Whenever it appears to the accountants that a change or decrease has occurred during the change period, and the change or decrease is disclosed in the registration statement, the phrase, “except for changes or decreases that the registration statement discloses have occurred or may occur,” should be included in the letter.

16. Cross-references to paragraph 29 are added to the illustrative comfort letters in —

Example A, paragraph 5b
Example A, paragraph 6
Example E, paragraph 5c
Example E, paragraph 6
Example F, paragraph 5b
Example F, paragraph 6
Example H, paragraph 6
Example J, paragraph 5b

Tables, Statistics, and Other Financial Information

This amendment provides guidance to the accountant in summarizing the descriptions of procedures and findings regarding tables, statistics, and other financial information, and it gives an example of such a summarized presentation.

17. Paragraph 41 is amended as follows:

41. In order to avoid ambiguity, the specific information commented on in the letter should be identified by reference to *specific* captions, tables, page numbers, or specific paragraphs or sentences. *Descriptions of the procedures followed and the findings may be listed individually for each item of specific information commented on. Alternatively, some or all of the descriptions may be grouped or summarized if the procedures are adequately described, the descriptions do not imply that the accountants assume responsibility for the adequacy of the procedures, and it is unlikely that the applicability of the descriptions to items in the registration statement will be misunderstood.* It should not refer, for example, to “all financial and statistical information” set forth (a) in the registration statement, (b) under specific captions, or (c) in response to specific item numbers in the registration statement.

18. A cross-reference to example L is added at the end of paragraph 42.

19. The following example is added as paragraph 58.

Example L: Summarized Description of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information

58. *Example L illustrates a method of summarizing the descriptions of procedures and findings regarding tables, statistics, and other financial information in order to avoid repetition in the comfort letter. The summarization of the descriptions is permitted by paragraph 41. Each of the comments is in response to a specific request. The paragraphs in example L are intended to follow numbered paragraph 6 in example A.*³

³Other methods of summarizing the descriptions may also be appropriately used. For example, a matrix may be presented listing the financial information and common procedures employed and indicating the procedures applied to specific items.

7. For purposes of this letter, we have also read the following, set forth in the registration statement on the indicated pages.

<u>Item</u>	<u>Page</u>	<u>Description</u>
a.	13	"History and Business—Sales and Marketing." The table following the first paragraph.
b.	22	"Remuneration of Management—19X5 Remuneration." The dollar amounts shown at the top of the page under the headings "Cash and Cash-Equivalent Forms of Remuneration—Salaries, Commissions and Bonuses and Securities, Insurance Benefits, Personal Benefits" and "Aggregate of Contingent Forms of Remuneration."
c.	33	"Selected Financial Data." The amounts of net sales, income from continuing operations, income from continuing operations per common share, total assets, long-term obligations, redeemable preferred stock, and cash dividends declared per common share for each of the five years in the period ended December 31, 19X5.

8. Our examination of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements taken as a whole. For neither the periods referred to therein nor any other period did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions such as those enumerated above, and, accordingly, we express no opinion thereon.

9. However, for purposes of this letter and with respect to the items enumerated in 7 above, except item a, we have (a) compared the dollar amounts to the amounts in the audited financial statements described in the introductory paragraph of this letter or the unaudited financial statements described in paragraph 3 to the extent such amounts are included in or can be derived from such statements and found them to be in agreement, (b) compared other dollar amounts to amounts in schedules prepared by the company and found them to be in agreement, and (c) verified the mathematical accuracy of the percentages and ratios based on the data in the above-mentioned financial statements, records, and schedules. With respect to item 7a, we compared the amounts of military sales, commercial sales, and total sales shown in the registration statement with the balances in the appropriate accounts in the company's general ledger for the respective fiscal years and for the unaudited interim periods and found them to be in agreement. (However, we make no comments regarding the appropriateness of such classification or the manner in which such classification has been made.) We verified the mathematical accuracy of the percentages of such amounts of military sales and commercial sales to total sales for the respective fiscal years and for the unaudited interim periods appearing in the registration statement.

10. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the registration statement and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

11. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Alternate Wording When the SEC Has Agreed to a Departure From Its Published Accounting Requirements

The following amendment changes example D to refer to separate financial statements of an unconsolidated subsidiary rather than to separate parent company financial statements, which are no longer required by SEC regulations.

20. Paragraph 50, example D is amended as follows:

Example D: Alternate Wording When the SEC Has Agreed to a Departure From Its Published Accounting Requirements

50. Example D is applicable when (a) there is a departure from the applicable accounting requirements of the Act and the related published rules and regulations and (b) representatives of the SEC have agreed to the departure. Numbered paragraph 2 of example A would be revised to read as follows:

In our opinion [include the phrase “except as disclosed in the registration statement,” if applicable], the financial statements and schedules examined by us and included or incorporated by reference in the registration statement comply in form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations; however, as agreed to by representatives of the SEC, separate ~~parent company~~ financial statements and schedules of *ABC Company (an unconsolidated subsidiary)* as required by ~~Rule 3-09~~ ~~Rules 3-03 and 3-04~~ of Regulation S-X have been omitted.

Numbered paragraph 5a of example A would be revised in part to read as follows:

(i) . . . do not comply in form in all material respects with the applicable accounting requirements of the Act and of the related published rules and regulations; however, as agreed to by representatives of the SEC, separate ~~parent company~~ financial statements and schedules of *ABC Company* as required by ~~Rule 3-09~~ ~~Rules 3-03 and 3-04~~ of Regulation S-X have been omitted; (ii) . . .

Miscellaneous

The following amendments are to respond to changes in SEC financial reporting regulations or to clarify guidance in the Statement.

21. References in paragraph 16 and in footnote 16 (paragraph 42) to “item 12(a) of Regulation S-K” are changed to “item 302(a) of Regulation S-K.”

22. In paragraph 16, reference is added to SAS No. 42 regarding guidance on reporting on interim financial information required by SEC Regulation S-K.

23. References in paragraphs 18 and 19 and in the headings preceding those paragraphs to “unaudited condensed financial statements” are changed to “unaudited condensed interim financial statements.”

24. Example J in paragraph 56 and the heading preceding that paragraph are changed to refer to Forms S-2 or S-3 rather than to Form S-16.

25. The first sentence of the example comfort letter in paragraph 44 is revised as follows to recognize that comfort letters may be addressed to the client as well as to the underwriter: “This letter is solely for the information of the addressees and to assist the underwriters in . . .”

Similar revisions are made in example A paragraph 7, example C paragraph 7, and example I paragraph 11.