November 21, 2003

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Re: Proposed Auditing Standards Concerning the Audit of Internal Control
(PCAOB Rulemaking Docket Matter No. 008)

The purpose of this letter is to respond on behalf of Irwin Financial Corporation to the proposed auditing standards for the audit of internal control over financial reporting performed in conjunction with an audit of financial statements. Irwin Financial Corporation is a diversified financial services company with $5 billion in assets that provides a broad range of consumer and commercial financial services in selected markets.

We believe, in general, that the Board's proposals to require greater oversight of internal controls by the external auditor will continue to enhance corporate governance practices and public confidence that registered companies in the United States have implemented and maintain appropriate control environments and systems of internal controls. However, we have some concerns regarding certain requirements in the proposal that we believe will result in substantial duplication of control testing and cost, and which will substantially exceed the benefits derived. Accordingly, our comments below address those specific issues in the proposal that are of greatest concern on our part.

The proposed standards equate the work performed by internal auditors with procedures and testing performed by management. The current proposal also places significant limitations on the ability of the external auditor to rely on the work of internal auditors. For example, the external auditor is required to perform all "walkthroughs" in each annual audit, all testing of information technology general controls, all work concerning evaluation of the control environment, including controls intended to prevent or detect fraud, and all testing of controls over the period-end financial reporting process. The standards also require that the external auditor's work must provide the "principal" evidence for their opinion.

We believe that the proposed standards are overly prescriptive and rigid. Based on our discussion with external auditors, these requirements will result in significant duplication of the work already performed by our internal auditors, significant increases in external audit costs, and significant disruptions to our operations as multiple parties review and test the same controls every year. We do not believe that such duplication and increased cost is necessary or warranted in most cases.

It appears that the prescriptive nature of the standards is based on a lack of comfort with the work performed by internal audit functions. In fact, the proposal does not distinguish between the work performed by internal audit and management. Most internal audit functions report directly to the audit committee of the Board of Directors, with the engagement, termination, and compensation of the Chief Audit Executive being determined by the Audit Committee, the same as in the case of the external auditor. Many internal audit functions are also highly professional, with staffs whose experience often exceed those of the external auditors participating in the examination of the company. On the other hand, control self-assessments or other control verification performed by management is not independent and may not be objective or completed by individuals with the appropriate level of expertise. Therefore, we believe that the standards should reflect these differences, and accordingly, the level of external auditor reliance that is appropriate based on the work of these groups should be differentiated.

We believe that the external auditor should have significant discretion in placing reliance on the work of internal audit and be able to rely on that work extensively, if deemed appropriate based on the quality of the internal audit function. Rather than placing significant restrictions on the use of internal audit work, we believe that it would be more appropriate to place standards that the internal auditor must satisfy in order for the external auditor to rely on their work. Standards established by the *Institute of Internal Auditors* or other professional organizations may be appropriate. Clearly, the external auditor must assess the independence, objectivity, competence and quality of the work performed by internal audit and their compliance with agreed-upon standards before they could conclude on their ability to rely on internal audit's work. Standards for such an assessment of the internal audit function are already addressed in SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, and could also be applied to the audit of controls over financial reporting. Based on the results of this assessment, the external auditor should then be able to place extensive reliance on the work of the internal auditor if it determines that it is appropriate based on the assessment of the internal audit function.

We believe this approach will also have positive side-benefits. Since weaknesses in internal audit functions will require greater external auditor validation of internal controls, and consequently greater cost, this will provide a significant incentive for board of directors and audit committees to raise the quality of their internal audit functions. Conversely, the currently proposed standards are likely to result in unintended consequences. Given the Board's responsibility to balance the expectations of various stakeholders, including shareholders, board of directors may conclude that the testing of internal audit functions is duplicative and unnecessary in those areas where the external auditor is not permitted to place reliance on internal audit work. This could result in situations where management certifications are solely based on management self-assessments, which may not be objective or verified by individuals who have expertise in risk and control analysis, with the independent validation left to the testing that the external auditor is required to perform. Therefore, we believe that the current proposals could result in decreased reliance in internal auditors and overall weakening of these independent risk and control oversight functions. Such an occurrence will actually result in reduced assurance on the quality of internal controls over financial reporting.

For example, although we currently have a small audit function consisting of 11 employees, the staff consists of professional auditors with an average of 11 years of audit experience and 19 years of financial services experience (including experience in senior financial reporting positions, such as controller, senior accounting managers, etc.). All of our internal auditors have at a minimum a bachelors' degree (primarily finance or accounting majors) with 36% having obtained a masters degree; 64% have obtained audit related professional certifications (CPA, CBA, CISA, etc.); and 36% of our staff have earned their CPA. We believe that continued investment in such an internal audit function will be difficult if the proposed standards limit the external auditor's ability to rely on their work, including reliance on the walkthroughs and I.T. general controls audits which are an integral part of our Corporation's internal audit processes.

The requirement that "the auditor must obtain evidence of the effectiveness of controls for all relevant assertions for all significant accounts and disclosures every year" also appears excessive. We believe that the external auditor should have the discretion to use their judgment and risk assessment to determine the extent of testing necessary to support the opinion concerning the effectiveness of controls over financial reporting. The current proposal could result in significant testing in areas where no changes have occurred from prior audits and does not adequately differentiate for different levels of risk at different organizations. For example, the level of control testing necessary should be much different in an organization with a history of poor controls, negative surprises, and significant changes than in an organization that has a strong control environment and stable operations that have proven effective for many years, and where changes from previous years have been minimal. However, this requirement does not permit the external auditor to differentiate the level of testing necessary based on such risk assessments.

We also believe that it is inappropriate to require the external auditor to assess the effectiveness of audit committees. This is not practical and will place the external auditor in a significant conflict of interest since the audit committee is responsible for the engagement or termination of the audit firm, as well as approval of any non-audit services that the external auditor performs and the level of compensation for such services. This will again place the external auditor in a conflict of interest situation when the intent of various reforms in recent year has been to reduce or eliminate such conflicts.

We also do not believe that the external auditor is in a position to assess the effectiveness of the audit committee. Audit committee members generally include individuals with significant experience and expertise in a broad number of areas. In addition to the external auditor's interaction with the audit committee, the committee has substantial interaction with members of management, corporate risk management, the internal auditor, and others without the external auditor's participation. Such interaction is necessary and appropriate for the committee to ensure that it is receiving information that is unbiased. Accordingly, we believe that the external auditor is not in the best position, in terms of breadth of knowledge or involvement in all committee activities, to assess the effectiveness of the committee. Furthermore, audit committees are required to be constituted entirely of independent directors, at least one of whom is acknowledged to be a financial expert, and to conduct annual self-assessments. We believe that the board of directors of the company is responsible for the oversight of the self-assessment process and the overall evaluation of the effectiveness of the audit committee.

In conclusion, we believe that the proposed standards will result in significant duplication of internal control testing and unnecessary cost. We believe that the external auditor should have the ability to use significant discretion and judgment in determining the level of testing necessary to support their internal control opinion. We also believe that the proposed standards should eliminate any restrictions on the use of internal audit work and the current requirements that the external auditor's own testing must provide the principal basis for their opinion. Instead, internal audit work should be used extensively if the internal audit function meets specified requirements and the external auditor validates that those standards have been met. Finally, we do not believe that the external auditor is in an appropriate position to evaluate the effectiveness of the audit committee.

We thank you for the opportunity to comment on the proposed auditing standard.

Sincerely,

Will Miller

Will Miller
Chairman & CEO

cc: Audit & Risk Management Committee, Irwin Financial Corporation