

May 4, 2023

The Honorable Sherrod Brown
United States Senate
503 Hart Office Building
Washington, DC 20510

The Honorable Tim Scott
United States Senate
104 Hart Office Building
Washington, DC 20510

The Honorable Debbie Stabenow
United States Senate
731 Hart Office Building
Washington, DC 20510

The Honorable John Boozman
United States Senate
555 Dirksen Office Building
Washington, DC 20510

The Honorable Patrick McHenry
United States House of Representatives
2134 Rayburn Office Building
Washington, DC 20515

The Honorable Maxine Waters
United States House of Representatives
2221 Rayburn Office Building
Washington, DC 20515

The Honorable Glenn "GT" Thompson
United States House of Representatives
400 Cannon Office Building
Washington, DC 20515

The Honorable David Scott
United States House of Representatives
468 Cannon Office Building
Washington, DC 20515

***RE: Proposed Legislative Text for Enhancing Corporate Governance at
Cryptocurrency Exchanges***

Dear Chairman Brown, Chairwoman Stabenow, Chairman McHenry, Chairman Thompson, Ranking Member Scott, Ranking Member Boozman, Ranking Member Waters, and Ranking Member Scott:

On behalf of The Institute of Internal Auditors (The IIA), the international professional organization representing over 230,000 internal auditors,¹ I am pleased to share with you a legislative proposal, for your consideration, designed to promote stronger corporate governance, greater transparency and accountability, and enhanced investor protections at cryptocurrency exchanges operating in the United States.

¹ "About Us," The Institute of Internal Auditors: <https://www.theiia.org/en/about-us/>

In my previous letter to you, on December 5, 2022² – immediately following the devastating collapse of the cryptocurrency exchange FTX³ – The IIA outlined the pivotal role of an independent internal audit function in bolstering objective assurance over corporate governance and internal control practices. As you are aware, the existence of an independent and properly resourced internal audit function enhances the value of an organization and strengthens its credibility with stakeholders and consumers. Specifically, internal audit supports a board of directors in the evaluation and understanding of:

- Effective governance, risk management, and control
- Responsible decision-making and oversight
- Sustainable value creation and protection
- Accountable stewardship of assets and reputation

Following The IIA’s original communication in December, our organization conducted numerous meetings with congressional staff and external stakeholders to determine the appropriate role that internal audit could serve in potential policy solutions that Congress might consider regarding the lack of sufficient investor protections and corporate governance safeguards at cryptocurrency exchanges. Consequently, the enclosed proposal represents a series of policy recommendations - with specific legislative language – that The IIA urges Congress to include in any future measure governing the operations of cryptocurrency exchanges. The proposal contains four key recommendations:

- Insertion of a definition for a “Certified Internal Auditor”
- Insertion of a definition for an “internal audit function”
- Establishment of a new requirement that all cryptocurrency exchanges operating in the United States, as well as any legally affiliated organizations, must possess an independent internal audit function to provide objective assurance over their internal controls
- Creation of an annual Internal Control and Evaluation Report in which senior management officials at a cryptocurrency exchange must certify the appropriateness and efficacy of the exchange’s internal controls

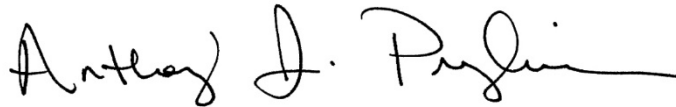
The IIA strongly believes the existence of a robust internal audit function is an essential component of any effort to restore and enhance consumer confidence in the digital asset marketplace.

² “IIA Letter to United States Congress,” The Institute of Internal Auditors: https://www.theiia.org/globalassets/documents/about-us/promote-the-profession/response-to-regulators/ia-letter-to-congress_12.5.22.pdf

³ “FTX head Sam Bankman-Fried’s downfall sends shockwaves through cryptocurrency,” *The Associated Press*, November 14, 2022: <https://www.pbs.org/newshour/nation/ftx-head-sam-bankman-frieds-downfall-sends-shockwaves-through-cryptocurrency>

Should you have any questions or concerns regarding these policy proposals, or if we can be of any assistance in the development of relevant legislation, please contact Michael Downing, Senior Director of U.S. Advocacy, at Michael.Downing@TheIIA.org.

Sincerely,

A handwritten signature in black ink, reading "Anthony J. Pugliese". The signature is fluid and cursive, with a long horizontal stroke at the end.

Anthony J. Pugliese, CIA, CPA, CGMA, CITP
President and Chief Executive Officer
The Institute of Internal Auditors

Enclosure

cc: Members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs
Members of the U.S. Senate Committee on Agriculture, Nutrition, and Forestry
Members of the U.S. House Committee on Financial Services
Members of the U.S. House Committee on Agriculture

PROPOSED CRYPTOCURRENCY LEGISLATIVE RECOMMENDATIONS

THE INSTITUTE OF INTERNAL AUDITORS

OVERVIEW OF THE ROLE OF INTERNAL AUDIT IN CORPORATIONS

The Institute of Internal Auditors (The IIA) is the international professional association for the internal audit profession, based in Lake Mary, Florida, and representing more than 230,000 internal audit professionals. The IIA is recognized as the internal audit profession's leader in standards, certification, education, research, and technical guidance.

