

## The audit committee role in financial communication

### Introduction

On February 5, 2009, members of the Audit Committee Leadership Network (ACLN) met in New York for the network's 19th stand-alone meeting. Members discussed funding and liquidity issues in today's capital markets and the impact of the financial crisis on audit committee oversight.<sup>1</sup> Members also discussed the audit committee's role in financial communication. For further information about the network, see "About this document," on page 11.

During the session on financial communication, members covered:

- **An evolving audit committee role in financial communication**
- **The impact of the global financial crisis**
- **The issue of earnings guidance**

Audit Committee Leadership Network members participating in the meeting, who sit on the boards of about 40 large-, mid-, and small-cap public companies between them, included:

- Denny Beresford, Audit Committee Chair, Kimberly-Clark
- Gene Fife, Audit Committee Chair, Caterpillar
- Marie Knowles, Audit Committee Chair, McKesson
- Mike Losh, Audit Committee Chair, Cardinal Health
- Oscar Munoz, Audit Committee Chair, Continental Airlines
- Chuck Noski, Audit Committee Chair, Microsoft and Morgan Stanley
- Pam Patsley, Audit Committee Chair, Texas Instruments
- Steve West, Audit Committee Chair, Cisco Systems
- Chris Williams, Audit Committee Chair, Wal-Mart

Ernst & Young partners participating in the meeting included:

- Steve Almassy, Americas Assurance Leader
- Steve Howe, Americas Managing Partner

<sup>1</sup> See Audit Committee Leadership Network, "Funding and liquidity in today's capital markets" *ViewPoints*, March 5, 2009. Available at [http://www.tapestrynetworks.com/documents/Tapestry\\_EY\\_ACLN\\_Mar09\\_View24.pdf](http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Mar09_View24.pdf)

*ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and guests and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations.

## **Executive summary**

During their discussions on the audit committee role in financial communication, members focused on the following topics, which are covered in more detail on the following pages:

- **An evolving audit committee role in financial communication** *(Page 2)*

The role of audit committees in reviewing and approving the financial statements of their companies, such as the Forms 10-K and 10-Q, has continued to increase in importance throughout the decade. Audit committees now spend a great deal of their in-person or telephone meeting time throughout the year on the form, content, and tone of these communications. Audit committees also pay special attention to press releases, which they scrutinize for language and tone, as well as what is said in terms of guidance. Some network members also play a role in other kinds of financial communications, such as listening to analyst calls or attending annual investor days, and may then provide feedback to management on what is communicated in these forums.

- **The impact of the global financial crisis** *(Page 7)*

Audit chairs discussed how the financial crisis is intensifying pressure to ensure the accuracy of financial statements and disclosures and to ensure financial communications do not inflate performance expectations. Audit committees are paying special attention to the management discussion and analysis (MD&A), liquidity and capital reserves (L&CR), and impairment disclosures as well as communication on risk factors. Audit chairs are concerned that the current crisis may exacerbate already onerous Securities and Exchange Commission (SEC) requirements for disclosures and increase the length of already unwieldy filings.

- **The issue of earnings guidance** *(Page 8)*

Current market volatility has made the provision of guidance – especially quarterly guidance – a particularly thorny issue. Several prominent companies have recently announced that they will no longer provide guidance, and already in 2009 a number of other companies are following suit, either permanently or temporarily. Audit chairs recognize the risk of providing guidance in this environment, even if they believe providing it is of benefit to the market. Those companies that have withdrawn guidance have felt compelled to provide other types of new disclosures, typically linked to long-term value drivers in the business.

## **An evolving audit committee role in financial communication**

The audit committee has taken on more and more responsibility for overseeing financial statements over the course of this decade, largely due to increased regulatory requirements relating to financial reporting. However, network members also report an intensification of audit committee attention to, and in some cases, involvement in, other types of financial communications.

## **A permanent role in the approval process of financial statements filed with the SEC**

The audit committee plays a critical role in overseeing the accuracy, integrity, and intent of its company's financial statements. This role was enhanced after the passage of the Sarbanes–Oxley Act of 2002, which required the senior officers of the company to certify the integrity of the financial statements and the audit committee to oversee internal control over financial reporting and the auditor.

