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

Via email: rule-comments@sec.gov

RE: File Number S7-11-06

Dear Ms. Morris:

We appreciate the opportunity to comment on the U.S. Securities and Exchange Commission's (SEC or Commission) *Concept Release Concerning Management's Reports on Internal Control Over Financial Reporting*, and respectfully submit our responses to your request for specific comments in the attached appendix.

We would be pleased to discuss our comments with you. Please contact R. Trent Gazzaway, Managing Partner of Corporate Governance at (704) 632-6834, if you have any questions.

Very truly yours,

Grant Thornton LLP

APPENDIX – RESPONSES TO REQUEST FOR SPECIFIC COMMENTS

The following comprises our responses to your request for specific comments.

INTRODUCTION

1. Would additional guidance to management on how to evaluate the effectiveness of a company's internal control over financial reporting be useful? If so, would additional guidance be useful to all reporting companies subject to the Section 404 requirements or only to a sub-group of companies? What are the potential limitations to developing guidance that can be applied by most or all reporting companies subject to the Section 404 requirements?

   Additional guidance on how to evaluate the effectiveness of a company's internal control over financial reporting (ICFR) will be valuable to all companies, albeit with some minor limitations. Additional guidance, beyond existing audit standards, will give companies a view towards effective internal control evaluation. It may also provide some direction that is unique to certain industries, company sizes or geographies that is not present in any consistent fashion today. However, new guidance should not be so rigid that it removes the ability of management to exercise judgment in the evaluation process. Likewise, it should not be perceived as a set of evaluation rules or checklists. Rather, it should strive to effectively highlight examples of how different companies might efficiently and effectively evaluate their systems of internal control.

2. Are there special issues applicable to foreign private issuers that the Commission should consider in developing guidance to management on how to evaluate the effectiveness of a company's internal control over financial reporting? If so, what are these? Are such considerations applicable to all foreign private issuers or only to a sub-group of these filers?

   Foreign private issuers (FPI's) face most of the same financial reporting risks as domestic issuers. As such, their status as FPI's does not warrant unique control evaluation guidance. However, companies with international operations, whether they are FPI's or domestic registrants, do face unique challenges in evaluating internal controls. Those challenges include, but are not limited to, language and cultural differences and international legal differences. These difficulties are exacerbated by the need to find qualified personnel in these disparate locations (whether internal audit or otherwise) who are qualified to conduct the control evaluation in a manner consistent with the organization's overall plan. Accordingly, any new internal control evaluation guidance should highlight ways in which international organizations can effectively deal with these issues.

3. Should additional guidance be limited to articulation of broad principles or should it be more detailed?

   One of the most daunting challenges associated with implementing the 1992 Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control – Integrated Framework* (COSO Framework) has been, until recently, a general lack of appropriately detailed guidance on how to implement the broad principles it established. The most recent COSO *Internal Control Over Financial Reporting – Guidance for Smaller Public Companies* (COSO Guidance for Smaller Public Companies) is an excellent step in providing that practical advice. Accordingly, although broad principles are necessary, such principles alone will not be sufficient without appropriately detailed guidance.

   In connection with providing additional guidance for evaluating systems of internal control, the Commission should take note of those lessons learned. Additional guidance should establish a framework of broad principles of control evaluation, and then provide specific examples of how that framework might be applied in various settings (e.g., small vs. large company; centralized vs. disaggregated company; domestic vs. international company; etc.). The broad principles will provide a general guide for corporate managers to make appropriate judgments and help ensure consistency of application. Effectively developed detailed guidance will enhance the understanding of the principles and ensure consistency of understanding between all parties (companies, auditors, regulators and investors), thus making the process more efficient.

4. Are there additional topics, beyond what is addressed in this Concept Release that the Commission should consider issuing guidance on? If so, what are those topics?

   The Commission's Concept Release is a comprehensive consideration of issues presently creating challenges for companies in conducting effective and efficient evaluations of their systems of internal control.

