November 20, 2003

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

Re: PCAOB Rulemaking Docket Matter No. 008 – Proposed Auditing Standard – An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements

Dear Board Members:

As Executive Vice President and Chief Financial Officer of the Health Insurance Plan of Greater New York ("HIP"), I am pleased to be able to respond to the request for comments from the Public Company Accounting Oversight Board regarding *Proposed Auditing Standard – An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statement (PCAOB Rulemaking Docket Matter No. 008).*

HIP is a managed care company with revenues in excess of $3 billion. Even though HIP is a not a public company, HIP began the process in February 2003 of building the infrastructure necessary to comply with the provisions of Sections 302 and 404 of the Sarbanes Oxley Act of 2002. HIP chose COSO as its framework for management's assessment of internal controls over financial reporting. As of November 2003, it is projected that the cost to complete the company's initial assessment, document all policies and procedures and perform the initial test work of internal controls will approximate $5 million in consulting hours alone (approximately 30,000 man hours of consulting time). Staffing costs to ensure ongoing compliance are estimated at $2.0 - 3.0 million annually. The company also estimates that annual audit costs may triple from current levels by fiscal 2005 due to the required internal control attestation. As with most managed care companies, HIP faces significant pressures from employer groups to hold premium increases to a minimum, in an environment of rapidly rising

medical costs. These additional audit and operational costs, if not recovered in additional savings from internal control improvements, will regrettably have to be passed along to HIP's subscribers, many of whom are small and medium size businesses.

The Sarbanes Oxley legislation specifically states that a public accounting firm that prepares and issues the audit report should attest to, and report on, the assessment of internal controls made by the issuer of the financial statements. The proposed auditing standard requires the external auditor not only to report on and attest to management's assessment, but also to perform a detailed audit of internal controls. If management has properly assessed the effectiveness of the company's internal controls, why is it necessary for the external auditor to duplicate this effort? Current auditing standards allow for an auditor to issue an attestation report on management's assertion over internal controls as opposed to auditing internal controls. Consideration must be given to the additional audit costs incurred and the serious disruptions to the company's operations caused by the duplicate testing and evaluation of internal controls required by the proposed standard.

If the auditor must evaluate and audit the effectiveness of internal controls in addition to attesting to the assessment made by management, why shouldn't they be able to follow current auditing standards related to the use of testing performed by the company's internal audit department? Under current auditing standards if a company has an effective, competent internal audit function that has performed relevant tests, an auditor may rely on such work. Relief should be given in the final standard to allow the auditor to place greater reliance, if appropriate, on management or internal audit's testing of internal controls.

The proposed standard also indicates that each year's audit of internal control must stand alone. If there have been no changes to a particular set of internal control activities, why shouldn't the external auditor be allowed to rotate the activities tested from year to year? The external auditor should be allowed to use some of the audit evidence obtained in previous years to support the current opinion on management's assessment.

We are also concerned that the Board has changed the definition of material weakness in internal controls from what currently exists in auditing standards. Current auditing standards define material weakness as a "reportable condition in which the design or operation of one or more of the internal control components does not reduce to a <u>relatively low level</u> the risk that misstatement caused by error or fraud in amounts that would be material in relation to the financial statements….. may occur and not be detected within a timely period…". The

proposed standard defines material weakness as "a significant deficiency that, by itself, or in combination with other significant deficiencies, results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected." We believe that the gap that exists between "low level of risk" of material misstatement and "more than remote likelihood" of material misstatement is significant. Based on the proposed standards, the auditor's attestation of management's assessment of internal control and the effectiveness of those controls is tantamount to a guarantee or warranty that the company's internal controls over financial reporting are effective and result in financial statements that are free of material misstatement. This is an invitation to the plaintiff's bar to bring yet more litigation in our already highly litigious society. The increased risk to auditing firms that will result from such a warranty can only result in greatly increased costs upon those firms and in due course upon public companies.

The requirement in the proposed standard that the external auditor evaluate the effectiveness of the audit committee's oversight is impracticable and untenable. A significant conflict of interest exists in having the external auditor assess the effectiveness of the audit committee, since the audit committee is responsible for hiring, compensating, and supervising the external auditor. The responsibility for hiring and managing the relationship with the external auditor has been placed with the audit committee, as opposed to management, in part to prevent a conflict of interest between management and the external auditor. Requiring the external auditor to evaluate the effectiveness of the audit committee merely re-establishes this conflict of interest at the audit committee level. The suggestion in the proposed standard that the external auditor can provide an honest evaluation of the effectiveness of the committee that determines its tenure to a full Board of Directors is fundamentally flawed. We believe that this process will not result in meaningful evaluations of the effectiveness of audit committees and, therefore, does not serve the public interest. It places unacceptable political burden on the external auditor and does not enhance, but rather complicates, good corporate governance. This aspect of the proposed standard should be dropped entirely.

HIP asks the Board to establish a set of standards that are reasonable, without creating unnecessary costs that are essentially impairing the productivity of public companies. It should be noted that none of the accounting scandals that gave rise to Sarbanes Oxley resulted from breakdowns of systematic operational and accounting controls. Instead, they resulted largely from improper, non-systematic transactions driven by a lack of integrity on the part of management and the Boards of those companies. The proposed standard requires significant focus, and therefore significant cost, be devoted to evaluating internal controls

operating within systematic processes. While significant focus should appropriately be directed at material non-systematic transactions, the requirement to expend significant resources evaluating systematic transactions does not appear to be cost-justified. There is no amount of money that can be spent, or control testing that can take place, to prevent unscrupulous, complicit individuals from committing a fraud if said individuals are determined to do so. We strongly urge the Board to consider ways to reduce the burden of the proposed standard, while still achieving the objectives of enhanced financial reporting and protection of the public interest.

Sincerely,

Michael D. Fullwood
Executive Vice President
Chief Financial Officer
Secretary and General Counsel
Health Insurance Plan of Greater New York