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September 6, 2006

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

Reference: File Number S7-11-06; Concept Release Concerning Management's Reports

Dear Ms. Morris:

We appreciate the opportunity to provide responses to the questions posed in the Concept Release. Alamo Group has over 2,250 employees and operates thirteen plants in North America, Europe and Australia. We have over three years experience working to comply with Section 404 of the Sarbanes-Oxley Act and see a need for a fresh start in defining related requirements. Accordingly we have taken the liberty to illustrate what we believe is an integrated, top-down, risk based approach that is scalable, applicable to all registrants, beneficial to shareholders and less expensive to implement. Our illustrated approach is described in three attached Exhibits:

Exhibit A – defines management requirements as might be promulgated by the SEC;
Exhibit B – illustrates auditor requirements that could be provided by the PCAOB;
Exhibit C – includes responses based on the above to the questions posed in the Concept Release.

These Exhibits illustrate adoption of broad principles and requirements for management's assessment as well as a significantly redefined role for the public accountant. They incorporate the twenty principal areas of control recently identified by COSO as the assessment framework applicable to all registrants. Terms such as "material weakness" are redefined to conform to a risk based approach. Described in broad strokes, the approach requires that:

- Management
  - develop a written control plan scaled to the size and complexity of their business, and
  - develop and execute a schedule of control testing that may span several years,
- The Audit Committee of the Board
  - annually review and approve management's control plan and testing schedule,
  - monitor testing results, and
  - approve management's evaluation of all significant control deficiencies and material weaknesses, as redefined in Exhibit A.
- The public accountant
  - review and test management's assessment as necessary to determine if it was conducted in accord with requirements promulgated by the SEC,
  - independently identify procedures the public accountant considers key in the company's control environment and obtain evidence that those procedures are in place and operating effectively, and
  - obtain evidence as to the effectiveness of any control procedure or group of control procedures that the public accountant intends to rely upon to support the effective or efficient execution of the public accountant's plan for the audit of financial results.

The illustrated approach recognizes that the identification of significant risks and the selection of specific control procedures are scalable, in that they are matters of judgment exercised by management in light of such considerations as the size of the business, the complexity of its systems and procedures and the need to appropriately allocate resources. The approach suggests control procedures be selected in a manner that management believes will provide reasonable, but not necessarily absolute, assurance that financial reporting risks will be reduced to acceptable levels and financial reporting objectives will be achieved by preventing or detecting errors or irregularities in amounts that management believes to be material.

In our view guidance provided by the SEC should address relatively high-level matters and be applicable to all registrants. More detailed "how-to" guidance can be developed as needed by the various professional auditing organizations. We believe the illustrated approach provides ***increased*** benefits to investors through:

- emphasis on the control environment and significant risks,
- focus on substantive matters rather than perfunctory testing,
- increased oversight related to internal control by the Board Audit Committee,
- reasonable coordination between management and the public accountant,
- more meaningful, risk-based evaluation and reporting, and
- reduced cost.

Several factors contribute to reduced cost. The public accountant's Section 404 work would be more focused and less time consuming since it would no longer involve an independent, comprehensive and fully redundant assessment of internal control each year. Management would have the ability to address only what they consider to be significant risks and control procedures, limit documentation to that specified in SEC requirements, and spread the cost of testing over several years.

While all prior efforts to interpret and build on prior releases have been commendable, they have not in our experience had a substantial effect on the amount of work, expense or benefit presently associated with Section 404 compliance. We see both the need and the opportunity for a fresh start in defining related requirements, and encourage future guidance that is relatively short, timely, scalable and applicable to all registrants.

Respectfully submitted,

Dennis M. Stevens
Director, Internal Audit
Alamo Group Inc.

