CalPERS
75 Years

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Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File No. PCAOB-2007-02 - Auditing Standard No. 5, *An Audit of internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements and Related Independence Rule and Conforming Amendments*

Dear Ms. Morris:

I am writing you on behalf of the California Public Employees' Retirement System (CalPERS). CalPERS is the largest US Public Pension Fund with total assets of $247.1 billion and more than 1.5 million members. CalPERS is pleased to provide the Commission with comment regarding Auditing Standard No. 5, an audit of internal control over financial reporting that is integrated with an audit of financial statements.

In February of this year, CalPERS participated in the comment period for both Rulemaking Docket No. 021 at the Public Company Accounting Oversight Board (PCAOB) and the Securities and Exchange Commission's (SEC' s) management guidance on Internal Control over Financial Reporting – File # S7-24-06.

CalPERS continues to be very supportive of the SEC's & PCAOB's efforts to enforce adherence to regulatory requirements and adoption of auditing standards. We believe the Sarbanes-Oxley Act of 2002 establishes reasonable and good faith "certainty", a necessary attribute for investors to maintain confidence in the integrity of a public company's financial statements. We continue to believe that improved standards are integral for ensuring the integrity of a public company's financial statements. We support the decision to make changes that will improve the coordination between the SEC's management guidance and the PCAOB standard.

Through this letter, CalPERS is providing the perspective of a large institutional investor. In response to your solicitation of comments, we offer the following:

1. Materiality should be defined with the end result in mind. If the auditor believes a certain account has a high risk of material misstatement during the planning phase of the audit then the auditor should include this perspective in their testing. We agree illustrating that the auditor should plan and perform the audit of internal controls using the same materiality measures used in the audit of the annual financial statements is helpful in clarifying the role of materiality.[1]

2. Communication between the auditor and the Audit Committee is critical to the audit process and to investors' confidence. We agree that this communication should contain all relevant information about control deficiencies. We are unsure of the value in determining whether significant deficiencies will divert auditors' attention away from material weaknesses. A control is either effective in design and operation or it is not. The Audit Committee and company board should be informed of all internal control deficiencies that may impact the integrity of the financial statements to ensure accuracy and fair representation. SOX 404 is very instrumental in directing audit firms on material-weakness disclosures and providing the subsequent improvements in companies' financial controls.

3. We agree that risk factors may affect whether a deficiency or a combination of deficiencies will result in a misstatement. However, ultimately the auditor is asked to express an opinion on the financial statements as a whole. We don't believe multiple control deficiencies should be looked at in combination only if they are related to one another. Internal control over financial reporting (ICFR) is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation in accordance with Generally Accepted Accounting Principles (GAAP).

4. Consistent with guidance in the past, "reasonable possibility" is understood by auditors and management as defined in Appendix A, A7 as "reasonably possible" or "probable". We agree that this definition, although subject to interpretation, should provide the auditor the ability to determine whether ICFR is effective.

5. Since at least 2003, the topic of whether auditors can use the work of others has been debated. We continue to agree that the auditor should evaluate the competence and objectivity of the work of others in determining whether the auditor can rely on this work. We support allowing the independent auditor to rely more on the work of others, particularly after the initial audit of internal controls has been completed.

[1] Material weakness is defined as "a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis."

6. We agree with the concept of cost-effective integrated audits but continue to disagree that a tiered approach based on company size should be considered in the audit of internal control over financial reporting when integrated with the audit of the financial statements.

7. As stated in our letter in February[2], we do not see the need to emphasize the scaling or tailoring of its evaluation methods and procedures based solely on size limits – specifically for smaller public companies. We believe one standard is needed for all companies.

We thank the SEC and PCAOB for their ongoing diligence in developing a robust auditing standard that will ensure the integrity of public financial statements. We support the Commission's approval of the proposed rules and conforming amendments.

CalPERS is prepared to provide assistance to the SEC upon request. Please contact Dennis Johnson, Senior Portfolio Manager–Corporate Governance at (916) 795-2731 if there are questions or if we can be of further assistance.

Sincerely,

Russell Read

cc: Fred Buenrostro, Chief Executive Officer, CalPERS
Anne Stausboll, Chief Operating Investment Officer, CalPERS
Christy Wood, Senior Investment Officer, CalPERS
Peter Mixon, General Counsel, CalPERS
Dennis Johnson, Senior Portfolio Manager, CalPERS

[2] Letter dated February 26, 2007, Nancy M. Morris, Secretary, SEC, File Number S7-24-06.