The Institute of Internal Auditors

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Office of the Secretary
Securities and Exchange Commission (SEC)
100 F Street, NE
Washington, DC 20549-1090

Via email: rule-comments@sec.gov

RE: File Number S7-13-15
Concept Release: Possible Revisions to Audit Committee Disclosures

Dear Office of the Secretary:

On behalf of the more than 180,000 global members of The Institute of Internal Auditors (IIA), one-third of whom reside in the United States, I am pleased to provide our response to the SEC's Exposure Draft *Possible Revisions to Audit Committee Disclosures.*

At a time when there are calls for rationalizing disclosures, we have considered the SEC's possible revisions to audit committee disclosures very carefully. We offer our comments on several questions or groups of questions related to the audit committee's oversight of risk management, control, and governance processes. These responses are provided in Attachment A.

Importantly, we are responding to the SEC's expressed interest in receiving comment on other issues pertaining to the audit committee and audit committee reports. To this end, we believe the current environment is conducive for the SEC to **require** internal audit functions for **all** publicly traded companies.

The presence of an effective internal audit function makes an unequivocal statement about the way a company's leadership views strong and effective risk management, internal control, and governance. When a publicly traded company does not have an internal audit function, one must ask: Who is providing the board (and specifically, the audit committee) with independent and objective assurance and insight on how well risk and the mitigating controls are being managed? And, in the best interest of the investing public and continued efforts toward restoration of investor confidence, an independent, objective, and competent internal audit function is basic and fundamental to effective corporate governance.

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More than a decade ago, the New York Stock Exchange recognized the value of an internal audit function and an equally important direct line of reporting to a company's audit committee. All NYSE-listed companies are required to have an internal audit function in place, upon or within the first year of listing, depending on the circumstances. NASDAQ, however, has never followed suit.

More recently, the Group of Thirty (G30) formally recognized the importance of internal audit in its call for sustained and comprehensive reform of banking conduct and culture. In its July 2015 report, the G30 recommended that banks ensure that the internal audit function "is robust, has operational independence, is suitably staffed, and has a clear mandate to examine adherence to standards."[1] In our view, these recommendations, in addition to a general mandate to provide independent and objective assurance and insight on risk management, control, and governance, are equally applicable to all companies.

Consequently, we strongly believe the time has come to formally recognize the value of an effective internal audit function for all publicly listed companies as a matter of basic good governance. At a minimum, publicly listed companies on exchanges that don't require internal audit should be required to disclose why they do not support internal audit as necessary to effective corporate governance (a comply or explain approach).

Internal audit, to be effective, must be conducted in accordance with a set of globally recognized standards. As an example, the Basel Committee on Banking Supervision's guidance for assessing internal audit's effectiveness in banks "promotes due consideration of prudential issues in the development of internal audit standards and practices," and calls on internal auditors to "comply with and to contribute to the development of national and international professional standards, such as those issued by The Institute of Internal Auditors."[2] Conducting internal audit work in compliance with such standards should be required of all publicly traded companies in the United States. And the disclosure of conformance with such standards, as part of an audit committee's oversight of internal audit, should be part of any mandatory disclosure regime.

Summarizing our views (further outlined in Attachment A), a requirement for all publicly listed companies to have an internal audit function in place; the audit committee's required disclosure on the internal audit function's stature, independence, and resources; and the audit committee's disclosure on the internal audit function's performance will help investors more effectively understand and evaluate a key element of audit committee performance.

Please do not hesitate to contact Kathy Anderson, The IIA's Managing Director of North American Advocacy, if you have any questions about this response and/or would like to schedule a time for us to meet either in person or via conference call. Ms. Anderson can be reached at kathy.anderson@theiia.org or +1-407-937-1291.

Best regards,

Richard F. Chambers

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[1] Group of Thirty, *"Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform,"* p. 15, July 2015
[2] Basel Committee on Banking Supervision, *"The internal audit function in banks,"* p. 1, June 2012

Attachment A

1. Requests for Comment

   6. *Should the audit committee provide disclosure of its work in other areas, for example, its oversight of the financial reporting process or the internal audit function? If so, what types of disclosures would be most useful and why?*

   73. Are there improvements that the Commission should consider to the reporting on the audit committee's oversight of the accounting and financial reporting process or internal audits?

