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Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 008

Members and Staff of the Public Company Accounting Oversight Board:

I would like to thank you for the opportunity to comment on the Proposed Auditing Standard – *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*. My response will address certain specific questions raised by the PCAOB, as well as some additional comments/observations regarding the text of the proposed standard.

The PCAOB asked the following question:

Q 6.: Is the scope of the audit appropriate in that it requires the auditor to both evaluate management’s assessment and obtain, directly, evidence about whether internal control over financial reporting is effective?

I believe that this is a key question regarding the interpretation of the External Auditor’s role in the SOX 404 certification process. As you know, section 404, paragraph (b) of the SOX Act states the following:

(b) INTERNAL CONTROL EVALUATION AND REPORTING.—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall **attest to, and report on, the assessment made by the management of the issuer**. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

The law requires the External Auditor to “*attest to, and report on, the assessment made by the management of the issuer*”. The law does not explicitly state that the External Auditor must perform an “audit of internal controls over financial reporting”. I understand that the External Auditors will still need to obtain sufficient evidence to

satisfy the requirements of the “attestation engagement” (outlined in AT Section 101, paragraphs .51 - .58), however, I am of the opinion that the scope of this work might differ from that of a full scope “audit” of internal controls. In addition, I am of the opinion that the overall quality of management’s assessment should have a significant impact on both the nature and extent of testing required by the External Auditors. I was encouraged by the following statement in the PCAOB *Briefing Paper* on the proposed auditing standard:

Nevertheless, the work that management performs in connection with its assessment can have a significant effect on the nature, timing, and extent of the work the independent auditor will need to perform. The proposed auditing standard would allow the auditor to use, to a reasonable degree, the work performed by others, including management. **Thus, the more extensive and reliable management's assessment is, the less extensive and costly the auditor's work will need to be.**

I agree with this statement, but I do not believe that this concept has been adequately addressed in the text of the proposed standard. I would like to see some language addressing the direct relationship between the robustness/quality of management’s assessment and the nature, timing and extent of the procedures required by the External Auditors. I am concerned that the External Auditors will not interpret the guidance in a manner consistent with the last sentence of the paragraph above. I would go as far as to say that it is not in their economic interest to interpret the guidance this way.

The strengthened role of the External Auditor, regarding the testing of internal controls, has created a situation where the External Auditor, with the support of the SOX Act, is in a much stronger position to determine the amount of “audit” work necessary to comply with SOX 404, paragraph (b). I believe that there are many ways to interpret the SOX Act, but many business people are concerned that the ultimate interpretation will be made by the External Audit firms. I see this as a potential conflict of interest and I am concerned that the External Audit profession is not equipped or structured to fulfill the role they have been entrusted with. I believe that if this situation is not resolved it could lead to serious conflict between business management and the External Audit profession and that would be counter productive to both the intentions and spirit of the SOX Act.

The PCAOB asked the following two questions:

Q 12.: To what extent should the auditor be permitted or required to use the work of management and others?

Q 14.: Does the proposed standard give appropriate recognition to the work of internal auditors? If not, does the proposed standard place too much emphasis and preference on the work of internal auditors or not enough?

The proposed standard allows the External Auditor to place some reliance on work performed by others, including management, internal auditors or third parties. To use

that work, however, the auditor would need to assess the competence and objectivity of the persons who have performed it. I am pleased that the standard does allow some reliance to be placed on work performed by others and I also agree that the auditor would need to assess the competence and objectivity of the persons who have performed the work. However, I do feel that there is a need for much more guidance in this area otherwise this will be at the total discretion of the External Auditor.

Many organizations view their internal audit department as a specialized group of accounting/information systems professionals who are “internal control experts”. Based on this, I believe that the internal audit function should play a significant role in many organization’s efforts to comply with SOX 404. This role will take many forms including: documentation of existing controls, consultation and design of needed controls, testing of controls for effectiveness, etc. I believe that many of these roles are appropriate, however we are of the opinion that certain roles could impair the overall effectiveness and independence of the internal audit function. I would like the PCAOB to address the internal audit function in more detail in the standard and to include some specific guidance regarding when the function can be relied upon, to the greatest extent, by the External Auditors. It might be appropriate to incorporate some of the guidance in AU Section 322 – *The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements* into the standard (rather than just referencing it in Appendix B).

Paragraph 104 of the proposed standard prohibits the External Auditors from placing any reliance on the work done by others in areas related to company-wide anti fraud programs. I have some concerns regarding the effectiveness of the External Audit function when it comes to auditing for fraud. This problem was highlighted once again by the recent corporate scandals in the U.S. where the External Auditors were not successful in uncovering fraud, of a material nature, that existed at their clients (even when, in some instances, they were alerted to it by employees within the organization). Many of the External Audit procedures that I have observed in this area are based around inquiries of management and other key personnel. I believe that inquiries serve a purpose, but they are certainly not the most effective way to uncover fraud in an organization. Many organizations have strengthened their corporate governance structures to address the issue of fraud prevention and detection. These new governance structures include some of the following components: fraud telephone “hotlines”, employee code of conduct manuals, fraud training for employees, fraud investigation units, etc. I would like the PCAOB to consider that some of the strongest evidence that the External Auditors can obtain in this area will come from management’s ongoing monitoring of their fraud prevention programs and from other independent functions within the organization (i.e. reports from fraud investigation units, internal audit, etc.). To limit the External Auditor’s ability to rely on the results generated by outside parties is a mistake in my opinion. I do acknowledge that their reliance should be based on their assessment of the quality and objectivity of the function generating the evidence in question.

Paragraphs 104 and 79 of the proposed standard address the issue of the External Auditor’s need to perform independent “walkthroughs” on all of the Company’s significant processes. I am very concerned about the impact of this guidance, as this is an

area where the internal audit function has traditionally been able to add considerable value, not just to the business process owners, but also to the External Auditors (in support of their financial audits). I see no reason why the External Auditors should not be allowed to place some reliance on walkthroughs generated by a qualified, objective, independent internal audit function. Under the current guidance, all of the existing work would need to be re-performed by the External Auditor and this would come at a significant cost to the business. In addition, I am of the opinion that a qualified and objective internal audit function is better positioned to produce a high quality walkthrough given their knowledge of the business operations. It has been my observation that this type of “walkthrough” work is typically assigned to the most junior auditors on an External Audit engagement team.

The internal and external audit functions at ING have always had a very strong working relationship. In our opinion, both groups play an important role in the overall assessment of internal controls within an organization and they should leverage off each other’s work to the greatest extent possible. I believe that some of the recent corporate failures have highlighted the need for a strong, independent internal audit function in Corporate America, rather than increased reliance on the External Audit profession. Lets not forget that it was an internal auditor who exposed the accounting irregularities at WorldCom – not an External Auditor.

I would like to see the standard better define the way the two groups can work together to meet the testing requirements of SOX 404, paragraph (b) in the most rational and efficient manner possible.