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December 24, 2010 **Via E-mail: markt-greenpaper-audit@ec.europa.eu**

Mrs. Nathalie de Basaldúa, Head of the Audit Policy Unit
European Commission
DG Internal Market and Services, Unit F4-Auditing
SPA 2/JII – 01/112
BE-1049 Brussels, Belgium

Dear Mrs. de Basaldúa:

Re: Consultation - Green Paper - Audit Policy: Lessons from the Crisis

I am writing on behalf of the California Public Employees' Retirement System (CalPERS) to provide comment on the European Commission (EC) Green Paper – Audit Policy: Lessons from the Crisis. CalPERS is the largest public pension fund in the United States with approximately $221 billion in global assets and equity holdings in over 9,000 companies in 47 markets. CalPERS provides retirement benefits to more than 1.6 million public workers, retirees, their families and beneficiaries.

CalPERS commends the Commission for issuing the Green Paper and providing opportunity for consultation. We consider the proposed changes to audit policy in the Green Paper to be important as CalPERS has significant economic interests in European securities.

CalPERS, as a provider of long-term capital, is a strong advocate of improving the independence, quality and objectivity of the external audit. Financial reporting is of great importance to investors, other market participants and regulators. The confidence of these users in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth.

CalPERS Board member Lou Moret co-chairs the Accounting and Auditing Practices Committee of the International Corporate Governance Network (ICGN). CalPERS Board member Lou Moret, as co-chair of the ICGN Committee, submitted a letter on 14 December to this consultation. As a signatory to the ICGN letter, CalPERS is writing this letter to confirm our thoughts and to highlight similar views CalPERS shares with the ICGN Committee regarding reform to the role of auditors in the wake of the financial crisis. CalPERS wishes to emphasize the important role of auditors and how their contribution to the integrity of financial reporting can be strengthened. The attached Appendix provides CalPERS thoughts and shared views on the consultation's specific questions. The following, specifically points on the financial crisis – the role of the auditor and Audit Committees, integrated reporting, introduction of an Auditor's Discussion and Analysis report, and international co-operation, should be emphasized as the EC strengthens audit policy, the role of auditors and corporate governance.

Financial Crisis – Where were the Auditors?

We agree with the Commission that "robust audit is key to re-establishing trust and market confidence; it contributes to investor protection and reduces the cost of capital for companies."

We share a similar view as the ICGN Committee in that the central role of the auditor should be to provide investors with an independent opinion as to whether the financial statements and disclosures therein, are free of material misstatement, whether caused by error or fraud, are materially accurate, complete, and provide a true and fair view. We also stress that this should include comments as to whether the company maintained appropriate internal controls, and kept proper accounting records. These are critical to effective risk management.

CalPERS encourages the EC to continue the emphasis on strengthening internal controls, and the use of control frameworks. Examples include the Enterprise Risk Management – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), Control Objectives for Information and Related Technologies (COBIT), ICGN's Corporate Risk Oversight Guidelines and other risk-based frameworks in its recommendations on audit policy. We believe auditors should refocus their attention on this as part of their role though ensuring basic reasonableness in the core of the audit. The audit of internal controls over financial reporting (ICFR) should be integrated into the audit of financial statements, and be risk-based in order to provide a true and fair view which focuses on substance over form.

The Green Paper highlights the fact that banks incurred significant losses on positions they held on and off balance sheets, but that auditors did not offer any comment and provided clean audit reports. In recent months, CalPERS has had discussions with boards overseeing some of the world's largest financial institutions. While our engagements have revealed examples of effective risk management, they have also highlighted failures of boards to identify key risks that ultimately harmed all market participants. This poses a fundamental question about the role of the auditor. We encourage the Commission to thoughtfully address these issues by clarifying the level of assurance required by auditors and enforcement of audit standards. We consider the review should include the role of Audit Committees and the overall competence and independence of Boards. CalPERS believes the quality of governance of the company's Board and its Committees has a direct impact on audit quality.

