Audit Committee Institute
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Audit Committee Quarterly

Issue 01

BELGIUM

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Welcome

We are pleased to bring you the first issue of the *Audit Committee Quarterly* for Belgium

The Audit Committee Institute (ACI) has been communicating with board and audit committee members on an international level since its formation in 1999. Our programs have allowed us to meet with thousands of directors and officers. ACI's initiatives include semi-annual roundtables, publication of the *Audit Committee Quarterly*, seminar and board presentations, periodic distribution of time-sensitive information, and our Web site, www.audit-committee-institute.be.

"What a difference a day makes" or so the saying goes. In the sphere occupied by boards of directors and their audit committees, perhaps the saying should be "What a difference the last two years have made!" It is, indeed, a different world compared to two years ago. Audit committees, newly installed or not, occupy center stage in the wake of corporate scandals and the resulting national, European and international reforms. The challenges for the audit committee in this environment are numerous, with perhaps the most important being for an audit committee to meet increasing regulatory compliance requirements and yet persist in overall effectiveness.

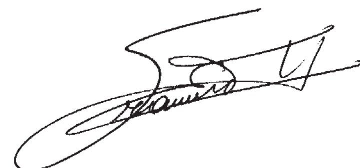
Wholly sponsored by KPMG, the ACI communicates with audit committee members and senior officers to enhance their awareness of, commitment to, and ability to implement effective audit committee processes.

A most valuable tool will be made available to ACI members: the ACI *Shaping the Belgium Audit Committee Agenda* publication will become your *Vademecum*, providing you with knowledge, tools and techniques to help fulfil your demanding mission. Please refer to the brief introduction further in this issue.

Effective audit committee oversight depends on the ongoing support of key components and considerations in a workable and beneficial framework, blueprinted in our first article. Further articles in the *Audit Committee Quarterly* for Belgium will update you on highlighted topics of these key components.

ACI's Web site, which provides audit committee tools and information, has been highly rated by directors and officers. The site's resources include additional information on topics discussed in the *Audit Committee Quarterly*, published articles from ACI, regulatory and technical content, and audit committee "hot topics" and additional resources. ACI's Web site address is www.audit-committee-institute.be

We look forward to welcoming you as a select member of this professional institute.



Theo Erauw
Chairman, KPMG

A Framework for Audit Committee Oversight

Facilitating effective audit committee oversight of financial reporting requires a framework that encompasses all key participants and processes, focused on key financial reporting. Ultimately, this framework should support a flow of information to enhance the audit committee's ability to meet its oversight objectives on a consistent, timely, and ongoing basis. Elements of audit committee oversight that build on each other to support financial reporting are:

- Organization and Operation– Planning and conducting activities, including the audit committee charter, consideration of membership, setting the " proper tone" with management and auditors, and establishing "whistleblower" procedures

- Financial Reporting Risk Assessment– The audit committee's approach, capabilities, and understanding of management's risk assessment as one of the primary drivers of the audit committee's agenda

- Internal Controls Over Financial Reporting

- Audit Processes– Including the oversight of external and internal auditors

In addition, elements occurring in tandem with those mentioned above are:

- Audit committee reporting to board of directors and shareholders

- Continuous improvement and education

Clearly, effective audit committee oversight depends on the ongoing support of key components and considerations in a workable and beneficial framework. Elements that continuously support the overarching principle of financial reporting should all work together to allow the audit committee to receive the right information directed toward the right individual at the right time, and in the right context –leading to effective audit committee oversight.

Shaping the Belgium Audit Committee Agenda

Excellence in corporate governance is an increasingly important element in business. Expectations of stakeholders in the corporate governance process, including financial reporting, have never been higher, and the scrutiny by regulators and investors never more stringent. The role of the audit committee has–and will rapidly increase in importance and expand in scope.

Recognising that effective corporate governance is the cornerstone of shareholder protection, initiatives by regulators and stakeholders to help shape and guide corporate governance practices have confirmed the audit committee's key role in corporate governance and oversight. Several international codes and our recently published national *Code Lippens* contain recommendations designed to strengthen the effectiveness of audit committees, clarify and enhance their oversight roles, and increase their accountability over the financial reporting process. Understanding the purpose and implications of these recommendations is critical in evaluating the challenges facing audit committees and the direction in which corporate governance is heading.