For US companies, the basic form and content of financial disclosures are mandated by Regulations S-X and S-K and Forms 10-Q and 10-K. Earlier in the decade, the SEC implemented Regulation Fair Disclosure (known as Reg FD) and Regulation G (Reg G). Reg FD prohibits selective disclosure to analysts and investors, while Reg G regulates the disclosure of non-GAAP financial measures (i.e., financial information presented on a basis other than US Generally Accepted Accounting Principles). Reg G also requires companies to reconcile any non-GAAP financial measure with the most directly comparable GAAP financial measure.<sup>2</sup> In addition to making those filings, companies listed on the New York Stock Exchange face additional requirements due to the need to comply with the corporate governance standards in the *Listed Company Manual*.<sup>3</sup>

At the network meeting, audit chairs discussed their oversight of the development of their companies' 10-Qs and 10-Ks. Most agreed that the data and content communicated in these documents are subject to continuous review by the audit committee throughout the year. One member said, *“Our [audit committee] agenda will focus on important accounting policies to make sure we understand revenue recognition, reserves, estimates, and pension funds [as well as other matters] that go into filings. We have a lot of meetings, including deep dives on [each issue]. When it comes to [developing] the filings, we are well prepared on the financials.”*

Members shared their approaches to reviewing and approving the final versions of the draft filings. One audit chair said, *“Our CFO, SVP finance, and investor relations [representative] are all in the room. They give a lot of input.”* Members also rely on their external auditor to identify key issues and to look at the disclosures. One audit chair said, *“I want my external auditor to point out any disagreements with how [information] is presented. Also, I ask [the external auditor] if there is a concern that I should reflect in the communication.”* Others highlighted private discussions that they hold with members of management and the external auditor in order to understand important considerations, including any differences of opinion between the parties.

Several members suggested that all audit committee members, not just the audit committee chair, should be reviewing the 10-Qs and 10-Ks on a page-by-page basis. One said, *“I’m not sure the whole committee reviews the entire filing. I’ve listed this as an issue. I want help.”* Another said, *“Our 10-K is several hundred pages long. I get the first draft on a Thursday and have to get comments back by Tuesday ... I read every word – for tone, edits, the big picture, and numbers. [But,] I’m afraid I’m the only one doing it.”*

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<sup>2</sup> Securities and Exchange Commission, “Final Rule: Conditions for the use of non-GAAP financial measures,” <http://www.sec.gov/rules/final/33-8176.htm>.

<sup>3</sup> NYSE Euronext, *Listed Company Manual* (New York: NYSE Euronext, 2009), 303A.07. Available at [http://www.nyse.com/Frameset.html?nyseref=http%3A//www.google.com/search%3Fq%3DNew+York+Stock+exchange+listed+company+manual%26ie%3Dutf-8%26oe%3Dutf-8%26aq%3Dt%26rls%3Dorg.mozilla%3Aen-US%3Aofficial%26client%3Dfirefox-a&displayPage=/lcm/lcm\\_section.html](http://www.nyse.com/Frameset.html?nyseref=http%3A//www.google.com/search%3Fq%3DNew+York+Stock+exchange+listed+company+manual%26ie%3Dutf-8%26oe%3Dutf-8%26aq%3Dt%26rls%3Dorg.mozilla%3Aen-US%3Aofficial%26client%3Dfirefox-a&displayPage=/lcm/lcm_section.html).

However, another member said, *“This has changed. I used to do it all as the audit committee chair, but now the whole committee [reviews the 10-Qs and -Ks as well].”* Another member suggested that if audit chairs receive no comments from committee members, they should galvanize the committee by telling them, *“Management assumes you don’t care.”*

Members shared their practices for incorporating their changes to the 10-Qs and 10-Ks. Several said this takes place at in-person meetings of the audit committee or full board. One described an approach in which each audit committee member provides changes directly to the chief accounting officer (CAO), who incorporates them. The member said, *“If there are big changes, [the CAO] sends those pages back. Then on the call [to discuss the filing], we review [the changes], but not in excruciating detail.”*

No matter the process, audit chairs emphasized the importance of tracking the audit committee’s input: *“Some [changes] are very important, and I ask for follow-up or a track record of what happened as a result of my comments.”* Another audit chair uses the internal audit function to track input and decisions relating to the filings.

