Grant Thornton

Accountants and Business Advisors

May 10, 2006

VIA ELECTRONIC MAIL

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

Re: File Number 4-511

Comments Re: The Audit of Internal Control over Financial Reporting

Dear Ms. Morris:

Grant Thornton LLP appreciates the opportunity to comment on the current state of the audit of internal controls over financial reporting. Equally welcome is the opportunity to participate again in this year's public roundtable being held by the Securities and Exchange Commission on May 10, 2006, in Washington, D.C.

Specifically, we would like to comment on (1) the continued integration of the internal control audit with the financial statement audit; (2) performing a more risk-based and efficient audit of internal controls, including both progress and related challenges that have emerged; and (3) the impact of the PCAOB's inspection process on the quality and conduct of the audit of internal control over financial reporting (ICFR).

Integration of internal control and financial statement audits

In 2004, the first year that integrated audits were required for accelerated filers, very few audits actually benefited fully from true integration. Benefits here are defined as either:

(1) Efficiencies gained in the financial statement audit because auditors were able to reduce or change the nature, timing and/or extent of their substantive financial statement audit procedures in light of positive ICFR audit results; or

(2) Improved quality, as auditors were able to increase or change their financial statement audit procedures in light of negative ICFR audit results.

Filers were unable to realize these benefits for two main reasons. First, Auditing Standard No. 2 (AS2) was passed in March of 2004 and was required to be implemented by the end of that year. Because the results of the ICFR audit could not have been known prior to their completion, it was impossible to factor related results into planning and executing the financial statement audit process. Second, many companies and auditors were working concurrently to complete their respective ICFR evaluations, with most of the work being performed in the fourth quarter or even after the end of the fiscal year. The compressed work schedule did not allow for effective integration.

Benefits were realized, however, in the quality of the integrated audit because auditors were able to increase their substantive financial statement audit procedures near the end of the year in areas where the ICFR audit had identified control weaknesses.

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The second-year integrated audit yielded some efficiency in the overall audit process because auditors were able to consider their deeper knowledge of internal controls in planning their substantive financial statement audit procedures. The full benefit of performing an integrated audit is yet to be realized, however, for two primary reasons:

(1) Most public companies that have been through the ICFR evaluation process had to correct, or are still correcting, one or more deficiencies in their internal control systems. The quality of the financial reporting process for these companies has improved significantly in the first two years of the integrated audit. However, additional time must pass before these improved control environments can demonstrate their stability to the extent that auditors, companies, regulators and investors will feel confident about substituting control tests in lieu of substantive financial statement audit procedures.

(2) Although traditionally auditors have been required to gain an understanding of internal controls in planning and performing their financial statement audit procedures, today little practical guidance exists to help the auditor know how much they can reduce or change those procedures in a fully integrated audit. The public has an expectation that auditors should reduce significantly their substantive financial statement audit procedures in situations where internal controls are deemed to be effective. **The auditing profession needs to develop more robust guidance on how and where reductions in scope might be realized without compromising overall audit quality.** In addition, the PCAOB inspection process should lend itself better to identifying and supporting such reductions where appropriate.

<u>Performing a risk-based audit of internal controls and improving audit efficiency</u>

The PCAOB indicated in its May 16, 2005, guidance and November 30, 2005, report on the implementation of AS2 that some auditors did not perform a top-down audit of internal controls and/or did not alter the nature, timing and extent of their ICFR audit procedures to reflect the level of risk. In the first year of AS2, as noted above, auditors had very little time to implement AS2 and very little practical guidance. In addition, the financial reporting profession suffers from a lack of implementation-level guidance regarding what constitutes appropriate internal control in various risk settings. The COSO Framework does a very good job of establishing high-level principles of internal controls, but it does not explain to the user what should or could be done in various risk environments to achieve the underlying objectives behind the principles.

The financial reporting profession, including auditors, practitioners from industry, regulators, investors and academics need to come together to create a body of guidance that all companies, particularly smaller companies, can use to evaluate the effectiveness of their own control systems.