Exhibit A

Management's Annual Assessment of Internal Control

Illustrative Requirements

Risk and Control Identification

Management's assessment of internal control performed under the provisions of Section 404 of the Sarbanes-Oxley Act of 2002 should address the principal areas of control identified by COSO as management considers necessary and appropriate to the size and complexity of their business:

Control Environment

1. ***Integrity and Ethical Values*** – Sound integrity and ethical values, particularly of top management, should be developed and understood and set the standard of conduct for financial reporting.
2. ***Board of Directors*** – The Board of Directors should understand and exercise oversight responsibility related to financial reporting and related internal control.
3. ***Management's Philosophy and Operating Style*** – Management's philosophy and operating style should support effective internal control over financial reporting.
4. ***Organizational Structure*** – The registrant's organizational structure should support effective internal control over financial reporting.
5. ***Financial Reporting Competencies*** – The registrant should retain individuals competent in financial reporting and related oversight roles.
6. ***Authority and Responsibility*** – Management and employees should be assigned appropriate levels of authority and responsibility to facilitate effective internal control over financial reporting.
7. ***Human Resources*** – Human resource policies and practices should be designed and implemented to facilitate effective internal control over financial reporting.

Risk Assessment

8. ***Financial Reporting Objectives* –** Management should specify financial reporting objectives with sufficient clarity and criteria to enable the identification of risks to reliable financial reporting.
9. ***Financial Reporting Risks* –** The registrant should identify and analyze risks to the achievement of financial reporting objectives as a basis for determining how the risks should be managed.
10. ***Fraud Risk*** – The potential for material misstatement due to fraud should be explicitly considered in assessing risks to the achievement of financial reporting objectives.

Control Activities

11. ***Integration with Risk Assessment*** – Actions should be taken to address risks to the achievement of financial reporting objectives.
12. ***Selection and Development of Control Activities*** – Control activities should be selected and developed considering their cost and their potential effectiveness in mitigating risks to the achievement of financial reporting objectives.
13. ***Policies and Procedures*** – Policies related to reliable financial reporting should be established and communicated throughout the registrant, with corresponding procedures resulting in management directives being carried out.
14. ***Information Technology* –** Information technology controls, where applicable, should be designed and implemented to support the achievement of financial reporting objectives.

Management's Annual Assessment of Internal Control
Illustrative Requirements

Information and Communication

15. ***Financial Reporting Information*** – Pertinent information should be identified, captured, used at all levels of the registrant, and distributed in a form and timeframe that supports the achievement of financial reporting objectives.
16. ***Internal Control Information*** **–** Information used to execute other control components should be identified, captured, and distributed in a form and timeframe that enables personnel to carry out their internal control responsibilities.
17. ***Internal Communication*** **–** Communications should enable and support understanding and execution of internal control objectives, processes, and individual responsibilities at al levels of the organization.
18. ***External Communication*** **–** matters affecting the achievement of financial reporting objectives are communicated with outside parties.

Monitoring

19. ***Evaluations*** **–** Ongoing and/or separate evaluations should be performed to enable management to determine whether internal control over financial reporting is present and functioning.
20. ***Reporting Deficiencies*** **–** Internal control deficiencies should be identified and communicated in a timely manner to those parties responsible for taking corrective action, and to management and the Board of Directors as appropriate.

An <u>internal control deficiency</u> exists when the design or operation of one or more control procedures was not as effective as management intended for a period of time. A <u>significant control deficiency</u> exists when the design or operation of all or most control procedures put in place to manage or mitigate one or more risks were not as effective as management intended for a period of time. During that time the business was exposed to more risk(s) than management intended. A <u>material weakness</u> in internal control refers to a situation where, in the opinion of management, one or more significant control deficiencies existed for a period of time that could be sufficient to allow a material adverse affect on any of the account balances or other data reported to the public.

Documentation

Management should document the manner and extent to which they identified risks and controls by developing a written control plan that identifies:

a) Financial reporting objectives, which generally relate to the fair and accurate presentation of material account balances and other data periodically reported to the public,
b) Business processes that develop or otherwise affect material account balances and other data periodically reported to the public,
c) Financial reporting risks, which generally pertain to possible errors or irregularities in each identified business process,
d) The control activities and procedures designed to manage or mitigate each financial reporting risk that management considers significant, and
e) Those elements of the control environment (as previously described) that contribute to the successful implementation of the control plan.

