Grant Thornton LLP
The US Member Firm of
Grant Thornton International

201 South College Street
Suite 2500
Charlotte, NC 28244
704 632 3500

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Ms. 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 S7-24-06

Dear Ms. Morris:

We appreciate the opportunity to comment on the U.S. Securities and Exchange Commission's (SEC or Commission) proposed interpretive guidance, ***Management's Report on Internal Control over Financial Reporting*** (the proposed guidance). We also appreciate the Commission's efforts to provide management, as well as auditors, with guidance on implementing the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. We are supportive of the Commission's approach, which can be scaled to companies of all sizes and complexities.

As it relates to the Commission's proposed guidance, we respectfully submit in the attached appendix our responses to your request for specific comments. We would be pleased to discuss our comments with you. If you have any questions, please contact Mr. John L. Archambault, Managing Partner of Professional Standards, at (312) 602-8701, or Mr. R. Trent Gazzaway, Managing Partner of Corporate Governance, at (704) 632-6834.

Very truly yours,

Grant Thornton LLP

APPENDIX – RESPONSES TO REQUEST FOR SPECIFIC COMMENTS

Proposed Interpretive Guidance

- Will the proposed interpretive guidance be helpful to management in completing its annual evaluation process? Does the proposed guidance allow for management to conduct an efficient and effective evaluation? If not, why not?

  The proposed interpretive guidance provides valuable direction to management on how to evaluate the effectiveness of internal control over financial reporting (ICFR). If the guidance is applied with reasonable judgment, management should be able to conduct an effective and efficient evaluation with appropriate documentation. However, the proposed guidance does focus extensively on the concept of "entity-level controls." Entity-level controls are not consistently understood today, and our concern is that this guidance could result in some companies monitoring internal controls at an inappropriately high level.

  The proposed guidance states, "If management determines that the risks for a particular financial reporting element are adequately addressed by **an** entity-level control (emphasis added), no further evaluation of other controls is required." The proposed guidance aptly defines "entity-level controls" in footnote 29. If a company implements effective entity-level controls that conform to the Commission's definition, we agree that management could use the information provided by those controls as a reasonable basis for forming an opinion about the effectiveness of its internal control. For example, a company that could demonstrate the following characteristics (all of which are embodied in the Commission's definition of entity-level controls in footnote 29) would be in a position to publicly assert regarding the effectiveness of its ICFR:

  - proper management philosophy and operating style,
  - integrity and ethical values,
  - board or audit committee oversight,
  - assignment of authority and responsibility,
  - controls over management override,
  - effective risk assessment process,
  - controls to monitor results of operations,
  - controls to monitor other controls (including internal audit, audit committee and self-assessment activities),
  - controls over the period-end financial reporting process, and
  - policies that address significant business control and risk management practices.

  However, it is unclear whether the Commission expects a company to apply all the elements of its definition. In fact, readers might reasonably conclude that the Commission does not intend for all elements of the definition to be applied, since some elements such as "centralized processing and controls" and "shared service environments" certainly will not be present in every company.

  The danger lies in the current overemphasis by many on two specific elements of the Commission's definition of entity-level controls—namely, controls to monitor results of operations and self-assessment activities. Both of these elements are important to an effective control monitoring program; however, many people believe that these two elements alone can form the primary, if not the sole, support for management's assertion regarding the effectiveness of ICFR. Such is rarely the case.

  Monitoring the results of operations can sometimes indicate if a significant problem has occurred, but it cannot normally, on its own, provide reasonable assurance that such a problem could not occur and remain undetected. Likewise, self-assessments establish accountability and provide some evidence that controls are operating as intended, but they lack the necessary objectivity to provide all the support necessary over long periods of time. In reality, both elements more effectively provide interim support

for a conclusion regarding control effectiveness between periodic, separate control evaluations. The length of time between and the intensity of these separate evaluations will be dependent on the level of risk and the strength of the evidence gathered during the interim periods.

The Commission should consider clarifying the discussion with regard to entity-level controls and their effect on management's assessment process, particularly in companies where the other elements of the Commission's definition of entity-level controls do not exist or are ineffective.

The Commission might also consider removing the terms "centralized processing and controls" and "shared service environments" from the definition of entity-level controls in footnote 29. Doing so would create a workable definition of entity-level controls that contains elements that should be present in all companies. The removed terms, which are important, could be listed separately as organizational-structure elements that would tend to lower the level of financial reporting risk in any organization, and thus may impact the scope of any necessary control testing.

