AEROSPACE INDUSTRIES ASSOCIATION

The Honorable John W. Douglass
President and Chief Executive Officer

February 26, 2007

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

Ms. Laura Phillips
Deputy Chief Auditor
Office of the Secretary, PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

Re: SEC File No. S7-24-06; PCAOB Release No. 2006-007 (12/19/06)
PCAOB Rulemaking, Docket No. 021

Dear Ms. Morris and Ms. Phillips:

The Aerospace Industries Association (AIA) appreciates the significant effort that the SEC and PCAOB have expended to further clarify and streamline guidance for compliance with Section 404 of the Sarbanes-Oxley Act of 2002. We are encouraged that there are many provisions in the draft documents (issued on 12/19 and 12/27/2006) that respond to previous comments and recommendations from industry, and specifically to suggestions from AIA provided in our letter of September 14, 2006.

We welcome the opportunity to respond again to your request for input. We are challenged, however, by the issuance of two separate, lengthy proposals from the SEC and the PCAOB that appear to contain differing guidance. Our member companies would be placed at risk by following the SEC guidance alone, without first reconciling it to the PCAOB auditor guidance and to reports of the PCAOB inspectors. Without the reconciliation and coordination with our external auditors on interpretation of the SEC and PCAOB proposals, our member companies could inadvertently reduce or seriously misalign their processes from that required by the auditors and PCAOB inspectors, resulting in added audit deficiencies and increases in auditing costs.

It would be valuable to management at our member companies, and to the firms that audit our companies, if the SEC and PCAOB were to align and reconcile the two sets of guidance.

Because of the length of the two documents, AIA has not had time to conduct a thorough side-by-side review in order to provide responses to all of the individual questions in both documents.

In review efforts that we have been able to conduct, we noted that there are many policy statements which are consistent in both documents and welcomed, such as: acceptance of the concept of a top-down, risk-based approach; focus on the most important controls to prevent material misstatement; more flexibility for external auditors to rely on the work of others; and reduced testing in lower risk controls. However, there are other aspects of the two documents such as multi-location specifics, definitions, types of IT controls, and other items listed in the attachment to this letter that appear to be inconsistent or are in need of further clarification.

As a final point, we would like to comment on the question of the application of SEC and PCAOB guidance to all firms that must comply with the Act. The intent of the Sarbanes-Oxley Section 404 legislation is to enhance the reliability of financial statements for investors by requiring the establishment and monitoring of a more robust system of internal controls. Such a system should be required at all companies, regardless of size and complexity. We believe that internal control, risk assessment and key controls are applicable to large and small companies alike. A "one size fits all" approach which identifies minimum requirements would be best to avoid compliance confusion.

If you have any questions concerning the comments above and in the attachment, please contact Mr. Dick Powers of my staff. Dick can be reached on 703-358-1042. His email address is dick.powers@aia-aerospace.org.

Sincerely,

John

John W. Douglass
President & CEO

Attachment

JWD:srs

Attachment

We believe further clarification from both the SEC and PCAOB should be provided in the following areas:

- **Multi-location specifics** - Particularly for those companies that have locations (subsidiaries, divisions, etc.) which alone do not pose a risk of material misstatement but could when unremediated deficiencies are aggregated. For example, consider a $10 billion company with 10 Business Units, with separate controls, which generate $1 billion in revenue each. Independently, no unremediated deficiencies at single business units would pose a risk of material misstatement to consolidated financial statements. However, when the deficiencies are aggregated, the question of material misstatements could arise. As a result companies are forced to test near 100% of financial statement and footnote disclosure items, causing overly redundant and costly testing.

- **Definition of critical controls** - A more descriptive definition of a critical control would relieve ambiguity between the external auditor and management processes. Also, on the general subject of definitions, we believe all key definitions in the PCAOB proposal should be consistent with all key definitions in the SEC proposal. In that regard, the PCAOB glossary format is easier to reference, and we prefer that format to the inclusion by the SEC of key definitions in the footnotes of its proposal.

- **IT general computer controls** - Company internal and external costs are disproportionate to the benefits received. There has been no change in any guidance with respect to the evaluation of general IT controls. The PCAOB continues to refer to Codification of Statements of Auditing Standards (AU) section 319 without further discussion of its application to the prevention and detection of material misstatements. We believe it is unlikely the level of effort expended by accounting firms and fees for that effort will decrease unless further guidance clarifying the inter-relationship of IT controls, entity-level, and process controls is provided. The Sarbanes-Oxley Act excluded operational controls from its scope, as does the proposed SEC guidance. However, this exclusion has not been consistently applied to the IT operational controls, which are still included. Therefore, to be consistent to the Sarbanes-Oxley scope, operational and physical IT controls should also be excluded.

- **The work of PCAOB inspectors and its effect on management's approach and testing** - The PCAOB inspectors often hold external audit firms to a higher standard than PCAOB AS2, or other guidance documents. We understand from our external auditor that while they believe that their methodologies are compliant with AS2, upon review by the PCAOB inspectors, differences materialize that are not part of any guidance. This causes the external auditor to not fully embrace the top-down, risk-based approach, and develop test plans that go beyond what is necessary. Further, this causes a departure in the methodologies between management and the external auditors that result in increased cost and effort to our member firms. We suggest that the PCAOB inspectors issue more timely feedback to the external audit firms, and that a review of the inspectors' findings be conducted in due course.

- **Materiality thresholds** - The PCAOB directs public accounting firms to use the same materiality thresholds when planning audits of internal controls over financial reporting and financial statements. SEC guidance does not provide specific direction on materiality; however, we expect by applying a top-down, risk-based approach, management may conclude one element of its financial statements has a higher materiality threshold than another based on various qualitative factors. We recommend the SEC retain the concept of materiality as it relates to management's assessment of its system of internal control, but add emphasis that it is not the intent of the guidance to restrict management's system of internal control to only those items that are material. Management's adopted recognized framework should be applied at various levels to provide management an appropriate level of operational reliance.

  We also noted the PCAOB applies the term 'significant' throughout its description of the auditor's process, including its evaluation of significant processes, accounts, locations, and business cycles. We believe PCAOB's continued emphasis on significant processes, accounts, etc., coupled with the continued requirement to evaluate significant deficiencies, will have the unintended consequence of reducing the auditor's threshold of materiality when evaluating controls. We recommend the PCAOB revise its description of the auditor's process to reflect the overall objective of obtaining reasonable assurance regarding the effectiveness of controls to prevent and detect material weaknesses. We believe this will help ensure management and auditors' evaluations are more closely aligned.

- **Effective date for guidance 2007 vs. 2008** - The effective date for both the SEC interpretive guidance and the PCAOB proposed standard should coincide and be effective by mid-year 2007. This would allow external auditors enough time to potentially adjust their assessment approach.

- **Rotational Testing** - Guidance should re-emphasize that management and auditors, without performing additional year-end testing, may rely on its direct and ongoing monitoring of the operation of controls tested earlier in the year to support its annual assessment. Guidance should also stress that management and auditors may rely on prior year tests for controls that have not changed and are of lower risk.

  This guidance would be particularly beneficial for companies with automated controls, including information technology general controls, and manual controls which remain stable from year to year. This would allow these types of controls to be tested at a level which better correlates to their overall risk to the financial statements.