



Colorado Public Employees' Retirement Association

Mailing Address: PO Box 5800, Denver, CO 80217-5800

Office Locations: 1300 Logan Street, Denver

1120 W. 122nd Avenue, Westminster

303-832-9550 • 1-800-759-PERA (7372)

www.copera.org

July 9, 2008

Advisory Committee on the Auditing Profession (ACAP)
Office of Financial Institutions Policy
Room 1418
U.S. Department of Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Re: Advisory Committee on the Auditing Profession Draft Report and Addendum

Chairman Levitt and Chairman Nicolaisen and Members of the ACAP:

Colorado Public Employees' Retirement Association (Colorado PERA) is pleased to offer the following comments to the U.S. Treasury Advisory Committee on the Auditing Profession ("Advisory Committee") regarding certain recommendations in its May 5, 2008, Draft Report ("Draft Report") and Addendum to VI. Firm Structure and Finances ("Addendum"):

VI. FIRM STRUCTURE AND FINANCES

Draft Report:

Recommendation 1. Strengthen auditing firms' fraud detection and prevention skills and clarify communications with investors regarding auditing firms' fraud detection responsibilities.

Colorado PERA agrees that substantial strengthening of auditors' fraud prevention and detection skills is warranted and will improve financial reporting and audit quality. This step combined with action to ensure that audit firms are accountable for the manner in which these skills are performed will enhance investor confidence in financial reporting and the auditing function. We also agree that it would be appropriate for the Public Company Accounting Oversight Board ("PCAOB") and the Securities and Exchange Commission ("SEC") to clarify in the auditor's report the auditor's role in detecting fraud under applicable auditing standards and that the PCAOB periodically review and update these standards.

Recommendation 4. Urge the SEC to amend Form 8-K disclosure requirements to characterize appropriately and report every public company auditor change and to require auditing firms to notify the PCAOB of any premature engagement partner changes on public company audit clients.

Colorado PERA supports the Advisory Committee recommendation that the SEC amend its Form 8-K disclosure on auditor changes by providing for the mechanism recommended by the Advisory Committee and that the auditing firms notify the PCAOB of any engagement partner changes on public company audits if made before the normal rotation period and the reasons for those changes.

Addendum:

Recommendation: Urge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's reporting model.

Colorado PERA supports the committee's recommendation to improve the auditor's reporting model. As a long term investor, Colorado PERA believes the Auditor's Report should include 1) a clear statement of the auditors responsibilities; 2) the components of the audit process specifically the fraud detection and data testing undertaken; 3) identification of critical accounting policies or practices; 4) identification of key risk areas; 5) identification of significant changes in risk exposures; and 6) 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.

Engagement Partner Signature

The audit partner and concurring partner should unquestionably sign the auditor's report in their own name. These signatures should be statutorily deemed to bind the entire firm, not just a separate office or subsidiary that employs that partner. Auditors should not be able to avoid liability of the whole by having audits "issue" out of entities with little or no financial accountability.

Investor confidence and the reliability of the audit work product are directly dependent upon the accountability of the authoring firm. As to liability, the accounting firm as a whole should be treated as a "speaker" under the securities laws regardless of who physically signs.

Auditors have successfully insulated themselves from liability under Section 10 (b) of the Exchange Act and Rule 10b-5 by contending that they were neither the signatories nor the issuers of the alleged materially false and misleading audit opinion and, therefore, did not make a "statement" upon which liability may be based. Under these circumstances, "non-speaker" auditors—even those who performed significant substantive work in the audit - are able to argue that the claims against them are nothing more than claims for "aiding and abetting" the speaking auditor's primary violation. The Supreme Court held such "aiding and abetting" claims to be untenable in both *Central Bank of Denver N.A. v First Interstate Bank of Denver, N.A.* 114 S. Ct. 1439 (1994) and *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008).

To avoid the constrains of *Central Bank* and *Stoneridge*, liability for primary violations of Section 10(b) and Rule 10b-5 should expand to include those auditors who substantially participate in issuing the audit opinion. Currently, there is a split of authority among the Circuit courts as to when a non-speaker may be liable for materially false and misleading statements. On the one hand, some courts hold that a non-speaker violates Rule 10b-5(b) by making statements that it knew or should have known would be communicated to the public. See, e.g., *Anixter v. Home-Stake Prod. Co.*, 77 F. 3d 1215 (10th Cir. 1996). Other courts, however, require that statements must be "directly attributable" to a non-speaker for it to be liable for a materially false and misleading statement. See e.g., *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998) (the statement must be attributed to the actor in question at the time that the statement is disseminated)

Too frequently, auditors that have a substantial role in issuing materially false and misleading audit opinions escape liability on the mere technicality that they did not sign the audit opinion. This practice elevates form over substance and undermines investor confidence while providing

a convenient shield where there should be none. Each auditor (or putatively independent unit of an auditing "association") that performs substantiative work upon which a materially false and misleading audit opinion is based should be subject to primary liability as a speaker under Section 10 (b) and Rule 10b-5.

Transparency

It is important for the investor community to have access to audit firms' financial statements in order to determine if liability reform is necessary and to assess the general state of health of the audit firms upon which we, as investors, heavily rely.

As was presented to the committee on March 5, 2008, in written testimony, an auditor should be required to disclose publicly its own financial information. Such disclosures would enable investors to better understand the financial strength of the audit firm. Auditors should also disclose, as notes to the Independent Auditor's Report, the fees that it received from the audited company for both audit and non-audit work as well as the fees for all audit and non-audit services derived from the client and all related entities for a five year period. Such disclosures will better enable investors to understand and appreciate the importance of the engagement to the auditor. Public financial disclosures should include a detailed section on the E&O Insurance coverage structure of the firm as a whole and each separate country subsidiary involved in the audit.