As acknowledged by the Chair of the Office of Fair Trading, in the United Kingdom, audit is "a public good" that serves to protect the public, and not just the owners of the company.[1] The

[1] See transcript page 10, House of Lords, The Select Committee on Economic Affairs, Inquiry on Auditors: Market Concentration and their Role, Evidence Session No. 5, November 9, 2010

recent banking crisis had a dramatic and negative impact on the investing public. Taxpayers, deposit holders, shareowners, and employees have been hit hard by the crisis. Although weak governance mechanisms were not the only factors that contributed to misjudgments of the nature and the scale of risks that banks were facing, they undoubtedly played a role.

As noted in the ICGN Committee's comment letter, we agree that the audit system also failed when auditors signed off on statements that banks were going concerns. In some cases, where there was a presumption that taxpayer money would be used to bail out banks, this introduced moral hazard, which was not addressed in audit reviews. As auditors themselves have commented: "[O]ne of the key features of giving assurance that the banks were going to continue was the likelihood of Government support."[2]

The Financial Crisis Inquiry Commission is currently examining the causes, domestic and global, of the financial and economic crisis within the United States. They are examining the major financial institutions which failed, or were likely to have failed, had they not received exceptional government assistance. Their report is expected in January 2011 and may shed further light on the issue of moral hazard and the failure of auditors to sound a warning.[3]

Integrated Reporting Audit- Corporate Social Responsibility (CSR)

CalPERS believes corporate reporting needs to integrate key financial and non-financial information. This is in order to identify risks related to the company's operational, financial, environmental, social, and governance status. Integrated reporting is necessary to understand risk management at a company and the drivers of value creation. CalPERS seeks financial and non-financial information that is relevant, timely, comparable, and of high quality. As the International Integrated Reporting Committee has commented "There is a need to develop more comprehensive and comprehensible information about an organization's total performance, prospective as well as retrospective, to meet the needs of the emerging, more sustainable, global economic model."[4]

CalPERS has a fiduciary duty of prudence, which requires that we take into account all of the information which identifies and mitigates risks and assists in identifying drivers of value creation. To fulfill this investors require comprehensive financial and non-financial disclosures by investee companies. In February 2010, CalPERS Board approved adoption of ICGN's

[2] House of Lords, The Select Committee on Economic Affairs, Inquiry on Auditors: Market Concentration and their Role, Evidence Session No. 6, transcript testimony of PwC's Ian Powell and Deloitte's John Connolly, pgs. 25-37 and 35, November 23, 2010.
[3] President Obama, on May 20, 2009, signed Public Law No. 111-21, the Fraud Enforcement and Recovery Act of 2009 (FERA) establishing the Financial Crisis Inquiry Commission.
[4] As noted on IIRC's website: http://www.integratedreporting.org/node/3
The objectives for an integrated reporting framework are to: a. Support the information needs of long-term investors, by showing the broader and longer-term consequences of decision-making; b. Reflect the interconnections between environmental, social, governance, and financial factors in decisions that affect long-term performance and condition, making clear the link between sustainability and economic value
c. Provide the necessary framework for environmental and social factors to be taken into account systematically in reporting and decision-making d. Rebalance performance metrics away from an undue emphasis on short-term financial performance; and e. Bring reporting closer to the information used by management to run the business on a day to day basis.

Statement and Guidance on Non-financial Business Reporting[5] which calls for companies to report both quantifiable and qualitative information necessary for investment decision making. As noted by ICGN, non-financial reporting should:

- Be genuinely informative and include forward-looking elements where this will enhance understanding;
- Be material, relevant and timely;
- Describe the company's strategy, and associated risks and opportunities, and explain the board's role in assessing and overseeing strategy and the management of risks and opportunities;
- Be accessible and appropriately integrated with other information that enables investors to obtain a whole picture of the company;
- Use key performance indicators that are linked to strategy and facilitate comparisons;
- Use objective metrics where they apply and evidence-based estimates where they do not;
- Be strengthened where possible by independent assurance that is carried out having regard to established disclosure standards applicable to non-financial business reporting, such as those issued by the International Accounting Standards Board (IASB).

As financial and non-financial reporting is combined, the audit should be broadened to ensure independent verification of the integrated report.

An Auditor's Discussion and Analysis - Better Communication

The audit report continues to have merit for investors as it provides a standard report that can quickly provide a view on whether an unqualified opinion was issued and which audit firm signed the report. In practice, rarely are qualified opinions issued, even though there is a need for additional focus on matters of concern. The financial crisis highlighted the need for more comment by auditors.

