



July 3, 2008

**EMPLOYEES  
RETIREMENT  
SYSTEM OF TEXAS**

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

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

Dear Committee Members:

The Employees Retirement System of Texas is pleased to respond to the request for comments from the U.S. Treasury Advisory Committee on the Auditing Profession ("Committee") regarding the Committee's recommendations in its May 5, 2008 Draft Report ("Draft Report") and Addendum to VI. Firm Structure and Finances ("Addendum"). With respect to certain recommendations in the Draft Report and Addendum, ERS' comments are as follows:

**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.** We agree with the Committee that continued enhancement of auditors' fraud prevention and detection skills will improve financial reporting and audit quality and enhance investor confidence in financial reporting and the auditing function. We also agree with the Committee's recommendation that the Public Company Accounting Oversight Board ("PCAOB") and the Securities and Exchange Commission ("SEC") clarify in the auditor's report the auditor's role in detecting fraud under current auditing standards.

**Recommendation 3. Urge the PCAOB and the SEC...to analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency at auditing firms.** As noted by the Committee, public company auditing firms, as private partnerships, are not subject to the requirements of the Sarbanes-Oxley Act of 2002 or exchange listing standards that mandate fully independent audit committees, nominating/corporate governance, and compensation committees. Instead, state laws and partnership agreements determine the governance of auditing firms and often times a firm's governing body is comprised of elected firm partners. We agree with the Committee that enhancing the corporate governance of the auditing firms through the appointment of independent board members to auditing firm boards could be particularly beneficial to auditing firm management and governance. We also agree with the Committee that the addition of independent board

members could improve investor protection through enhanced audit quality and firm transparency.

**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.** We agree with the Committee recommendation that the SEC amend its Form 8-K disclosure on auditor changes by providing for the mechanism recommended by the Committee. We also agree with the Committee's recommendation 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:**

**Auditors Report.** As noted by the Committee, the auditor's report is the primary means by which the auditor communicates to the users of financial statements regarding its audit of financial statements, which has not been altered since the 1930's. We agree with the Committee's recommendation that the PCAOB address this issue. As noted by the PCAOB Standing Advisory Group in 2005 and the Committee, the auditor's report should include more information relating to the auditor's judgments regarding financial reporting quality, particularly with respect to key risk areas.

**Engagement Partner Signature.** As noted by the Committee, SEC regulations require that the auditor's report be signed with the audit firm name. However, we agree with the Committee's recommendation to request that the PCAOB revise its auditor's report standard to require the engagement partner's signature on the auditor's report to improve audit quality.

**Transparency.** We agree with the Committee's recommendation that the PCAOB require by 2010 that larger auditing firms produce a public annual report that contains the information outlined in the Addendum to improve the transparency of auditing firms.

**Litigation.** The Committee has requested comments regarding whether it would be appropriate to have exclusive federal jurisdiction for claims that presently may be brought in state courts against auditors related to audits of public company financial statements. We do not believe it is in the best interests of investors to eliminate state court jurisdiction for these types of claims against auditors in lieu of exclusive federal court jurisdiction, which would weaken investors rights and remedies.

## **VII. CONCENTRATION AND COMPETITION**

**Draft Report:**

**Recommendation 1(a). Require disclosure by public companies in their annual reports and proxy statements of any provisions in agreements with third parties that limit auditor choice.** We agree with the Committee that requiring public disclosure of limitation of liability provisions in agreements would assist in the growth of the smaller firms and their entry into the large public company audit market. We also agree with the Committee that the SEC should

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require public companies to disclose any provisions in agreements limiting auditor choice with the information as outlined in the Committee Draft Report.

**Recommendation 3. Recommend the PCAOB...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 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. We agree with the 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, we agree with the Committee's recommendation that the PCAOB, through its inspection process, should monitor these indicators once identified.

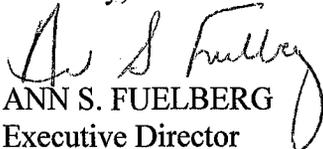
**Recommendation 4(a). Compile the SEC and PCAOB independence requirements into a single document and make this document website accessible...in the case of public companies)...indicate, at each place in their standards where differences exist, that stricter SEC and PCAOB independence requirements applicable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

**Recommendation 5. Adopt annual shareholder ratification of public company auditors by all public companies.** We agree with the 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 Committee encouraging such an approach as a best practice for all public companies and having exchange self-regulatory organizations also adopt such a requirement as a listing standard. In addition, we agree with the 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.** We agree with the Committee that global regulatory coordination and cooperation are important elements in making sure public company audit firms are contributing effectively to audit quality, particularly as regulators move to one high quality set of global accounting standards under the International Financial Reporting Standards.

In conclusion, thank you for providing ERS with the opportunity to comment. Should you have any questions, please feel free to contact Cynthia Richson, Director of Corporate Governance, at [cynthia.richson@ers.state.tx.us](mailto:cynthia.richson@ers.state.tx.us) or 512.867.7384.

Sincerely,

  
ANN S. FUELBERG  
Executive Director