September 18, 2006

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

Re: Release No. 34-54122: File No. S7-11-06

Dear Ms. Morris:

On behalf of AeA (American Electronics Association), the nation's largest high-tech trade association, I am writing in response to the SEC's Concept Release seeking public comment regarding internal control over financial reporting. Meaningful Section 404 action is urgently needed, and we respectfully submit the following comments.

Many millions of dollars are being drained annually from the innovative and productive activities of businesses that have merited access to our public capital markets. If the problems associated with Section 404 of the Sarbanes-Oxley Act (SOX) are not addressed, it will negatively impact U.S. competitiveness by hindering the ability of smaller, innovative companies to grow and compete in global markets and by encouraging companies to list on foreign exchanges. This will continue to negatively impact the U.S. economy as a whole.

Our primary recommendations are that: (1) the SEC should issue guidance that is scaled and appropriate depending on the size and complexity of a company;

(2) the guidance should clearly provide that management, and not the external auditor, is primarily responsible for identifying and maintaining internal controls; and (3) the SEC should clearly state the need for a risk-based focus on those internal controls most likely to materially impact a company's financial statements. We continue to support the SEC Advisory Committee on Smaller Public Companies' (ACSPC) report which recommends stratifying Section 404's compliance requirements to reduce the compliance burdens on registrants.

Below are our specific responses to the Concept Release.

Question 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?

AeA believes that additional guidance from the SEC is necessary in order to improve Section 404 implementation and better align the law with its original congressional purpose. It is apparent that many of SOX's provisions have had positive effects on corporate governance practices; however, the current costs associated with Section 404 compliance continue to outweigh the perceived benefits in terms of fraud detection. To date, auditors have controlled implementation by applying a one-size-fits-all approach to Section 404. Audit compliance and documentation steps are not scaled down to be proportionate to the risks at smaller companies, and consequently, smaller companies thus far required to comply are diverting an unreasonable amount of funding and attention away from operational matters, which in turn lowers shareholder value and negatively impacts U.S. competitiveness overall.

AeA strongly believes that the any new guidance should be scaled in order to alleviate many of the excessive burdens that currently exist. Companies operate differently depending on their size and the internal controls rules should reflect this. Investors in smaller public companies are more likely to benefit from "tone at the top" and high-level monitoring controls, rather than documentation and testing, which appear to be more useful in larger companies. AeA has commented numerous times in support of a scaled approach to Section 404, and the chairman of AeA's SOX 404 Committee, Alex Davern, was a member of the ACSPC and a participant in both of the SEC and PCAOB roundtables on internal controls. In addition, AeA Board member, Marty Singer, serves on the PCAOB's Standing Advisory Group.

Although the SEC is not seeking comment on the ACSPC's recommendations, AeA believes those recommendations take an appropriate approach to Section 404 compliance necessary for smaller public companies. The ACSPC's recommendations represent an understanding of the unique circumstances smaller companies face in complying with Section 404, based on a thorough analysis of inputs by professionals directly engaged in efforts to comply. The recommendations balance the need to provide investor protection with the desire to ensure that smaller companies continue to have access to the American capital markets. In addition, smaller companies could choose to fully comply with Section 404 in its current form, which would allow the financial markets to determine whether there is a benefit for smaller companies that decide to comply with Section 404 in its entirety.

Future guidance should also affirm that management is responsible for identifying and assessing internal controls. In addition, any new guidance should clearly provide that management should use a top-down, risk-based approach in identifying those internal controls that will most likely have a material impact on a company's financial statements.

Question Three: Should additional guidance be limited to articulation of broad principles or should it be more detailed?

AeA believes the new guidance should generally be principles-based so that auditors are not compelled to use a checklist approach to all companies in order to avoid exposure to criticism or liability. Guidance should, however, be detailed enough so that companies can be reasonably confident in their assessments.

Question Five: Would additional guidance in the format of a Commission rule be preferable to interpretive guidance? Why or why not?

Although interpretive guidance would likely take less time to develop and be more flexible, AeA recommends the SEC issue guidance in the form of a rule because it would constitute a more authoritative form of guidance. On May 16, 2005, the SEC and PCAOB released guidance that addressed many of the problems relating to Section 404 implementation. Unfortunately, because the various points addressed were not in the form of a rule, they had little impact on improving the process. Should the SEC issue interpretive guidance alone, we are concerned that auditors will continue to force companies to rely on the PCAOB's Auditing Standard No. 2 (AS2) in developing and managing their internal controls.

Question Six: 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?

