

ARTICLE REPRINT

Stay Tuned... to the SOX Accountability Era

by Hank Boerner

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Stay Tuned ... to the SOX Accountability Era

By Hank Boerner

As summer vacations wind down, managers look forward to a new business year to crank up the energy level of their organizations. But while you were on vacation, an important anniversary quietly slid by. No banners were raised or cakes with sparkling candles served, but in late July, the third anniversary of the signing of the Sarbanes-Oxley Act took place, and we have entered the fourth year of the *New Era of Corporate Accountability*. Did you notice?

What does this mean to you as major changes continue in corporate governance, accountability, financial reporting, increased disclosure, corporate-shareowner relations, SEC enforcement, and *on and on and on*. ... No part of the IRO's professional portfolio, it seems, was left untouched in the three calendar years since passage of SOX.

A Long Journey to Reform

The 75-plus-page SOX legislation moved immediately to various federal agencies for implementation through rules and regulations — including the Securities and Exchange Commission, Department of Justice, U.S. Sentencing Commission, General Accountability Office and others. A new not-for-profit entity within SEC was created to oversee the entire issuer audit process: the Public Company Accounting Oversight Board.

The market reforms and investor protections did not all begin with SOX passage in 2002. Reg FD preceded the act with the help of then-SEC Chairman Arthur Levitt, who worked this regulation through the House and Senate to final adoption by his agency. The effort began with proposed rule making in late 1999 to

address “the detrimental effects of selective disclosure on public markets,” especially material corporate information.

NIRI supported Reg FD's basic objective of eliminating selective disclosure and helped to shape the final rule. NIRI's focus began in the early 1990s; its 1996 *Standards and Guidance for Disclosure* noted: “Integrity of the capital markets is based on full and fair disclosure of information. ‘Selective disclosure’ of information by



corporations, whether to institutional investors or securities analysts or others, raises concerns about the fairness of the dissemination of information to the securities markets as well as the specter of liability.”

Still ahead was the Nasdaq tech wreck and 3,000-point sell-off in its index — and close to 4,000 points about to be sliced off the Dow Jones major index. And what changes were in store: corporate scandals involving the financial reporting practices of Enron, WorldCom, Adelphia, etc. Showcase trials of once media-worshipped CEOs. Jail time for some fallen corporate stars. Billions of dollars in plaintiff bar lawsuits against companies, brokerages, investment bankers and research analysts. New York Attorney General Elliot Spitzer’s well-headlined prosecutions of investment bankers and their financial analysts, mutual fund advisers, large insurance companies and others involved in the capital markets. Massive changes in financial research practices (and the emergence of the independent research house).

No wonder SOX was so attractive to lawmakers! Starting with Reg FD, one could say, the movement toward the final objective — to increase the effective-

ness and accountability of boards, outside auditors and management — began to gain momentum exponentially. SOX in that context was a part of the process — an important part, but still one package of elements of a revolution that was much broader and deeper, and continues today.

Tomorrow?

It is somewhat ironic that while in the last months of the Clinton administration there was a flurry of proposed new laws and rules addressing securities protection, it was under Republican George W. Bush that the most sweeping governance reforms since the 1930s were enacted into law or adopted as regulations. In both decades, the tenor of the times demanded dramatic action, and the Congress and White House responded.

IROs should expect that the sweeping, comprehensive reforms of the past five years will continue, at least for a while. Perhaps, as savvy market veterans predict, when the stock indexes begin to climb again, investors will relax their guard and plunge in to ride the hockey stick back up. Until then, keep in mind that some of the provisions of SOX are still in the process of being adopted. We have a ways to go before all the new rules are firmly in place.

The final rules for foreign issuers are yet to be issued. Small-cap firms are moving toward compliance with most sections of SOX (there are some exceptions), and received a reprieve of sorts in extended deadlines for compliance. But a lot of other forces continue to shape the investor relations process.

What to Watch

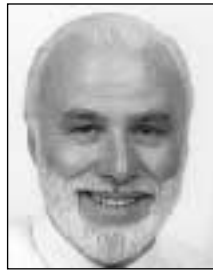
We usually advise *IR Update* readers to Stay Tuned! As the accountability revolution continues, watch for future developments around the following:

Stay Tuned ... to stock options. Pat McConnell, head of the accounting analyst practice at Bear Stearns, advises that companies are accelerating the vesting of stock options in anticipation of FAS 123 (requiring expensing). More than 234 companies have so far done this, with median capital of \$378 million (tech companies lead at 36 percent). Companies want to get ahead of mandates, and more than \$2 billion in stock option expense has bypassed future income statement recognition. Watch for more companies to follow.

Stay Tuned ... to more accountability from corporate executives. At the April annual meeting of Daimler-Chrysler, fund managers and individual investors shouted their displeasure with performance as earnings sagged. Reaction from the usually insulated leaders? Within 90 days, the high-profile CEO stepped down! Watch for investors with short patience to step up pressure on both U.S. and foreign corporate leaders if they lag competitors, peers and the marketplace.

Stay Tuned ... to more intense focus on corporate directors. Even the fabled supra-investor Warren Buffett is not immune; Institutional Shareholder Services opposed the wondrous market guru's return to the Coca-Cola board. Many more magnifying glasses are being applied to corporate proxy statements for returning and new board candidates — a trend that will surely accelerate.

Stay Tuned ... to more visible means of identification of market laggards. The California Public Employees' Retirement System (CalPERS) perfected this approach, now being emulated by others. This year, it is American International Group, AT&T, Delphi, Novell and Weyerhaeuser on the radar screen, mainly for poor corporate governance (according to Rob Feckner, president of CalPERS). These five firms were selected from 1,800 U.S. companies in which CalPERS invests. You may want CalPERS on your list of institutional holders — but watch out if you land on its laggard list!



Hank Boerner

Stay Tuned ... to new approaches to analyst coverage. Nasdaq and Reuters announced at NIRI's recent annual conference that they would join forces in a new venture, the Independent Research Network, to provide multiple, independent research providers to perform and distribute research on behalf of undercovered companies. (The tab could run as much as \$100,000 per year for a three-year commitment.) More than half of all issuers are not covered today; watch for innovative approaches to emerge — and become more acceptable to investors who have questioned the validity of such "sponsored" reports. Necessity is still the mother of invention!

Stay Tuned ... to the Watchers Being Watched: The Government Accountability Office, the independent investigative arm of Congress, zeroed in on the SEC and reported in May that the agency was, *ahem*, not quite in control of its own controls, as SEC focused on corporate controls (such as Section 404). GAO said SEC failed to maintain effective internal control over financial reporting (its own financial data). No one is safe in the new era of accountability!

That's our short list for now. We will continue to alert you to trends, issues and events to Stay Tuned to in the months ahead. Happy birthday, SOX! **IRU**

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