Similarly presented in ICGN's letter, CalPERS considers that an Auditor's Discussion and Analysis Report (AD&A) addressed to shareowners, could provide this additional comment. An AD&A could highlight issues such as the following:

- The auditor's opinion on management's assessment of internal controls;
- Key business and audit risks the auditor has considered;
- Other relevant types of material risks including financial, operational, strategic, compliance, environmental, social and governance risks that may or may not be covered are in Management's Discussion and Analysis (MD&A);
- The auditor's perspective on key assumptions used in judgments that materially affect the financial statements and probabilities;
- Changes to accounting policies that have a significant impact, such as reclassifications;

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[5] ICGN Statement and Guidance on Non-financial Business Reporting, 11/2/09.
http://www.icgn.org/files/icgn_main/pdfs/best_practice/buss_reporting/icgn_statement_&_guidance_on_non-financial_business_reporting.pdf

- Unusual transactions, restatements, and significant changes in segmental reporting and consolidation;
- Accounting applications and practices including performance ratios that are particular to the industry or in comparison to peers;
- Explanation of changes in the view and interpretation of material information by the external auditor compared to prior reporting periods, plus, key audit issues and their resolution;
- The auditor's judgments regarding the quality, and not just the acceptability, of a company's accounting principles;
- Summary description of the audit procedures and limitations in detecting error or fraud;
- The auditor's perspective on how objectivity and independence have been maintained despite any non-audit services and fees, or their tenure as auditor;
- Assertion of compliance with the Audit Committee's and Board's policy on non-audit services.

International Co-operation

CalPERS supports the EC's intention to provide the basis for close co-operation between audit oversight bodies. We believe these efforts assist in strengthening audit quality and consistency globally. CalPERS supports steps towards mutual reliance and equivalence provisions. We support the EC allowing oversight bodies, such as the United States' Public Company Accounting Oversight Board (PCAOB), the ability to engage and inspect an audit firm outside of their jurisdiction or to co-operate via mutual recognition. We believe ongoing discussions on international co-operation will benefit from the full involvement of the International Forum of Independent Audit Regulators (IFIAR).

Thank you for considering our comments above and in the appendix which follows. If you would like to discuss any of these points, please do not hesitate to contact me at 1-916-795-4129.

Sincerely,

Mary Hartman Morris

MARY HARTMAN MORRIS
Investment Office
Global Equity

cc: Lou Moret, Board Member – CalPERS, Co-Chair of ICGN Accounting & Auditing Practices Committee
Joseph Dear, Chief Investment Officer – CalPERS
Janine Guillot, Chief Operations Investment Officer – CalPERS
Eric Baggesen, Senior Investment Officer – CalPERS
Anne Simpson, Senior Portfolio Manager – CalPERS

Appendix

ROLE OF THE AUDITOR

Questions

(4) Do you believe that audits should provide comfort on the financial health of companies? Are audits fit for such a purpose?

The auditor should provide specific language on the financial health of an entity which we consider should be part of an enhanced form of disclosure addressed to shareowners, such as an Auditor's Discussion and Analysis (AD&A). This would include comment not only on the major risks but what steps the board took to ensure that risks were addressed.

(5) To bridge the expectation gap and in order to clarify the role of audits, should the audit methodology employed be better explained to users?

It would be useful to include details on audit methodology as part of the report to shareowners.

(6) Should "professional scepticism" be reinforced? How could this be achieved?

Auditors need to apply an appropriate level of "professional scepticism" to ensure a high quality audit. We agree that this topic is timely in the wake of the financial crisis and should be addressed.

Unless auditors are prepared to challenge management's assertions, they will not act, nor be able to opine with confidence, on whether a company's financial statements give a true and fair view. The Auditing Standards define "professional scepticism as an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. It is widely acknowledged that a sceptical attitude of mind is essential if an audit is to be rigorous and performed with professional due care."[6]

Academic study has highlighted the importance of possessing an attitude of "professional scepticism" and concluded that effective fraud risk assessments are more frequent with a partner who emphasizes this.[7]

We share a similar view as the ICGN Committee in that we believe companies also have a role through establishing the appropriate "tone at the top" and culture, along with measures such as whistle blower protections, which support transparency.

