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STAY TUNED ... to 2004: Changing Environment Means Challenges & Opportunities for IROs

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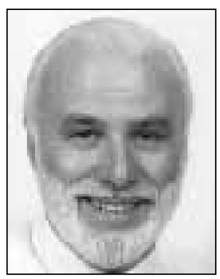
STAY TUNED ... to 2004: Changing Environment Means Challenges & Opportunities for IROs

by Hank Boerner

Dramatic events in recent years underscored the importance to investors of effective financial reporting, timely disclosure, accurate and independent financial analysis and research and regulatory compliance. The coming confluence of critical trends and events will bring important challenges for companies and could present unique opportunities for IROs. There is potential to bring boards, CEOs, CFOs and IROs closer together to help the corporation communicate more effectively with investors. 2004 is the year for IROs to get involved in key issues at their companies. Here's a preview of coming events ...



Hank Boerner

Stay Tuned ...as companies work to comply with Sarbanes-Oxley and resultant SEC rules and regulations, most of which will be in full force in 2004. These powerful forces will drive immediate change and intimately shape boardroom and executive suite behavior. SOX also has created momentum for change in securities regulation and will bring about more reforms to both corporate America and Wall Street.

While SOX provides an important framework for IROs in 2004, *other forces* are shaping activities in which corporate finance managers play major roles, such as the relationship between the board and management, the company and its investors and the company and capital markets. IROs could well see their jobs being redefined in the new year by these changed relationships.

Stay Tuned ... to State Investigators and Ripple Effects

New York's crusading Attorney General Eliot Spitzer, joined by counterparts in other states, is exerting significant pressure on the capital markets with headline-making investigations. While the focus is on Wall Street, corporate America will be facing complex new challenges in 2004, thanks to crusading state AGs.

Take sell-side research: Spitzer and 10 major investment banking houses reached agreement in 2003 on methodology for providing "independent" analyst reports to investors (sell-side customers). Bankers and brokers have recruited a corps of independent sell-side analysts — supposedly with no brokerage and banking business — to produce "additional" reports on your company. The list of the 10 monitors was published by the SEC on its Web site Nov. 14.

The coming "disclosures" about your corporate performance — and perhaps new or contrarian views on your valuation — by independent researchers could (and will) compete with traditional sell-side analyst research. IROs could see conflicting reports distributed by the sell-side houses covering their firms. Less qualified researchers may be encouraged to cover your company by the availability of the AG's settlement money to generate new business for themselves — the research pot of gold is almost $400 million over several years.

How it will work: Every major investment house covering a public company will purchase research on that company from up to three independent research firms (recruited by the 10 monitors). If sell-side analyst research is available to a customer, up to three independent analysts reports also have to be made available *on the same company*. In theory, all 10 houses covering a blue chip, for instance, could provide as many as 30 separate reports on a combined basis *if* every independent had a report on the target company.

The negotiated settlement was intended to achieve independence for sell-side analysts — but "independent research" provided by a range of analysts could pose significant challenges for CFOs and IROs as they respond to investor questions. Here, a clearly stated corporate disclosure policy could help the board, management, corporate communicators and IROs — front-line troops for timely disclosure — as companies try to avoid disclosure pitfalls, and if communication with analysts becomes more complex.

Stay Tuned …to Greater Mutual Fund Disclosure

AG Spitzer and other state attorneys general have moved on to the $7 trillion mutual fund industry. Complicating life for funds and companies they invest in: SEC rules adopted in 2003 require mutual fund advisers to publish internal guidelines on corporate governance voting (for companies in their portfolios) and the record of their entire year's proxy voting (for shareholders to examine if they have an interest).

Stay Tuned … to Changes in Your Boardroom

What is keeping your board up at night? Not all IROs have the ability to ask — but that could begin to change in the months ahead. The question oft heard as corporate scandals hit the headlines: *Where was the board?* Observers predict that behavior in the boardroom will dramatically change in the coming year.

The National Association of Corporate Directors recently held its annual corporate governance conference, drawing more than 300 directors. Charles Elson, director of the Center for Corporate Governance at the University of Delaware, told the assembled that a *sea change* had occurred, with new demands imposed on board members and creating important changes in the way they do business.

"You will be operating under more stringent laws and regulations," Elson said. "You will be devoting many more hours to board duties, including your committee assignments, and serving on nominating, compensation and audit committees will mean extraordinary time demands for you as a committee member.

"Boards of directors," Elson continued, "will increase their level of individual professionalism, as they come into compliance with Sarbanes-Oxley, NYSE and Nasdaq listing rules and meet rising shareholder expectations. The key adjustment will be that CEOs will work for the board … not the reverse."

Stay Tuned …to Changes in Corporate Culture

John Krol, former CEO of DuPont and now lead director of the (new) Tyco International Board, who also spoke at the same conference as Elson, believes that most boards and senior executives really try to *do the right thing* for shareholders, employees and their organizations. He told the NACD directors: "Whether there are new accounting, reporting or governance rules to comply with or not, boards should encourage development of a strong corporate culture, one with honesty and integrity, committed to full disclosure, a culture that sets high standards for its senior managers."

Stay Tuned … to the Magna Carta of Corporate Governance in 2004

Richard Breeden, former chairman of the SEC and now a federal court-appointed monitor to WorldCom (renamed MCI), stirred up interest recently when he issued a comprehensive package for improving corporate governance at the company. This may be the *Magna Carta* for U.S. corporations as they move into an era of greater responsibility to stakeholders, he suggests.

"Disclosure will be the best friend for boards of directors," he said. "Board members should ask themselves, 'What are our values?' then define and communicate them. The quality of corporate disclosure at all levels is going to be a critical factor in the new operating environment for boards and their companies." (The report is available online at www.nysd.uscourts.gov /rulings/02cv4963_082603.pdf.)

Stay Tuned … to New Levels of Oversight Accounting

Speaking at a meeting of the Directors Roundtable, a nonprofit civic group that conducts forums for director and officer discussions in major cities, Terry Iannaconi, a KPMG partner, shared his observation that new levels of board oversight include making sure outside auditors go beyond bread-and-butter issues, including searching for potential fraud as an ongoing part of the audit process.

The SEC is expected to issue new rules and opinions addressing critical accounting policies in 2004, he advised, and these will pose additional compliance challenges for companies, making effective corporate disclosure even more important. Iannaconi said he believes the SEC will adopt more conservative views and a more intense regulatory focus on the important subject of revenue recognition.

Stay Tuned ... to Greater SEC Focus in 2004 on accounting restatements, which KPMG's Iannaconi described as now being "epidemic," numbering in the dozens. "The majority are because of human error, not fraud," he suggested, "but the SEC tracks all restatements, and this focus could trigger an investigation of a company, creating headline risk."

Stay Tuned ... to New Standards from the PCAOB

This could trigger more negative headlines for companies unable to attest that new "controls" are in place to deter financial shenanigans.

There is your short list of trends to *Stay Tuned* to in 2004. We'll provide more in future columns. For IROs, the risks may be increasing — but so are the opportunities! IRU

Hank Boerner is managing director-NY of Rowan & Blewitt, where he provides corporate governance and accountability counsel to public companies. The views expressed are his own. He can be reached at hank@pb.net.