

**IMPACT OF SOX ON THE ELECTRONICS INDUSTRY**  
**Section 404 Material Weaknesses**  
**For Companies with Years Ended in 2006**  
**As of May 14, 2007**

The following is a copy of the nine adverse reports that were issued from companies in the Electronics industry with years ended in 2006. These were all of the accelerated filers in the Electronics industry with adverse Sarbanes-Oxley Section 404 management self assessments. This information was gathered using the online research tool called Audit Analytics an Ives Group, Inc company.

The following is a summary of the **material internal control weaknesses** reported in the eight adverse Section 404 Self Assessments:

Internal Controls - Accounting documentation, policy and/or procedures	8
Internal Controls - Material and/or numerous auditor /YE adjustments	7
Internal Controls - Accounting personnel resources, competency/training	5
Internal Controls - Information technology, software, security & access issue	2
Internal Controls - Journal entry control issues	1
Internal Controls - Non-routine transaction control issues	1
Internal Controls - Remediation of material weakness identified	1

The following is a summary of the **material accounting weaknesses** reported in the eight adverse Section 404 Self Assessments. Section 404 is not just about internal control issues, but also about misapplication of financial accounting and reporting issues:

Accounting - Inventory, vendor and cost of sales issues	4
Accounting - Revenue recognition issues	3
Accounting - Foreign, related party, affiliated and/or subsid issues	2
Accounting - Liabilities, payables, reserves and accrual est failures	2
Accounting - Acquisition, merger, disposal or reorganization issues	1
Accounting - Balance sheet classification of asset issues	1
Accounting - Capitalization of expenditures issues	1
Accounting - Consolidation, (Fin46r/Off BS) & foreign curr transl issues	1
Accounting - Deferred, stock-based or executive comp issues	1
Accounting - Depreciation, depletion or amortization issues	1
Accounting - PPE, intangible or fixed asset (value/diminution) issues	1
Accounting - Tax expense/benefit/deferral/other (FAS 109) issues	1

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## **RAE SYSTEMS INC**

### **10-K 2006 Management - Internal Control Assessment**

Management's Report on Internal Control over Financial Reporting Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles in the United States. Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the consolidated financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management has conducted an assessment, including testing, of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In making its assessment of internal control over financial reporting, management used the criteria in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Our management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of RAE Coal Mine Safety Instruments (Fushun) Co., Ltd. ("RAE Fushun"), which was acquired on December 10, 2006, and which is included in our consolidated balance sheet as of December 31, 2006. RAE Fushun constituted 21% of total assets as of December 31, 2006. The operations of RAE Fushun are not being reflected in consolidated financial statements until January 2007. Our management did not assess the effectiveness of internal control over financial reporting of RAE Fushun because of the timing of the acquisition, which was completed in December 2006. Based on the results of this assessment, our management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2006 due to the discovery of a material weakness. In evaluating the Company's internal control over financial reporting as of December 31, 2006, management concluded that the Company's controls that ensure financial information from its Chinese subsidiaries has been properly adjusted from a local statutory basis to reflect Generally Accepted Accounting Principles in the United States of America ("US GAAP") for inclusion in the worldwide consolidated financial statements, failed to detect certain adjustments arising out of an audit conducted by the Company's independent registered public accounting firm. Principally, the Company failed to detect adjustments relating to: depreciation on property and equipment, inventory reserves and certain balance sheet reclassifications. As a result of these failures, management concluded that the controls that ensure information from its Chinese subsidiaries has been properly adjusted to US GAAP for inclusion in the consolidated financial statements were inadequate, and as a result, there existed as of December 31, 2006 a more than remote likelihood that a material misstatement of the Company's annual or interim financial statements could occur and not be prevented or detected. A material weakness is a control deficiency within the meaning of the Public Company Accounting Oversight Board (United States) Auditing Standard No. 2, or combination of control deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by employees in the normal course of their assigned functions. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 has been audited by BDO Seidman, LLP, an independent registered public accounting firm, as stated in their report which appears herein.

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## **FARO TECHNOLOGIES INC**

### **10-K/A 2006 Management - Internal Control Assessment**

#### Management's Report on Internal Control Over Financial Reporting

Our Chief Executive Officer and Chief Financial Officer, together with other members of management of FARO Technologies Inc., are responsible for establishing and maintaining adequate internal control over financial reporting.