[6] International Standards on Auditing (ISAs), International Auditing and Assurance Standards Board: http://www.ifac.org/IAASB/Pronouncements.php#Standards

[7] "Professional Scepticism: The Effects of a Partner's Influence and the Presence of Fraud on Auditors' Fraud Judgments and Actions, by Professors Tina Carpenter and Jane Reimers, September 2009."

(7) Should the negative perception attached to qualifications in audit reports be reconsidered? If so, how?

There is a need for more discussion on the value of qualified audit reports and how the auditor can provide additional disclosures. We support an Auditor's Discussion and Analysis (AD&A) (see covering letter for details).

(8) What additional information should be provided to external stakeholders and how?

We consider integrating environmental, social and governance reporting to be important. As above, the Auditor should consider providing an "Auditor's Discussion and Analysis" to provide additional insight to the audit, the risks of the company and what steps the auditor took to come to its opinion. (see covering letter for details)

(9) Is there adequate and regular dialogue between the external auditors, internal auditors and the Audit Committee? If not, how can this communication be improved?

Companies should establish and maintain an effective internal audit function that has the respect, confidence and cooperation of both the board and management. Where the board decides not to establish such a function, full reasons for this should be disclosed in the annual report, as well as an explanation of how adequate assurance has been maintained in its absence. The internal audit function should have a reporting line to the board via the Audit Committee chair. The Audit Committee should be ultimately responsible for the appointment, performance assessment and dismissal of the head of internal audit or outsourced internal audit provider. The external auditor should not provide internal audit services to the company.

(10) Do you think auditors should play a role in ensuring the reliability of the information companies are reporting in the field of Corporate Social Responsibility (CSR)?

Please see the covering letter as we expand on the need for integrated reporting which includes Environmental, Social and Governance (ESG) disclosures, which is CalPERS equivalent term. We regard it as important that the auditor's role be expanded accordingly.

(11) Should there be more regular communication by the auditor to stakeholders? Also, should the time gap between the year end and the date of the audit opinion be reduced?

Timely audit is important but speed may compromise quality. Hence a balance needs to be struck.

(12) What other measures could be envisaged to enhance the value of audits?

Level of Assurance to Stakeholders

Investors expect auditors to bring independence, objectivity, and professional competence to the financial reporting process. We do agree that auditors should ensure that substance prevails over form during the audit but feel it is critical to continue a multi-faceted approach in determining what opinion the auditor will express. We emphasize the need for a risk-based audit approach. This will include the auditor's responsibilities for considering the risk of error or fraud during an audit. We believe several measures could improve the level of assurance to stakeholders. These include expanding the Auditor's Report, with an Auditor's Discussion and Analysis, better disclosure of the function and role of the Internal Auditor and a full Audit Committee report which includes key issues discussed with the auditor

Better Communication by the Audit Committee

Robust communication with the auditor helps promote investor confidence by ensuring the Audit Committee has the information it needs to serve as an effective monitor. The auditor should communicate to the Audit Committee 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 complaints or concerns raised regarding accounting or auditing matters.

The Audit Committee should consider providing a summary document of its discussions with auditors to enhance shareowners' confidence in the audit process, including:

- Detailed, consistent description and amounts of all non-audit services provided by the auditors should be disclosed to shareowners
- Explanation of why individual non-audit service engagements were provided by the company's auditor rather than by another party and how the auditor's independence has been safeguarded
- The Audit Committee's policy on non-audit services, and any limitations or restrictions should be outlined
- How the Audit Committee reached its recommendation to the board on the appointment, reappointment or removal of the external auditor. This explanation should include supporting information on tendering frequency, the tenure of the incumbent auditor and any contractual obligations that acted to restrict the Audit Committee's choice of external auditors
- The rotation period of the auditors should be defined in the company's policy
- If the external auditor resigns, the Audit Committee should disclose the issues giving rise to such resignation and whether any action is required
- Whether the level of fees in respect of the audit services provided is appropriate and why the Audit Committee considered that an effective audit can be conducted for such a fee
- How the Audit Committee assessed the independence and objectivity of the external auditor annually with disclosures assuring that the auditors and their staff have no financial, business, employment or family and other personal relationships with the company which could affect the auditor's independence and objectivity