- Are there particular areas within the proposed interpretive guidance where further clarification is needed? If yes, what clarification is necessary?

  To the extent that management's process for assessing ICFR is part of its monitoring activities, the auditor will still need to document and evaluate such monitoring procedures in his or her audit of ICFR. Accordingly, the proposed interpretive guidance should clarify that an auditor must still consider management's monitoring of the effective operation of internal control in order to conclude on the effectiveness of ICFR and, therefore, management should maintain the necessary documentation that provides support for its assessment.

- Are there aspects of management's annual evaluation process that have not been addressed by the proposed interpretive guidance that commenters believe should be addressed by the Commission? If so, what are those areas and what type of guidance would be beneficial?

  In addition to the above-noted recommendations with respect to a company's monitoring of internal control and how it may assist management with its assessment of ICFR, we believe the following matters, which are discussed in more detail below, require additional clarification:

  - Management's responsibility to establish and implement fraud controls
  - The concept of "aggregation"
  - Multi-location testing considerations
  - Evaluating control deficiencies

Management's responsibility to establish and implement fraud controls

Several comprehensive surveys have been performed that highlight the existence of fraud in public companies and the impact of fraudulent financial reporting on investors—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 guidance issued by the American Institute of Certified Public Accountant's Fraud Task Force, including the publications entitled ***Management Antifraud Programs and Controls*** and ***Management Override of Internal Controls: The Achilles' Heel of Fraud Prevention—The Audit Committee and Oversight of Financial Reporting***. More guidance in this area is needed for public companies and auditors, particularly with regard to the identification of controls that may address the risk of fraud. Accordingly, the Commission should incorporate into the guidance the valuable concepts from such literature that are relevant to the prevention and detection of fraud.

The concept of "aggregation" of control deficiencies

Page 26 of the proposed interpretive guidance states, "At the end of this identification process, management will have identified for testing only those controls that are needed to adequately address the risk of a material misstatement in its financial statements and for which evidence about their operation can be obtained most efficiently." In this phrase and throughout the proposed interpretive guidance, the concept of aggregation of control deficiencies seems lost.

Auditors are well aware of the concept of "aggregation": that is, planning and performing the audit to obtain reasonable assurance that deficiencies that, individually or in the aggregate, would represent material weaknesses are identified. We do not believe this concept is well understood by management and therefore needs additional clarification and emphasis in the proposed interpretive guidance.

Multi-location testing considerations

Including in the scope of evaluation a substantial portion of a company's operations that are material to its financial statements is a critical component of an effective evaluation of ICFR. Other than Appendix B of AS No. 2, no guidance exists in this area. Accordingly, we believe the interpretive guidance should be enhanced to fully discuss the concepts along the lines of the guidance in AS No. 2. It is not necessary to mandate this guidance, but it would be helpful for management to understand the importance of coverage in the ICFR evaluation process. Without such emphasis, some companies may conclude that it is appropriate to include as little as fifty percent or less of their operations in the scope of the ICFR evaluation. While the level of effort involved in evaluating ICFR might vary in each location based on risk, it is important to include enough locations to form a reasonable basis for an overall conclusion regarding the effectiveness of controls.

An exception might be found in companies that have a large number of homogeneous locations, such as a large restaurant chain. In these companies, few financial reporting controls reside at the location level. In addition, the monitoring procedures performed at the corporate office would normally detect any financial reporting anomalies that could possibly be material to the consolidated financial statements. In these organizations, it is important to periodically test store-level controls to ensure that no pervasive control problems impair the value of the information being monitored at the corporate office, but the scope of such an evaluation would not need to cover a substantial portion of the company's operations.

Evaluating control deficiencies

The proposed interpretive guidance refers to an analysis for evaluating control deficiencies. Since the profession and accelerated filers have been using a consistent approach and methodology—***A Framework for Evaluating Control Exceptions and Deficiencies*** (developed by representatives from nine accounting firms that audit public companies and by a professor)—we recommend that the SEC make reference to this guidance. We believe such a reference will reduce the risk of inconsistencies in the marketplace in reporting material weaknesses.

- Do the topics addressed in the existing staff guidance (May 2005 Staff Guidance and Frequently Asked Questions (revised October 6, 2004)) continue to be relevant or should such guidance be retracted? If yes, which topics should be kept or retracted?