Internal control over financial reporting is the process designed under our supervision, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

There are inherent limitations in the effectiveness of internal control over financial reporting, including the possibility that misstatements may not be prevented or detected. Accordingly, an effective control system, no matter how well designed and operated, can provide only reasonable assurance of achieving the designed control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management over ride of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. During the year end closing process, the external auditors identified invoices containing delivery terms of FOB Destination which were not delivered to the customer by December 31, 2006. The Company's terms and conditions of sale generally specify FOB Origin. There are two review controls intended to ensure all customer purchase orders conform to Company policies. These controls failed to operate effectively in identifying the delivery terms containing FOB Destination.

Management has evaluated the effectiveness of internal control over financial reporting as of December 31, 2006, in relation to criteria described in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations Commission of the Treadway Commission (COSO). Based upon this evaluation, management has concluded that certain deficiencies exist in the design and operation of internal controls related to financial reporting, which represent a material weakness in internal control over financial reporting.

As a result of these findings, management has undertaken the following actions to address the control deficiencies:

- Implemented additional training programs for the personnel responsible for reviewing customer purchase orders for compliance with Company policies.
- Modified the Company's internal sales order software to identify those sales orders containing the delivery terms of FOB Destination in order to record the shipment in the correct period.
- Implemented additional month end closing and review procedures to confirm delivery dates for all FOB shipments.

Grant Thornton LLP, our independent registered public accounting firm, has issued their report on management's assessment of internal control over financial reporting.

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## SONOSITE INC

### [10-K](#) 2006 Management - Internal Control Assessment

Management's report on internal control over financial reporting

Our management is responsible for establishing and maintaining adequate internal controls over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2006 as required by the Exchange Act Rule 13a-15(c). In making this assessment, our management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework.

A "material weakness" is defined as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Our management's evaluation and assessment of our internal control over financial reporting concluded that internal control over financial reporting was ineffective as of December 31, 2006, as a result of the following material weakness:

As of December 31, 2006, we did not have the appropriate level of expertise to properly prepare and review our accounting for income taxes. As a result of this deficiency in our internal control over financial reporting, we did not detect errors in the measurement of income tax amounts as of and for the year ended December 31, 2006. In addition, this deficiency resulted in more than a remote likelihood that a material misstatement of income taxes in the annual or interim consolidated financial statements would not be prevented or detected.

KPMG LLP, an independent registered public accounting firm, has issued an audit report on management's assessment of our internal control over financial reporting. Their report is included in Item 8. in the section titled "Reports of Independent Registered Public Accounting Firm."

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## ANAREN INC

### [10-K/A](#) 2006 Management - Internal Control Assessment

Management's Annual Report on Internal Control Over Financial Reporting (as restated)

The management of Anaren is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. With the participation of the Chief Executive Officer and the Chief Financial Officer, management conducted an evaluation of the effectiveness of our internal control over financial reporting as of June 30, 2006, based on the framework and criteria established in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In the Company's Annual Report on Form 10-K for the year ended June 30, 2006, as originally filed on September 6, 2006, management concluded that our internal control over financial reporting was effective as of June 30, 2006. Subsequently, management identified the following material weaknesses in internal control over financial reporting at June 30, 2006:

- o The Company's policies and procedures for review and testing of program changes did not operate effectively.

Specifically, the control requiring that management test the program change prior to approving it was not operating effectively. As a result, a program change error in a work-in-process inventory system was not detected and, accordingly, the value of material costs was incorrect when certain conditions existed; and

o The Company lacked adequate technical expertise to ensure the proper application of the criteria with respect to accounting for foreign currency translation adjustments for discontinued operations in accordance with the provisions of Statement of Financial Accounting Standards No. 52, Foreign Currency Translation.

The material weakness matters noted above resulted in errors that were material to previously issued financial statements and in our restatement of those consolidated financial statements for the year ended June 30, 2006, and the quarters ended December 31, 2005, March 31, 2006 and for the year ended June 30, 2004.

As a result of these material weakness matters, our management has revised its earlier assessment and has now concluded that our internal control over financial reporting was not effective as of June 30, 2006.

Anaren's independent auditor, KPMG LLP, a registered public accounting firm, has issued an audit report on our management's revised assessment of our internal control over financial reporting as of June 30, 2006.

