STATE BOARD OF ADMINISTRATION
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February 14, 2005

Office of the Secretary
Public Company Accounting Oversight Board (PCAOB)
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 017

Dear Sir or Madam:

The State Board of Administration (SBA) of Florida is writing in support of the PCAOB's proposed "ethics and independence rules concerning independence, tax services, and contingent fees." Managed by the SBA, the Florida Retirement System (FRS) is the fourth largest public pension plan in the United States with approximately 850,000 beneficiaries and retirees, and assets totaling approximately $110 billion.

The SBA, as a large institutional investor in global capital markets, has a significant interest in promoting the highest ethical and independence standards of registered public accounting firms. Accurate financial information is necessary in order for investors to make reasonably informed decisions and for the orderly functioning of the U.S. capital markets.

We believe that tax compliance services should be permitted, but only if the audit committee 1) pre-approved such services, 2) found those services to be in the best interest of the shareholders, and 3) provided disclosure of that finding to investors in the annual proxy to shareholders. In pre-approving all non-audit services provided by an independent accountant, the audit committee should have all the relevant facts including the terms of the engagement as set forth in the engagement letter. Without such a framework, it is difficult to understand how an audit committee can make a finding consistent with the SEC's rules.[1] Historically, engagement letters have not commonly

[1] Regulation S-X, Article 210.2-01(b) states: "The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission."

been provided to audit committee members, including instances of inappropriate contingent fees where members may have been unable to exercise the proper judgment and oversight.

The SBA believes that large amounts of non-audit revenues received for providing non-audit and other consulting services can impair a firm's ability to independently review a company's financial situation. A survey of financial analysts by The CFA Institute noted that non-audit fees that exceeded 50 percent of audit fees caused a majority of the analysts to conclude an auditor's independence was impaired. The report of the Conference Board Commission on Public Trust and Private Enterprise states:

> "The Commission believes that any work performed by the company's outside auditors be closely related to the audit. Auditors' development and recommendations of new tax strategies for their clients is not closely related to the audit and, in our opinion, removes focus from their audit work and poses a potential conflict of interest."[2]

In 2000, the SEC adopted revised auditor independence rules and has required proxy disclosure of billing for auditing and other types of services. These standards assure investors that the auditor of a company's financial statements has no other financial interest at stake with the company, and, therefore, it can be objective. The SBA believes strongly that a corporate audit committee's responsibility is to determine that an auditor's non-audit work for the company will not jeopardize the auditor's independence and to pre-approve such work.[3] Ideally, a company's external auditor should not perform *any* non-audit services for the company, except those required by statute or regulation.

<u>The SBA believes an auditor should *not* provide tax planning including tax opinions, structuring, shelter or expatriate type services to a company they audit.</u> An auditor should not provide a tax opinion on tax issues that subsequently must be examined by the independent auditor in connection with an examination of the financial statements. In some instances (e.g., expatriate tax work), tax services do not contribute to the quality of an audit; rather such service raises concerns and may not be in the best interest of shareholders.

Additionally, an auditor's independence is impaired when they are providing tax services to senior officers of an audit client, as well as those on the Board of Directors in an oversight role (i.e., members of the audit committee). If so, such services can put the auditor into the conflicted position of having to serve the interests of these individual officers that at times, may conflict with those of shareholders. Accordingly, we believe the PCAOB should expand its proposal to prohibit tax services being provided to at least the members of the audit committee of the board of directors.

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[2] *Report of the Commission on Public Trust and Private Enterprise.* The Conference Board, 2003, Page 41.
[3] The SBA's *Corporate Governance Principles & Proxy Voting Guidelines* also supports annual ratification of the independent audit firm by shareholders (available at www.sbafla.com).

We concur that an auditor should be prohibited from entering into contingent or commission fee arrangements with a company they audit. Finally, we believe the SEC's definitions of key terms, such as an affiliate of an accounting firm, should be emulated by the PCAOB to avoid differences that could contribute to confusion among auditors.

In their public interest role, auditors are to make an independent and unbiased examination of a company's financial statements and render an opinion as to whether they fairly present the results of operations, cash flows and financial condition of the company. I commend the PCAOB's efforts towards achieving meaningful auditor independence reforms.

Sincerely,

Coleman Stipanovich
Executive Director

cc: Mr. Donald Nicholiasen, Chief Accountant, SEC
Ms. Ann Yerger, Exec. Dir., Council of Institutional Investors
Mr. Kurt Schacht, Exec. Dir., CFA Centre for Financial Market Integrity