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May 17, 2004

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

Re: Public Company Accounting Oversight Board (PCAOB);  
Notice of Filing of Proposed Rule on Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* PCAOB-2004-03; 69 FR 20672 (April 16, 2004)

Dear Mr. Katz:

The Institute of Internal Auditors (IIA) welcomes the opportunity to comment on the SEC's release on the proposed PCOAB standard "An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements," as referred to in Section 404(b) of the Sarbanes-Oxley Act of 2002 (SOX).

The IIA, representing over 93,000 members worldwide, is the principal voice of the internal auditing profession. Internal Auditors are well positioned to offer unique insights into issues related to improving corporate governance, risk management, and control processes. The IIA maintains the *International Standards for the Professional Practice of Internal Auditing (Standards)*, which are recognized around the globe and support the internal auditing profession.

The PCAOB has worked hard in its efforts to codify the standard governing the implementation of sections 404(b) and 103(a)(2)(A) of SOX. Clearly, the public exposure process to date has identified a number of concerns with the original proposal. The PCAOB certainly considered all commenters' views as it crafted the final proposal and we applaud this effort.

Many of the comment letters you will receive will undoubtedly acknowledge the appropriate concessions made in areas such as reliance on the work of others, scope of walkthroughs, etc. Others will still remain troubled by certain aspects, including lower than expected reliance on the work of others, lower thresholds for significant deficiencies, and most importantly, the cost/benefit of full compliance.

We offer further comments:

1. We are supportive of efforts to strengthen internal controls and the "tone at the top" in Corporate America. However, we are cognizant of the costs organizations will bear to comply with the PCAOB standard and requirements of Sarbanes-Oxley. We believe the SEC should measure and assess such costs to determine the underlying causes and remedies for excessive costs and measure the benefits of full

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implementation and report the results to its stakeholders.

2. The IIA supports the SEC approval of the New York Stock Exchange (NYSE) listing requirement that an internal audit function be established. We continue to recommend that all publicly held companies should be expected to establish and maintain an objective, adequately resourced, and competently staffed internal audit function to provide management and the audit committee with ongoing assessments of the organization's risk management processes and the accompanying system of internal control. Lack of an effective internal audit function is an indicator of weak monitoring of controls and control environment. If an internal audit function is not present, the board of directors should disclose in the company's annual report why the function is not in place and the auditor should consider such disclosure in reporting significant deficiencies. Though the PCAOB standard is developed for external audits, the establishment of an effective internal audit department impacts an organization's control environment and the testing, cost and reporting of the external auditor. As such, we recommend the SEC provide additional detailed guidance that internal audit efforts should be in compliance with The IIA's *Standards* and that the function is encouraged to be established for all publicly traded companies.

3. The PCAOB standard's emphasis that the external auditor, wherever possible and beneficial, rely on the work of internal audit and others is significant. While the criteria provided by the PCAOB to evaluate internal audit is comprehensive, The IIA believes it should also include a recommendation that internal audits be performed in compliance with The IIA's *Standards*. The IIA recommends the SEC provide further detail guidance regarding the evaluation of the competence and objectivity of the internal audit function. Internal auditors complying with The IIA's *Standards* and reporting directly to the Audit Committee, in our view, would demonstrate the highest level of competence and objectivity.

We appreciate the opportunity to express our views on these important matters and welcome further discussion at any time.

Best regards,

A handwritten signature in cursive script that reads "David A. Richards".

David A. Richards, CIA