The internal audit profession serves as the independent "eyes and ears" of an organization and internal audit functions within organizations provide objective assurance on organizational risk, corporate governance, and internal controls. In order to accomplish these objectives, an internal audit function is independent from management and reports to a board of directors, a responsibility which is usually delegated to the independent directors on an audit committee. This reporting relationship enables the assessments and conclusions of the internal audit function to be objective, credible, and trustworthy.

The existence of an independent, competent, and properly resourced internal audit function enhances the value of an organization and strengthens its credibility with stakeholders. Specifically, internal audit supports a board of directors in the evaluation and understanding of:

- Effective governance, risk management, and control
- Responsible decision-making and oversight
- Sustainable value creation and protection
- Accountable stewardship of assets and reputation

The independent role of the internal audit profession is articulated in The IIA's [Three Lines Model](#) (3LM). The 3LM clarifies specific corporate governance roles and responsibilities among an organization's leadership (i.e., board of directors, management, and the internal audit function) to promote strategic and operational alignment, proper oversight, and independence of the internal audit function.

It is imperative for organizations – specifically those involved in the financial services industry, such as cryptocurrency exchanges – to possess a clearly defined governance structure (as articulated by the 3LM), including an internal audit function within the organization identifying excessive risk and potential internal control failures. Such a paradigm helps ensure sound business operations, strengthens consumer protections, and best serves the public interest.

The following document articulates four proposed legislative recommendations intended to bolster objective assurance over corporate governance and internal controls at cryptocurrency exchanges. The IIA believes inclusion of new internal audit requirements will, in part, promote transparency and accountability designed to restore investor confidence in the cryptocurrency market.

Should you have any questions regarding the proposal set forth by The IIA, please do not hesitate contact Michael Downing, Senior Director of U.S. Advocacy, at Michael.Downing@TheIIA.org.

SUMMARY OF PROPOSED RECOMMENDATIONS FOR CRYPTOCURRENCY EXCHANGES

The IIA is proposing the following recommendations for inclusion in any future legislation governing the operations of cryptocurrency exchanges:

- Insertion of a definition for a “Certified Internal Auditor.”
- Insertion of a definition for an “internal audit function.”
- Establishment of a new requirement that all cryptocurrency exchanges operating in the United States, as well as any legally affiliated organizations, must possess an independent internal audit function to provide objective assurance over their internal controls.
- Creation of an annual Internal Control and Evaluation Report in which senior management officials at a cryptocurrency exchange must certify the appropriateness and efficacy of internal controls.

The next section provides The IIA’s draft legislative text for each of the four proposals. A brief commentary is appended to each proposal explaining The IIA’s rationale for the recommendation.

DRAFT LEGISLATIVE LANGUAGE WITH COMMENTARY

PROPOSAL #1:

Definitions.

CERTIFIED INTERNAL AUDITOR.—The term “Certified Internal Auditor” means an individual who has obtained the Certified Internal Auditor credential awarded by The Institute of Internal Auditors.

COMMENT: The Certified Internal Auditor (CIA) credential is the only globally recognized certification for the practice of internal audit. The professional credential is awarded by the Institute of Internal Auditors following completion of a rigorous exam and work experience requirements. CIA’s must also complete an annual continuing education program to maintain an active certification.

The CIA designation sets the standard for excellence within the profession and reflects the highest level of internal audit expertise. Over 185,000 CIAs have been issued globally since the credential was first launched.

More information regarding the Certified Internal Auditor credential can be accessed at <https://www.theiia.org/en/certifications/cia/>.

PROPOSAL #2:

Definitions.

INTERNAL AUDIT FUNCTION.— The term “internal audit function” means a professional individual or group within a covered entity who, in conformity with a set of globally accepted internal auditing standards, is responsible for providing the board of directors and management with: objective assurance over the covered entity’s internal controls; consulting services; and strategic advice on risk mitigation. For the purposes of this Act, an internal audit function shall be—

(A) Independent from management, reporting to the entity’s board of directors, a committee, or another body to which the board of directors has delegated certain functions;

(B) Led by a qualified professional responsible for effectively managing all aspects of the internal audit function and ensuring the quality performance of internal audit services;

(i) The leader of the internal audit function, and relevant staff, shall hold:

(I) appropriate professional certifications, such as the Certified Internal Auditor, or other credentials;

(II) specialty credentials or degrees providing expertise in cryptocurrency or blockchain technology.

(ii) No provision in this Act shall exclude the option of a co-sourced internal audit function, provided the entity fulfilling the internal audit function does not provide external audit services to the same covered entity.

(C) Required to establish a written internal audit charter agreed upon by both the board of directors and the qualified professional leading the internal audit function, which defines the internal audit function's authority, role, and responsibilities.

