May 10, 2004

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

**Re: Public Company Accounting Oversight Board (PCAOB) Audit Standard No. 2– An Audit of Internal Control Over Financial Reporting Performed In Conjunction With An Audit of Financial Statements (the Standard)**

Dear Mr. Secretary:

I am pleased to submit this comment letter to the Securities Exchange Commission ("Commission" or the "SEC") regarding the above-referenced PCAOB Audit standard. The thoughts contained in this document are my personal opinions, and do not represent the official position of The Rouse Company.

Overall, The Rouse Company's Internal Audit Department supports the actions of the SEC and the PCAOB to implement the requirements indicated in the Sarbanes-Oxley Act of 2002 (the Act), but, as I indicated in my response to the PCAOB in October 2003, I am concerned that the unintended consequences of implementing the proposed requirement to perform an external audit of internal controls over financial reporting at this time and in the manner laid out in the Standard are potentially significant and must be considered in order to ensure the protection of investors and the integrity of our securities markets.

Accordingly, I have set out in this letter, my perspective, my observations, and a proposed short-tem solution for consideration by the Commission.

***Perspective***

I am the Director of Internal Audit for The Rouse Company. I recently assumed this position after serving as a director in Marriott International's Internal Audit function. In these roles, I have and continue to work closely with management and our external auditors to develop and implement an approach to achieve compliance with the requirements of Sarbanes-Oxley. I am, as are many of my counterparts, a product of one of the four major accounting firms and have worked on both sides to interpret requirements of audit standards and coordinate the planning and execution of an appropriate audit plan to meet the requirements, while maintaining the objectivity of the Internal Audit function and the independence of the external auditors. This is a challenge faced on every financial statement audit and in the performance of service auditor examinations, but never on the scale we face now.

***Observations***

From the initial discussions in Congress, through the issuance of the Act, I fully supported the need for significant reform of the control process over financial reporting in public companies. I believe the Act was responsive to those needs, and in fact has resulted in change. The benefits to date include:

- Increasing consciousness of management of public companies regarding their responsibility to shareholders and potential investors, for complete and accurate reporting of financial results.
- Growing awareness of the difference between processes which guide performance as intended, and controls which ensure performance as intended or detect exceptions/variations from intended/expected process/results.
- Broad recognition of the value of strong internal controls, which continue to increase as management addresses any opportunities to improve controls identified in preliminary testing of controls over financial reporting. This recognition, in many organizations, has not only resulted in improved controls under examination, but has driven improvements in change management processes to include, more often, a thorough evaluation of business risks and the development of appropriate controls in the new or improved business process or system.

I have, as indicated above, worked closely with management and our external auditors to plan and perform our assessment of internal controls over financial reporting. I have also been conferring with my counterparts in numerous other large public companies and their auditors. Based on my observations, I note the following concerns/unanswered questions which I believe must be considered and/or resolved as we endeavor to enhance corporate governance:

- Expectations gap: Technology and prosperity have opened our securities markets over the past few decades to a broad cross-section of America and the world. As a result, a significant number of less sophisticated investors are now exposed to financial loss in US securities markets. The expectation gap or difference between what investors believe or expect regarding the reliability of audited financial statements to be, and the fact that the audit of financial statements is designed to provide "reasonable assurance" regarding their accuracy and completeness, has always existed. This gap is much wider for the less sophisticated investor, and I believe that the addition of an external report regarding the effectiveness of controls over financial reporting, despite language regarding the limitations of internal controls, will widen this gap. We would not ask a governor to report on the effectiveness of law enforcement in his/her state and hold him/her responsible if the crime rate increased, but to the less sophisticated investor a report on internal controls is a guarantee that the financials are accurate and complete. I believe all citizens can appreciate that we could prevent all murder and other violent crimes by the few, only with significant loss of freedom enjoyed by many. Likewise, I believe all investors, with some basic and ongoing education, possibly delivered by the SEC, the PCAOB, and/or the exchanges, will understand that there is a limit to the assurance that we can legislate, without increasing the costs for doing business as a US corporation to a point where they cannot compete with foreign corporations. Because an external report on internal control will not eliminate the risk of investor losses as a result of control failures, it should not be issued without efforts to educate investors regarding its cost, limits, purpose, and benefit.
- Inconsistent Implementation of the Standard: Based on discussions with numerous Internal Audit directors, and partners from each of the major public accounting firms, it is apparent that companies are implementing widely varied approaches toward the assessment of internal controls over financial reporting. Contributing factors appear to include the lack of specific guidance in the PCAOB's standard for management's assessment and the reluctance of public accounting firms, in many cases, to provide specific guidance for fear that this assistance may be perceived to affect their independence. I don't presume my interpretation to be more correct than that of my peers in internal audit, but I do request that the Commission recognize that there are different interpretations of the requirements of the Standard with respect to Management documentation. I understand that the standard is designed to provide guidance for external audits of internal controls, but the lack of precedent for this type of review within most companies leaves them ill prepared for a review of this scope.
- Inadequate Resources: Qualified accounting and audit professionals were never overly abundant, but now, the level of effort required for the audit of internal controls over financial reporting raises the staffing requirements of public companies, public accounting firms, the PCAOB and SEC. The level of demand is driving up costs and raising the question whether there will be adequate resources to perform all of the required audits.
- Assessments of Service Provider Controls: This is really a subset of my concern regarding the inconsistent application of the standard, but one which deserves special attention. The Standard provides guidance for the use by management and external auditors of a Service Auditors report (SAS 70) in the performance of the audit, and suggests that if such a report does not exist, or to the extent that it does not cover all of the service provider's controls relevant to a user organization's financial reporting process, that the auditor must perform tests of controls at the service organization. Though released over a decade ago, and being provided more regularly each year, a relatively small percentage of service organizations will have a SAS 70 report to share with external or internal auditors for a 2004 audit of internal controls over financial reporting. Thus, many companies and their auditors must plan and perform audits of numerous service providers as part of the audit. Many service organizations are resisting such procedures and changing service providers to obtain a SAS70 is not always an option and often will be cost prohibitive and/or result in operational issues.
- External Audit Fee Increases: I fully expect this to be the most common concern the SEC receives in comments to the proposed audit standard. I have seen, heard and read of the increases and the numbers are widely varied and sometimes staggering. The fact is, the effort to perform an audit of internal control over