(d) Remediation of Material Weakness in Internal Control

We believe that, as of the date of this filing, we have fully remediated the material weakness in our internal control over financial reporting with respect to program change controls. The remedial actions included:

o Improving training and education in the area of program change controls to ensure all relevant personnel involved in the program change management review and approval process fully understand their responsibility for testing the completeness and accuracy of all output reports and related financial data before approving the program change and placing it into operation;

o Adding enhanced controls and testing to any program change affecting financial reports prior to implementing a program change; and

o Introduction of a new control requiring authorized users requesting program changes to retest and recalculate the completeness and accuracy of the first output reports and related financial data generated directly after the program is placed into operation.

To remediate the material weakness related to the accounting for foreign currency translation adjustments for discontinued operations described above and enhance our internal control over financial reporting, subsequent to the filing of this Form 10-K/A, management has implemented the following change:

o Improve training and education and understanding of accounting for foreign currency translation adjustments for discontinued operations in accordance with generally accepted accounting principles for all relevant personnel involved in foreign currency accounting.

## **THERMA WAVE INC**

### **10-K 2006 Management - Internal Control Assessment**

Management's Report on Internal Control over Financial Reporting Management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of

financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America. Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our management has assessed the effectiveness of our internal control over financial reporting as of April 2, 2006. In making its assessment of internal control over financial reporting, our management used the criteria described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). A material weakness is a control deficiency or combination of control deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management has identified the following material weakness. As of April 2, 2006, the Company did not maintain effective controls to ensure that journal entries were reviewed and approved. Specifically, the Company did not maintain effective controls over the completeness and accuracy of the recording of journal entries. This control deficiency resulted in audit adjustments to certain inventory balances and warranty accruals in the Company's third quarter interim consolidated financial statements as well as the 2006 annual consolidated financial statements included in Item 8 of this Form 10-K. This control deficiency could result in a misstatement of the Company's financial statement accounts that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness. Because of this material weakness, management has concluded that the Company did not maintain effective internal control over financial reporting as of April 2, 2006, based on the criteria established in "Internal Control — Integrated Framework" issued by the COSO. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of April 2, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

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## **ASYST TECHNOLOGIES INC**

### **10-K 2006 Management - Internal Control Assessment**

Management's Report on Internal Control over Financial Reporting Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has assessed the effectiveness of our internal control over financial reporting as of March 31, 2006. In making this assessment, our management used the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management's assessment identified the following material weaknesses in our internal control over financial reporting as of March 31, 2006: 1. We did not maintain effective controls over the completeness and accuracy of revenue and deferred revenue. Specifically, effective controls were not designed and in place to prevent or detect our (a) failure to properly defer revenue for post-delivery installation obligations at our wholly-owned subsidiary in Japan, Asyst Japan, Inc. ("AJI"), (b) failure to recognize installation revenue on a timely basis at our majority-owned joint venture in Japan, Asyst Shinko, Inc. ("ASI"), and (c) failure to properly defer revenue on one contract until the contract was signed. This control deficiency resulted in audit adjustments to the interim consolidated financial statements for the second and