   The IIA's Comment

   In further support of a requirement for an internal audit function to be present in all publicly traded companies, we recommend that the audit committee be required to disclose:

   - Whether the internal audit function has the stature, independence, and resources to fulfill its mission "to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight," and
   - Whether the internal audit function is performing in accordance with globally recognized standards, such as The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* (*Standards*).

   These disclosures can help investors understand and evaluate audit committee performance.

2. Requests for Comment

   19. Should the audit committee report disclose the frequency with which it met privately with the auditor? Would confirmation that private conversations occurred be useful disclosure even if there are no disclosures about the topics discussed? Should there be a requirement to disclose the topics discussed?

   The IIA's Comment

   Private meetings with the auditor provide the audit committee with the opportunity to be apprised of or to raise risk, systems, procedures, or control issues at an early stage. Confirmation that private conversations between the audit committee and the auditor took place may help investors to draw conclusions about the audit committee's performance with regard to its role in overseeing the auditor. However, there should be no requirement to disclose the frequency or topics discussed, as they could be subject to faulty inference and misinterpretation by investors, with the potential to impact competition and disrupt markets. Topics discussed should be considered confidential and proprietary information.

3. Requests for Comment

   50. Would investors benefit from the audit committee disclosures being presented in one location? If so, where should the disclosures appear and how would investors benefit? If not, why is the existing location of the various audit committee disclosures appropriate?

   60. Would the disclosures discussed herein result in boilerplate information? If so, how could the requirements be crafted to avoid boilerplate disclosure?

   The IIA's Comment

   Yes, investors would benefit from the audit committee disclosures being presented in one location. It is not realistic to expect investors to comb through a company's voluminous disclosure reports to locate and, more importantly, connect the dots between audit committee disclosures. Investors need a clear and concise overview of the company's risk management, control, and governance processes; as well as the audit committee's performance in oversight of the same. These disclosures should avoid lengthy boilerplate text, and be easy for investors to locate and understand.

4. Request for Comment

74. Should the Commission consider the potential for changes that would affect the role and responsibilities of the audit committee, such as those related to qualifications of members of the audit committee or areas for which audit committees should (or should not) be responsible? Should the audit committee disclose its role, if any, in risk governance? Should the audit committee report on other areas of oversight? For example, audit committees may be charged with overseeing treatment of complaints, cyber risks, information technology risks, or other areas. Would this disclosure distract from the report's focus on oversight of the audit function? In this regard, we note that commentators have recently indicated concern that audit committees are becoming the catch all of board committees by overseeing anything related to risk.

The IIA's Comment

The stated concern regarding the audit committee becoming a catchall of board committees is valid. According to The IIA Research Foundation, U.S. publicly traded companies hold an average of 6.9 formal audit committee meetings per year, up from 6.2 in 2006.[3] We attribute this increase to crowded agendas covering a growing list of topics, such as those stated in the question above.

The concern that audit committees are becoming the catchall of all board committees by overseeing anything related to risk is potentially valid. The complexities of balancing the agenda for an audit committee in relation to time, risk, and board member experience are challenging. Providing guidance to assist companies and audit committees when navigating these complexities is ever more needed. Establishing minimum requirements, minimum qualifications, minimum training expectations, and disclosure of compliance with such would be an effective step in the right direction.

Strong, competent internal audit functions have the ability to help ease the various burdens placed on audit committees and can go a long way to help facilitate the disclosure of meaningful information to investors. Internal audit functions conforming to the globally accepted *Standards* and assessing and making appropriate recommendations for improving the governance process in its accomplishments of the following objectives are critical to overall effective corporate governance:

- Promoting appropriate ethics and values within the organization;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization; and
- Coordinating the activities of and communicating information among the board, external and internal auditors, and management.[4]

[3] The IIA Research Foundation's Common Body of Knowledge (CBOK) Study, 2006 and 2015
[4] IIA Standard 2110: Governance