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February 28, 2012 Via E-Mail: comments@pcaobus.org

James R. Doty, Chairman
Public Company Accounting
Oversight Board (PCAOB)
1666 K Street N.W.
Washington, DC 2006-2083

Re**: PCAOB Release No. 2011-008, Docket Matter No. 030** "Proposed Auditing Standard related to Communications with Audit committees, Related Amendments to PCAOB Standards and Transitional Amendments to AU Sec. 380"

Dear Chairman Doty:

I am writing on behalf of the California Public Employees' Retirement System (CalPERS), the largest public pension fund in the United States with approximately $236.6 billion in global assets and equity holdings in more than 9,000 publicly traded companies. CalPERS provides retirement benefits to more than 1.6 million public workers, retirees, and their families and beneficiaries.

<u>Reproposal – Audit Standard related to Communications with Audit committee</u>

Thank you for the opportunity to provide comment to the Public Company Accounting Oversight Board (PCAOB) on the reproposed auditing standard, *Communications with Audit committees* and related amendments that will replace interim standards AU sec. 380 and AU sec. 310, *Appointment of the Independent Auditor*. We continue to support the need for a comprehensive and robust standard since submitting a comment in 2010 and agree with the need to repropose the standard based on:

1. Better alignment with the eight new risk assessment standards issued since the original proposal;
2. Providing the ability of brokers and dealers, their boards, and their auditors the ability to comment since the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the registration and inspection of audit firms of brokers and dealers; and
3. The new requirement that auditors communicate to audit committees significant unusual transactions that are out of the normal business for the company or that otherwise appear to be unusual, ensuring communication by the auditor their understanding of the business rationale for such transactions.

Objectives

We strongly support the four objectives outlined in the reproposal of the auditor's communications with the audit committee which includes:

1. The auditor's responsibilities in establishing an understanding of the terms of the audit engagement with the audit committee;
2. Obtaining information from the audit committee that is relevant to the audit;
3. Communicating the overall audit strategy and timing; and
4. Timely observations arising from the audit that are significant to the financial reporting process.

We agree that the new proposed standards should be applicable to all audits of brokers and dealers and in the interim that AU sec. 380 should apply to audits of brokers and dealers required under section 982 the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Overall, CalPERS is pleased to see that the reproposal provides a number of specific matters that must be discussed with the audit committee, including the audit strategy and structure and timing of the audit; the auditor's assessment of risk areas, including fraud risks; the auditor's use of external experts and other auditors; the discussion of difficult and contentious issues that arise in the course of the audit; significant unusual transactions; significant accounting policies, judgments and estimates; and going concern evaluation and issues of other matters.

Auditor and Audit Committee Roles

The need for this standard is underscored by the important role that audit committees play in protecting the interests of investors and in overseeing the integrity of the company's financial reporting process. CalPERS as a significant long-term institutional investor, believes both the roles of auditors and audit committees are critical to the confidence, efficiency and integrity of the capital markets. The financial interests of CalPERS beneficiaries are most effectively served in an environment where investors can confidently utilize financial statements to evaluate risks and rewards.

CalPERS does not agree with the following significant changes in the reproposal. These include:

1. No longer requiring that auditors evaluate the two-way communications process between the auditor and the audit committee;
2. Omitting the requirement that auditors discuss with the audit committee the quality, clarity and completeness of the company's financial statements and related disclosures; and
3. Restructuring requirements on the communication between the auditor and audit committee on management's critical accounting estimates.

Observations and Recommendations:

With this in mind, we would like to offer the following observations and recommendations on the reproposal of this standard.

- Clearly outline the roles of the auditor and audit committee, ensuring the underlying objective of transparency, and integrity of the financial reporting process. CalPERS Global Principles of Accountable Corporate Governance state "the auditor should articulate to the audit committee, risks and other matters arising from the audit that are significant to the oversight of the financial reporting process, including situations where the auditor is aware of disputes or concerns raised regarding accounting or auditing matters. The audit committee should consider providing to investors a summary document of its discussions with auditors to enhance investor confidence in the audit process."

- Investors are particularly interested in any auditor communications and information that may be material to the integrity of the financial reports and possibly to the share price of the issuer's stock, including:

    1. Key business, operational and audit risks believed to exist and considered;
    2. Assumptions used in judgments that materially affect the financial statements, and whether those assumptions are at the low or high end of the range of possible outcomes;
    3. Appropriateness of the accounting policies adopted by the company;
    4. Changes to accounting policies that have a significant impact on the financial statements;
    5. Methods and judgments made in valuing assets and liabilities;
    6. Unusual transactions;
    7. Accounting applications and practices that are uncommon to the industry;
    8. Identification of any matters in the annual report that the auditors believe are incorrect or inconsistent, with the information contained in the financial statements or obtained in the course of their audit;
    9. Audit issues and their resolution which the audit partner documents in a final audit memo to the Audit committee;
    10. Evaluation of whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time (which should be defined);
    11. Quality and effectiveness of the governance structure and risk management;
    12. A view on how the entity compares to its peers in the effectiveness of its internal controls and financial reporting practices; and
    13. Completeness and reasonableness of the audit committee report.

- The standard should include requirements for the auditor to communicate, or to evaluate whether management has adequately communicated:

    1. How management subsequently monitors critical accounting estimates;
    2. Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity;
    3. A discussion of any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements and the information that supports or challenges such changes; and
    4. When critical accounting estimates involve a range of possible outcomes, how the recorded estimates relate to the range and how various sections within the range would affect the company's financial statements.

- The guidelines should foster a two-way meaningful exchange between auditors and audit committees which are documented to avoid misunderstandings. We do not believe documentation will constrain robust, frank and effective discussions and it is important that communications not solely be oral.

- Audit committees also need to also do a better job at providing effective disclosures to investors. CalPERS principles outline this responsibility as including:

    1. Assessment of the independence and objectivity of the external auditor to assure the auditors and their staff have no financial, business, employment or family and other personal relationships with the company;
    2. Assessment of the appropriateness of total fees charged by the auditors;
    3. Assessment of non-audit services and fees charged including limitations or restrictions tied to the provision of non-audit services;
    4. Explanation of why non-audit services were provided by the auditor rather than by another party and how the auditor's independence has been safeguarded;
    5. Rationale for recommending the appointment, reappointment or removal of the external auditor including information on tendering frequency, tenure and any contractual obligations that restrict the choice of external auditors;
    6. Auditor rotation period;
    7. Assessment of issues which resulted in auditor resignation.

The financial crisis has resulted in concerns that auditors and audit committees may not be receiving adequate information from management, including better two-way communication between the auditor and the audit committee. We therefore welcome the PCAOB's attention to this important subject.

Thank you for considering our comments. If you have any questions, please do not hesitate to contact me at (916) 795-9672 or my colleague, Mary Hartman Morris at (916) 795-4129.

Sincerely,

ANNE SIMPSON
Senior Portfolio Manager
Investment Office
Head of Corporate Governance

cc: Board Members – PCAOB
J. Gordon Seymour, General Counsel and Secretary – PCAOB
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