5. Would additional guidance in the format of a Commission rule be preferable to interpretive guidance? Why or why not?

   Regardless of whether the Commission chooses a rule or interpretive guidance, the result should be perceived by the marketplace as being authoritative. The Commission should take care not to remove the ability of company management to exercise judgment in practice, nor should they encourage a checklist mentality that results in companies seeking to meet the form of the requirement rather than the substance behind it. The Commission's guidance should provide a starting point for management to exercise appropriate judgment in a wide variety of circumstances. That guidance should establish minimally acceptable criteria in terms of scoping, evaluating, testing and documenting their internal control over financial reporting. It is not possible to anticipate every possible control evaluation scenario in a set of rules. It is possible, however, to design appropriate interpretive guidance that can be analogized to most, if not all, evaluation scenarios.

6. What types of evaluation approaches have managements of accelerated filers found most effective and efficient in assessing internal control over financial reporting? What approaches have not worked, and why?

   The most effective evaluation approaches begin with assembling a team of qualified professionals to plan the evaluation, assess the financial reporting risk, identify the controls that mitigate those risks, and design and execute tests to verify that those controls are in place and operative effectively. The least effective evaluation approaches are the result of a general unwillingness by some corporate executives to approach the evaluation with the intention of truly evaluating and improving their systems of internal control. These organizations typically assign existing financial reporting staff members, who have little or no experience in auditing or evaluating internal control, with the responsibility to "evaluate" internal control. These efforts usually result in the completion of a simple checklist and normally result in minimal improvement opportunities. Management's tone at the top, as it relates to the internal control evaluation, is normally a direct indicator of the effectiveness of the evaluation.

7. Are there potential drawbacks to or other concerns about providing additional guidance that the Commission should consider? If so, what are they? How might those drawbacks or other concerns best be mitigated? Would more detailed Commission guidance hamper future efforts by others in this area?

   As noted above, the Commission should take care to note that some may treat their implementation guidance as a set of rules, rather than general guidance that will help them apply reasonable judgment. The key to making interpretive guidance comprehensive and effective will be to ensure that the right mix of professionals design the guidance. That mix should include corporate practitioners, auditors, regulators and possibly academics. Without an appropriate cross section of professionals, the guidance may lack some practical substance and/or not be effectively accepted by all of the stakeholders involved.

8. Why have the majority of companies who have completed an assessment, domestic and foreign, selected the COSO framework rather than one of the other frameworks available, such as the Turnbull Report? Is it due to a lack of awareness, knowledge, training, pressure from auditors, or some other reason? Would companies benefit from the development of additional frameworks?

   The 1992 COSO Framework is a robust and comprehensive outline of an effective system of internal control. Its effectiveness in addressing risks at the control-principle level has made it attractive as a tool for evaluating internal control over financial reporting for over a decade, particularly for banks subject to the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requirements. No other framework has improved on the COSO Framework as it relates to financial reporting risks, nor has any contradicted its general principles. Accordingly, the COSO Framework was and is a highly effective tool for use in conducting an evaluation of internal control.

Recent history has proven, however, that while the high-level principles embodied in the 1992 COSO Framework are the right principles to measure against, the guidance surrounding them is not detailed enough to demonstrate how those principles might be effectively applied in a wide variety of situations. It is worth noting that no other available framework includes such guidance either. In fact, most have even less guidance regarding practical application than the original COSO Framework. As noted in our answer to question #3 above, the recently issued COSO Guidance for Smaller Public Companies is an excellent step in providing that level of control guidance. It helps companies see how they might practically apply the general principles of internal control that we all agree are the right principles.

As COSO's guidance is adopted, and as it is continually improved, all companies will find the COSO Framework the easiest and most comprehensive framework to apply. Accordingly, no other framework needs to be developed. In fact, the development of additional frameworks will likely serve to confuse companies and result in inefficiencies in application.

9. Should the guidance incorporate the May 16, 2005 "Staff Statement on Management's Report on Internal Control over Financial Reporting"? Should any portions of the May 16, 2005 guidance be modified or eliminated? Are there additional topics that the guidance should address that were not addressed by that statement? For example, are there any topics in the staff's "Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports Frequently Asked Questions (revised October 6, 2004)" that should be incorporated into any guidance the Commission might issue?