Exhibit A

Management's Annual Assessment of Internal Control

Illustrative Requirements

A <u>significant</u> <u>financial</u> <u>reporting</u> <u>risk</u> is generally one that should be reduced to levels that management finds acceptable in order to reasonably assure the achievement of financial reporting objectives. The identification of significant financial reporting risks and the selection of specific control procedures are matters of judgment exercised by management in light of such considerations as the size of the business, the complexity of its systems and procedures and the need to appropriately allocate resources. Control procedures should be selected in a manner that management believes will provide reasonable, but not necessarily absolute, assurance that financial reporting risks will be reduced to acceptable levels and financial reporting objectives will be achieved by preventing or detecting errors or irregularities in amounts that management believes to be material.

The control plan should document the manner in which management elects to define materiality, and management should coordinate with their external auditor in this regard. The definition of materiality should be consistent with that used or intended to be used by the external auditor in the audit of financial results, and should generally be consistent with the definition used by management in prior internal control assessments.

The control plan should be sufficiently detailed to demonstrate that management considered the business's processes as well as the risks inherent in them and identified control procedures designed to mitigate each significant financial reporting risk to a degree acceptable to management. Once developed the control plan should be continuously monitored and updated as needed to reflect underlying changes in the business environment or related procedures.

As further discussed below, management's documentation should also include a testing schedule as well as a description of test results.

<u>Evaluation</u>

Effective monitoring on a continuous basis is an essential component of a sound system of internal control. The design of internal controls documented in the control plan should be reviewed and tested as considered necessary to determine if control procedures are operating effectively. The frequency and scope of testing is generally a matter of judgment exercised by management, although management should again coordinate with their external auditor in this regard.

In management's initial assessment testing should, at a minimum, be sufficient to assess the effectiveness of controls in mitigating all financial reporting risks that management considers significant. In subsequent annual assessments, management should reconsider all significant financial reporting risks and consider expanding the scope of its assessment. In subsequent annual assessments management may consider such things as changes in personnel, systems or procedures and their affect on controls to identify procedures to be tested. Management may elect to test certain control procedures frequently while others may be tested only once every few years.

Management's documentation should include a testing schedule prepared in sufficient detail to identify each significant financial reporting risk and the year(s) in which related control procedures will be tested. Test results should be documented in sufficient detail to permit a party independent of those performing the test(s) to identify what was tested, how tests were performed, and the facts that served as a basis for a conclusion as to whether tested controls were operating as intended by management.

Exhibit A

Management's Annual Assessment of Internal Control

Illustrative Requirements

Board Oversight

At least annually, the Audit Committee of the Board of Directors should review management's control plan and related testing schedule to determine if:

- **A.** The plan includes a reasonably comprehensive identification of business processes and risks that can affect the achievement of financial reporting objectives,
- **B.** The plan identifies control procedures reasonably adequate in their design to mitigate each financial reporting risk that the Audit Committee considers significant,
- **C.** The plan reasonably identifies elements of the control environment designed to contribute to the successful implementation of the control plan,
- **D.** The testing schedule is reasonably sufficient to assess, in a time period that the Audit Committee considers reasonable, the effectiveness of controls in mitigating all financial reporting risks that the Audit Committee considers significant.

The control plan and related testing schedule should be approved and monitored by the Audit Committee, and management should regularly provide the Committee progress reports on the results of their testing and other monitoring efforts. These reports should provide a balanced assessment of the significant financial reporting risks and the effectiveness of the system of internal control in managing those risks. Any significant control deficiencies (as previously defined) identified should be discussed in the reports, including the impact that they had or may have had on the company and the actions being taken to rectify them. The Audit Committee should review and approve management's evaluation of all significant control deficiencies and material weaknesses.

Reporting

Considered as a whole, management's control plan, testing schedule and documentation of test results should support management's internal control report required under the provisions of Section 404 (a) of the Sarbanes-Oxley Act of 2002. That report should state that management's assessment was conducted in accord with these requirements and contain an assessment of the effectiveness of internal control. In their assessment, management should describe any material weakness in control (as previously defined). The description of each material weakness in control should identify the risks to which the registrant was exposed, the period of time such exposure existed and, if necessary, an estimate of the period of time such exposure will continue to exist until the matter is resolved.