Even with a best-practice review and approval process, several members voiced frustration over the length of the filing documents, which they feel ultimately undermines the documents’ usefulness in the market. One said, *“Our 10-K is 180 pages, and one-third is redundant ... because legal usually wants a message [to be mentioned] three times.”* Another agreed, saying, *“This is the elephant in the room: the legal environment we live in. There are [so many] pages because there are redundancies. This is a real challenge in these capital markets.”* One audit chair added, *“It’s a 400-page document that the analysts don’t use. It’s just litigation currency.”* Several members reported an interest in reducing the length of the filings. Another member shared company efforts to enhance the content of the 10-K by *“changing some of the [content, such as] strategy and competition, [as well as] tone ... to tell the story of the company. I think the SEC wants management’s best expression of the company.”*

## **An increasing role in other types of financial communication?**

Although not required by law, audit committee chairs play a significant role in reviewing earnings press releases. In addition, some are paying more attention to scripts for earnings calls and financial communications provided by senior executives in other forums. Members discussed:

- earnings press releases
- scripts for earnings calls
- analyst calls, investor days, and industry conferences

### **Earnings press releases**

Audit committee chairs focus a considerable amount of attention on ensuring that the 10-Q and 10-K forms and the MD&A are consistent, in content and tone, with the earnings press releases. One audit chair commented, *“Press releases trouble me more than 10-Qs.”*

Audit committees scrutinize press releases out of concern about language, tone, and the inclusion of guidance. A member said, *“We focus on tone, and we ask, ‘What does that mean?’ or ‘Is that the right*

*message?’ A lot of judgment [is applied.]” Another said, “We go through [the press release] line by line. Directors look at tone. I’m worried about statements like ‘We’ve had a great quarter, but the last month was terrible.’” Given the financial crisis, members are particularly concerned about what their companies are saying by way of earnings guidance, which is often included in press releases. One asked, “How do you leave people feeling when they’ve read [the press release]?” For more information on members’ views on the provision of guidance, see page 8.*

Some members reported a trend towards overlap in the timing of the review and release of 10-Qs and press releases. A member said, “[Now] people are gun-shy about putting the press release out much before the 10-Q ... We review the 10-Q and press release at the same time; this is a change. We used to do the press release earlier in the cycle. Now we’ve brought the 10-Qs forward and the press releases back.” Another said, “We get the release and the 10-Q at the same time. We have a call to review both at the same time.”

Several members expressed concern over how little time they have for review. One reported, “If we are going to make a release on a Friday, [we hold a conference call on] Thursday morning at dawn with the external auditor, etc. We are sent the file the night before, which we read at 10–11 pm at night to discuss at 6 am [the next morning]. It tends to be rushed.”

### Scripts for earnings calls

Network members reported less frequent involvement in reviewing the scripts that are used in quarterly or annual earnings calls, including the talking points for the question-and-answer session. However, one member said, “We don’t spend much time on the press release, but [we do spend] more time on the earnings call and guidance. [Before the analyst call, the audit committee] does a conference call discussion by phone. We discuss concepts to use on the call. And [then] we get a report on the stock in real time [during the analyst call].”

Several members said that they relied on the head of investor relations to develop key messages for the earnings calls and press releases, in consultation with key senior executives. At one member’s company, senior finance people are rotated in to run investor relations, and they run the calls “in order to be in different roles and to take questions from analysts.”

Some members report listening to earnings calls (either live or after the fact) for a sense of “how it went” and “to see how the [executive] team plays in that environment.” Several focus specifically on the question-and-answer session. Members who listen to earnings calls tend to provide feedback to management afterward.

An audit expert reported listening to earnings calls in order to “see if [they are] different from what I’m told internally, which would be a red flag.” Inconsistency in messaging would be a signal to external auditors of potential trouble with the “tone at the top” of the organization. Having senior executives maintain a consistent and ethical tone is an important element in fraud prevention.