The Commission's October 6, 2004, and May 16, 2005, guidance was comprehensive. While companies should have already integrated that guidance into their evaluations of internal control, the Commission should incorporate it into any new guidance to ensure that it is read and considered, and to avoid any confusion over new versus old guidance.

Only minor modifications need to be made to bring the guidance up to date. For example:

- The impact of falling below the new accelerated filer criteria on the Section 404 requirements should be discussed.
- Discussions regarding the definition of material weakness (e.g., Question #13 in the October 2004 guidance) might need to be modified if the SEC approves possible changes suggested by the PCAOB.
- Questions #16 and #18 in the October 2004 guidance should be updated to reference the COSO Guidance for Smaller Public Companies.
- Section D in the May 2005 guidance regarding evaluating internal control deficiencies could be updated to reference *A Framework for Evaluating Control Exceptions and Deficiencies* issued in December 2004, which has become the standard framework for such evaluations.

10. We also seek input on the appropriate role of outside auditors in connection with the management assessment required by Section 404(a) of Sarbanes-Oxley, and on the manner in which outside auditors provide the attestation required by Section 404(b). Should possible alternatives to the current approach be considered and if so, what? Would these alternatives provide investors with similar benefits without the same level of cost? How would these alternatives work?

Auditors should be encouraged to have open and robust dialog with their audit clients regarding internal control related matters. However, the Commission should make it clear that auditors cannot maintain their independence while designing, documenting and / or testing internal controls on behalf of their audit clients.

With respect to the auditor's requirement under Section 404(b), some have suggested that the auditor perform fewer procedures than what would be necessary to issue an annual audit opinion on the effectiveness of internal control. An example of these suggestions includes having the auditor only perform procedures to attest to the effective design of the internal controls, and not the effective operation of those controls. Another example includes requiring the auditor to perform an audit of internal control less than annually (e.g., every three years). Implementation of these suggestions would have negative consequences to the quality with little improvement in the overall cost of conducting an audit of the consolidated financial statements. Very often, weaknesses in internal control are identified when auditors perform tests of the operation of controls they initially thought were present and operating effectively. Removing the tests of operating effectiveness would eliminate this valuable source of control deficiency identification. In addition, performing an audit of internal control less than annually will yield inefficiencies in the internal control audit process and preclude the auditor from using the results of annual internal control tests to alter the nature, timing and extent of their substantive testing of the financial statements.

11. What guidance is needed to help management implement a "top-down, risk-based" approach to identifying risks to reliable financial reporting and the related internal controls?

Management needs guidance regarding how to conduct an appropriate risk assessment and identify key controls (discussed below). This guidance could take the form of example risk assessments, case studies and evaluation templates. COSO's recent guidance is a good starting point. It is worth noting that COSO has effectively reorganized the depiction of the COSO Framework from that of a cube, to an effective process flow that starts with risk assessment, and flows sequentially through the control environment, control activities, information & communication, and monitoring. The Commission should consider building on COSO's suggested process to most effectively link any new guidance on evaluating internal control with existing guidance on what good internal control might look like.

Risk and Control Identification

12. Does the existing guidance, which has been used by management of accelerated filers, provide sufficient information regarding the identification of controls that address the risks of material misstatement? Would additional guidance on identifying controls that address these risks be helpful?

Prior to the development of COSO's recent guidance, there was a clear lack of practical direction, particularly for smaller companies. COSO's guidance provides a good starting point for understanding what good internal control might look like in various environments, but it is only a beginning. Companies continue to need help understanding what constitutes a "key" control. Accordingly, additional example and case study material is needed.

A diverse body of qualified professionals, as noted in the answer to question #7 above, who can discuss and develop this guidance would benefit all companies. This group could be even more effective if it included a mechanism for companies and auditors to submit risk and control-related questions. These questions could serve as the basis for the case study material, thus assuring its real-world applicability.

13. In light of the forthcoming COSO guidance for smaller public companies, what additional guidance is necessary on risk assessment or the identification of controls that address the risks?