third quarters of fiscal 2006 and audit adjustments to our fiscal 2006 annual consolidated financial statements. Additionally, this control deficiency could result in a misstatement of revenue and deferred revenue that would result in a material misstatement to our interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness. 2. We did not maintain effective controls over the completeness, accuracy and timeliness of recognition of accrued liabilities and deferred costs. Specifically, effective controls were not designed and in place to prevent or detect our (a) capitalization of certain operating expenses that should have been expensed, (b) failure to accrue certain freight charges on a timely basis and (c) failure to accurately and timely accrue certain cost of sales at ASI. This control deficiency resulted in audit adjustments to the interim consolidated financial statements for all quarters of fiscal 2006 and audit adjustments to our fiscal 2006 annual consolidated financial statements. Additionally, this control deficiency could result in a misstatement of prepaid costs, accrued liabilities, cost of sales and operating expenses that would result in a material misstatement to our interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness. Because of the material weaknesses discussed above, we have concluded that Asyst did not maintain effective internal control over financial reporting as of March 31, 2006, based on the criteria established in Internal Control — Integrated Framework issued by the COSO. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of March 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein. Management's Remediation Initiatives The material weaknesses described above also existed at March 31, 2005. In response to the material weaknesses discussed above, we plan to continue to review and make necessary changes to improve our internal control over financial reporting. We plan to further strengthen our controls over revenue recognition and accrued liabilities and deferred costs with additional hiring and continuous improvements in our training in the application of U.S. generally accepted accounting principles for revenue recognition, accrued liabilities and deferred costs. We plan to further improve the discipline throughout the organization to achieve greater compliance with policies, procedures and controls that have already been introduced by us. Remediation of Previously Disclosed Material Weaknesses Changes in our internal control over financial reporting during the fourth quarter of fiscal 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting relate to the completion of our plan to remediate the material weaknesses described below which were previously disclosed in our Annual Report on Form 10-K for the year ended March 31, 2005. In connection with our remediation plan, completed during the fourth quarter of fiscal 2006, management: (i) identified the control objectives and new controls, that result in the material weaknesses being eliminated; (ii) obtained sufficient evidence of the design and operating effectiveness of the new controls including documentation of the new controls; and (iii) determined the new controls have been in effect for a sufficient period of time to permit the assessment of their design and operating effectiveness. As a result of this assessment, management has concluded the following material weaknesses were remediated as of March 31, 2006. We did not maintain an effective control environment based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Specifically, the financial reporting organizational structure was not adequate to support the size, complexity or activities of the Company. Our remedial actions with regard to this material weakness included the hiring additional qualified accounting personnel in the U.S. and in Japan, in the areas of general accounting, compliance reporting, internal audit and tax; and implementing an enhanced formal training process for financial staff in an effort to ensure that personnel have the necessary competency, training and supervision for their assigned level of responsibility and the nature and complexity of our business. We did not maintain effective controls over the timely and accurate reconciliation and review of ASI's intercompany accounts. Our remedial actions with regard to this material weakness included the development of effective controls and the training of accounting personnel to ensure the timely and accurate reconciliation and review of ASI's intercompany accounts between ASI and its subsidiaries. ASI did not maintain effective controls over the identification and reporting of related party transactions. Specifically, ASI's controls over its related party transactions were ineffective in identifying all significant related party transactions between ASI and its minority joint venture partner on a timely basis in order for such transactions to be appropriately reflected in our interim and annual consolidated financial statements. Our remedial actions with regard to this material weakness included the development of controls over ASI's related party transactions that were effective in identifying all significant related party transactions between ASI and its minority joint venture partner on a timely basis. ASI did not maintain effective controls over the timely preparation, review and approval of account reconciliations for significant financial statement accounts. Specifically, ASI did not maintain effective controls over significant account

reconciliations for inventory, accruals, other assets and suspense accounts. Our remedial actions with regard to this material weakness included implementing new month-end closing procedures with improved account reconciliation controls and the use of standardized checklists to help ensure such procedures are consistently and effectively applied throughout at ASI. ASI did not maintain effective controls over the timely review and approval of ASI financial information included in our consolidated financial statements. Specifically, our review of ASI's financial results, including the review of manual post-close journal entries, both at ASI and Corporate, were not sufficient to detect errors in ASI's interim and annual financial information. Our remedial actions with regard to this material weakness included the implementation of overall improvements throughout our consolidated financial reporting process in an effort to ensure accurate and timely preparation and review of our consolidated financial statements. We did not maintain effective controls over inventory and the related cost of sales accounts at ASI and our operations in the United States. Specifically, our controls over the accuracy of the allocation of inventory variances and the valuation of inventory reserves were not effective. Our remedial actions with regard to this material weakness included the implementation of key controls over the accuracy of the allocation of inventory variances and the valuation of inventory reserves. We did not maintain effective controls over the accounting for awards made under our various stock compensation plans. Specifically, modifications to stock compensation arrangements and non-routine stock compensation arrangements were not timely communicated to the appropriate accounting personnel responsible for recording the financial consequences of such modifications in our consolidated financial statements. Our remedial actions with regard to this material weakness included the implementation of a key control to ensure that modifications to stock compensation arrangements and non-routine stock compensation arrangements were communicated on a timely basis to the accounting personnel. We did not maintain effective controls over our income tax provision and the related balance sheet accounts. Specifically, we failed to properly allocate the release of the deferred tax asset valuation allowance between the income statement and intangible assets. This control deficiency resulted in audit adjustments to our fiscal 2005 annual consolidated financial statements. Our remedial actions with regard to this material weakness included increasing our diligence throughout our tax process in an effort to ensure accurate and timely preparation of tax calculations and disclosures, as well as the hiring of a qualified Tax Director. We did not maintain effective controls over the preparation of our interim and annual consolidated financial statements. Specifically, we did not maintain effective controls over the process for identifying and accumulating certain required supporting information to ensure the completeness and accuracy of our interim and annual consolidated financial statements and the related disclosures. Our remedial actions with regard to this material weakness included the implementation of overall improvements throughout our consolidated financial reporting process in an effort to ensure accurate and timely preparation and review of our consolidated financial statements.