In spite of these challenges, however, we were able to consider risk more effectively in our second-year AS2 application. Our internal control testing methodology under AS2 has always been based, in part, on our assessment of risk inherent in each business process. Our auditors evaluate inherent risk as being high, medium or low in a given process by evaluating judgmentally a series of risk characteristics. High-risk processes receive more control-testing attention, whereas low-risk processes receive little or no control-testing attention. With that risk assessment process as a foundation, we have realized ICFR audit improvements in two areas:

(1) In many engagements, we were able to capitalize on lessons learned in the first year and identify areas where we may have addressed the same or similar risks in multiple places. In those cases, we altered our approach to make the audit more efficient.

(2) We linked our control testing methodology and scopes more effectively to our assessment of critical assertions in the financial statements. Controls in high-risk processes that were associated with critical financial statement assertions received more direct testing from Grant Thornton LLP auditors at higher scopes. Conversely, for lower-risk processes associated with financial statement assertions that were less-than-critical, we utilized more of the work of others and performed less direct testing.

We expect to continue refining this process as we perform more of these audits; however, two factors will hamper everyone's ability to realize and maximize available benefits. One, the lack of available practical internal control guidance will leave all auditors working in an environment in which no auditor (and no company, for that matter) will have confidence that they are responding to the true inherent risk in the proper fashion. Two, the PCAOB inspection process must allow latitude for reasonable auditor judgment in selecting scopes. **In fact, having seen how all firms view and address inherent risk, the inspectors are in a unique position to foster communication among firms and to create consistency in the ICFR audit methodologies.** To that end, we encourage the PCAOB to work with the auditing profession to create an effective and practical audit guide for the audit of internal controls over financial reporting.

Impact of the PCAOB's inspection process

The PCAOB inspection process has been valuable to the auditing profession. We have found our PCAOB inspectors to be eminently qualified and knowledgeable about auditing. They have performed thorough inspections in a professional manner, and we have found the majority of their comments to be very helpful in improving what we consider to be a strong audit methodology.

As it relates to the audit of ICFR, we are mindful that this process is new to everyone – auditors and inspectors included. As such, time is needed for all parties to gain experience in this area. The lack of practical internal control guidance makes the inspector's job even more difficult.

With these benefits and challenges in mind, there are two areas in which the PCAOB's inspection process could generate greater value for auditors, companies and investors:

(1) The PCAOB has stated publicly that they expect auditors to exercise judgment and to use a risk-based approach in conducting their ICFR audits; however, at times we, and other firm experts with whom we have discussed this issue, have had reasonable auditor judgments questioned. Where judgments are unreasonable, they should be questioned; but in areas where reasonable people can disagree, the auditor must be given some room to make judgments without fear of regulatory retribution.

(2) The public has taken the PCAOB's comments that "some" auditors did not use a risk-base approach in conducting their ICFR audits to mean that no auditors used a risk-based approach. As noted earlier, our ICFR audit methodology has always been risk-based. Further, we have received no comments in our inspections indicating that we have performed excessive ICFR audit procedures on any engagement. Other firm experts with whom we have discussed this issue have had similar experiences. We encourage inspectors to suggest process improvements through which auditors might generate reasonable efficiencies; however, these improvements must not come at the expense of audit quality. The PCAOB should also take steps to dispel the myth that all auditors are performing unnecessary audit procedures.

Conclusion

The implementation of Auditing Standard No. 2 has been the single largest change to emerge in the history of the auditing profession. It was passed in March of 2004 and had to be implemented within nine months. It is not surprising, then, that its execution has been fraught with some confusion and inefficiency.

In the last two years, the auditing profession has made great strides in improving the process; but there is plenty of room for further improvement. First, the financial reporting profession should develop effective ground-level guidance that helps differentiate how different companies with different risk characteristics might control similar risks. Second, the auditing profession should develop robust guidance to help all auditors understand more fully how to audit internal controls and how to modify the financial statement audit process in light of the results of the ICFR audit process. Finally, the PCAOB should look for ways to improve the audit process and, at the same time, provide leeway for auditors to make reasonable judgments. If we accomplish these three objectives, we will simultaneously increase audit efficiency and improve the financial reporting process. Meeting these two goals will benefit every auditor, CEO, CFO and investor.

We thank the SEC for this opportunity to add the benefit of our experience to this very critical debate.

Please direct your questions to me at 954.331.1178, or shelley.stein@gt.com, or Trent Gazzaway, Managing Partner Corporate Governance, at 704.632.6834, or trent.gazzaway@gt.com.

Very truly yours,

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