Letter to Members of the House-Senate Conference Committee
From Jack Ehnes
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California State Teachers' Retirement System

This letter is being sent by the California State Teachers' Retirement System (CalSTRS) to strongly urge the Conferees to adopt the tough protections enacted in the Public Company Accounting Reform and Investor Protection Act of 2002, as passed by the Senate. These provisions make significant and meaningful financial reporting and corporate accountability reforms to restore confidence in the financial reports on which investors rely and provide increased protections for the nation's capital markets. These provisions address many of the specific concerns that the Teachers' Retirement Board, which administers CalSTRS, has identified during this troubling year.

CalSTRS is a public pension fund, established for the benefit of California's public school teachers almost 90 years ago. CalSTRS represents approximately 687,000 members and retirees and has assets of about $100 billion. A significant portion of CalSTRS' domestic equity assets are passively managed or indexed, thus making us very long term holders in the U.S. equity market. Institutional investors with similar long-term profiles are not just investors; they are long-term owners who have a vested interest in the long-term value of corporations.

Throughout the year, the Teachers' Retirement Board has been very concerned about the activities of various major corporations and their accounting firms that have resulted in major restatements of financial reports and corresponding disruptions to financial markets and the lives of employees and investors. Recent revelations, after the House passed its legislation, point out the urgent need to improve the governance practices of corporations to restore the confidence of both institutional and individual investors in publicly-held companies. The provisions enacted by the Senate will significantly address that need.

CalSTRS holds the view that external auditors should be severely limited in their ability to perform non-audit work for corporations. In other words, external auditors generally should not perform consulting work for a client while also performing the audit of the corporation. Naturally, we refer to listed companies here as we are concerned about investor confidence in the public markets. The Senate provisions impose significant constraints on the non-audit activities of auditing firms.

The Teachers' Retirement Board has been concerned about the need to ensure the accuracy and independence of audit reports. CalSTRS supports proposals in the Senate version that strengthen the accountability of corporate officers by requiring both the Chief Executive Officer and the Chief Financial Officer to certify the accuracy of the audit report, requiring the forfeiture of compensation paid to these executives if a restatement of a financial report is required as a result of corporate misconduct, and making it illegal for an officer or director to influence, coerce, manipulate or mislead an outside accountant in the course of an audit. CalSTRS also supports provisions that prohibit an accounting firm from performing an audit of a company that hired a senior financial officer from that firm within the prior year. CalSTRS also supports the imposition of independence and competency requirements on the public company audit committees. Further, CalSTRS supports provisions in the Senate version that prohibit the listing of companies that fail to comply with these audit committee independence requirements. We believe that since attracting capital at the most inexpensive rate is a fundamental mission of corporations, a de-listing proposal will be effective. It also has the benefit of being both simple and expeditious to apply.

CalSTRS also supports efforts to ensure the independence of research analysts who make recommendations on securities and who work for firms with investment banking relationships with those same recommended companies. This month, the Teachers' Retirement Board adopted principles that direct CalSTRS staff, in determining whether to retain money management firms or financial organizations that provide investment banking services, to consider the extent to which the firm maintains specific policies that insulate the analyst from influence by the investment banking staff of that firm. CalSTRS supports provisions in the Senate bill that adopt similar principles nationwide.

CalSTRS also supports provisions that address the issue of accounting oversight by establishing an official body that has investigatory and disciplinary power. CalSTRS believes that it is important to ensure that all relevant workpapers are kept intact for auditing purposes. CalSTRS supports provisions that ensure the preservation of audit workpapers for a period of five years from the end of the fiscal period in which the audit or review was concluded.

As investors, we find ourselves amidst some of the worst cases of corporate fraud in our nation's recent history. CalSTRS believes that it is important for Congress to strengthen the deterrents to corporate fraud, and supports the review of federal sentencing guidelines for obstruction of justice and extensive criminal fraud. First, CalSTRS supports provisions enhancing criminal liability and penalties for defrauding shareholders of publicly traded companies, as well as the disgorgement of ill-gotten gains of said criminals. Second, CalSTRS supports the provisions that prohibit the discharge of debt in a bankruptcy if the debt was incurred as a result of securities fraud, as we believe that those who have committed securities fraud should not be able to hide behind the shield of bankruptcy to avoid investor lawsuits. Third, CalSTRS also supports provisions in the Senate bill that extend the period of limitations for securities fraud cases brought by investors against public corporations. Finally, CalSTRS believes in the importance of protecting corporate whistleblowers who provide valuable information in connection with disclosure of fraud to regulators.

The American market is the most successful example of profitable capitalism in the world and Congress takes a large part of the credit for that success. The creation of the Securities and Exchange Commission almost 70 years ago and the strengthening of financial disclosure and transparency go to the heart of the free-market that we enjoy today. Our long-term liabilities mandate that we be fully invested, that a large portion of that investment be in public equities and further, that the majority of the investment in public equities is held in the domestic market.

CalSTRS applauds the current initiatives to restore financial market credibility, and provide better protection for, and more accurate information to public retirement systems and the millions of other investors in U.S. financial markets, as well as the provisions that impose criminal penalties on persons who commit egregious violations of securities laws, and other provisions that would increase corporate and criminal fraud accountability.

CalSTRS commends the efforts of Congress to address these pressing problems, and strongly urges the Conferees to adopt the Senate version of the Public Company Accounting Reform and Investor Protection Act of 2002. If you would like to discuss CalSTRS' positions on these matters and related issues, please feel free to contact me at (916) 229-3706.