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Members of the California Delegation
US House of Representatives
Washington, DC 20515

Subject: CalPERS Concerns with HR 1564

Dear Members of Congress:

We understand that House plans to consider the Audit Integrity and Job Protection Act (HR 1564) later this week and we would urge you to oppose the bill. We believe this measure would unnecessarily restrict the ability of the Public Company Accounting Oversight Board (PCAOB) to impose an auditor rotation requirement for registered public auditing firms, in the event they determine rotation is appropriate.

Clearly, auditors play a vital role in the integrity of financial reporting and the efficiency of the capital markets. As a long-term investor, and a strong advocate of reform we believe independence of an auditor is critical to investor confidence and the stability and effective functioning of the capital markets. It is the important role of auditors that brings standardization and discipline to corporate accounting which in turn enhances investor confidence.

CalPERS Global Principles of Accountable Corporate Governance (Principles) highlight the importance of auditor independence requiring audit committees to assess the independence of their external auditor on an annual basis. Also, as part of the engagement we recommend that audit committees require written disclosure from the external auditor of:

- all relationships between the registered public accounting firm or any affiliates of the firm and the potential audit clients or persons in a financial reporting oversight role that may have a bearing on independence;
- the potential effects of these relationships on the independence in both appearance and fact of the registered public accounting firm; and
- the substance of the registered accounting firm's discussion with the audit committee.

CalPERS expressly supported mandatory rotation in the wake of the scandals which led to the Sarbanes-Oxley Act of 2002. CalPERS communicated its viewto the European Parliament Committee on Legal Affairs, that "mandatory auditor rotation is an effective means of increasing auditor independence". CalPERS Principles state that "Audit Committees should promote the rotation of the auditor to ensure a fresh perspective and review of the financial reporting framework."

We believe that audit committees should endorse expanding the pool of auditors for the annual audit to help improve market competition and minimize the concentration of audit firms from which to engage for audit services. We support audit committees having the ability to determine audit independence by requiring auditors to provide 3 prior years of activities, relationships and services (including tax services) with the company, affiliate of the company and persons in financial reporting oversight roles that my impact the independence of the audit firm.

Additionally, we would note that the PCAOB's Investor Advisory Group (IAG), of which I am a member, urged the agency to consider firm rotation in the context of lessons learned from the financial crisis. The PCAOB IAG indicated that the purpose of an audit is to provide confidence to investors that an independent set of eyes have looked at the numbers reported by management and objectively without bias determined they can indeed be relied upon. If investors' confidence in this process is diminished or lost, the benefits of the audit and its costs may be questioned.

Over the last two years, the PCAOB has thoughtfully reviewed auditor independence and mandatory rotation, holding a series of roundtables on the issues. We note the issue of mandatory rotation has been addressed by the European Commission (EC). The EC has voted to draft law to open up the European Union audit services market and improve audit quality and transparency including mandatory rotation of the auditor whereby an auditor may inspect a company's books for a maximum of 14 years. We believe that it is essential and beneficial for the PCAOB to collaborate with non-U.S. regulators and standard-setters on this matter.

Ultimately, we believe that audit committees are in the best position to select the auditor. However, we are strong supporters of the PCAOB and have faith in their thoughtful approach to the regulation of the audit profession. If they ultimately conclude that mandatory rotation is appropriate, we will support this judgment consistent with our support for the position taken by the EC. Accordingly, because HR 1564 would eliminate the PCAOB's discretion in this area, we cannot support the measure and we urge you to oppose the bill.

Thank you for your consideration. If you have any questions, please do not hesitate to contact me at (916) 795-9672 (anne_simpson@calpers.ca.gov) or Don Marlais of Lussier, Gregor, Vienna & Associates - our federal representatives - at (703) 888-4522 (dmarlais@lgva.net).

Sincerely,

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Director of Global Governance