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## **AMKOR TECHNOLOGY INC**

### **10-K 2006 Management - Internal Control Assessment**

Management's Report on Internal Control Over Financial Reporting Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate. Management conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 based on the framework established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the

Treadway Commission (“COSO”). A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. We previously reported the following material weaknesses in our internal control over financial reporting in our 2005 Form 10-K/A, filed on October 6, 2006. These material weaknesses continued to exist, as they were not remediated as of December 31, 2006. 1. We did not maintain effective governance and oversight, controls to prevent or detect instances of management override, and risk assessment procedures. Specifically, we failed to establish effective governance and oversight by the Compensation Committee of the Board of Directors of our activities related to the granting of stock options. Additionally, controls were not effective in adequately identifying, assessing and addressing significant risks associated with the granting of stock options that could impact our financial reporting. Finally, our controls were not adequate to prevent or detect instances of potential misconduct by members of senior management. This control deficiency resulted in the restatement of our consolidated financial information for each of the years ended from 1998 through 2005, for each of the quarters of 2005 and 2004, as well as for the first quarter of 2006. Additionally, this control deficiency could result in misstatements of our financial statement accounts and disclosures that would result in a material misstatement of the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, our management has determined that this control deficiency constitutes a material weakness. This material weakness also contributed to the existence of the following additional material weakness. 2. We did not maintain effective controls over our accounting for and disclosure of our stock-based compensation expense. Specifically, effective controls, including monitoring, were not maintained to ensure the existence, completeness, accuracy, valuation and presentation of activity related to our granting and modification of stock options. This control deficiency resulted in the misstatement of our stock-based compensation expense and additional paid-in capital accounts and related disclosures, and in the restatement of our consolidated financial information for each of the years ended from 1998 through 2005, for each of the quarters of 2005 and 2004, as well as for the first quarter of 2006. Additionally, this control deficiency could result in misstatements of the aforementioned accounts and disclosures that would result in a material misstatement of our annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, our management has determined that this control deficiency constitutes a material weakness. Our principal executive officer and principal financial officer concluded that the material weaknesses described above existed, as they were not remediated as of December 31, 2006. As a result, we concluded that we did not maintain effective internal control over financial reporting as of December 31, 2006, based on the criteria in Internal Control — Integrated Framework issued by the COSO. Management’s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing under Item 8.

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## **IXIA**

### **10-K 2006 Management - Internal Control Assessment**

Management’s Report on Internal Control over Financial Reporting Our management, including our Chief Executive Officer and our Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external purposes in accordance with U.S. generally accepted accounting principles (“GAAP”). Because of its inherent limitations, our internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes and conditions, or that the degree of compliance with policies or procedures may deteriorate. As of December 31, 2006, our management assessed the effectiveness of our internal control over financial reporting using the criteria set forth in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of December 31, 2006 we did not maintain effective controls over the completeness and accuracy of revenue reporting for implied PCS obligations. Specifically, we did not maintain effective controls to ensure that (i) we did not provide software upgrades and support to customers after the

expiration of the contractual PCS periods and (ii) the circumstances under which our sales and support personnel provided software upgrades and support beyond the contractual periods were adequately identified, communicated to, and reviewed by our finance personnel to ensure the proper recognition of revenue for implied PCS obligations in accordance with generally accepted accounting principles. This control deficiency resulted in the restatement of our 2005, 2004 and 2003 annual consolidated financial statements, all of our interim condensed consolidated financial statements for 2005 and 2004 as well as the first two interim periods of 2006. Additionally, this control deficiency could result in a misstatement of revenue and deferred revenue that would result in a material misstatement of our annual and interim consolidated financial statements that would not be prevented or detected. Accordingly, we have determined that this control deficiency constitutes a material weakness. Because of the material weakness described above, management has concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2006 based on criteria established in 45 Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Management’s assessment of our internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, our independent registered public accounting firm, as stated in their report which is included elsewhere herein.