Audit Quality

We agree with the Financial Services Authority (FSA) and the Financial Reporting Council (FRC)[8] that "audit quality is influenced by many factors. Factors include the audit firm's culture, the skills and personal qualities of audit partners and audit staff and the effectiveness

[8] "Enhancing the auditor's contribution to prudential regulation", Financial Services Authority & Financial Reporting Council , June 2010

of the audit process. CalPERS also believes that an audit firm's governance has an impact on audit quality, as does the effectiveness of the audited firm's audit committee and their oversight relationship with the auditor.

CalPERS recommends that disclosure of key performance indicators should be required of audit firms in order to foster greater audit quality. These could include the level of resources devoted to staff training, the relevant experience of staff, and partner time allocated to each audit. Audit firms should also consider strengthening peer review as well as sharing key performance indicators to strengthen audit quality by both parties.

2.2 International Standards on Auditing (ISAs)

Questions

(13) What are your views on the introduction of ISAs in the EU?

As we encourage convergence to one set of high quality international accounting standards, we also encourage evolution to international auditing standards.

(14) Should ISAs be made legally binding throughout the EU? If so, should a similar endorsement approach be chosen to the one existing for the endorsement of International Financial Reporting Standards (IFRS)? Alternatively, and given the current widespread use of ISAs in the EU, should the use of ISAs be further encouraged through non-binding legal instruments (Recommendation, Code of Conduct)?

We see logic behind the suggestion of a legal process but there is benefit in using instruments such as Codes of Conduct and Audit Firm Governance Codes, which can be a more immediate and flexible response.

(15) Should ISAs be further adapted to meet the needs of Small and Medium Enterprises and SM Practitioners?

We support publicly listed companies being subject to the same standards in order to protect investors.

3. GOVERNANCE AND INDEPENDENCE OF AUDIT FIRMS

Questions

(16) Is there a conflict in the auditor being appointed and remunerated by the audited entity? What alternative arrangements would you recommend in this context?

Auditors should be appointed by the independent members of the Audit Committee and on behalf of the shareowners. The selection of the auditor should be ratified by shareowners annually.

Audit committees should expand the pool of auditors considered for the annual audit. This would help to improve market competition to the extent that a wider range of audit firms could be considered for audit services.

To give audit committees a robust foundation for determining independence, auditors should provide a three year history of relationships, and services (including tax services) with the company, affiliates of the company and persons in financial reporting oversight roles.

(17) Would the appointment by a third party be justified in certain cases?

We support shareowners continuing to ratify the appointment of the auditor.

(18) Should the continuous engagement of audit firms be limited in time? If so, what should be the maximum length of an audit firm engagement?

Audit committees should promote rotation of the auditor to ensure a fresh perspective and review of the financial reporting framework.

(19) Should the provision of non-audit services by audit firms be prohibited? Should any such prohibition be applied to all firms and their clients or should this be the case for certain types of institutions, such as systemic financial institutions?

Non-audit consulting services can impair the objectivity of the auditor. The board, through its Audit Committee, should ensure that excessive non-audit fees are prohibited. The Audit Committee should explain why individual non-audit service engagements were provided by the company's auditor rather than by another party and how the auditor's independence is safeguarded. To limit the risk of possible conflicts of interest and independence of the auditor, non-audit services and fees paid to auditors for non-audit services should both be approved in advance by the Audit Committee and disclosed on an annual basis.[9]

(20) Should the maximum level of fees an audit firm can receive from a single client be regulated?

The amount an auditor receives from a company for non-audit services may affect the independence of the auditor and introduce potential conflicts of interest. Our concern is ensuring that the fees paid to auditors are adequate to ensure the quality of the audit. We don't see the imposition of a maximum allowing sufficient flexibility.

(21) Should new rules be introduced regarding the transparency of the financial statements of audit firms?

