



CalPERS

**Dennis A. Johnson, CFA**

**Investment Office**

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

Telephone: (916) 795-2731; Fax: 916-795-2842

June 13, 2008

Advisory Committee on the Auditing Profession

(ACAP)

Office of Financial Institutions Policy

Room 1418

Department of the Treasury

1500 Pennsylvania Avenue, NW

Washington, DC 20220

Chairman Levitt and Chairman Nicolaisen and Members of the ACAP:

I am writing on behalf of the California Public Employees' Retirement System (CalPERS). As the largest public pension system in the U.S., CalPERS manages approximately \$247 billion in assets providing retirement and health benefits for nearly 1.5 million members.

This letter is CalPERS' response to the ACAP's Addendum to Section VI. Firm Structure and Finances, issued on May 30, 2008. CalPERS' comments on the addendum are as follows:

### **Auditor's Report**

CalPERS supports the Committee's recommendation to improve the auditor's reporting model. As a long term investor, we believe the Auditor's Report should include identification of key risk areas, significant changes in risk exposures and provide specific information on how the audit opinion was reached, specifically in areas where significant assumptions and uncertainty in measurement require a higher level of professional judgment.<sup>1</sup> As outlined in CalPERS' written testimony on February 4, 2008, of critical importance to investors is that auditors accept

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<sup>1</sup> CalPERS' written and oral testimony to the Securities and Exchange Commission, Advisory Committee on Improvement to Financial Reporting, Panel Regarding Materiality, Restatements and Professional Judgment, 13 March 2008.

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responsibility for detecting fraud and improving the timely communication of these frauds to investors and shareowners.<sup>2</sup>

CalPERS believes the auditor's judgments about accounting principles and critical accounting policies and practices should be incorporated into the auditor's report. CalPERS agrees with the ACAP's conclusion that an improved auditor's report would likely lead to more relevant information for users of financial statements and would clarify the role of the auditor in the audit of financial reporting.

### **Engagement Partner Signature**

CalPERS agrees with ACAP's consideration to recommend that the PCAOB revise the auditor's report standard to mandate the engagement partner's signature on the auditor's report to affirm the accountability of the auditor. CalPERS' testimony on February 4, 2008, also recommended public access to all firm-specific inspection reports even if potential defects in the audit firm's quality control systems are addressed. Making these inspection reports available to the public would provide an incentive for audit firms to continuously strive to improve audit quality.

### **Transparency**

CalPERS supports ACAP's recommendation that the PCAOB require auditing firms to produce a public annual report incorporating information such as the firm's financial results on statutory audits, directly related services on a comparable basis and required disclosure of key performance indicators to foster greater audit quality. CalPERS believes the ACAP should also include the requirement as outlined in the European Union's Eight Directive, Article 40 Transparency Report, that audit firms provide a description of their quality control system and a statement on the effectiveness of the quality control system. Similarly, CalPERS applauds the recent action by the PCAOB which requires registered public accounting firms to submit an annual report requiring two types of additional reporting obligations. This includes basic information about the audit firm and the firm's issuer-related practice over the most recent 12-month period. The second requirement would include specific reportable events that must be

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<sup>2</sup> CalPERS' written and oral testimony to the US Treasury, Advisory Committee on the Auditing Profession, Panel on General Sustainability, 4 February 2008.

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disclosed within 30 days The PCAOB will make each firm's annual and special reports available to the public.<sup>3</sup>

CalPERS supports the ACAP's recommendation that required key performance indicators include average headcount, staff turnover, diversity, client satisfaction, audit and non-audit work, proposal win rate, revenue, profit, profit per partner, engagement team composition, the nature and extent of training programs and the nature and reason for client restatements. CalPERS also suggested in its February 4, 2008 testimony other key performance indicators such as average experience of staff, partner time allocated to each audit and percent of training dollars spent on staff as a percentage of the fees received for the audit. Audit firms should also consider strengthening peer reviews as well as sharing key performance indicators during these reviews to facilitate and strengthen audit quality throughout the industry.

ACAP is considering whether the PCAOB beginning in 2011 require auditing firms to file on a confidential basis, its audited financial statements prepared in accordance with either GAAP or IFRS, allowing the PCAOB to (1) determine, based on broad consultation, whether these audited financial statements be made public in consideration of their utility to audit committee members and investors in assessing audit quality, or alternative 2, which would require audit firms' audited financial statements be made available publicly. To ensure better transparency and provide audit committees and investors the ability to assess audit quality, CalPERS supports alternative 2, that all audited financial statements of audit firms be available on the PCAOB's website publicly.

When there is a change in the external auditor, the Audit Committee of companies should publicly disclose to shareowners the reasons for the change in greater detail than what is required by the SEC and within four days of the change. CalPERS also has the position that the independent external auditor should be ratified by shareowners annually.

### **Litigation**

ACAP should not recommend that Congress provide federal courts with exclusive jurisdiction over some categories of claims, which presently may be brought in state courts against auditors, when such claims are related to audits of public company financial statements. CalPERS believes that federal jurisdiction

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<sup>3</sup> PCAOB will submit to the SEC for approval adoption of rules for annual and special reporting requirements by audit firms, 10 June 2008.

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over the public company auditing profession would weaken plaintiffs' rights and remedies.

Thank you for considering our comments in response to the Advisory Committee on the Auditing Profession's draft report and addendum. Please contact me at (916) 795-2731 if you have any questions or if I may be of further assistance.

Regards,

A handwritten signature in cursive script that reads "Dennis A. Johnson".

Dennis Johnson, CFA  
Senior Portfolio Manager  
Corporate Governance