### Analyst calls, investor days, and industry conferences

In discussions prior to the ACLN meeting, network members raised questions about the issue of hidden guidance, that is, management statements regarding financial performance made in other venues. Of

particular concern are statements that could violate Reg FD. Some members questioned whether these communications, which are subject to less oversight, could be problematic:

- **Ongoing communication with analysts.** Many companies feel compelled to respond to analysts' remarks and inquiries regarding their expected performance, outside of the earnings calls. When an analyst provides a data point that is in conflict with a company's expectations, the company may provide additional information to clear up misconceptions. However, as one member put it in a pre-meeting conversation, "There's a fine line between expressing one's disagreement with an analyst's view and sharing non-public information to change their mind." Both audit committees and the full board need to understand how management is likely to respond to analyst coverage.
- **Annual investor days.** Occasionally, board members communicate directly with investors in these forums. One member said, "*I go and I learn a lot that I don't hear in the board room. It's a more holistic view of our strategy.*" Sometimes, directors have informal one-on-one discussions. Those who attend are often prepared in advance with answers to common questions, in part to help avoid violating Reg FD.
- **Industry conferences at which management speaks directly to the public.** In a pre-meeting conversation, one member noted that CEOs "always want to talk up their company." Major industry conferences present real opportunities for them to do so. "What my CEO says at those conferences can be significant, about the company's prospects or that of the industry," this member noted. Most members however, said that they do not review executive speeches. Instead, those documents "go through the general counsel and the CEO's office." Although the audit committee does not play a specific role in approving executive speeches, they can assist management in maintaining discipline by focusing on the talking points for the earnings call, which can then be used in other forums.

#### What audit chairs expect from their external auditor on financial communication

- A thorough review of all disclosures
- Notification of any discussions or disagreements with management on how something is presented
- Discussion and feedback on the press release
- Feedback on analyst calls
- Off-cycle conversations with the audit chair, offering insight on key issues. A member said, "*I want an honest dialogue.*" Members emphasized the importance of keeping these conversations confidential so as to strengthen their relationship with the external auditor.
- More than the required communication. One member reported asking, "*Tell me what you think.*" Another audit chair requests that the auditor provide a "*watch list*" section at the end of the required communication in order to uncover issues.

## The impact of the global financial crisis

The financial crisis has increased pressure on companies to ensure that financial statements and disclosures are accurate and that financial communications do not inflate performance expectations. While network members did not report any significant changes to their process for reviewing financial communications that they could attribute to the financial crisis, several reported a difference in the language and tone of financial disclosures. Speaking before the meeting, one member said, “We are urging conservatism, [using] language like ‘prioritizing capex,’ and ‘conserving cash,’ and we are urging [management] to focus their [talking points] on the balance sheet as opposed to P&L.”

Some members wondered whether the current crisis will usher in a new wave of regulatory requirements, including for financial reporting. Several members fear the crisis may intensify the SEC’s ongoing push for more disclosures, despite the length of existing filings. One said, “*The danger [now] is also the pressure on the SEC – will they now be looking for more minutiae?*”

Specific areas that companies are paying additional attention to include:

- **MD&A disclosures.** In his October 2008 speech on current financial reporting issues, John White, then director of the SEC’s Division of Corporation Finance (Corp Fin) said, “If there’s a year when you were going to go back and basically write your MD&A on a clean slate ... this has really got to be that year.”<sup>4</sup> Subsequently, he said Corp Fin staff would examine the MD&A disclosures of all companies, not just financial institutions, and he provided a “top ten” list of best practices related to fair value disclosures in the MD&A.<sup>5</sup> He has also referred companies to two recently issued “Dear CFO” letters highlighting additional fair value measurement disclosure items.<sup>6</sup> Members have noted that a particular area of focus now is whether items are potentially material, and if so would need to be disclosed.
- **Liquidity and capital reserves (L&CR) disclosures.** One member, speaking in advance of the meeting, framed the discussion of L&CR disclosures in terms of the changed financial landscape: “With the government coming to the fore and liquidity problematic, you have to be very careful with the adjectives and adverbs used. We’ve got a new entrant. The US government is guaranteeing debt and commercial paper, so it’s a whole new ballgame ... These are the kinds of discussions we’re having now, that we never used to have.” Several members have reported more frequent audit committee and board-level discussions of these issues and how to disclose them.
- **Accounting and disclosing goodwill impairments.** SEC staff members discussed accounting estimates used to determine goodwill impairments, and the disclosures needed in these cases at the 2008 AICPA National Conference on Current SEC and the Public Company Accounting Oversight

<sup>4</sup> Melissa Klein Aguilar, “Proxy Guidance, MD&A Advice, More From SEC Brass,” *Compliance Week*, November 25, 2008. Available to subscribers at <http://www.complianceweek.com/article/5162/proxy-guidance-md-a-advice-more-from-sec-brass>.