Companies need examples (not rules) of quantitative and qualitative analysis that might be conducted to assess risk and identify necessary controls. See the answer to question #16 below.

14. In areas where companies identified significant start-up efforts in the first year (e.g., documentation of the design of controls and remediation of deficiencies) will the COSO guidance for smaller public companies adequately assist companies that have not yet complied with Section 404 to efficiently and effectively conduct a risk assessment and identify controls that address the risks? Are there areas that have not yet been addressed or need further emphasis?

    See the answer to question #12 above.

15. What guidance is needed about the role of entity-level controls in evaluating and assessing the effectiveness of internal control over financial reporting? What specific entity-level control issues should be addressed (e.g., GAAP expertise, the role of the audit committee, using entity-level controls rather than low-level account and transactional controls)? Should these issues be addressed differently for larger companies and smaller companies?

    All companies would benefit from guidance regarding how entity-level monitoring controls can be considered to be key controls that effectively mitigate financial reporting risks. Specifically, they need examples of how monitoring controls can operate at a sufficient level of detail to detect material errors before they reach the financial statements. It is our experience, however, that companies rarely have entity-level controls that operate at a sufficient level of precision to accomplish this goal. Entity-level controls must operate at a level of precision that would detect or prevent the same errors as would the controls at the individual account or transaction level.

    Smaller companies would also benefit from guidance regarding the increased significance of management's direct oversight in areas where segregation of normally incompatible duties is not practical. For example, what level of direct management oversight might effectively compensate for a lack of segregation between setting up new vendors and the payment of accounts payable?

16. Should guidance be given about the appropriateness of and extent to which quantitative and qualitative factors, such as likelihood of an error, should be used when assessing risks and identifying controls for the entity? If so, what factors should be addressed in the guidance? If so, how should that guidance reflect the special characteristics and needs of smaller public companies?

    All companies would benefit from additional guidance regarding quantitative and qualitative financial reporting risk assessments. Factors that might be included in such guidance include:

    - Evaluating quantitative materiality at the entity level (i.e., what locations are important) and financial statement level (i.e., what accounts and classes of transactions are important). Those "material" locations, accounts or classes of transactions might be considered "in-scope," with the amount of evaluation work to be performed on them varying depending on other qualitative risk factors.
    - Other qualitative risk factors might include:
        - Complexity (e.g., specialized skills required; potential for introduction of errors; or complex accounting, judgments or estimates, etc.)
        - Potential for fraud (e.g., related party transactions; financial reporting areas that impact key ratios or compensation; the potential for misappropriation of assets, etc.)
        - The existence of recent changes (e.g., in the process or people; in accounting principles or practices, etc.)

17. Should the Commission provide management with guidance about fraud controls? If so, what type of guidance? Is there existing private sector guidance that companies have found useful in this area? For example, have companies found the 2002 guidance issued by the AICPA Fraud Task Force entitled "Management Antifraud Programs and Controls" useful in assessing these risks and controls?

    Several comprehensive surveys have been performed that highlight the existence of fraud in public companies. Most notably, COSO's study entitled, *Fraudulent Financial Reporting: 1987-1997*, and the Association of Certified Fraud Examiners *2006 Report to the Nation*. Yet, little practical guidance exists for companies regarding deterring and detecting fraud, other than the useful AICPA Fraud Task Force publication highlighted above. More guidance in this area is needed for public companies and auditors, particularly with regard to the differentiation between fraud controls and other types of controls that may also address the risk of fraud as well as error.

18. Should guidance be issued to help companies with multiple locations or business units to understand how those affect their risk assessment and control identification activities? How are companies currently determining which locations or units to test?

    Companies with multiple locations do need additional guidance regarding scoping and conducting their internal control evaluations. Any guidance developed for companies, however, should be coordinated with the PCAOB's direction to auditors regarding the same subject. For example, Appendix B of Auditing Standard No. 2 contains guidance regarding multi-location testing considerations. The Commission and the PCAOB should be in general agreement regarding the scope of work expected in multi-location environments for both companies and auditors. It may be that companies may need to conduct more testing in more locations than the auditors, but it should not be the case that auditors are expected to include more locations in their audit testing, or perform more work in certain locations than management.