**Remediation Efforts to Address Material Weakness** Our management has worked, and continues to work, to strengthen both our disclosure controls and procedures and our internal control over financial reporting. We are committed to ensuring that such controls are operating effectively. Since identifying in 2006 the material weakness in our internal control over financial reporting that existed as of December 31, 2005 and the related ineffectiveness of our disclosure controls and procedures and internal control over financial reporting, we have taken, and have committed to take, a number of actions in an effort to address such ineffectiveness and to remediate the material weakness that existed at December 31, 2005 and that continued to exist at December 31, 2006. The actions that we have taken and that we will take in order to prevent the recurrence of circumstances such as those that resulted in the Restatement include, without limitation, the following:

- **License Management System (“LMS”) —** In December 2006, we completed the implementation of a license management system, or LMS, for all of our significant software products. This system locks a software license to a specific computer or Ixia hardware chassis on which our software resides and manages the provision of software upgrades to ensure that the upgrades are only provided to customers that are entitled to receive such upgrades during an initial or extended PCS period. The use of the LMS to control our software upgrades is a significant improvement over the use of our legacy password system that did not sufficiently control the circumstances under which upgrades were provided for many of our software products. Under our legacy password system, the software upgrade files were protected with passwords that were readily accessible to sales and support personnel. These passwords were not frequently changed and were not provided under any system of license management. During the accounting review, management determined that, for a variety of reasons, including to (i) provide bug fixes, (ii) facilitate the sale of new products that did not function with a customer’s existing Ixia products, and (iii) meet competitive pressures, our sales and support personnel used such readily accessible passwords and/or disseminated them to customers to provide software upgrades at a time when the customers were not contractually entitled to receive such PCS. The practices were not documented (for example, on sales quotations or customer purchase orders) in a manner that identified them to our management and finance personnel to enable them to review and account for them in accordance with SOP 97-2. As a result, we did not, as required by SOP 97-2, defer revenue for these implied PCS obligations. Our completion during the fourth quarter of 2006 of a license management system for all of our significant software products now provides us with an effective preventative control in that the license management system restricts the provision of software upgrades to only those customers that are entitled to such upgrades. This system should eliminate the possibility of customers receiving free PCS without the knowledge of our finance personnel. For certain software products that are not subject to license management and for certain customers for which free extended PCS periods are to be provided, we will defer revenue for implied PCS obligations in accordance with SOP 97-2.
- **Enhanced Revenue Recognition Policies and Practices —** During the quarter ended December 31, 2006 and in light of the Company’s accounting review and Restatement, we thoroughly reviewed, supplemented and clarified our written revenue recognition policies and practices in an effort to ensure that our sales, support and other personnel are aware of and clearly understand these policies. The Audit Committee has reviewed, and we are currently in the process of finalizing, the enhanced documentation for our revenue recognition policies and practices. By the end of the first quarter of 2007, members of senior management and finance will distribute the revised and enhanced revenue recognition policies and practices to all Company personnel. We will also post a copy of the policies and practices on our Intranet site for easy reference.
- **Communication and Training Regarding PCS and Revenue Recognition Policies —** Subsequent to the determination