To date the practice has been to focus on low-level transactions. In its May 16, 2005 "Staff Statement on Management's Report on Internal Control over Financial Reporting," the SEC addressed the need for a top-down and risked-based approach to internal controls; however, auditors continue to require companies to

focus on low-level transactions and accounts. The approach clearly has not worked and has resulted in a tremendous drain on time and resources with little benefit to financial reporting.

Question Eight: 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 majority of companies have selected the COSO framework because their auditors have insisted on it. AS2 solely references COSO as an example of an appropriate framework, and as a result, auditing firms have required companies to use it. It also appears that audit firms have based their compliance tools around AS2.

AeA strongly recommends that the SEC and PCAOB clearly state that companies may use other frameworks, such as the Turnbull Report, and that the appropriate framework may vary depending on the complexity and size of a company.

Question Nine: *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?*

AeA believes that any new guidance should incorporate the SEC's May 16, 2005 "Staff Statement on Management's Report on Internal Control over Financial Reporting." The statement laid out numerous principles, which if given the authoritative force of a rule, could substantially improve implementation of Section 404. In addition, incorporating previous guidance would eliminate the need for management to search through multiple documents, which could save a significant amount of time.

Questions Ten: 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?

The costs associated with the auditor attestation clearly outweigh any benefit to the investing community. This is particularly true for smaller public companies. As previously stated, AeA supports the ACSPC's recommendations relating to internal controls. The recommendations pertaining to smaller companies would significantly reduce the costs and burdens associated with Section 404 in a manner that would better serve the investing community. The ACSPC reviewed numerous comment letters and spent months listening to all interested parties before finalizing its recommendations. Those recommendations represent a balanced and appropriate approach to applying Section 404 to smaller companies, and AeA believes the SEC should give those recommendations further consideration.

It is important to note that by relieving smaller public companies of the external auditor attestation provision of Section 404, companies would not be exempt from

good corporate governance. These companies would still be subject to the many other SEC and exchange compliance requirements, as well as SOX Section 302, which require an effective system of internal controls.

Additional SEC and PCAOB guidance requiring auditors to utilize their professional judgment is also critical. External auditors are requiring companies to document and test controls that do not impact the financial statements. This all-inclusive approach applied by external auditors, in particular to information technology (IT) controls, has resulted in massive costs for little value. Examples of what do and do not constitute "key controls" would likely be beneficial to both auditors and management; however, it should be clear that any examples provided are not intended to be a fully comprehensive list and that professional judgment still needs to be applied.

Question Twenty-Five: 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.

Clarification and examples in this area would be helpful since there seems to be a bit of inconsistency. Seeking auditor advice on a complex accounting question should not constitute a material weakness. In addition, judgment should be required in determining whether a material weakness or significant deficiency exists instead of having certain situations automatically qualify for those determinations.

The current definitions of "materiality" lend themselves to the creation of artifacts, and in particular the overstatement of control issues. This problem is particularly severe among smaller companies. Inventory control is an example of how "materiality" is transformed from small discrepancies to reportable deficiencies. The basic problem is that differences in inventory value are not compared against

total inventory value but rather to GAAP-based earnings. This benchmark is generally used by less experienced auditors who are usually assigned to smaller companies. If a growth company, particularly one that has made acquisitions, has close to breakeven GAAP earnings, then small variations in inventory can result in "material" weaknesses. This characterization does nothing to protect shareholder interests. Indeed, if that same small company had substantial losses, small inventory variations would no longer be material. It is this type of mechanistic approach to materiality that frustrates smaller companies.

Question Twenty-Seven: 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 useful. Companies have been issuing restatements for a variety of reasons, many of which are unrelated to SOX and internal controls; however, those restatements are treated as evidence of a material weakness in internal controls. For example, we do not believe a material weakness in internal controls should necessarily arise when an adjustment is made due to a difference in opinion over the accounting treatment in a complex area. Examples would be helpful.

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Thank you for the opportunity to comment on this important matter. Please let me know if you have any questions or need additional information.

AeA is the nation's largest high-tech trade association, representing nearly 2,500 U.S.-based technology companies. Membership spans the industry product and service spectrum, from semiconductors and software to computers, Internet and

telecommunications systems and services. With 18 US offices, and offices in Brussels and Beijing, AeA brings a broad industry and grassroots perspective to the public policy arena. In 1943, David Packard of Hewlett Packard Corporation founded AeA.

Sincerely,

Marie K. Lee
Director and Counsel, Finance and Tax Policy