Colorado PERA believes the ACAP should endorse the requirements 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.

We also support 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.

To ensure better transparency and provide audit committees and investors the ability to assess audit quality, Colorado PERA supports alternative 2, that all audited financial statements of audit firms be available on the PCAOB's website publicly.

Litigation

The notion that the federal courts should have exclusive jurisdiction for all direct non-governmental claims against accountants may have some appeal where such jurisdiction is already provided for in federal law. However, claims against auditors arising from audits of either non-public or public companies that are not brought under the federal securities laws should continue to be decided in state courts under applicable state common law for malpractice, breach of contract, fraud, aiding and abetting and breach of fiduciary duty claims. Bedrock principals of federalism require that the citizens of the several States have open and unfettered access to the courts of their States for wrongs committed against them. Additionally, the federal courts are already overwhelmed by an expanding criminal docket. The notion that those courts would be able to handle an avalanche of traditionally state law claims from the nation's state courts is simply unsupportable.

It was noted in reviewing the written testimony of Kathryn A. Oberly, Americas Vice Chair and General Counsel, Ernst & Young L.L.P., before the Federal Advisory Committee on the Auditing Profession, United States Department of the Treasury, June 3, 2008, that a uniform standard

was being endorsed that would require plaintiffs to demonstrate that a defendant acted with actual knowledge. Ms. Oberly requested that the Department of the Treasury make the “incremental change” of requiring “actual knowledge for liability under Rule 10b-5, instead of mere recklessness.” She noted that this change would be “a huge improvement” because “Courts and juries have a difficult time figuring out when and whether the recklessness standard is met” and that it is therefore untrue that the current “scienter requirement under Rule 10b-5 protects good faith conduct from litigation risk.” We believe that an actual knowledge standard would dramatically undermine the reliability of audit reports as well as promote audit designs intended to avoid discovery or actual knowledge.

The appropriate standard of care would be that applicable to other professional service providers where the failure to adhere to the practices of other similarly situated services providers constitutes negligence and gives rise to liability. Such a standard will encourage vigorous design and implementation of the audit as well as clarity in reporting audit results. The impact will be to restore transparency and potentially investor confidence.

VII. CONCENTRATION AND COMPETITION

Recommendation 2. Monitor potential sources of catastrophic risk faced by public company auditing firms and create a mechanism for the preservation and rehabilitation of troubled larger public company auditing firms.

Colorado PERA is unaware of evidence being made available which would support the expenditure of the resources of the PCAOB and, potentially the over burdened SEC, for the purpose of developing a catastrophic risk management and firm rehabilitation program for larger public company audit firms. The failure by the audit firms to make adequate disclosure of either the realistic liability exposures or the true economic condition including available insurance coverage's, prevents any legitimate assessment of the purported need for these steps.

Recommendation 3. Recommend the PCAOB, in consultation with auditors, investors, public companies, audit committees, boards of directors, academics, and others, determine the feasibility of developing key indicators of audit quality and effectiveness and requiring auditing firms to publicly disclose those indicators. Assuming development and disclosure of indicators of audit quality are feasible; require the PCAOB to monitor these indicators.

As noted by the Advisory Committee, a key issue in the public company audit market is what drives competition for audit clients and whether audit quality is the most significant driver. Currently, there is minimal publicly available information regarding indicators of audit quality at individual auditing firms.

Colorado PERA agrees with the Advisory Committee's recommendation that the PCAOB determine the feasibility of developing key indicators of audit quality and requiring auditing firms to publicly disclose those indicators. In addition, Colorado PERA agrees with the Advisory

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Committee's recommendation that the PCAOB, through its inspection process, should monitor these indicators once identified.

Recommendation 4(a). Compile the SEC and PCAOB independence requirements into a single document and make this document website accessible...in the case of public companies)...indicate, at each place in their standards where differences exist, that stricter SEC and PCAOB independence requirements applicable to public company auditors may supersede or supplement the stated requirements...

Colorado PERA agrees with this recommendation.

Recommendation 5. Adopt annual shareholder ratification of public company auditors by all public companies.

Colorado PERA agrees with the Advisory Committee that shareholder ratification of auditor selection through the annual meeting and proxy process can enhance the audit committee's oversight to ensure that the auditor is suitable for the company's size and financial reporting needs and may enhance competition in the audit industry. We also agree with the Advisory Committee's desire to encourage such an approach as a best practice for all public companies and its urging exchange self-regulatory organizations to also adopt such a requirement as a listing standard. In addition, we agree with the Advisory Committee's recommendation that disclosure in the company proxy statement regarding shareholder ratification include the name(s) of the senior auditing partner(s) staffed on the engagement.

Recommendation 6. Enhance regulatory collaboration and coordination between the PCAOB and its foreign counterparts, consistent with the PCAOB mission of promoting quality audits of public companies in the U.S.

Colorado PERA supports with the Advisory Committee's conclusion that global regulatory coordination and cooperation are important elements in making sure public company audit firms are contributing effectively to audit quality, particularly as we move to one high quality set of global accounting standards under the International Financial Reporting Standards.

In summary, thank you for the opportunity to comment. Should you have any questions, you may contact me at 303-837-6271 or gsmith@copera.org.

Sincerely,

/s/

Gregory W. Smith
General Counsel
Colorado PERA

GWS/dma