<sup>5</sup> Ernst & Young, “Highlights: Compendium of Significant Accounting and Reporting Issues, 2008 AICPA National Conference on Current SEC and PCAOB Developments,” December 17, 2008.

<sup>6</sup> US Securities and Exchange Commission, “Sample Letter Sent to Public Companies on MD&A Disclosure Regarding the Application of SFAS 157 (Fair Value Measurements),” September 2008. The earlier letter is dated March 2008. Both letters are available at <http://www.sec.gov/divisions/corpfin/cfactfinrptfms.shtml> under “Commonly Requested Disclosures.”

Board (PCAOB) Developments. The SEC staff expects objective evidence to support the judgments a company makes when reconciling the fair values of its goodwill reporting units to its market capitalization (which the SEC is allowing registrants to determine over a “reasonable period,” given the market volatility).<sup>7</sup>

- **Risk factors in the 10-K.** One member said, “*There have been changes on specific things like risk factors. [For example, how we discuss] our ability to access credit markets, non-secured lending sources, has been modified because things are different.*”

## The issue of earnings guidance

Earnings guidance typically appears in companies’ quarterly or annual earnings press releases and may be general or specific in nature: some companies provide a generalized performance forecast, whereas others provide specific earnings-per-share (EPS) targets, often in a range. While guidance has been a controversial issue in the United States for some time, most commonly because of the view that it creates short-termism in the marketplace, the crisis is making the question of whether or not to provide it even more salient. Market volatility has made it very difficult to provide forecasts, and specific EPS targets are of particular concern.

## Why companies provide guidance

US companies began issuing earnings guidance forecasts in the early 1980s, after the SEC’s 1978 decision to allow companies to include forward-looking performance projections, as long as they were accompanied by the appropriate cautionary information.<sup>8</sup> The practice became more popular in the late 1990s, after Congress protected companies from liability for statements about their expected performance via the Private Securities Litigation Reform Act of 1995. In the 1990s, almost all public companies were issuing some form of quarterly forecast,<sup>9</sup> with many issuing EPS targets in addition to generalized performance expectations. The trend continued for many years, only beginning to slow after 2000, when several major US public companies stopped issuing guidance, including Gillette in 2001 and subsequently The Coca-Cola Company, Dell, McDonalds, Motorola, and Pfizer.

In a 2008 National Investor Relations Institute (NIRI) and CFA Institute Centre survey, NIRI members said their primary reason for providing guidance was “to ensure sell-side consensus and market expectations are reasonable.”<sup>10</sup> Several members have said that they feel compelled to provide guidance if competitors do so. One said, “*Stopping would undermine our credibility.*” Another member said guidance provides a benefit to the market: “*I believe [providing guidance] provides better transparency.*” Others have pointed out that analysts will issue expected earnings per share on large public companies whether the company provides the information or not. A member said, “*Even companies who don’t give [guidance] do so indirectly. They give all but earnings per share.*”

<sup>7</sup> Ernst & Young, “Highlights: Compendium of Significant Accounting and Reporting Issues, 2008 AICPA National Conference on Current SEC and PCAOB Developments.”

<sup>8</sup> Joseph McCafferty, “The Long View,” *CFO.com*, May 1, 2007. Available at [http://www.cfo.com/printable/article.cfm/9057969/c\\_9064230?f=options](http://www.cfo.com/printable/article.cfm/9057969/c_9064230?f=options).

<sup>9</sup> *Ibid.*

<sup>10</sup> Kathy Valentine and Matt Brusck, “NIRI and CFA Institute Centre Release Results of Joint Study on Public Company Guidance Practices and Preferences,” press release, May 28, 2008. Available at [http://www.cfainstitute.org/aboutus/press/release/08releases/20080528\\_01.html](http://www.cfainstitute.org/aboutus/press/release/08releases/20080528_01.html).