CalPERS has as similar view as the ICGN Committee in that we support the idea that audit firms should publish audited financial statements. We believe this enhanced transparency by audit firms will provide valuable information to Audit Committees and shareowners. We also

[9] See the October 14, 2010, article titled, "Accountancy firms: A conflict of interest? A question of holding the accountants to account", The Economist, "The trend is clear. For the big four – which also include KPMG – consulting now generates between a sixth and a third of global revenue, and this figure is growing."

believe with improved transparency, audit firms will have additional incentives to raise audit quality and disclose key performance indicators to distinguish their firm's competitiveness.

(22) What further measures could be envisaged in the governance of audit firms to enhance the independence of auditors?

CalPERS supports the view that audit firms should strengthen their governance and organizational requirements to further mitigate conflicts of interest and reinforce their independence. We agree with and support the use of the Audit Firm Governance Code[10]

As noted by the Chair of the Financial Reporting Council, Baroness Hogg, "I think the focus on audit firm governance has been important and has been internationally leading in putting pressure on the audit firms to improve their own systems of governance."[11]

(23) Should alternative structures be explored to allow audit firms to raise capital from external sources?

At the present time, most audit firms are legally structured as limited liability partnerships and do not raise capital through public markets. We believe that alternative ownership structures should be examined to determine whether new structures will provide improvement not only in the governance of audit firms but also improvement in audit quality. We believe (as outlined as discussion points in the Audit Governance Code) that audit firms should consider the establishment of an independent board of directors to oversee the governance and management of audit firms in order to enhance audit quality and audit firm governance and transparency.

(24) Do you support the suggestions regarding Group Auditors? Do you have any further ideas on the matter?

We can see the value of this being further explored. However, we encourage consideration of practical matters such as individual audit firm accountability, access to reports and other documentation from auditors reviewing sub-entities and the coordination and transparency of the audit.

4. SUPERVISION

Questions

(25) Which measures should be envisaged to improve further the integration and cooperation on audit firm supervision at EU level?

(26) How could increased consultation and communication between the auditor of large listed companies and the regulator be achieved?

[10] Audit Firm Governance Code of the FRC and Institute of Chartered Accountants in England and Wales (ICAEW), January 2010.
[11] in her House of Lords testimony on November 9, 2010, The Select Committee on Economic Affairs, Inquiry on Auditors: Market Concentration and their Role, Evidence Session No. 5, transcript page 20,

We agree that the supervision of audit firms should be performed on an integrated basis with closer cooperation between the national audit oversight systems within and beyond the European Union.

CalPERS agrees that there is a need to reinforce the dialogue between regulators and auditors. We support the supervisory authority's obligation to share examination reports and findings with the independent auditors. Supervisory authorities should also make available agreements the regulator has entered into with financial institutions.
Conversely, the auditor should make available to the supervisory authorities their audit work papers, audit reports, and management letters. The external auditor should be receptive to inquiries by the authorities regarding audit scope, significant audit risks and issues, and significant audit findings, including deficiencies in internal controls, governance, or management.

If a supervisory examination occurred in the most recent period under audit, the independent auditor should be required to inquire of the supervisory authority as to significant matters and risks that came to the attention of the examiner and document how those items will be addressed in the course of the audit.

5. CONCENTRATION AND MARKET STRUCTURE

Questions

(27) Could the current configuration of the audit market present a systemic risk?

(28) Do you believe that the mandatory formation of an audit firm consortium with the inclusion of at least one smaller, non systemic audit firm could act as a catalyst for dynamising the audit market and allowing small and medium-sized firms to participate more substantially in the segment of larger audits?

(29) From the viewpoint of enhancing the structure of audit markets, do you agree to mandatory rotation and tendering after a fixed period? What should be the length of such a period?

(30) How should the "Big Four bias" be addressed?

(31) Do you agree that contingency plans, including living wills, could be key in addressing systemic risks and the risks of firm failure?

(32) Is the broader rationale for consolidation of large audit firms over the past two decades (i.e. global offer, synergies) still valid? In which circumstances, could a reversal be envisaged?