    In addition, companies that have a large number of homogeneous locations often struggle with whether they need to test controls at individual locations versus testing only home office controls. The Commission and the PCAOB should agree on the level of testing needed at the individual location level by both management and the auditor.

MANAGEMENT'S EVALUATION

19. What type of guidance would help explain how entity-level controls can reduce or eliminate the need for testing at the individual account or transaction level? If applicable, please provide specific examples of types of entity-level controls that have been useful in reducing testing elsewhere.

    See the answer to question #15 above.

20. Would guidance on how management's assessment can be based on evidence other than that derived from separate evaluation-type testing of controls, such as on-going monitoring activities, be useful? What are some of the sources of evidence that companies find most useful in ongoing monitoring of control effectiveness? Would guidance be useful about how management's daily interaction with controls can be used to support its assessment?

    We believe such guidance would be very useful to management. However, such guidance should be specific as to the types of monitoring controls that might provide strong-enough evidence to negate the need for separate evaluation-type testing. We believe there is a lot of misunderstanding in this area, and monitoring controls mean different things to different people. In fact, monitoring controls can operate at the individual account or transaction level of an organization as well as the entity-level. We do not believe it is sufficient for management to rely exclusively on entity-level monitoring controls to support their assertion.

21. What considerations are appropriate to ensure that the guidance is responsive to the special characteristics of entity-level controls and management at smaller public companies? What type of guidance would be useful to small public companies with regard to those areas?

    As previously stated in our answer to question #15 above, we agree that entity-level controls could reduce the need to test at the activities-level, provided they operate in a manner precise enough to detect or prevent errors as activities-level controls. However, we have not observed many of these types of controls.

    That said, we do not believe size is the driver for guidance in this area.

22. In situations where management determines that separate evaluation-type testing is necessary, what type of additional guidance to assist management in varying the nature and extent of the evaluation procedures supporting its assessment would be helpful? Would guidance be useful on how risk, materiality, attributes of the controls themselves, and other factors play a role in the judgments about when to use separate evaluations versus relying on ongoing monitoring activities?

    Similar to the expectations of auditors, it is often appropriate for management to alter the nature, timing and extent of testing to avoid predictability. Regardless, the Commission's guidance should require companies to perform sufficient procedures to support an annual assessment.

23. Would guidance be useful on the timing of management testing of controls and the need to update evidence and conclusions from prior testing to the assessment "as of" date?

    Since the assessment is made as of the "as of" date, management would benefit from guidance as to when to perform their testing. The consequences of testing very near the "as of" date could be serious if deficiencies are discovered through such testing that cannot be remediated due to timing. Management would also benefit from guidance as to the types of procedures to perform to bring their prior testing closer to the "as of" date (rollforward procedures).

24. What type of guidance would be appropriate regarding the evaluation of identified internal control deficiencies? Are there particular issues in evaluating deficient controls that have only an indirect relationship to a specific financial statement account or disclosure? If so, what are some of the key considerations currently being used when evaluating the control deficiency?

    We believe management should evaluate internal control deficiencies consistent with the manner in which auditors evaluate them. The auditing profession developed a framework for evaluating control deficiencies that is widely used in practice. We recommend that through this process, the Commission acknowledge this framework and urge management to use it.

25. Would guidance be helpful regarding the definitions of the terms "material weakness" and "significant deficiency"? If so, please explain any issues that should be addressed in the guidance.

    We urge the Commission to avoid any modifications of the definitions. This could cause confusion and the impression that management can use different definitions. We believe it is essential that all parties (management, auditors, investors, etc.) use the same definitions and the same guidance as established in Auditing Standard No. 2.

26. Would guidance be useful on factors that management should consider in determining whether management could conclude that no material weakness in internal control over financial reporting exists despite the discovery of a need to correct a financial statement error as part of the financial statement close process? If so, please explain.

    By definition, internal control does not provide absolute assurance that all errors will be prevented or detected. In practice, however, errors detected by the auditor are ordinarily considered to be the result of a material weakness. Accordingly, we believe guidance is needed in this area to determine when errors are material weaknesses versus inherent limitations in internal control.