### Concerns about the data used to generate guidance

Network members have raised concerns about the way in which data used to provide guidance are generated, given that it is not governed by the same legal requirements as internal controls over financial reporting and that it requires a great deal of management judgment. Members felt audit committees should question the due diligence involved in developing this forward-looking information. One member said, “[We have] a fairly decent process to ensure consistency and quality even though it’s not audited.” Prior to approving any new guidance, this member’s audit committee:

- reviews the earnings forecast from the previous period
- considers what was presented at the previous board meeting
- discusses a sensitivity analysis on the numbers

Hearing about this approach caused another member to decide to go back and “ask our CFO [for more detail] about our ability to forecast.”

### A trend away from quarterly EPS guidance

The financial crisis may be fueling a trend away from providing quarterly EPS guidance, given the difficulty in developing forecasts. A finance expert<sup>11</sup> suggested that under the current circumstances, the audit committee should be looking at “contingent liability or legal liability” because “there is a source of uncertainty if the world isn’t like what we think it will be.” At the network meeting, some members indicated that their boards may be reconsidering their approaches to guidance. One member said, “There is difficulty in getting the revenue numbers [now]. If the range is too wide, it is meaningless.” Another member said, “Given the headwinds, the regulatory environment, and the changing commodity prices, I’ve seen some outrageously wrong estimates from management.” In addition, several members agreed with their fellow audit chair who said, “The cost of not hitting guidance is huge.”

Two recent prominent examples of companies that have stopped providing quarterly earnings guidance are the General Electric Company (GE), whose decision is permanent, and Microsoft, whose decision is temporary:

- **General Electric Company.** During GE’s annual outlook investor meeting on December 16, 2008, CEO Jeff Immelt announced the decision to stop quarterly forecasts. The accompanying press release stated, “The Company also announced that it will no longer provide specific quarterly EPS guidance. Instead, the Company will provide a full-year operating framework with detail in the industrial and financial businesses. The Company remains committed to high levels of disclosure and transparency, and will continue to report all of its quarterly segment details.”<sup>12</sup>

<sup>11</sup> Seven experts were interviewed in advance of the ACLN meeting to provide input on this topic. See Appendix 2 for names and affiliations.

<sup>12</sup> General Electric, “GE Provides Outlook for 2008 and 2009,” press release, December 16, 2008. Available at [http://www.ge.com/pdf/investors/events/12162008/ge\\_webcast\\_pressrelease\\_12162008.pdf](http://www.ge.com/pdf/investors/events/12162008/ge_webcast_pressrelease_12162008.pdf).

- **Microsoft.** The press release from Microsoft announcing its change in approach to providing guidance stated, “Due to the volatility of market conditions going forward, Microsoft is no longer able to offer quantitative revenue and EPS guidance for the balance of this fiscal year.”<sup>13</sup>

Some network members have predicted that while there may be a move away from quarterly guidance, including EPS, companies are likely to continue offering annual guidance, which may or may not include an annual EPS target. The NIRI and CFA Institute Centre survey provides some evidence of this: among CFA Institute members responding to the survey, 60% considered it best practice to provide annual earnings guidance.<sup>14</sup>

### The implications of eliminating guidance

Companies fear that giving up issuing quarterly guidance will provoke negative reactions from their investors and analysts. In a pre-meeting conversation, a network member noted, “The market will think one of three things: the company wants to hide something, the company philosophically disagrees with guidance, or management does not know what it’s doing. Two of the three things aren’t good news for investors.” Experts tend to agree: “There is cynicism [regarding] ... a company [that] tries to stop providing earnings guidance since there were companies that stopped doing it because they were doing poorly.”

Evidence has shown that companies take a hit to their stock price<sup>15</sup> when they stop providing quarterly earnings guidance, but some say this is a temporary, one-time hit. A member said, “*The headline hurts for a day or two.*” Additional reasons companies fear giving up guidance include the loss of analyst coverage, a broader range of analyst forecasts that are less accurate, and the fear of greater share price volatility. A 2006 academic study that investigated firms that stopped providing earnings guidance from 2000 to 2006 did observe increases in analyst forecast dispersion and decreases in forecast accuracy following firms’ decisions to stop providing guidance, but found “no change in overall stock return volatility or analyst following.”<sup>16</sup>

Subject matter experts interviewed before the meeting agreed that companies that do decide to stop providing guidance need to maintain an ongoing commitment to communicating openly and frequently and to providing as much information as possible to allow analysts to draw their own conclusions. One expert said, “Just stepping away from earnings guidance is not the answer ... [You need] a robust communications plan ... that gives them a broader picture of the company.” Indeed, many companies that stepped away from providing quarterly guidance, such as GE, have made a commitment to providing more information in the form of additional metrics the company uses to gauge performance. In short, if the company is not providing a number or range, then it must give analysts the tools they need to develop their own models and forecasts.