The Public Accounting Firm's Report On Management's Assessment
Illustrative Requirements

Section 404 of the Sarbanes-Oxley Act of 2002 requires "each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer". Such attestation is to be made in accordance with standards for attestation engagements issued by the Public Company Accounting Oversight Board.

When reporting on its assessment of internal control, management makes two principal assertions: 1) that management's assessment was conducted in accord with related requirements promulgated by the Securities and Exchange Commission, and 2) that management's reported conclusions concerning the effectiveness of internal control were fairly described. Each of these two assertions should be reviewed and tested by the public accountant as described below.

The public accountant should review and test management's assessment as necessary to determine if it was conducted in accord with requirements promulgated by the Securities and Exchange Commission. The public accountant's work should include determinations as to whether:

a) management's assessment reasonably addressed the principal areas of control identified in the Risk and Control Identification section of the requirements,
b) management's control plan appeared sufficiently detailed to demonstrate that management considered the business's processes as well as the risks inherent in them and identified control procedures designed to mitigate each significant financial reporting risk to a degree acceptable to management,
c) management's control plan included a definition of materiality that was largely consistent with both the definition of materiality the public accountant used in the current audit of financial results and the definition of materiality used by management in their prior assessments, if any,
d) management prepared a testing schedule in sufficient detail to identify each financial reporting risk that management considered significant and the year(s) in which related control procedures will be tested,
e) management documented test results in sufficient detail to permit the public accountant to identify what was tested, how tests were performed and the facts that served as a basis for management's conclusions,
f) the Audit Committee of the Board of Directors reviewed and annually approved management's control plan and related testing schedule,
g) management regularly reported to the Audit Committee on the results of their testing and other control monitoring efforts,
h) the Audit Committee of the Board of Directors reviewed and approved management's evaluation of all significant control deficiencies for possible reporting as a material weakness,
i) all material control weaknesses noted by management were included and appeared fairly described in management's internal control report required under the provisions of Section 404 (a) of the Sarbanes-Oxley Act of 2002.

Exhibit B

The Public Accounting Firm's Report On Management's Assessment

Illustrative Requirements

Additionally, the public accountant should review and test management's assertion concerning the fairness of management's conclusions on the effectiveness of internal control as follows:

1. The public accountant should independently identify procedures the public accountant considers key in the company's control environment (as described in the requirements) and obtain evidence that those procedures are in place and operating effectively, irrespective of whether those procedures were identified or tested by management. Any significant control failing or weakness noted by the public accountant should be reported to both management and the Audit Committee of the Board of Directors in a manner that permits timely consideration of disclosure in the company's periodic reports to the Securities and Exchange Commission.

2. Additionally, the public accountant may elect to independently obtain evidence as to the effectiveness of any control procedure or group of control procedures that the public accountant intends to rely upon to support the effective or efficient execution of the public accountant's plan for the audit of financial results. Alternatively, the public accountant may elect to coordinate with management so as to ensure such control procedures are included in management's testing schedule and tested sufficiently to support reliance by the public accountant after his or her review and test of management's results.

3. Finally, while performing the audit of financial results the public accountant should be alert to identify any circumstance or condition that suggests:
   a) management's control plan should consider additional financial reporting risks, or
   b) the design of control procedures was not adequate to mitigate risks to a degree acceptable to management, or
   c) control procedures identified in management's control plan were not operating effectively.

   Such circumstances or conditions should be reported to management for investigation, resolution and reporting when appropriate.

The public accountant's report on management's assessment would generally be expected to indicate that: 1) management's assessment was performed in accord with related requirements promulgated by the Securities and Exchange Commission and 2) in the course of reviewing and testing management's assessment or in the course of performing the financial audit, no unreported condition that the public accountant considers to be a material weakness in internal control or other matter that was inconsistent with management's report on internal control came to the public accountant's attention. Any exceptions noted should be described in the public accountant's report on management's assessment.