The topics addressed in the existing staff guidance continue to be relevant and, therefore, need not be retracted. It would be helpful to amend the answer to Question 18 to refer to the final interpretive guidance.

- Will the proposed guidance require unnecessary changes to evaluation processes that companies have already established? If yes, please describe.

We do not believe the proposed interpretive guidance will require unnecessary changes to the evaluation process. Many processes that are already established will satisfy the evaluation "requirements" in the

proposed interpretive guidance. However, our concern remains that if a company does not have effective monitoring procedures, the lack of guidance in this area could cause companies to perform evaluations that are deficient in assessing ICFR effectiveness.

- Considering the PCAOB's proposed new auditing standards, *An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements* and *Considering and Using the Work of Others In an Audit*, are there any areas of incompatibility that limit the effectiveness or efficiency of an evaluation conducted in accordance with the proposed guidance? If so, what are those areas and how would you propose to resolve the incompatibility?

  For the most part, the PCAOB's proposed new auditing standard and the SEC's proposed interpretive guidance are aligned. However, if management does not apply the proposed interpretive guidance with reasonable judgment, there may be a potential misperception in the work effort that would be required by the auditor, particularly when management's assessment is deficient or lacks appropriate documentation. There is general concern that, because of the interaction between the quality of management's assessment (including documentation) and the efficiency of the audit effort (including the ability to use the work of others), some actions that reduce management's assessment costs could increase the audit effort required. This should be acknowledged.

  In addition, we believe the following areas, if not clarified, could result in a misunderstanding regarding the respective assessments of ICFR by management and by the auditor, and the ability of the auditor to use the work of others in his or her assessment:

  - The explicit omission (in footnote 50 of the SEC's proposed interpretive guidance) of a requirement for management to consider "significant accounts" during its risk assessment process. This may indirectly suggest the acceptability of monitoring activities that are less robust than what is required by the COSO ***Internal Control – Integrated Framework***. While the term "significant account" may be more familiar to auditors than other financial reporting practitioners, we believe its consistent use and understanding in any consideration of the effectiveness of a system of internal control is important. Accordingly, as indicated previously, including guidance that is similar to paragraphs 40 through 46 of AS No. 2 will provide a benchmark for management when performing its assessment.

  - The difference in documentation requirements that exists between the proposed interpretive guidance and the requirements of AS No. 3, ***Audit Documentation***. The lack of documentation on the part of management could increase the amount of work for the auditor and minimize the auditor's ability to use the work of others. It could also cause the auditor to conclude that the company's monitoring is ineffective and that a material weakness exists. Robust documentation by management is critical to effectively and efficiently manage a business and a financial reporting process. It will improve consistency, assist management when personnel changes occur and better support management's decisions. Clarifying this matter in the interpretive guidance would give management an understanding of the consequences relating to the lack of documentation.

- Are there any definitions included in the proposed interpretive guidance that are confusing or inappropriate and how would you change the definitions so identified?

  Aside from the minor adjustment suggested to the definition of "entity-level controls" suggested on page 3, the definitions included in the proposed interpretive guidance are appropriate and do not need additional clarification or revision.

- Will the guidance for disclosures about material weaknesses result in sufficient information to investors and if not, how would you change the guidance?

  If the suggested disclosures about material weaknesses are provided by a company, such disclosures would result in sufficient information being provided to investors. However, the language in the

proposed interpretive guidance is not strong enough to indicate that such disclosures should ordinarily be made (or that disclosures that are not as robust would ordinarily be unacceptable).

- Should the guidance be issued as an interpretation or should it, or any part, be codified as a Commission rule?

  It is unnecessary to codify the proposed interpretive guidance as a Commission rule. The proposed interpretive guidance provides management with the ability to exercise judgment in the evaluation process. Such guidance need not be rules-based to be effective.

- Are there any considerations unique to the evaluation of ICFR by a foreign private issuer that should be addressed in the guidance? If yes, what are they?

  Foreign private issuers (FPIs) face most of the same financial reporting risks as domestic issuers. As such, their status as FPIs does not warrant separate control evaluation guidance. However, companies with international operations, whether they are FPIs or domestic registrants, do face unique challenges in evaluating ICFR. 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 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, some additional control evaluation guidance may highlight ways in which international organizations can effectively deal with such issues.

