STATE BOARD OF ADMINISTRATION
OF FLORIDA
1801 HERMITAGE BOULEVARD
TALLAHASSEE, FLORIDA
32308
(850) 488-4406

VIA EMAIL

May 16, 2005

Office of the Secretary
Public Company Accounting Oversight Board (PCAOB)
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 018

Dear Sir or Madam:

The State Board of Administration (SBA) of Florida is writing in support of the PCAOB's proposed Auditing Standard, "Reporting on the Elimination of a Material Weakness."

Managed by the SBA, the Florida Retirement System (FRS) is the fourth largest public pension plan in the United States with approximately 850,000 beneficiaries and retirees, and assets totaling approximately $107 billion. As a large institutional investor in global capital markets, the SBA has a significant interest in promoting accurate financial information in order for investors to make reasonably informed decisions and for the orderly functioning of the U.S. capital markets. We believe the proposed standard addresses the need of investors to know whether previously reported material weaknesses[1] in a company's internal controls have been ameliorated. The SBA believes that this standard is a reasonable response to an issue unaddressed by Auditing Standard 2 (A.S. 2)[2].

As background, the SBA believes Section 404 is a core piece of the Sarbanes-Oxley Act and was enacted in response to well-documented failures of internal controls at a number of high-profile U.S. companies. Under Section 404 of the Act, for the first time, the investing public has received audited financial statements coupled with reports from management and the auditor explaining the soundness of the control system used to produce the financial statements. While the recent focus over this important provision has centered on the costs of Section 404, we strongly believe the benefits of 404 are significant and outweigh short-run implementation charges. As voiced by many different parties in a recent SEC/PCAOB roundtable, panelists discussed a range of realized and expected benefits including an improved "tone at the top," more

[1] Defined as those weaknesses in a company's internal controls that could lead to a potentially material error in the financial statements.
[2] The SBA views A.S. 2 as fundamentally sound and not in need of major overhaul. It appropriately recognizes that reviews shouldn't be a checklist or a one-size fits all exercise, it appropriately requires auditors to exercise professional judgment, and it appropriately gives auditors the discretion to rely on the work of others. It does not require testing of all controls—only those that are intended to make it probable that the financial statements are materially wrong.

involved boards of directors, more robust audits by external auditors, enhanced internal audit resources and performance, higher quality financial statements and fewer restatements of company financials. Although these benefits are long-term in nature and may be difficult to quantify, such efforts will be a positive for all involved in the U.S. capital markets.

Section 404 is identifying problems with internal controls, and it is indicating that some companies have significant internal control deficiencies[3]. Some of these lacking controls must be reported to investors as material weaknesses but many others are being identified and remediated before disclosure is required. Until the company eliminates the material weakness, however, investors may be left uncertain about the reliability of the company's financial statements. Although companies have an obligation on a quarterly basis to report any material changes in their internal controls, including a remediation of previously disclosed material weaknesses, verification[4] by an independent auditor of a remediation will undoubtedly benefit investors. As noted within the proposed standard, "both managements and report users have recognized the importance of a mechanism for telling investors the rest of the company's story when a material weakness in internal control over financial reporting has been disclosed."

The proposal has been flexibly structured in order to give companies the ability, on a voluntary basis, to seek an auditor's opinion that one or more material weaknesses have been corrected and allows the engagement to be undertaken at any time during the year. The proposal also provides guidance to audit firms for issuing such an opinion—requiring the auditor's opinion to identify explicitly the material weakness in question and to restrict the auditor's conclusion with respect to the effectiveness of other controls.

I commend the PCAOB's efforts to promote and enhance accurate financial information for the investment community.

Sincerely,

Coleman Stipanovich
Executive Director

cc: Ms. Kayla Gillan, Board Member, PCAOB
Mr. Donald Nicholiasen, Chief Accountant, SEC
Mr. Kurt Schacht, Executive Director, CFA Centre for Financial Market Integrity
Ms. Ann Yerger, Executive Director, Council of Institutional Investors

[3] At least one research firm has noted the positive correlation between control deficiencies and financial restatements, separate and apart from the negative effect that strong internal controls have on financial defalcations.

[4] An auditor would perform an evaluation of management's assertion and the performance of audit procedures necessary to determine that the controls specified in management's assertion were designed and operated effectively to eliminate the material weakness.