

ARTICLE REPRINT

Stay Tuned . . . to Tipping Points for the IRO

by Hank Boerner

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FOR SUBSCRIPTIONS OR CHANGE OF ADDRESS,

CONTACT: NIRI-*IR Update*, 8020 Towers Crescent Drive, Suite 250, Vienna, VA 22182, Phone: (703) 506-3570, FAX: (703) 506-3571, e-mail: amumeka@niri.org

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PLEASE SEND QUERIES OR SUBMISSIONS TO:

Laura Bernstein, Editor, Phone: (540) 955-3696, e-mail: irupdate@niri.org

ADVERTISING AND REPRINTS:

Melissa S. Jones, Production Manager, Phone: (703) 404-2065 FAX: (703) 723-6548, e-mail: mjones@niri.org

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Stay Tuned ... to Tipping Points for the IRO

By Hank Boerner

In his recent best-selling book, "The Tipping Point: How Little Things Can Make a Big Difference," author Malcolm Gladwell theorizes on how certain social, economic, financial, political or cultural phenomena have reached a "tipping point," sometimes on a very slow basis and at other times seemingly overnight.

When the tipping point is reached, dramatic shifts and/or transitions usually occur, often affecting public opinion.

When applied to the everyday work of an IRO, some issues, trends or critical events do seem to occur on both an overnight basis — "Enron files for bankruptcy protection!" — while others have a very long, slow buildup — the implementation of Reg FD, for example, and the daily effect on your corporate disclosure policies and practices.

In this space we regularly try to put issues, trends and potential "tipping points" in context and explain the "who/what/when/where/how" of these for investor relations professionals. Our current list is growing by leaps and bounds as corporate

America is buffeted by one storm or another — some natural, others human-crafted.

Here's a quick list of current issues at or very near the tipping point that could or will affect the day-to-day life of the IRO.

Stay Tuned ... to new accounting rules for corporate pension funds. David Zion, chief accounting and tax analyst and researcher for Credit Suisse First Boston, predicts that the Financial Accounting Standards Board (FASB) will be adding pension accounting to the fall agenda, perhaps as you read this issue. "Defined benefit pension plans will get lots of attention over the next few months," he noted. "With two major [airline] bankruptcies making headlines, talk of reform should heat up in Washington, D.C. Companies may start highlighting that their pension plans have weakened this year. Most important, we expect the FASB to add a major project on pension accounting."

This project may be the most significant and contentious the FASB has tackled in its 30-plus-year history — especially if it involves a complete overhaul of pension accounting, added Zion. The board could propose putting plan assets and obligations on the balance sheet at fair value — with any changes reflected in earnings, a mark-to-market approach. The recent abandonment of four employee defined benefit plans by United Air Lines and the shift of obligations of almost \$9 billion to the Pension Benefit Guaranty Corporation has put such plans in sharp focus, both on Capitol Hill and Wall Street.

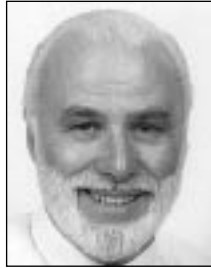
Stay Tuned ... to a "New Financial Order" shaping up (as seen by Robert Herz, chairman of FASB) as accounting standards — as in U.S. GAAP and the International Financial Reporting Standards (IFRS) as issued by the IASB (International Accounting Standards Board) — become more closely aligned. Herz notes in an op-ed in *Chief Executive* magazine that while many foreign subsidiaries of American companies use U.S. GAAP, IFRS is gaining acceptance in 70 countries — and all listed companies in the European Union must begin using the new standards this year.

What does Herz see on the 2006 horizon? One possibility is to let U.S. companies use either GAAP or IFRS, or accelerate the convergence of both standards as the best solution for the capital market users and issuers. Any convergence, Herz believes, must have high-quality



standards that improve financial reporting around the world. Chairman Herz sees convergence occurring slowly, with “pain” for everyone (take note, IROs!). In the end, FASB’s objective is to create better, less costly and more comparable and consistent financial information.

Stay Tuned ... to the pain of EU companies early in 2006 as the first reports from issuers under IFRS hit the markets. Kenneth Lee, Citigroup Research’s London-based accounting and valuation specialist, told a gathering of NIRI New York members that as EU companies begin to report under IFRS, there would be (1) a wide range of valuations and opinions among analysts about the same companies as well as companies within the same sectors, and (2) a wide range of media coverage about different companies in the same sector or industry.



Hank Boerner

“There has not been much analyst or investor reaction yet to the switch to the new standards,” Lee explained to NIRI members, “but momentum is building because over the next two years, IFRS will become the only game in town for many countries, and the former GAAP regimes of individual countries will be replaced.” As this occurs, research databases could become useless, and 10 years of analyst modeling work could be set aside. “Clear explanations as to the meaning of data may be very hard to come by in the beginning, and this will directly affect 2006 valuations,” Lee said.

One solution (before the tipping point occurs) could be to have companies come together as peers to agree on common interpretations. As conversion to the international standards continues, the cooperation of peer companies could smooth the transition. Will IFRS ever come to the United States? Not likely — but U.S. issuers (and especially multinationals) will begin to feel the effects of transition beginning with 2006 reporting.

Speaking of 2006, let’s loop back to CSFB’s Zion. **Stay Tuned ...** to what he calls “Building the New Consensus,” with most companies required to expense employee stock options and most earnings guidance and analyst estimates not yet reflecting this cost. *Ouch!* This could be a painful transition for companies in the U.S., starting with the coming earnings season (and issuance of guidance for the new year).

Zion believes most major sell-side firms will have their own policies in place by year-end 2005 that will require analysts to include employee stock option expenses in earnings estimates. So the question is this: *Individual and consensus earnings estimates should start reflecting option costs for most companies; if those companies would rather ignore those costs, and the new consensus kicks in estimates (trending down), P/E multiples changing, etc., how will the market react?* Our question for you: Is this an important tipping point for IROs?

Stay Tuned ... to H5N1, the dreaded avian (bird) flu. The media is filled with news about a possible pandemic and its human and financial impact. All it takes is a switch of a few genes here and there, and the re-sorted “bugs” could be heading our way. This is a serious matter for business leaders.

“Clear explanations as to the meaning of data may be very hard to come by in the beginning, and this will directly affect 2006 valuations.”

— Kenneth Lee, Citigroup

It is not too early for the IR professional to begin planning for a corporate crisis. As you read this, the U.S. Department of Health and Human Services will be issuing an updated crisis response plan. The Centers for Disease Control have a plan available. Industry groups are putting plans in place. Do tune in to these important planning resources for your own guidance. H5N1 may never touch American shores — but if the pandemic does occur, events may exceed your most ambitious “worst case” planning scenarios, with very dramatic effects on your company’s top and bottom lines.

That’s our current list. **Stay Tuned ...** for more possible tipping points to be highlighted in the months to come. [IRU](#)

Hank Boerner is managing director-NY for Rowan & Blewitt, a management consultancy. The views presented here are his own. He can be reached at hank@hankboerner.com.