



California State Teachers'  
Retirement System  
Anne Sheehan, Director of Corporate Governance  
100 Waterfront Place, MS-04  
West Sacramento, CA 95605-2807  
(916) 414-7410  
asheehan@calstrs.com

August 23, 2017

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

via Email: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Re: [File Number PCAOB-2017-01, Release # 34-8117 "The Auditor's Report"](#)

Dear Mr. Fields,

I am writing on behalf of the members of the California State Teachers' Retirement System (CalSTRS) in response to the Securities and Exchange Commission's (SEC, Commission) request for comments on the Public Company Accounting Oversight Board (Board, PCAOB) adoption of new rules and amendments to auditing standards (AS3101) to make the auditor's report more informative and relevant to investors and other financial statement users.

Thank you for the opportunity to provide our comments supporting the adoption of an auditing standard to enhance the auditor's report. We view this standard which extends and heightens the importance and value of the auditor's report as strengthening the integrity and financial reporting quality by providing meaningful direct disclosures by the external auditor. CalSTRS can affirm from our perspective as a long-term investor, the communication of critical audit matters (CAMs) provides an augmented basis from which investors can more fully understand challenging, subjective or complex auditor judgement which serves as the foundation of evidence for the auditor's opinion and investor confidence. CalSTRS recommends the SEC expeditiously approve the PCAOB's adoption of AS3101 on the auditor's report. We strongly support the adoption of this standard as it builds on more than six years of Board outreach in which many investors including CalSTRS reinforced the need to make the auditor's report more relevant and informative.

CalSTRS is the largest educator only pension fund in the world, with a global investment portfolio valued at approximately \$213.5 billion as of July 31, 2017.<sup>1</sup> CalSTRS' mission is to secure the financial future and sustain the trust of California's educators. We serve the

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<sup>1</sup> CalSTRS Current Investment Portfolio for the period ending July 31, 2017.  
<http://www.calstrs.com/current-investment-portfolio>

investment and retirement interests of approximately 914,000 plan participants and their beneficiaries. It is important to us with long-term nature of CalSTRS liabilities, the composition of our portfolio with more than fifty six percent (~\$119.7 billion) of our current fund's assets being invested in the public equity market; that rules and regulations are structured to ensure investors more fully understand the auditor's planning and gathering of sufficient competent evidential matter, to not only support the external auditor's opinion but also to associate and grasp how critical audit matters relate to accounts or disclosures that are material to the financial statements. CalSTRS relies on the quality and soundness of financial reporting and believes a robust auditor's report is integral to our capital allocation analysis done on behalf of our beneficiaries. CalSTRS has a vested interest in ensuring the integrity, stability and efficiency of the capital markets to pay out benefits to CalSTRS' beneficiaries, California teachers.

CalSTRS agrees with the statement of James R. Doty, Chairman of the PCAOB that "the new standard will breathe new life into a formulaic reporting model." We also agree that, "in today's complex economy, and particularly in light of lessons learned after the financial crisis, investors want a better understanding of the judgments that go into an auditor's opinion...the specific judgments that were most critical to the auditor in arriving at the opinion."<sup>2</sup> As stated in our 2016 letter to the PCAOB, "CalSTRS believes the proposed rule changes (auditor's reporting) will provide four important attributes – transparency, relevance, reliability and credibility. Investors are the intended beneficiaries of public company audits, with shareholders capital paying for the auditor's report."<sup>3</sup>

As you are aware, the International Auditing and Assurances Standard Board (IAASB) adopted new and revised auditor reporting standards designed to enhance auditor's reports for investors and other users of financial statements. These standards are effective for audits of financial statements for periods ending on or after December 15, 2016. The intended benefits of the expanded audit report included:

- Enhanced communication between auditors and investors, as well as those charged with corporate governance
- Increased user confidence in audit reports and financial statements
- Increased transparency, audit quality, and enhanced information value
- Increased attention by management and financial statement preparers to disclosures referencing the auditor's report
- Renewed auditor focus on matters to be reported that could result in an increase in professional skepticism and
- Enhanced financial reporting in the public interest.

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<sup>2</sup> Statement on Adoption of an Auditing Standard on the Auditor's Report, James R. Doty, Chairman, June 1, 2017. <https://pcaobus.org/News/Speech/Pages/Doty-statement-auditors-report-standard-adoption-6-1-17.aspx>

<sup>3</sup> CalSTRS comment letter, Anne Sheehan, Director of Corporate Governance, August 12, 2016. [https://pcaobus.org/Rulemaking/Docket034/042c\\_CalSTRS.pdf](https://pcaobus.org/Rulemaking/Docket034/042c_CalSTRS.pdf)

The SEC has the opportunity to make a difference and approve the PCAOB's adopted rules on the auditor's report. As noted by Matt Waldron, Technical Director at the IAASB, "Similar expanded audit report rules are already in force in the United Kingdom, Europe and other parts of the world; all told 124 countries have adopted or are adopting those standards."<sup>4</sup>