Today, medium sized and even large accounting firms are not competitive with the Big Four in terms of number of personnel, offices and a presence in other countries. In essence, much of the consolidation in earlier years was the direct result of the large accounting firms responding to the need for a cross-border presence, in order to provide audit coverage required by businesses operating internationally. In addition, the consolidation gave the large auditing firms an advantageous economy of scale that makes it difficult for smaller firms to compete. The larger auditing firms have lower overhead costs, greater presence on college campuses allowing them to recruit new hires more effectively, the ability to provide audit resources in each major country around the globe, and national offices that can provide necessary resources for accounting, auditing, local and foreign taxes and business issues.

A 2007 report by Oxera[12] examined ownership and management rules related to audit firms, their corporate structures and their access to capital. The Oxera study showed that restrictions on access to capital were one of several potential barriers for smaller firms' entry into the market. Other barriers included reputation, the need for international coverage, international management structures and liability risk. The study also determined to what extent the corporate structures adopted by audit firms, whether driven by the rules or by commercial factors, currently affect the market's ability to deliver a more open configuration that would reduce some of the concerns about concentration and choice in the audit market. Employee ownership is seen to provide important benefits to audit firms in terms of the ability to retain and develop human capital. At the same time several aspects of the employee-owned corporate form of ownership adopted by audit firms are likely to raise the required rates of return of audit firms, as well as restrict their ability to access capital in the first place. The report concludes that relaxing these rules could create new investment and entry opportunities.

CalPERS does believe that such concentration and barriers need to be addressed and ongoing discussions are helpful. We believe that Audit Committees should broaden their pool when considering who to appoint auditors from outside the Big Four and assess how best to achieve audit quality in choosing an auditor.[13] The Association of British Insurers supports increasing the choice in selecting an audit firm.[14]

BDO's Simon Michaels has testified that "The issues are much more, we think, around some of the institutional prejudice that exists there; that size and revenue in terms of size is seen as the proxy for quality and maybe that it's a safer bet to buy the Big Four rather than buying one of the mid-tier firms."[15]

[12] "Ownership rules of audit firms and their consequences for audit market concentration", http://www.oxera.com/main.aspx?id=6588, October 2007.
[13] CalPERS currently utilizes Macias Gini and & O'Connell as its external auditor and knows of other institutional investors engaging firms outside of the Big Four firms.
[14] "Governance, Accounting and Auditing Critical to the Functioning of Organizations", Michael McKersie, Assistant Director, Capital Markets at the Association of British Insurers.
[15] House of Lords, The Select Committee on Economic Affairs, Inquiry on Auditors Market Concentration and their Role, Evidence Session No. 4, transcript page 7, November 2, 2010.

6. CREATION OF A EUROPEAN MARKET

Questions

(33) What in your view is the best manner to enhance cross border mobility of audit professionals?

(34) Do you agree with "maximum harmonisation" combined with a single European passport for auditors and audit firms? Do you believe this should also apply for smaller firms?

If this concept is pursued, we believe "maximum harmonization" combined with a single European passport for auditors and audit firms should also apply to smaller firms. This concept should be discussed with audit regulators outside the European Union to further cross-border professionalism.

7. SIMPLIFICATION: SMALL AND MEDIUM SIZED ENTERPRISES AND PRACTITIONERS

7.1. Small and Medium Sized Enterprises (SME's)

Questions

(35) Would you favour a lower level of service than an audit, a so called "limited audit" or "statutory review" for the financial statements of SMEs instead of a statutory audit? Should such a service be conditional depending on whether a suitably qualified (internal or external) accountant prepared the accounts?

(36) Should there be a "safe harbour" regarding any potential future prohibition of nonaudit services when servicing SME clients?

(37) Should a "limited audit" or "statutory review" be accompanied by less burdensome internal quality control rules and oversight by supervisors? Could you suggest examples of how this could be done in practice?

CalPERS is in agreement with the ICGN Committee in that we do not support a lower level of service audit, or "limited audit", to small and medium sized listed enterprises. We understand that based on risks the statutory audit may entail some scaling but do not agree that providing special allowance to small and medium sized publicly listed enterprises is beneficial to the company, investors and shareowners. We do not support a "safe harbour" for a subset of publicly listed companies.

8. INTERNATIONAL CO-OPERATION

Questions

(38) What measures could in your view enhance the quality of the oversight of global audit players through international co-operation?

Please see the comments on international co-operation in our letter. We support further dialogue with the International Forum of Independent Audit Regulators.