COMMENT: This subsection defines the term “internal audit function” and establishes minimum criteria for the internal audit function to ensure it:

- Conforms with corporate governance best practices, such as the [Three Lines Model](#)
- Effectively provides objective assurance over the covered entity’s internal controls.

For purposes of this Act, the definition places a special emphasis on guaranteeing expertise among internal audit staff as it relates to cryptocurrency and blockchain technology.

The definition also retains maximum flexibility in the structure of organizational internal audit functions. For example, while most internal audit functions are truly internal, some corporations, on occasion, will contract out some or all of their internal audit function. Nothing in this Act would preclude outsourcing or co-sourcing the internal audit function provided it does not create a conflict of interest in the provision of external audit services.

PROPOSAL #3:

Establishment of an Internal Audit Function

(a) Cryptocurrency exchanges operating in the United States, and any legally affiliated organization, shall each possess an independent internal audit function.

(b) It shall be the responsibility of the internal audit function to provide objective assurance to one or more of the entities enumerated in Section X(2)(A) [Definitions] on issues including, but not limited to—

- (1) Internal controls;
- (2) Corporate governance;
- (3) Organizational risk identification;

(c) Unless otherwise prohibited by law, cryptocurrency exchanges covered by this Act shall comply with all requests from the internal audit function in order to promote transparency and accountability.

(d) The leader of the internal audit function, or an official representative, shall brief the board of directors on the material risks confronting the organization no less than twice per annum.

COMMENT: The collapse of cryptocurrency exchange FTX in November 2022 revealed the devastating consequences of internal control and corporate governance failures. John Ray III, the current CEO at FTX, bluntly stated in a U.S. Bankruptcy Court [filing](#): “Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here.”

This proposal is intended to reduce the potential for internal control and corporate governance failures at cryptocurrency exchanges – such as those exposed at FTX – through the existence of a required internal audit function. In essence, internal audit is responsible for providing objective assurance, independent from management, on subjects related to risk and internal controls. Internal auditors are

trained to continuously evaluate the systems and actions of an organization to ensure potential investor and other stakeholder risks are identified and mitigated.

The existence of an internal audit function is widely considered an essential corporate governance best-practice for promoting organizational transparency and accountability. For example, the New York Stock Exchange (NYSE) requires all registrants to have an internal audit function, stating:

Listed companies must maintain an internal audit function to provide management and the audit committee with ongoing assessments of the listed company's risk management processes and system of internal control, (Section 303A.07(c) of the [NYSE Listed Company Manual](#)).

In addition to encouraging sound corporate governance and internal controls, an internal audit requirement may help to restore investor and public confidence in the cryptocurrency market. Ultimately, the presence of an independent and properly resourced internal audit function provides a private sector solution for strengthening oversight and accountability at cryptocurrency exchanges.

PROPOSAL #4:

Management Certification of Internal Controls

(a) Internal Control Evaluation and Report.— On an annual basis, the management of a cryptocurrency exchange shall provide an Internal Control Evaluation and Report to [insert appropriate regulators] and investors.

(b) The Internal Control Evaluation and Report shall be prepared by management, and the cryptocurrency exchange's principal executive officer shall certify that--

(1) based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;

(2) the signing officers—

(A) are responsible for establishing and maintaining internal controls;

(B) have evaluated the effectiveness of internal controls as of a date within 90 days prior to the report;

(C) have engaged the organization's internal audit function, with the oversight of the audit committee of the board of directors (or persons fulfilling the equivalent function), to provide objective assurance on the appropriateness and effectiveness of internal controls; and,

(D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;

(3) the signing officers have disclosed to the audit committee of the board of directors (or persons fulfilling the equivalent function) and investors—

(A) all significant deficiencies in the design or operation of internal controls and any material weaknesses in internal controls; and,

(B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and

(4) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

(c) The Internal Control Evaluation and Report shall be electronically filed with the [insert regulator(s)]. The exchange must also publish the report on its website and notify all investors when it is available for public review.

(d) Not later than one year after the date of the enactment of this Act, [insert regulator(s)] shall publish interim guidance for satisfying the requirements of paragraph (a).

COMMENT: This subsection establishes a requirement that the senior management of cryptocurrency exchanges, on an annual basis, shall publish an Internal Control Evaluation and Report certifying the appropriateness and effectiveness of organizational internal controls.

The proposal – adapted and modeled after the provisions set forth in [15 U.S. Code § 7241](#) – is intended to accomplish multiple objectives:

- Align cryptocurrency exchanges with certain statutory reporting requirements governing publicly traded companies
- Supply current and prospective investors with broad transparency on any significant internal control deficiencies as well as a description of any actions taken to ameliorate the issue(s)
- Provide the organization’s audit committee – and by extension investors – with objective assurance on the accuracy and completeness of management’s identified deficiencies based upon a review by the internal audit function

Ultimately, this proposal establishes a straightforward and commonsense approach for guaranteeing that investors receive, on an annual basis, access to pertinent and objective information regarding the operations of cryptocurrency exchanges. The disclosure of potential internal control deficiencies – as well as the organization’s associated mitigation efforts – enables consumers to execute a more informed investment strategy based upon their specific risk tolerance.