financial reporting is not a small task, so a fee increase is no surprise. The rates per hour do indicate that the costs of increasing demand, discussed above, are being passed on. The significant variances in estimates from company to company leads me to believe that that the firms have varied approaches, or the companies they are auditing have employed widely different approaches for their assessment, as I suggest above.

- Inconsistent Assessments of Deficiencies: There will always be a need to apply judgment in an assessment of the significance of a deficiency, but there are many situations that many, if not all companies will face in a review of internal control over financial reporting that demand consistent guidance. Examples include weak passwords and inability to provide the population of system changes. The questions with respect to weak passwords, for a system deemed in scope for the audit, include: what password characteristics must be in place for the auditor to deem access controls effective; and what controls, if any, mitigate the risks of unauthorized access to a system with weak passwords? The questions with respect to a company's inability to provide a population of system changes, for a system deemed in scope for the audit, include: do restrictive access rights provide sufficient evidence that unauthorized changes weren't moved into the Company's production environment; and what controls, if any, mitigate the risks of unauthorized system changes?
- Benefit of the External Report: The external reports on internal control over financial reporting are estimated to cost public companies $billions which is in addition to the $billions shareholders are ultimately paying for managements assessments. While, as I indicated above, the benefits of management's assessment are real and growing, I do not expect the investor to derive much, if any value from the external report.
- Future of the Accounting Profession: There were no sighs of relief or cheers of joy from competing firms, when Arthur Andersen was eliminated. In fact, I get the feeling that there is little confidence among the remaining firms that the future is certain for any of them. Many, it appears, believe that the PCAOB is operating under a political imperative that they identify and make an example of another firm during examinations in 2005. Whether or not this is a reality, it is affecting service levels, as it appears to be a significant factor in their reluctance to coordinate the audit of internal controls with internal audit.

***Proposed Solution***

As I indicated above, I believe that the Act has produced significant benefits, and I do not suggest that the SEC should permit management to stop or even delay current efforts to document and evaluate internal control over financial reporting.

In light of the concerns I indicated above, I do suggest that the SEC work with the PCAOB and public companies on a revised short-term solution and forgo implementation of the Standard at this time.

The approach I recommend is as follows:

- Require management of accelerated filers to continue to perform their assessment of internal control over financial reporting and provide documentation to external auditors for their interim audit procedures.
- Require external auditors to perform walkthroughs of significant controls, as indicated in the Standard, and require them to issue a management letter indicating any internal control deficiencies identified in their walkthroughs. Existing audit standards regarding the consideration of internal controls in the performance of a financial statement audit, should still apply, and accordingly, the auditor should document their assessment of controls and their plans to test and rely of controls, where applicable, and the nature timing and extent of control and substantive test procedures.
- Require management to respond to the management letter and resolve each noted deficiency, as appropriate.
- Require management to complete testing of internal controls over financial reporting as of year end, and report results of their review and make related documentation available to their external auditors for inclusion in audit documentation, as appropriate.
- Require management to include conclusions of their assessment in the CEO and CFO certification for each 10-K.
- Require the PCAOB to perform examinations of public accounting firms, according to their current schedule. In addition to providing findings and recommendations to each firm, as a result of each examination, require that the PCAOB gather and summarize lessons learned, common mistakes and leading practices.

- Require the PCAOB, in the 3rd quarter 2005, to present the summarized results of their examinations and recommendations for enhancing audit methodologies, documentation, etc , to the SEC, and Audit firms.
- Require the PCAOB to evaluate existing audit standards for evaluation of controls of service providers (e.g. SAS70, SSAE10) and propose a standard to enable business partners to cross-certify controls relevant to the assessment of internal controls over financial reporting most efficiently.
- Require the PCAOB, to present their recommendation to the SEC regarding an external audit of internal controls over financial reporting (e.g. cost/benefit, revised guidance, etc.).

I believe that significant benefits will be realized if the SEC adopts this approach, as it will:

- Enable the SEC, the PCAOB, the AICPA and others to explore the best future state financial reporting solution for public companies and investors, and accordingly implement a long-term solution that will result in the most transparent, reliable, relevant and timely disclosures.
- Enable the PCAOB to gather leading practices for assessing internal controls over financial reporting, and to share these practices with external auditors, the SEC and public companies.
- Provide PCAOB and the SEC an opportunity to explore the best option for internal and external audit evaluations of internal controls at service providers.
- Allow the PCAOB to work with public accountants to build workable solutions to challenging issues regarding internal controls over financial reporting. In doing so, the PCAOB's function may be perceived as less adversarial, which will better position them to lead the accounting profession through a period of potentially significant improvement of the audit process.
- Reduce external audit fees increases.

I appreciate your consideration of my comments on the proposed standard and other considerations.

Sincerely,

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