



California Public Employees' Retirement System

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Phoebe Brown  
Office of the Secretary  
PCAOB  
1666 K Street, NW  
Washington, DC 20006-2803

March 18, 2020

**Subject: PCAOB Release No. 2019-003, Concept Release, *Potential Approach to Revisions to PCAOB Quality Control Standards***

Dear Secretary:

On behalf of the California Public Employees' Retirement System (CalPERS), I write to express support for revising the PCAOB quality control (QC) standards to focus firms on improving their QC systems as outlined in the Concept Release, "Potential Approach to Revisions to PCAOB Quality Control Standards" (Release).

As the largest public defined benefit pension fund in the United States, we manage approximately \$350 billion in global assets on behalf of more than 1.9 million public employees, retirees, and beneficiaries. Our duty to pay benefits decades into the future requires that we take a long-term view in assessing whether the companies that we hold in our portfolio are effectively managed. Financial reporting plays an integral role in this assessment by providing transparent and relevant information about the economic performance, conditions, and operations of businesses. 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.

CalPERS supports the PCAOB's approach in the Release to update and improve the QC standards that provide a framework for accounting firms to perform high-quality audits. There is no need to reinvent the wheel; the existing International Auditing and Assurance Standards Board's (IAASB) standards, when complete, will represent a good starting point for the PCAOB that can be tailored to fit the specific needs of the U.S. market as outlined in the Release. Many accounting firms are multi-national organizations using world-wide auditing practices and are already familiar with the IAASB standards which will ease the transition.

We would like for the PCAOB to consider investor-related issues, such as enhancing independence in audit firm leadership structures, enhancing transparency and promoting more timely information to investors to improve investment decision-making, and guiding additional focus of the accounting and auditing industry on long-term risks. CalPERS believes that the Release is a step in the right direction but would caution the PCAOB from using the new standards as an opportunity to replace or weaken existing regulations. We have noted intense lobbying by audit firms and their organizations to reduce auditing regulations which runs counter to actually enhancing QC standards. This would create a situation where the audit firms will be able to report more substantial compliance with weaker regulations but leaves investors reliant on those reports at greater risk. We would also like to see a greater focus on risk, not just to audit quality but risk to the audited companies as going concerns, such as long-term sustainability risks, including climate risk.

Our responses are limited to certain questions addressed below.

***Question 1 – Should PCAOB QC standards be revised to address developments in audit practices and provide more definitive direction regarding firm QC systems?***

Yes. We applaud the effort to update the QC standards to reflect the changed environment and other developments in the auditing profession, including the increased use of technology and service delivery centers. Certain audit firms have taken steps to enhance quality on their own. It is important that the new requirements support and broaden the positive efforts.

***Question 2 – Is it appropriate to use ISQM 1 as the basis for a future PCAOB QC standard?***

It is logical to begin with the ISQM 1 standards rather than attempting to develop a bespoke PCAOB QC standard. We support using ISQM 1 as a base, but we acknowledge that it ISQM 1 has not been completed. Once complete, ISQM 1 will need certain tailoring for the US market. The Release provides a workable plan to complete QC standards for the US market.

***Question 7 – Would the approach to quality control standards described in this concept release be preferable to the current PCAOB quality control standards?***

Yes. The approach described in the Release would constitute a needed update and an improvement over the existing standards without creating a significant disruption. A major part of the update includes catching up, in part, to where the industry has progressed.

***Question 17 – Should a future PCAOB QC standard incorporate mechanisms for independent oversight over firms' QC systems (e.g., boards with independent directors or equivalent)?***

CalPERS advocates for independence throughout our system of governance, including corporate boards, audit committees, and audit firms as an effective mechanism to bring the transparency, focus and independent judgment needed to oversee the company's risk management approach. Therefore, having independence within the governance structure strengthens investor trust in the system. Independent directors can mitigate concerns over a firm being too commercially driven. Section D.4. of CalPERS' Governance & Sustainability Principles (Principles) states that, "Auditors should bring integrity, independence, objectivity, and professional competence to the financial reporting process." The Principles also call for

companies to assess the independence and objectivity of the external auditor. Having high level independent oversight in a company's governance structure provides an objective point to mitigate concerns with conflicts of interest as well as assessing the effectiveness of the auditor. We support more independent governance structures and would like it to become a central part of audit firm governance.

***Question 18 – Is the approach to the firm's risk assessment process appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?***

CalPERS agrees with the SAG members supporting revision of the PCAOB QC standards to add requirements for identifying, assessing, and responding to quality risks. The IQSM 1 requirements constitute an improvement to the current standards. We would embrace additional transparency and investor friendly enhancements.

***Question 19 – Are principles-based requirements sufficient to prompt firms to appropriately identify, assess, and respond to risks, or is supplemental direction needed? If supplemental direction is needed, what requirements would assist firms in identifying, assessing, and responding to risks?***

Conceptually, principles-based requirements should be enough for audit firms operating with the appropriate QC standards; however, in practice in the U.S., there is a need to have line-item requirements to make certain that audit firms operating at the tail-end of the quality distribution curve improve quality. Culturally, some U.S. market participants refrain from taking actions that are not required. The question turns on whether the PCAOB would like to improve average performance or have a greater impact on the riskiest firms. Ideally, standards may be developed that address both and yield improvements by the weaker performers while improving average quality. We do acknowledge the difficulty in crafting a one-process-fits-all approach, but principles-based requirements are not enough without a shift in culture.

***Question 35 – Should a future PCAOB QC standard expressly require firms to design and implement controls to prevent unauthorized access to technology and data?***

Yes. It is essential that audit firms keep client information safe. This should be a baseline requirement.

***Question 39 – Should a future PCAOB QC standard require public disclosure by firms about their QC systems? If so, what should be the nature and timing of such disclosures (e.g., information about the firm's governance structure)?***

Firms should discuss their QC systems regularly, but at a minimum, annual reports should transparently disclose how the firm ensures that it produces high-quality audits. It would be important for the audit firm to disclose its audit quality indicators (AQIs). At this time, it is possible that agreement could be reached on a few AQIs that should be included in all reports given improvements in technology and a changing market.

Again, CalPERS appreciates the focus on high-quality audits through QC standards. Thank you for considering our views. We look forward to continuing to work with Congress as governance

and diversity initiatives are considered. Please do not hesitate to contact Danny Brown, Chief of our Legislative Affairs Division, at (916) 795-2565, if we can be of any assistance.

Letter body text goes here.

Sincerely,

Marcie Frost  
Chief Executive Officer

cc: Danny Brown