CalSTRS believes adoption of the enhanced audit reporting standard will amplify similar benefits appreciated by global investors. One example that demonstrates the need for this rule change is the disparity which currently exists in audit reports issued for the same company depending on jurisdiction audit disclosures requirements. This gap is apparent in the quality, and type of disclosures provided to investors of Aegon NV. The Aegon audit report issued by PricewaterhouseCoopers (PwC) in the Netherlands issued an eight page qualitative report outlining materiality and key audit matters.<sup>5</sup> Whereas the same auditor, PwC, issued a one page template audit report which only provided minimal information or insights to investors through Form 20F filing with the SEC<sup>6</sup>. The divergence is the current audit report standard by the PCAOB and SEC versus the new auditor's report standard by the IAASB.<sup>7</sup> In reading both auditors' reports, the value to investors is easily discernible. The SEC should approve the PCAOB's adopted rules on the Auditor's Report and require a rapid adoption effective for audits of financial statements for periods ending on or after December 2017.

CalSTRS does not believe the expanded audit report will lead to increased liability costs for businesses and audit firms. Yet, there are still some that continue to express their concerns that the expanded audit report standard will not only increase liability but will disrupt audit committee-auditor communications. Notwithstanding these comments, CalSTRS recognizes the PCAOB's thoughtful and rigorous review of all comments received over the last 6 years prior to recommending adoption of the new auditor reporting standard. There isn't any evidence that the IAASB's standard has created more liability or agitated the relationships between the audit committee and the auditor. Lynn Turner, a former chief accountant at the SEC thinks the opposite, "the obligation to come clean on critical items in the report means that auditors will have more ability to push back on management."<sup>8</sup>

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<sup>4</sup> Intelligent Investor, "New Rule Could Bring Sunshine to Markets," by Jason Zweig, Wall Street Journal, Business & Finance, August 19, 2017. <https://blogs.wsj.com/moneybeat/2017/08/18/how-a-new-audit-rule-could-bring-sunshine-to-u-s-markets/>

<sup>5</sup> Aegon, Independent auditor's report, 2016 Annual Report, pages 319-327. <https://www.aegon.com/contentassets/ba816ee01cd54e9abcd942f2fb9fcfe/aegon-annual-report-2016.pdf>

<sup>6</sup> Aegon, Auditor's report on the 2016 Annual Report on Form 20-F, page 332. <https://www.aegon.com/contentassets/62a62a4b50b14e0e829672a368087113/aegon-annual-report-2016-on-form20f.pdf>

<sup>7</sup> IAASB, The New Auditor's Report, <http://www.iaasb.org/new-auditors-report>

<sup>8</sup> Intelligent Investor, Wall Street Journal, August 19, 2017. <https://blogs.wsj.com/moneybeat/2017/08/18/how-a-new-audit-rule-could-bring-sunshine-to-u-s-markets/>

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Secretary  
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Additionally, we support the disclosure of the tenure of the auditor with a statement containing the year the auditor began serving consecutively as the company's auditor, not only for informational purposes but also to advance the Audit Committee's fiduciary responsibility in determining the appropriate maximum length of tenure to ensure the independence of the auditor. CalSTRS Corporate Governance Principles support companies clearly articulating their policy on audit firm rotation.<sup>9</sup>

In our previous letters to the PCAOB, we outline our continued support, request and desire for a more robust audit report.<sup>10</sup> We hope our summary perspective as a long-term investor provides our critical support for the SEC to purposefully adopt the PCAOB's adopted rule on the expanded audit report. If you have any questions or would like to discuss this letter further, please do not hesitate to contact me at 916-414-7410, [ASheehan@calstrs.com](mailto:ASheehan@calstrs.com) or Mary Hartman Morris, Investment Officer at 916-414-7412, [MMorris@CalSTRS.com](mailto:MMorris@CalSTRS.com).

Sincerely,



Anne Sheehan  
Director of Corporate Governance  
California State Teachers' Retirement System

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<sup>9</sup> CalSTRS Corporate Governance Principles, III. B. 4. page 9, November 16, 2016.  
[https://www.calstrs.com/sites/main/files/file-attachments/corporate\\_governance\\_principles\\_1.pdf](https://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf)

<sup>10</sup> CalSTRS letter to the PCAOB, Phoebe W. Brown, and Secretary regarding the Auditor's Report, August 12, 2016.  
[https://pcaobus.org/Rulemaking/Docket034/042c\\_CalSTRS.pdf](https://pcaobus.org/Rulemaking/Docket034/042c_CalSTRS.pdf)

CalSTRS letter to the PCAOB, February 11, 2014.  
[https://pcaobus.org/Rulemaking/Docket034/237b\\_CalSTRS.pdf](https://pcaobus.org/Rulemaking/Docket034/237b_CalSTRS.pdf)