that we had a practice of providing software upgrades and support to certain customers that differed from our standard PCS policies and contractual agreements beginning in the quarter ended December 31, 2006, we have expressly and repeatedly communicated and reinforced, both orally and in writing, to our sales, support, management and finance personnel, our policy with respect to the provision of PCS services (i.e., no unauthorized "out-of-maintenance" services should be provided). We have also begun to create additional training materials regarding our PCS and revenue recognition policies, which materials will be distributed to our sales, support, product management and order management personnel (as well as to new hires in those groups) in order to ensure that such personnel appropriately understand and consider these policies in the course of their employment with the Company. These materials will include copies of the policies and an explanation of the role that sales and support personnel play in ensuring that we comply with those policies. In 2007, we plan to continue to enhance our communication and training program regarding PCS and revenue recognition policies by conducting a number of revenue recognition training sessions that will be presented by persons having expertise in SOP 97-2 and in-depth knowledge regarding our business, our PCS policies and our revenue recognition policies and practices. The training program included training provided at our January 2007 international sales conference for all sales personnel and will include new hire training, as well as annual, mandatory training sessions and regular refresher sessions. To the extent practicable, we will conduct training in person and in small group sessions to enhance the effectiveness of the training. In 2006, we also communicated to our sales and customer support personnel that we will take appropriate disciplinary actions, up to and including termination of employment, if they do not comply with our PCS policies and our policies and procedures that affect our accounting for matters relating to revenue recognition.

- Communication among Functional Groups within the Company — The practices and errors that resulted in the Restatement occurred in part because of a lack of effective communication among various Ixia departments and specifically between our finance group, on the one hand, and our sales and customer support personnel, on the other. The Company is in the process of implementing more formalized and regular communications among the various functional groups within the Company, including finance, sales, customer support, product management and order management personnel, with respect to matters that may affect the Company's accounting and financial reporting. The Company plans, among other things, to arrange for regular meetings between members of these departments and finance and for discussions across departments regarding field-level and other practices that may affect the Company's accounting and financial statements.
- Finance Group — The Company has taken and is continuing to take steps to ensure that the Company's finance group receives adequate resources and is effectively staffed and organized. The Company is also requiring that its finance personnel regularly attend continuing education training courses in accounting and finance to enhance their knowledge of and expertise in the accounting principles applicable to the Company's business and particularly SOP 97-2.
- Revenue Recognition Senior Manager — In late February 2007, we further strengthened our control environment with respect to revenue recognition by hiring a Senior Manager, Revenue Recognition who has technical understanding and experience in this highly complex area. This individual, who is a certified public accountant is responsible for monitoring and helping ensure compliance with our revenue recognition policies, including training our internal personnel (e.g., sales, finance, customer support, product management and order management personnel) with regard to the policies, participating in reviewing contract provisions and sales and other business practices, including our PCS policies and practices, that affect revenue recognition and overseeing the implementation of and monitoring controls designed to ensure compliance with our revenue recognition policies and GAAP.
- Quarterly Certification Letters — We have also revised, supplemented and clarified the certification letters that certain sales personnel are required to execute on a quarterly basis regarding the absence of side letter agreements and concessions and regarding other matters that affect our accounting for sales transactions. We have revised these certifications to ensure that the persons signing them clearly understand the meaning of the representations that they are making in the certifications, including representations that would require them to identify any circumstances that might give rise to implied PCS obligations, and that they clearly understand the PCS practices that are prohibited, as well as the consequences to the individual and to the Company of violating those prohibitions. We first presented the revised certification form to certain sales employees with respect to the quarter ended September 30, 2006. We have also created a similar certification letter that certain support personnel will be required to execute on a quarterly basis. We first presented this new certification form to those employees with respect to the quarter ended December 31, 2006. In order to promote substantive understanding of and communication about the certifications generally and about any transactions that are potentially exceptions to the certifications, we also plan to modify, beginning with the quarter ending March 31, 2007, the processes by which personnel complete and return their certification letters.



These revised processes will impress upon Company personnel the need for accurate representations, the Company's reliance on these representations, and the potentially severe consequences of inaccurate or improper certifications.

As noted above under "Management's Report on Internal Control over Financial Reporting," notwithstanding the remediation measures that, as described above, were completed by the Company prior to December 31, 2006, management has concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2006. Management believes that while we had made substantial progress prior to December 31, 2006 in implementing the remediation measures that are outlined above, the completion of certain measures, such as the formal communication of our revenue recognition policies and practices to all Company personnel and the hiring of our Revenue Recognition Senior Manager, was necessary in order to fully remediate the material weakness. As indicated above, we will continue to work to complete the implementation of these measures and we will carefully monitor the improvements in our controls over the completeness and accuracy of revenue reporting for implied PCS obligations in order to ensure remediation of the material weakness. We will also continue to seek to actively identify, develop and implement additional measures that are reasonably likely to materially improve and strengthen our internal control over financial reporting.

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