Exhibit C

Responses to Questions

Concept Release Concerning
Management's Reports on Internal Control Over Financial Reporting

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?*

We believe there are substantial practical limitations to developing detailed "how to" guidance that can be applied by most or all reporting companies. Chief among these would be the amount of time involved. We suggest the development of "how to" guidance be left to the auditing community through such organizations as the American Institute of Certified Public Accountants, the Institute of Internal Auditors, and the Association of Certified Fraud Examiners.

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?*

In our view any and all guidance provided by the Securities and Exchange Commission should be applicable and useful to all reporting companies.

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

We strongly urge the Commission to limit additional guidance to the articulation of broad principles and requirements. Exhibit A reiterates the twenty principles recently suggested in COSO's "Internal Control Over Financial Reporting – Guidance for Smaller Companies". Those principles appear applicable to all registrants regardless of size. Exhibit A further encourages management and Board decisions as to how those broad principles and requirements will be met through development and monitoring of a control plan that is scalable to the size and complexity of the business.

Responses to Questions

Concept Release Concerning
Management's Reports on Internal Control Over Financial Reporting

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 Concept Release addresses risk and control identification, management's evaluation and documentation requirements, all of which are incorporated in Exhibit A. Additionally we suggest and have illustrated guidance on:

- how the Board should exercise oversight responsibility,
- management reporting,
- the need for some measure of consistency in defining "materiality" as between management and external auditors as well as between consecutive management assessments,
- the need for communication and coordination between management and external auditors concerning the scope and timing of testing,
- how management might assess the significance of risks,
- what is to be considered or defined as a control deficiency, significant deficiency and material weakness in internal control.

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

A Commission rule would be preferable. While all prior efforts to interpret and build on prior releases have been commendable, they have not had a substantial effect on the amount of work, expense or benefit presently associated with SOX 404 compliance. There is both the need and the opportunity for a fresh start.

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?*

Our approach was developed in coordination with our external auditors and is based on the identification of significant account balances and other data as well as related business processes, risks and controls, all as suggested in points a) through e) in the Documentation section of Exhibit A. We have used this approach consistently and successfully for the past several years and have no experience with approaches that have not worked.

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 indicated in our response to Question 1, we believe there are substantial practical limitations to developing detailed "how to" guidance that can be applied by most or all reporting companies.

Responses to Questions

Concept Release Concerning
Management's Reports on Internal Control Over Financial Reporting

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?*

Neither COSO nor any other framework was a driving force in our assessments. The purpose of a "framework" appeared to involve defining project boundaries – identifying what our assessment of internal control should reasonably be expected to include. For this purpose we relied on experience and coordination with our external auditors. Plans developed in this manner were then compared to the COSO framework to ensure reasonable coverage. COSO was selected largely based on ready availability.

Additional frameworks appear necessary only if the boundaries of management's assessment of internal control are to be different for various registrants. If a number of frameworks are used, the result would probably be an additional level of complexity, confusion and lack of comparability. We suggest future guidance be kept simple, made applicable to all registrants, and incorporated directly in SEC rules in the manner suggested in Exhibit A.

9. *Should the guidance incorporate the May16, 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 Act Periodic Reports Frequently Asked Questions (revised October 6, 2004)" that should be incorporated into any guidance the Commission might issue?*

As previously suggested, there is now both the need and the opportunity for a fresh start.

Responses to Questions

Concept Release Concerning
Management's Reports on Internal Control Over Financial Reporting

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 the alternatives work?*

We believe changes to the outside auditor's role are absolutely necessary. Requiring the outside auditor to provide an independent, comprehensive assessment of internal control that is <u>in addition to and entirely redundant with</u> management's assessment has been the single largest factor contributing to our unnecessarily high level of expense associated with SOX 404 compliance.

