

NEW YORK STATE COMPTROLLER H. CARL McCALL

TESTIMONY
Before the
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

March 20, 2002

Good morning Chairman Oxley, Ranking Member LaFalce and members of the Committee. Thank you for giving us this opportunity to address issues of corporate accountability and investor confidence. In the past few months, Americans have learned that the integrity of the financial markets and, in fact, the economic well-being of our country depend on these issues.

I commend the Committee for holding this hearing. It's essential that we have a national discussion on these issues. I assure you, our future depends on it.

We need action at the Federal level to prevent another "Enron" in the future. I applaud my good friend, Congressman LaFalce, for his leadership in introducing the Comprehensive Investor Protection Act of 2002.

As Comptroller of the State of New York, I serve as sole Trustee of the State's \$112 billion Common Retirement Fund – the pension fund for nearly one million New York State and local government employees and retirees. The Fund owned nearly 4 million shares of Enron through its index portfolio and active managers prior to the company's catastrophic downfall. Our losses are expected to exceed \$58 million.

While our Fund is strong enough to absorb the financial blow inflicted by these corporate collapses, we are deeply shaken by the lack of diligent oversight by the independent auditors, boards of directors, rating agencies and analysts on whom investors rely.

And we are not alone. In fact, I believe that the loss of investor confidence is the most devastating effect of the corporate collapses experienced over the last several months.

And if we don't restore that confidence quickly and completely, the consequences will be immeasurable.

The bill before the Committee today – the Corporate and Auditing Accounting, Responsibility and Transparency Act of 2002 – offers measures for enhanced auditor oversight. However, this is no time for small steps. I believe additional

standards are necessary to ensure the restoration of investors' confidence in auditors and their findings.

The Comprehensive Investor Protection Act that Congressman LaFalce introduced goes much further towards that goal. I urge the Committee to consider a legislative compromise that includes some form of the provisions included in the Comprehensive Investor Protection Act that would correct what is currently a failed regulatory structure. I am speaking, in particular, of provisions that align with recommendations I've made as New York State Comptroller.

Let me explain.

First, we need standards to make auditors more independent from the companies they audit. I've submitted proposals to the Securities and Exchange Commission and to the "Big 5" auditing firms and called on companies to take three steps:

1. Prohibit auditors from providing non-audit services to audit clients except under limited circumstances.
2. Limit audit relationships to a maximum of seven years.
3. Restrict auditors from accepting employment with clients for two years following work on an audit.

In short, auditor independence is critical to long-term shareholder value and confidence. That's why I supported the SEC's proposed revision of Auditor Independence Requirements in 2000 – and why I submitted these proposals. And that is why I have pushed for change in my various roles as a public servant.

As a state official, I introduced legislation that would require all New York State agencies to adopt these standards in their relationships with auditing firms. In addition, I issued an Executive Order to implement these standards in the Office of the State Comptroller.

I believe these are important steps towards achieving meaningful auditor independence. But we can't achieve comprehensive reform on a state-by-state basis. We also need a national effort. For this reason, the provisions in the Comprehensive Investor Protection Act that promote auditor independence are extremely important.

As a shareholder, I have adopted a proxy voting policy to oppose the appointment of any auditor that also performs non-audit services to the company.

I also sent a letter to the Common Retirement Fund's 50 largest holdings, explaining our proposed standards and requesting information about how long companies have retained their current auditor. This information will be used to determine our proxy voting policies going forward.

I sent another letter to all of our private equity partnerships, asking them to urge their portfolio companies to adopt policies that promote auditor independence. As private equity firms take companies public, it will be beneficial to the markets for these policies to be already in place.

As Comptroller, I can take these steps at the Common Retirement Fund, and I can encourage my counterparts around the country to do likewise, but it is essential that we hear from Washington on these matters. It is essential to know that our legislators share our commitment to investor protection. The work of this Committee sends a vital signal to all investors.

To ensure that I continue to develop appropriate proposals to increase investor protection, I have also created a panel of advisors who will focus specifically on measures that enhance board independence and corporate accountability and minimize conflicts of interest in the marketplace.

As a last resort, I have also taken legal action against Enron. I filed a Notice of Joinder in the U.S. District Court for the Southern District of Texas in support of a legal application to freeze the assets of directors and executives who may have benefited from stock sales based on information that was not available to other shareholders.

I applaud this Committee for seeking input from a variety of sources, especially from the private sector. While it is critical that government play a pro-active role in restoring investor confidence, it is essential that the private sector act, as well.

As a member of the Board of the New York Stock Exchange, I serve as co-chairman of the Committee on Corporate Accountability and Listing Standards. The Committee will review corporate governance and shareholder accountability issues such as the composition of corporate boards and committees, disclosure requirements and the role of independent audit committees. The Committee will also consider new listing standards that would have a profound impact on the marketplace.

In closing, I would like to say that I am acutely aware of my fiduciary responsibility to the retirees and hard-working people of New York State. Their ability to enjoy an economically secure retirement depends on the faithful and prudent investment of the Common Retirement Fund.

In nine years as Comptroller, I have never heard from as many members of the pension systems as I have in the past few months. They are nervous and frightened, and beginning to question the rationality of equity markets generally.

This is not an encouraging sign for the marketplace. We must restore their confidence. Each of us – fiduciaries, legislators and regulators – has a role to play.

I thank you for your reasoned and constructive approach to the important issues before us. I look forward to working together with you to restore investor confidence and ensure the long-term viability of the American marketplace.

Again, I thank Chairman Oxley, Ranking Member LaFalce and members of the Committee for allowing me to testify today.