27. Would guidance be useful in addressing the circumstances under which a restatement of previously reported financial information would not lead to the conclusion that a material weakness exists in the company's internal control over financial reporting?

    Guidance in this area would be very helpful to management and to auditors, even if the Commission can only provide examples of such situations. The concept exists in theory, but is hard to operationalize in practice.

28. How have companies been able to use technology to gain efficiency in evaluating the effectiveness of internal controls (e.g., by automating the effectiveness testing of automated controls or through benchmarking strategies)?

    Technology, when used effectively, does provide efficiency. Many accelerated filers purchased applications and used them effectively. Such applications help with consistency throughout the organization. Also, in succeeding years, technology provides the opportunity to leverage work initiated in earlier years. We believe the use of technology should be encouraged.

    Benchmarking is a strategy that has not been well developed. Additional guidance is needed if benchmarking is to be implemented effectively.

29. Is guidance needed to help companies determine which IT general controls should be tested? How are companies determining which IT general controls could impact IT application controls directly related to the preparation of financial statements?

    This continues to be an area of tremendous confusion and accordingly, we believe management would benefit from guidance. Whether IT general controls directly impact application controls is a facts and circumstances issue that depends on the design of the IT systems. Because there are so many potential configurations of systems, it is very difficult to develop guidance in this area. Therefore, we recommend that any such guidance clarify that it has to be considered in light of the facts and circumstances of the organization.

30. Has management generally been utilizing proprietary IT frameworks as a guide in conducting the IT portion of their assessments? If so, which frameworks? Which components of those frameworks have been particularly useful? Which components of those frameworks go beyond the objectives of reliable financial reporting?

    It is our observation that currently available frameworks go well beyond the objectives of reliable financial reporting. It is also our observation that the frameworks themselves have common elements, but provide varying degrees of depth which, in our opinion, go beyond the objectives of reliable financial reporting. We believe the Commission could resolve much confusion by identifying the aspects of existing frameworks that satisfy expectations regarding financial reporting.

Documentation to Support the Assessment

31. Were the levels of documentation performed by management in the initial years of completing the assessment beyond what was needed to identify controls for testing? If so, why (e.g., business reasons, auditor required, or unsure about "key" controls)? Would specific guidance help companies avoid this issue in the future? If so, what factors should be considered?

    We observed inefficiencies in the assessment process related to both documentation and testing. Partially, this was primarily due to the fact that little guidance was available during the initial implementation period. In addition, there was a natural learning curve for everyone involved. Our observations further indicate that there comes a point when management becomes comfortable and the level of documentation is appropriate. Although more guidance would be helpful, we believe it is hard to avoid some inefficiency in the initial implementation.

32. What guidance is needed about the form, nature, and extent of documentation that management must maintain as evidence for its assessment of risks to financial reporting and control identification? Are there certain factors to consider in making judgments about the nature and extent of documentation (e.g., entity factors, process, or account complexity factors)? If so, what are they?

    Guidance regarding the form, nature and extent of documentation that management must retain would be helpful. Regardless of the guidance the Commission issues, it should harmonize management's documentation requirements with those of the auditor.

33. What guidance is needed about the extent of documentation that management must maintain about its evaluation procedures that support its annual assessment of internal control over financial reporting?

    Similar to our response to question #32 above, we believe such guidance is needed and that management's documentation requirements should be comparable to that required of auditors.

34. Is guidance needed about documentation for information technology controls? If so, is guidance needed for both documentation of the controls and documentation of the testing for the assessment?

    We believe documentation for information technology controls to be no different than documentation for other controls. Thus, additional guidance in this area is not needed.

35. How might guidance be helpful in addressing the flexibility and cost containment needs of smaller public companies? What guidance is appropriate for smaller public companies with regard to documentation?

    The creation of guidance discussed earlier in this document would provide effective guidance for companies of all sizes on how to conduct and document their evaluation of internal control. Accordingly, separate guidance for smaller companies is not warranted and could add confusion.