<sup>13</sup> Microsoft, “Microsoft Reports Second-Quarter Results,” press release, January 22, 2009. Available at [http://www.microsoft.com/msft/earnings/FY09/earn\\_rel\\_q2\\_09.msp](http://www.microsoft.com/msft/earnings/FY09/earn_rel_q2_09.msp).

<sup>14</sup> Kathy Valentine and Matt Bruschi, “NIRI and CFA Institute Centre Release Results of Joint Study on Public Company Guidance Practices and Preferences.”

<sup>15</sup> Shuping Chen, Dawn Matsumoto, and Shiva Rajgopal, “Is Silence Golden?” working paper, October 2006. Available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=820644](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=820644).

<sup>16</sup> Ibid.



However, some members are skeptical about such an approach. They point out that if the company is going to provide enough data for the analysts to calculate EPS accurately, it might as well include the EPS guidance itself.

## Conclusion

The last wave of corporate governance reform ushered in by Sarbanes-Oxley and changes to the NYSE listing requirements have increased the role of the audit committee in the oversight of financial communications. The expansion of time spent on page-by-page reviews of the 10-K and 10-Q was perhaps expected. The focus on the language and tone of the press release and key points used in other financial communications, such as analyst calls, may not have been. Yet audit committees appear to be approaching these forms of financial communication with the same degree of seriousness. In addition, many audit chairs also consider it their responsibility to encourage management and the board to discuss the company's approach to the provision of earnings guidance, particularly in current market conditions.

## About this document

The Audit Committee Leadership Network is a select group of audit committee chairs from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit committee environment.

*ViewPoints* is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *ViewPoints* may share it with those in their own network. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

*The views expressed in this document represent those of the Audit Committee Leadership Network. They do not reflect the views nor constitute the advice of network members, their companies, Ernst & Young, or Tapestry Networks. Please consult your counselors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organization, including the US member firm of Ernst & Young LLP.*

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## Appendix 1: Questions for audit committees to consider on financial communication

- ? What is your company's philosophy on financial communication? Are you satisfied with the overall quality and degree of transparency? What would you like to see change?
- ? How do you think the work done to clarify the role and improve the effectiveness of audit committees post-Sarbanes-Oxley will help them deal with the pressures of the financial crisis? In what ways can the audit committee's oversight of financial statements and related disclosures still be improved?
- ? What particular concerns do you have about your financial statements and related disclosures, given the financial crisis? How is the audit committee addressing these concerns?
- ? What are your expectations of both internal and external auditors?
- ? What lasting impact do you feel the financial crisis will have on financial statements and disclosures?
- ? How involved are you in your company's decisions about guidance? How satisfied are you with the control environment around guidance? How do you seek input from experts? What role does the audit committee play in helping a company determine whether or not to stop issuing guidance?
- ? What are the pros and cons for your company of providing guidance, given the industry and the current economic climate?
- ? How comprehensive are the metrics and information your company provides to investors and analysts about earnings and predicted performance? Could more, or different, metrics be provided to allow these constituents to draw their own conclusions, thus reducing pressure on your company to provide specific EPS guidance?



## **Appendix 2: Subject matter experts interviewed on financial communication**

- Laura Hewett, Counsel, Corporate Finance Practice Group, King & Spalding
- Jeff Morgan, President and CEO, National Investor Relations Institute
- Matt Orsagh, Senior Policy Analyst, CFA Institute Centre for Financial Market Integrity
- Kurt Schacht, Director, CFA Institute Centre for Financial Market Integrity
- Jeff Stein, Partner, Corporate Practice Group, King & Spalding
- John Wilson, Director, Corporate Governance, TIAA-CREF
- Ann Yerger, Executive Director, Council of Institutional Investors