



Comments re: SEC Concept Release S7-11-06

Please find attached the policy position of the Silicon Valley Leadership Group regarding the Sarbanes-Oxley Act of 2002.

Silicon Valley Leadership Group (SVLG), founded in 1978 by David Packard of Hewlett-Packard, represents more than 200 of the Silicon Valley's most respected employers. SVLG members collectively provide nearly 250,000 local jobs, or one of every four private sector jobs in Silicon Valley.

SVLG commends the U.S. Securities and Exchange Commission for continuing to seek input from the business community and public on the impacts of the Sarbanes-Oxley Act (SOX). We believe that it is time to take a serious look at section 404 of SOX and its impact on publicly traded companies. The sweeping internal controls for financial reporting, recordkeeping and financial record maintenance required by 404, which include several layers of outside auditor review, have unintended negative effects.

SVLG and its member companies support the objectives of SOX, including increased management accountability for corporate financial statements, an improved control environment, and detection of fraud and malfeasance. However, we believe there are more effective and efficient means of meeting these objectives than SOX 404 compliance as it is currently understood and practiced.

In many respects, SOX has been beneficial. However, the significant compliance costs and related implementation complexities have caused delays in product development and shortfalls in projected profits (AEA Report on Sarbanes-Oxley Section 404). Many employers are spending anywhere from .15% to 3% of gross revenue on Section 404 compliance alone. (*Business Week*, Financial Executives International, *San Jose Business Journal* 03-2005.)

SOX compliance brings with it a heavy burden that strains resources that could otherwise be used for critical research and development or other corporate initiatives to improve company management, expand into new markets and increase investor value. Initially, the SEC suggested that the average company would have to spend \$91,000 dollars annually. However, in a recent survey of National Association of Manufacturers members about 50% of respondents reported spending more than \$5 million in 2004 to comply. More recently, a Financial Executives International (FEI) survey of 274 public companies indicated a 16.3 % reduction in SOX related costs in 2005 from the year previously, but that the total average cost for compliance was \$3.8 million.

Reforms to the statute should not impair the SEC's ability to insure transparency and honesty for publicly traded companies. However, current compliance guidelines need to be reevaluated and modified by the SEC and the Public Company Accounting Oversight Board (PCAOB) to prevent continuing damage to U.S. competitiveness, job growth retention and creation.

We offer the following recommendations as a baseline for improving Sarbanes-Oxley, particularly Section 404 and its associated guidance, so that the outcomes we all desire are achieved at a price we can afford.

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Recommendations:

- Develop a reward system whereby superior internal control environments are recognized. Move to a performance-based system of conducting external SOX audits on a rotating basis (as described in Attachment 1) for those companies who have achieved an annual audit with no material weaknesses. While we agree that detailed internal controls documentation is essential for all complex and high volume transaction processes, we encourage more widespread use of the integrated audit, whereby substantive audit procedures supplemented with summary controls documentation will suffice for certain non-complex and low volume transaction processes.
- Modify the timeframe for management testing of internal controls to span a longer period, e.g. three year cycle, based on a risk assessment model. With this approach, higher risk processes/ controls are tested annually, and lower risk processes/controls are tested on a rotating basis. A risk-based approach to testing permits more time and emphasis to be placed on higher risk areas and internal control enhancements. While this model will require close coordination between auditors and their clients, we do not believe it would result in any notable incremental effort over the amount currently expended to coordinate management and external auditor testing.
- Modify Section 404, and applicable professional standards (e.g., Audit Standard 2: An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements) to reflect the recommendations above, including the wording of attestation and management certification.
- Recommend that an appropriate independent entity, such as the Government Accountability Office (GAO), conduct a study of companies to assess the effects of the Sarbanes-Oxley Act of 2002 on corporate behavior and the relative cost effectiveness of each provision. See Attachment 2 for example questions.
- Develop a corporate equivalent of the “Awards for Excellence in Government Finance” bestowed by the Government Finance Officers’ Association to those governments meeting its standards.
- Develop more detailed guidance for auditors to counter-balance the incentive for audit firms to interpret SOX conservatively. Incentivising factors may include the increased opinion/litigation risk inherent in the other provisions, as well as revenue considerations. While understandable, a healthy counter-balance to this conservatism is required to prevent bloated, ineffective audit regimes. The PCAOB, for example, needs to clarify and codify risks, definitions, and scope – both quantitative and qualitative. We also recommend revisiting PCAOB and SEC guidance surrounding key definitions relied upon in Section 404 compliance, including “significant deficiency”, “remote likelihood” and “material weakness”.

Given the current environment, there is a logical presumption that stockholders are over-paying for SOX 404 compliance. We feel that the costs and effort associated with SOX as currently interpreted is damaging to American competitiveness, as demonstrated in higher costs, lower profitability and lower stock price valuation. We encourage the SEC (and PCAOB) to follow through on their commitment made in a press release on May 17, 2006 “to improve the implementation of Section 404 so that it will work efficiently and effectively for companies and auditors of all sizes and types while still maintaining the important investor protections it provides.” We believe the above noted recommendations are practical, actionable steps which can be taken to attain the regulators goals.

