



Colorado Public Employees' Retirement Association

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October 6, 2008

Testimony of

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**Before the
United States House of Representatives
Committee on Oversight and Government Reform
Causes and Effects of the Lehman Brothers Bankruptcy**

Chairman Waxman and Members of the Committee on Oversight and Government Reform:

Thank you for the opportunity to address the Committee regarding the failure of Lehman Brothers. As an entity responsible for the retirement security of over 420,000 public servants we believe it is important at the outset to recognize that the impact of the failure of Lehman extends far beyond the fat cats on Wall Street. In light of the melt down of our capital markets in recent weeks we can safely conclude that the crisis has arrived on every main street in America. Every man or woman with a 401(k), an IRA or a retirement plan of any kind is feeling the effects of the collapse and is facing life changing adjustments to his or her financial planning.

We at the Colorado Public Employees' Retirement Association (CoPERA) are entrusted as fiduciaries with investing retirement assets of every state employee, Judge, State Trooper, K through 12 teacher (except those in Denver), and many employees of local units of government. Each and every month we are responsible for putting to work more than \$125 million of contributions from our membership in a diversified portfolio. In the past year CoPERA has paid benefits of over \$2.5 billion to over 80,000 retired public servants helping to fuel the economy of communities throughout Colorado. Our asset base as of our most recent audited financial statements was \$43 billion.

In order to meet the needs of our membership we, like our peers that exist in virtually every state in the nation, are entirely dependent on the strength, efficiency, and transparency of our capital markets. What has become apparent in recent weeks is that the strength of our markets is ultimately entirely dependent upon the confidence of investors. Confidence that the environment in which they are considering investing is an environment that promotes investor rights and policies which further the interests of investors. Confidence that violations are the subject of enforcement actions and perpetrators are held accountable. Confidence that the financial statements presented to investors by management are compliant with accounting standards that are designed to reflect all the information relevant to financial analysis. Confidence that a rigorous audit process has verified management's representations and the adequacy of internal controls in the company to prevent fraud. In each of these critical areas of investor confidence we have experienced significant deterioration in recent years and remain at significant risk for further erosion.

We do not presume to know or be able to articulate what it will take to restore investor confidence in the markets so as to allow the current seizure of the markets to be alleviated. Nor do we profess to know the ultimate outcome of what will undoubtedly be an extensive effort to allocate blame and responsibility for the recent events including Lehman's collapse. We do believe we can provide a perspective on what resources are essential to long-term confidence and what tools are essential for investors going forward.

At the outset there must be a regulatory environment that is realigned with the interests of investors rather than the recent alignment with corporate management. Transformation of the regulatory environment requires sustained funding of the applicable regulatory bodies in a manner that does not breed conflicts or promote policies adverse to investors. Sustained investor confidence requires a regulatory framework that allows investors an opportunity to be heard in a meaningful and timely way through access to the corporate proxy by investors, through say on pay for investors regarding executive compensation, and through an unwavering commitment to pursue corporations and individual executives who disregard the duty owed to the shareholders. We respectfully refer the Committee to a compilation of articles which provide a valuable overview of the SEC's recent funding history and enforcement activities. See Appendix A.

Long term investor confidence would be promoted by restoring the quality of the disclosure and transparency standards historically imposed on companies that want to access the U. S. markets. The standards for accounting must not permit off balance sheet liabilities to go undisclosed, must require that valuations be based on market values of assets and must accurately reflect the operations and current financial condition of the reporting entity. The offloading of bad debt and obfuscation of leverage through the use of off balance sheet entities has devastated investor confidence. The reliability of the numbers reported by management and the perception by investors of transparency in the financial reporting by corporate America has disappeared. The shift from U.S. Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS) presently under consideration by the SEC is premature and should only occur in the event the International Standards are developed further. The current void of investor confidence would likely not be aided by a shift to unfamiliar standards that alter the nature and extent of disclosures required of companies, the thresholds of materiality and are silent on a broad array of issues addressed by GAAP. The Council of Institutional Investors (CII), a nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion, has conducted extensive analysis of the convergence of accounting standards issue. We respectfully ask the Committee to consider the attached Appendix B response by CII to a recent Concept Release on the issue by the SEC and a white paper prepared at the request of CII by Professor Donna L. Street, Mahrt Chair in Accounting, University of Dayton.

The recent suggestions that mark to market or fair value accounting should be abandoned would merely provide a short term disguise for the problem and ultimately undermine market strength. The demise of fair market valuation of assets would render the balance sheets and financial reporting of affected companies essentially meaningless to any investor attempting to make a rational and informed decision regarding investing in the company. We respectfully refer for the Committees consideration a white paper titled "Fair Value Accounting: Understanding The Issues Raised by the Credit Crunch", prepared for CII by Stephen G. Ryan, Professor of Accounting and Peat Marwick Faculty Fellow, Stern School of Business, New York University. See Appendix C.

Finally, the most fundamental tool used in the investment process is the independently verified financial statements of a company. The accuracy and thoroughness of the financial disclosures are the critical foundation for sound financial analysis. As fiduciaries, our reliance upon audited financial statements has long been recognized as reasonable and appropriate. This reliability has been based on the fact that a qualified and independent auditor has reviewed the internal operations of the company, assessed its internal controls, as well as the systems within the organization, and conducted random statistically appropriate samplings to verify the accuracy of the accounts presented by management. Based on the examination, the auditor or audit firm has certified the accuracy of the disclosures and attested to the appropriateness of the internal controls and operations. Further, if the auditor's certification proves inaccurate or defective, they have traditionally been accountable through both regulatory sanctions and civil liability.

The importance of our ability to rely upon audited financials in our investment decision making cannot be overstated. However, the very features which have allowed us to rely upon the auditors' verification and certification have been under vigorous attack by the auditors themselves for several years. The result has been Congressional limits on accountability and judicial decisions severely limiting investor recourse against audit firms. Recently an active effort has been under way to attain even greater protections by audit firms. The audit function is a critical element in the reliability of managements' representations and thus the investors' perception of transparency. The practice standards for public company auditors and their accountability for breach of those standards must be strengthened and clearly established.

Viewed in their totality, these developments are a call to action for Congress to restore the U.S. market framework in a manner that attracts investment capital and promotes investor confidence. A return to genuine transparency within a regulatory environment where investors set priorities and have a voice that is heard and acted upon.

Thank you for the opportunity to convey our perspective during these critical times.

Respectfully submitted by
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Colorado Public Employees' Retirement Association