The alternative we suggest is described in Exhibit B. When considered in combination with management's requirements as described in Exhibit A our alternative would provide ***improved benefits*** to investors since it provides guidance on how the Board should exercise oversight responsibility related to internal control, requires increased focus on the more significant control considerations generally included in the control environment, and reduces cost by 1) permitting management to develop a test schedule that spans several years and 2) eliminating the redundant annual assessment of <u>all</u> controls presently required of both management and the outside auditor. Key elements of our suggested approach would require the outside auditor to:

a. independently obtain evidence that procedures the outside auditor considers key in the company's control environment are in place and operating effectively, irrespective of whether those procedures were identified or tested by management,

b. review and test management's assessment process as necessary to determine if it was conducted in accord with related requirements promulgated by the Securities and Exchange Commission (Exhibit A),

c. report any condition that came to the outside auditor's attention in the course of reviewing and testing management's assessment or in the course of performing the financial audit that the public accountant considers to be an unreported material weakness in internal control or other matter that was inconsistent with management's report on internal control.

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?*

When used by an individual with a reasonable level of training and experience in assessing internal controls, we believe Exhibit A should suffice, with specific emphasis on points a) through e) under Documentation.

Responses to Questions

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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?*

We do not see a need for such additional guidance.

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?*

It would be helpful to recognize that the principles described in the COSO guidance are applicable to all registrants. Additionally, a definition of <u>significant</u> financial reporting risks would be of benefit. Both have been incorporated in Exhibit A.

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?*

Guidance should be provided concerning the level of required documentation. In Exhibit A, required documentation is generally limited to a control plan, a testing schedule and documentation of test results. Test results are required to be documented in sufficient detail to permit a party independent of those performing the test(s) to identify what was tested, how tests were performed, and the facts that served as a basis for a conclusion as to whether tested controls were operating as intended by management. The intent is that within these limits <u>management</u> should decide what documentation is needed to contribute to improved controls. Extensive narratives and flowcharts for example, which frequently appear to have been required in start-up efforts, would only be used if management found them helpful.

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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?*

We believe "entity level" or "control environment" procedures merit emphasis, and accordingly in Exhibits A and B suggest an approach where such controls would be independently evaluated by both management and the public accountant each year. Emphasis is warranted because these controls provide the foundation for virtually all other control activities, and because management may have difficulty evaluating elements like "integrity and ethical values" in an entirely objective manner.

We do not believe further guidance about the role of such controls is needed from the SEC, and we do not believe these issues should be addressed differently for larger and smaller companies. When control environment considerations are described as principles as suggested in Exhibit A, the desirable effect is that they become scalable based on the size and complexity of the related business.

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?*

As indicated in Exhibit A, we believe the identification of significant financial reporting risks and the selection of specific control procedures are matters of judgment exercised by management in light of such considerations as the size of the business, the complexity of its systems and procedures and the need to appropriately allocate resources. A significant financial reporting risk is generally one that should be reduced to levels that management finds acceptable in order to reasonably assure the achievement of financial reporting objectives. Control procedures should be selected in a manner that management believes will provide reasonable, but not necessarily absolute, assurance that financial reporting risks will be reduced to acceptable levels and financial reporting objectives will be achieved by preventing or detecting errors or irregularities in amounts that management believes to be material.

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?*

As above.

Responses to Questions

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Management's Reports on Internal Control Over Financial Reporting

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?*

Alamo Group has multiple locations spread over five countries. In determining which locations to visit and what to test at each location, we largely consider prior experience, the principal accounting systems in use at each location, accounting procedures performed at each location, local staff experience, degree of management oversight, and various metrics as to financial significance. As indicated previously, we suggest guidance at this level of detail should be left to the auditing community.

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.*

Entity level controls might be a consideration in management decisions about acceptable levels of risk in other areas of operations. The level of acceptable risk in turn would be considered in designing control procedures as well as the scope and frequency of effectiveness testing.

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 is assessment?*

As indicated previously, we suggest guidance at this level of detail be left to the auditing community.

Responses to Questions

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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?*

The guidance should be written in a way that permits its application to be scalable based on the size and complexity of the related business. As illustrated in Exhibit A, this might be accomplished by:

- **a.** Describing control considerations as principles,
- **b.** Recognizing that the selection of specific control procedures and the related degree of acceptable risk is a matter of judgment exercised by management in light of such considerations as the size of the business, the complexity of its systems and procedures and the need to appropriately allocate resources,
- **c.** Providing guidance as to how the Board of Directors can exercise an appropriate degree of oversight responsibility related to internal control.

