The Institute of Internal Auditors

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July 18, 2007

Ms. Nancy M. Morris
Secretary, U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Response e-mailed to: rule-comments@sec.gov

Re: SEC Release Nos. 33-8811; 34-55930; File No. S7-24-06
DEFINITION OF A SIGNIFICANT DEFICIENCY

Dear Ms. Morris:

The Institute of Internal Auditors (The IIA) welcomes the opportunity to provide additional comment on defining a “significant deficiency”. Our comments are based on in-depth analysis and discussions, harnessing the experience of a core team of prominent chief audit executives from major U.S. corporations who serve on The Institute of Internal Auditors’ Professional Issues Committee.

Our response to each of the questions contained in the release is noted below.

1. **Would the definition of a “significant deficiency” (“a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of a registrant’s financial reporting”) facilitate more effective and efficient certification of quarterly and annual reports if it were defined as discussed above?**

We support the definition, which is consistent with our recommendation to the SEC and PCAOB. It relies on judgment, by both the auditor and management. There is a possibility that management and the auditor will, from time to time, disagree on whether a control deficiency represents a significant deficiency requiring disclosure to the Audit Committee. Such a disagreement, where management believes an issue is not significant but the auditor does, should not prevent the certifying officers asserting that all significant deficiencies have been disclosed to the Audit Committee and the auditors.

2. **Conversely, should the definition of “significant deficiency” include a likelihood component or other specific criteria? If so, should we align such a definition with the PCAOB’s auditing standard, and how?**

As noted above, we support the definition without amendment.

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3. We do not anticipate that the definition will impact the amount of time it takes for management to evaluate whether identified deficiencies are significant deficiencies, nor do we anticipate that this definition will affect any existing collection of information. However, are there any additional costs or burdens involved in evaluating whether identified deficiencies meet the definition of significant deficiency? If so, what are the types of costs, and the anticipated amounts? In what way can the definition be further modified to mitigate such costs while still appropriately describing deficiencies that should be disclosed to audit committees and auditors?

We agree that the impact on costs should, if anything, be positive. Less time should be involved in assessing likelihood and impact, and negotiating with the auditor, than is required to exercise the judgment to determine whether the matter is a significant controls issue.

4. We believe one of the benefits of the definition is that it focuses on the desired result of identifying matters that are important enough to merit attention, which will allow management to use sufficient and appropriate judgment to determine the deficiencies that should be reported to the auditor and the audit committee while allowing management to use its judgment to determine what those matters are. Are there additional potential benefits we have not considered? Additionally, a potential consequence of the definition is that, due to the flexibility provided in the definition, there may be less comparability among companies in terms of what management determines is a significant deficiency. Is this accurate? Are there other potential costs or burdens? How should we mitigate such costs or burdens?

Significant deficiencies are not typically disclosed in filings with the SEC. Therefore, there should not be any impact on comparability. The value in the new definition, in addition to that noted above, is that discussions between the auditor, management, and the Audit Committee can focus on the quality of the system of internal control and the reliability of upcoming financial statements. Because there may be disagreement between auditor and management as to whether control deficiencies are significant, we believe <u>all</u> deficiencies in key controls should be reported to the auditor. Best practice is to disclose in summary form to the Audit Committee the results of management testing of controls, with significant deficiencies and potential material weaknesses discussed in detail.

5. Is there any special impact of the definition of significant deficiency on smaller public companies? If so, what is that impact and how should we address it?

We do not expect there to be any special impact on smaller public companies.

Again, The IIA would like to offer its support to the SEC in the development of their guidance. We have an extensive volunteer network of individuals with specific knowledge in this area that could be valuable contributors to the SEC.

The IIA welcomes the opportunity to discuss any and all of these recommendations with you.

Best regards,

David A. Richards, CIA, CPA

About The Institute of Internal Auditors

The IIA is the global voice, acknowledged leader, principal educator and recognized authority of the internal audit profession and maintains the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These principles-based standards are recognized globally and are available in 25 languages. The IIA represents more than 130,000 members across the globe, and has 247 affiliates in 92 countries that serve members at the local level.