Possible Audit Rotation Schedule (Attachment 1)

Status	Events & Triggers	Audit Type	
		External	Internal
Year 1	Clean Opinion.	Full Scope Audit.	Full Scope Audit.
Year 2		Full Scope Audit for 1/3 of Companies, Based on a Rotating Schedule; Attestation and Management Certifications to Correspond.	Rotation of key control testing based on risk assessment.*
Year 3		Full Scope Audit for 1/3 of Companies, Based on a Rotating Schedule; Attestation and Management Certifications to Correspond.	Rotation of key control testing based on risk assessment.
Year 4 +		Cycle continues.	
Any Year - Isolated Material Weakness	<i>Isolated Material Weakness:</i> Limited to a single functional area or financial statement line item. (e.g., tax process or A/R financial statement line item).	Limited Scope Audit.	Full examination audit of key controls related to process or financial statement line item where material deficiency occurred. Rotation of key control testing based on risk assessment.
Any Year - Pervasive Material Weakness	<i>Pervasive Material Weakness:</i> More than one material weakness or multiple significant deficiencies involving a pervasive break-down in controls (e.g., personnel hiring / staffing deficiencies or pervasive lack of appropriate reconciliations or management reviews).	Full Scope Audit.	Full Scope Audit.
Plus - 1 Year (enters Year 2-3 cycle above)	Clean Opinion.	Full Scope Audit.	Full Scope Audit.
Any Year - Material change in entity-wide controls over financial reporting	For example, major changes in key company personnel or an ERP implementation.	<i>Full or Limited Scope Audit,</i> based on risk assessment. If change or factors could have a pervasive impact on processes and/or financial statement accounts, then full examination is called for.	<i>Full or Limited Scope Audit,</i> based on risk assessment.

* Risk assessment to include quantitative and qualitative considerations. With this approach, higher risk processes/ controls are tested annually, and lower risk processes/controls are tested on a rotating basis. A risk-based approach to testing permits more time and emphasis to be placed on higher risk areas and internal control enhancements.

Proposed Survey of Effectiveness for SOX Sections (Attachment 2)

On July 30, 2002, the Sarbanes-Oxley Act of 2002 was signed into law. The Act makes a number of significant changes to federal regulation of public company corporate governance and reporting obligations. The Act also meaningfully alters the standards for accountability of directors and officers of those companies. In addition, the Act adopts new rules governing the behavior of auditors, securities analysts and legal counsel working with public companies. Each section of the act has specific costs and benefits for companies. We suggest that a study where each section is analyzed for its values based on the following questions:

1. What is the annual cost, in U.S. dollars, to your company to execute this provision? (In U.S. Dollar, Millions)
2. Beside cost considerations, how disruptive is this provision to on-going business operations? (A = <100 hours, B >100<1,000 hours, C >1,000<10,000 hours, D >10,000)
3. In your opinion, how effective is this provision in detecting or preventing Fraud? Impact = (High, Moderate, Low)
4. Has this provision prevented fraud at your company? (Yes, No)
5. Has this provision detected fraud at your company? (Yes, No)
6. Has this provision improved your Board of Directors' understanding of their corporate governance responsibilities? Impact = (High, Moderate, Low)
7. Has this provision improved your executive management team's understanding of their corporate governance responsibilities? Impact = (High, Moderate, Low)
8. Has this provision improved your company's understanding of how functions and internal controls outside of your finance department impact the accuracy of your financial statements? Impact = (High, Moderate, Low)
9. Has this provision improved your investors and analysts' understanding of your financial statements? (Significantly, Moderately, Not at All)
10. Has this provision caused your external auditors to require your company to adopt stringent internal policies which have hindered normal business activity? Impact = (High, Moderate, Low)
11. Has this provision caused your company to decrease normal business risk? Impact = (High, Moderate, Low)
12. What impact has this provision had on your company's ability to innovate? Impact = (High, Moderate, Low)
13. Has this provision decrease your company's ability to collaborate with your external auditors to determine the right accounting interpretation for complex transactions? Impact = (High, Moderate, Low)
14. Has this provision allowed foreign based competitors to gain a competitive advantage over your company? (Yes, No)

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15. Has this provision allowed foreign based competitors to decrease an innovative cycle deficit? Impact = (High, Moderate, Low)
16. Has this provision caused your Executive Management team or Board of Directors to consider de-listing your company's stock from public markets? (Yes, No)
17. Has this provision caused delays in your company's efforts to implement important information technology improvements? Impact = (High, Moderate, Low)
18. Has this provision caused delays in your company's efforts to implement important internal control improvements? Impact = (High, Moderate, Low)