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?*

As indicated previously, we believe guidance at this level of detail should be left to the auditing community.

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

Guidance on the timing of management testing is essential. Present practice as inherited from the public accounting firms essentially requires that a comprehensive test plan be repeated in its entirety every fiscal year. This requirement adds considerably to the time and expense associated with management's assessment.

Guidance should permit management's testing to be performed over several years on a schedule that is acceptable to management and the Board of Directors. Management might be encouraged to consider such things as changes in personnel, systems or procedures and their affect on controls to identify procedures to be tested.

Responses to Questions

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24. *What type of guidance would be appropriate regarding the evaluation of identified internal control deficiencies? Are the particular issues in evaluating deficient controls that have only in 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?*

Please see item 25 below.

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 believe definitions of these terms should be substantially revised. While the overall direction of management's assessment goes toward a "top-down, risk-based" approach, the definitions of "control deficiency", "significant deficiency" and a "material weakness", which ideally should be applied when evaluating results, do not contain the word "risk" and do not otherwise appear to be risk-based. Exhibit A suggests revised definitions:

- An internal control <u>deficiency</u> exists when the design or operation of one or more control procedures was ineffective for a period of time.
- A <u>significant</u> control deficiency exists when the design or operation of all or most control procedures put in place to mitigate one or more financial reporting risks were ineffective for a period of time. During that time the business was exposed more risk(s) than management intended.
- A <u>material</u> <u>weakness</u> in internal control refers to a situation where one or more significant control deficiencies existed for a period of time which could be sufficient to allow a material adverse affect on any of the account balances or other data reported to the public.

In our experience, using present definitions of these terms results in evaluating the effectiveness of individual control procedures. The intent is to move toward an evaluation of all control procedures put in place to manage or mitigate an identified risk.

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.*

Control procedures applied as part of the financial statement close process are nevertheless part of the system of internal control. Many small businesses for example do not have adequate staff to rigorously enforce segregation of functions and apply extensive procedural controls on a daily basis; instead they elect to very closely review results as part of the close process. In such cases, when errors are caught as part of the close process, it suggests the control system worked as designed.

Exhibit C

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27. *Would guidance be useful in addressing 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?*

Such a situation should naturally cause management and the Board to reexamine the control plan to determine if it failed to identify significant risks and/or if the risks identified need to be more strenuously mitigated. Accounting and auditing literature has consistently stressed that control procedures should provide reasonable, <u>but not necessarily absolute</u>, assurance that material errors or irregularities will be prevented or detected. In the absence of absolute assurance restatements will occur, and all parties concerned might be better served by guidance concerning appropriate follow-up.

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 has provided the ability to do more comprehensive testing and accordingly has helped us more in gaining effectiveness than efficiency.

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?*

We suggest guidance at this level of detail be left to the auditing community.

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?*

No IT "framework" was a driving force in our assessments. We relied on experience and coordination with our external auditors. Key components were generally logical access to computing resources, program change control and back-up procedures.

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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?*

Our documentation went beyond developing a simple list of controls and included all steps a) through e) under Documentation in Exhibit A. A number of narratives were developed at external auditor request. More significant was the amount of time and attention dedicated to overcoming the notion that "if a procedure is not documented, it did not happen". Future guidance should make clear that, beyond certain minimum requirements, documentation is required to the extent that management and the Board feel necessary and appropriate in the circumstances.

32. *What guidance is needed about the form, nature, and extent of documentation that management must maintain as evidence for is 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?*

We suggest guidance in the manner described in Exhibit A.

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?*

As indicated in Exhibit A, considered as a whole management's control plan, testing schedule and documentation of test results should support management's internal control report. Test results should be documented in sufficient detail to permit a party independent of those performing the test(s) to identify what was tested, how tests were performed, and the facts that served as a basis for a conclusion as to whether tested controls were operating as intended by management.

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 see no need for special considerations in documenting information technology controls.

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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?*

Flexibility and cost containment needs of **ALL** public companies should be considered in future guidance.