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August 18, 2017

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Subject: FILE NUMBER PCAOB-2017-01

Dear Mr. Fields:

On behalf of the California Public Employees' Retirement System (CalPERS), thank you for the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB) Proposed Rules on the Auditor's Report. CalPERS is the largest defined benefit plan public pension fund in the United States with approximately \$330 billion in global assets in more than 11,000 public companies. CalPERS invests these assets on behalf of more than 1.8 million employees, retirees, and beneficiaries.

Financial reporting plays an integral role in the capital markets by providing transparent and relevant information about the economic performance and condition of a company. As such, CalPERS expects fair, accurate, and timely reporting on how companies identify and manage risks related to the three forms of capital: financial, physical, and human. The CalPERS Governance and Sustainability Principles¹ make clear that effective financial reporting depends on high-quality accounting standards and rigorous independent audits.

The PCAOB's efforts to finalize improved standards on the auditor's report reflect seven years of work and the consideration of a wide range of perspectives. CalPERS supports the work of the auditing experts at the PCAOB to enhance the quality of the auditor's report. We believe that these improvements would help to better protect shareowner interests and increase investors' confidence in capital markets. Accordingly, we are delighted to see the PCAOB's Proposed Rules.

CalPERS has had consistent involvement in PCAOB discussions, engagements, and consultations regarding Docket No. 034 on enhancing the auditor's report, including:

¹ See, [CalPERS Governance & Sustainability Principles](#), dated April 17, 2017

Comment Letter October 20, 2011,² Comment Letter May 2, 2014,³ and Comment Letter August 15, 2016,⁴ as well as participation in the initiating event On Docket No. 034, the PCAOB Auditor Reporting Roundtable September 15, 2011.⁵

We note that the PCAOB has considered and responded directly to comments from companies, auditors, and investors by modifying the initial proposal – setting limits on the source of potential critical audit matters (CAMs), adding a materiality requirement, narrowing the definition of a CAM, and revising the required documentary and reporting requirements. As a result, the Proposed Rules include numerous revisions from interested stakeholders and represent a well-balanced outcome.

An enhanced audit report requirement with the threat of CAM disclosure would provide a meaningful incentive for good company behavior, as corporate management would be motivated to improve operations and disclosures given the independent auditor's requirements. Essentially, companies would be encouraged to disclose financial issues ahead of potential auditor disclosure, thus narrowing the information gap for shareowners. Currently, company boards and management are already aware of the CAM issues. However, there is no requirement to disclose those issues to shareowners if the company passes the audit. Through CAM disclosure, investors would have more information to make investment decisions and management would be less likely to benefit from, or take advantage of, the information gap.

As we indicated in previous comment letters, we believe that the inclusion of CAMs would enhance transparency, relevance, reliability, and credibility in audits. We also believe that the Proposed Rules represent a meaningful improvement of the current pass/fail standard audit report. Although the Proposed Rules fall short of the more robust independent audit reports adopted in other parts of the world, they represent an important improvement over the current standard.

One need only review an Independent Auditor's Report from a jurisdiction that has adopted enhanced auditor's reports to see how such reports may be improved in the

² See, CalPERS [letter](#) to the PCAOB re: Release No. 2011-003, Rulemaking Docket No. 034, Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB standards, dated October 20, 2011.

³ See, CalPERS [letter](#) to the PCAOB re: Release No. 2013-005, Rulemaking Docket No. 034, Proposed Auditing Standards – The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; the Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report; and Related Amendments to PCAOB Standards, dated May 2, 2014.

⁴ See, CalPERS [letter](#) to the PCAOB re: Rulemaking Docket No. 034, Reproposed Auditing Standard – The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards, dated August 15, 2016.

⁵ See, CalPERS PCAOB Auditor Reporting Roundtable [Discussion and Talking Points](#), dated September 15, 2011.

U.S. For example, please see the Rolls-Royce Independent Auditor's Report⁶ and compare it to the pass/fail reports in the U.S. The PCAOB's Proposed Rules would not go as far as the rule in the United Kingdom, given the PCAOB's efforts to respond to a broad range of company concerns. However, as submitted, the Proposed Rules would enhance transparency in U.S. auditor's reports. Just as importantly, the Proposed Rules align with the PCAOB's mission "to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports."

Immediately prior to the financial crisis, many companies with a number of significant risks, which later became evident when the financial crisis hit, received a passing audit. The auditor's reports for 2007, 2008, 2009, and 2010 read exactly the same, and the only indication that investors would have had that any issues existed was the increased cost of the audits. The auditors were often aware of the risks, but had no duty to reveal such risks. Subsequently, shareowners voted to approve the selection of auditors and the nomination of board members without being fully aware of the financial risks known by corporate boards and management.

By comparison, the most recent Rolls-Royce Independent Auditor's Report provides information about the items that are most likely to cause a material misstatement, such as: bribery and corruption, unrealized losses in derivatives contracts, measurement of revenue and profit in certain business units, trends in profit of items that are uneven in frequency or amount, as well as pressure and incentives for management to meet targets. Auditors have the information the Proposed Rules require them to provide, yet even under the Proposed Rules they must share only certain material information to shareowners. Pass/fail auditor's reports perpetuate an information gap that serves only corporate boards and management. The Proposed Rules would provide shareowners much-needed material information and close the information gap.

Thank you for considering our comments. If you have any further questions, you may contact me at [REDACTED], or your staff may contact Wylie Tollette, Chief Operating Investment Officer, at [REDACTED].

Sincerely,



MARCIE FROST
Chief Executive Officer

⁶ See, Rolls-Royce Holdings plc Annual Report 2016, <https://www.rolls-royce.com/~media/Files/R/Rolls-Royce/documents/annual-report/tr-ar2016-other-information.pdf>