Proposed Rule Amendments

- Should compliance with the interpretive guidance, if issued in final form, be voluntary, as proposed, or mandatory?

  Compliance with the interpretive guidance should be voluntary, with a strong recommendation that it be followed with reasonable judgment. The Commission appropriately recognizes that there is a variety of evaluation methods, and that an evaluation conducted in accordance with the interpretive guidance would satisfy the evaluation requirements in the existing rules.

- Is it necessary or useful to amend the rules if the proposed interpretive guidance is issued in final form, or are rule revisions unnecessary?

  The proposed interpretive guidance does not fundamentally change the existing requirements. As such, rule revisions are unnecessary.

- Should the rules be amended in a different manner in view of the proposed interpretive guidance?

  For the reasons indicated herein, the existing rules do not need to be amended. Regardless of whether the Commission chooses a rule or interpretive guidance, the result should be perceived by the marketplace as being authoritative, and therefore should set a bar for what would be minimally expected. In addition, the Commission should take care not to remove management's ability to exercise reasonable judgment in practice, nor should it encourage a checklist mentality that results in companies seeking to meet the form of the requirement rather than the substance behind it.

- Is it appropriate to provide the proposed assurance in Rules 13a-15 and 15d-15 that an evaluation conducted in accordance with the interpretive guidance will satisfy the evaluation requirement in the rules?

  It is appropriate to indicate in Rules 13a-15 and 15d-15 that an evaluation conducted in accordance with the interpretive guidance will satisfy the evaluation requirements of the existing rules. As noted above, in order for the evaluation to satisfy the existing rules, the judgments exercised, where allowed, must be reasonable. The interpretive guidance should make that fact clear.

- Does the proposed revision offer too much or too little assurance to management that it is conducting a satisfactory evaluation if it complies with the interpretive guidance?

  Unless otherwise indicated herein with regard to clarifications and enhancements that could be made to the interpretive guidance, if management exercises reasonable judgment in following such guidance, it should be able to conduct an effective evaluation of ICFR. Accordingly, the assurances suggested in the interpretive guidance and related rules are reasonable.

- Are the proposed revisions to Exchange Act Rules 13a-15(c) and 15d-15(c) sufficiently clear that management can conduct its evaluation using methods that differ from our interpretive guidance?

  The proposed revisions to Exchange Act Rules 13a-15(c) and 15d-15(c) are clear that management may conduct its evaluation using methods that differ from the interpretive guidance. However, as indicated above, such rules should be sufficiently clear that evaluation methods less robust than those suggested by the proposed interpretive guidance would ordinarily be unacceptable.

- Do the proposed revisions to Rules 1-02(a)(2) and 2-02(f) of Regulation S-X effectively communicate the auditor's responsibility? Would another formulation better convey the auditor's role with respect to management's assessment and/or the auditor's reporting obligation?

  The proposed revisions to Rules 1-02(a)(2) and 2-02(f) of Regulation S-X effectively communicate the auditor's responsibility to report on management's assessment by expressing an opinion directly on the effectiveness of ICFR. The Commission's proposed revisions, along with the PCAOB's proposed new auditing standard, rightfully recognize the importance of the auditor's conclusion about the effectiveness of ICFR and not just management's process for evaluating ICFR. The auditor must audit ICFR—not just management's process for evaluating ICFR—in order to form an opinion on effectiveness. It is management's assessment (or assertion) regarding effectiveness coupled with the auditor's independent opinion that gives investors confidence that the financial reporting process is operating effectively as of the end of the fiscal year.

- Should we consider changes to other definitions or rules in light of these proposed revisions?

  There are currently no other definitions or rules outside of the proposed revisions that we believe warrant changes at this time.

- The proposed revision to Rule 2-02(f) highlights that disclaimers by the auditor would only be appropriate in the rare circumstance of a scope limitation. Does this adequately convey the narrow circumstances under which an auditor may disclaim an opinion under our proposed rule? Would another formulation provide better guidance to auditors?

  The proposed revision to Rule 2-02(f) adequately conveys the rare circumstances in which a disclaimer of opinion due to a scope limitation would be appropriate. While an ineffective management process for assessing ICFR may no longer result in a disclaimer of opinion, the SEC (and the PCAOB) should clarify that ineffective monitoring of ICFR would be a strong indicator that one or more material weaknesses in ICFR exist, and that the existence of such material weaknesses would require the auditor to issue an adverse opinion on ICFR.