While effective corporate governance is recognised to be a cornerstone in maintaining public confidence, ineffective corporate governance certainly is a dangerous obstacle–even threatened with psychological pitfalls. Audit committees may be envied by the board of directors for their power, or pitied for the weight of their increased responsibility. Audit committees could become paralyzed by the level of increased scrutiny, fearful that any move will be criticized. They may elect to "not make waves" rather than be guided by the importance of doing the right thing. Formal self-evaluation is one of the tools which audit committees can use to avoid such pitfalls.

Useful tools and knowledge will be freely provided to our members in our *Shaping the Belgium Audit Committee Agenda* publication, such as:

- A description of basic principles for audit committees
- A template audit committee meeting agenda
- A format for effective audit committee self-evaluation
- Internal and external audit assessment forms
- Specimen terms of reference.

With an increased emphasis on the role of the audit committee in corporate governance, audit committees must assess what they are doing now, and how they are doing it, to ensure they are ready for the challenges ahead. We believe that the building blocks of an effective audit committee, from an effective agenda and committee structure to a keen awareness of current and emerging issues, are fundamental in fulfilling the audit committee's responsibilities. *Shaping the Belgium Audit Committee Agenda* identifies current and emerging issues that audit committees must be aware of and react to, and describes audit committee practices that provide the support and structure necessary to fulfil their terms of reference. We believe all audit committees and boards of directors can benefit from comparing their practices against those described in this publication, in their effort to critique, tailor and improve their own processes.

It is clear that audit committees and their members are facing significant challenges. In today's complex and evolving business environment, audit committees can contribute tremendously to a "no surprises" environment. Rules and regulations increase virtually on a daily basis, with perhaps the greatest challenge being to strike the right balance between enforcement and compliance. An audit committee that operates effectively is a key feature in a strong corporate governance culture, and can bring significant benefits to a company.

We trust that *Shaping the Belgium Audit Committee Agenda* will bring important knowledge, tools and techniques enabling you to achieve your objectives to bring added value to the board of directors, the organisation and its stakeholders.

If you are interested in receiving this publication, please return the enclosed registration card or go to our Web site www.audit-commitee-institute.be and register free of charge.

IFRS - The Next Phase: Communication

Perhaps unsurprisingly, the introduction of International Financial Reporting Standards (IFRS) on 1 January 2005 passed without apparent catastrophe. The turn of the year marked the beginning of a new period that will be fundamental to the relative success or failure of every listed company's transition to IFRS.

Many companies have expended significant efforts in Belgium and elsewhere in the preparation for IFRS. Much progress has been made, though some companies are more prepared than others. For many, this preparation phase will continue for some time, and those that are less well advanced should redouble their efforts if they are not to be left behind by their peers.

However, the recent publication of the first quantified descriptions of the impact of IFRS heralds the start of a very different phase in its implementation–the period during which companies must explain to analysts, the markets and other users the results of all that preparation.

Communication phase

Financial reporting is merely a means of communication, and IFRS is simply another language. If the message you wish to communicate is to be understood, both you and the recipient must speak the same language competently. Unfortunately, while the markets must also become familiar with IFRS, it is not clear whether this is yet the case.

KPMG recently commissioned MORI to interview 100 buy-side and sell-side analysts. Of those surveyed, 40 percent rated their current IFRS knowledge as poor, compared with 8 percent who said they felt they knew a great deal about IFRS. Given that 69 percent said that they had received no training from their employer, and were not aware of any on offer, it is clear that companies should not rely on others to educate those that track their performance. Even if the analysts that track your company are in the knowledgeable minority and consider themselves fluent speakers of IFRS, the communication challenge remains significant.

The first challenges are for the communication and explanation of IFRS information at a company's date of transition (i.e., an opening IFRS balance sheet), and for the comparative period to be included in the first IFRS financial statements. Here, the challenge is compounded because of the availability of different financial information for the same date or period based on the previous GAAP.

As revised turnover, profit and net asset information is presented, the objective may be to explain changes that are the result of developments in the business already reported under previous GAAP, and to differentiate those from the variances that reflect only a change in accounting or disclosure. In respect of the second category, there is a need to explain the meaning of this new or different information. Analysts in our survey remain concerned that new information on the underlying fundamentals of business performance will be lost in the transition.

This information, represented on the basis of IFRS, should provide the starting point as companies move to IFRS and report new periods, whether as interims or for the full year of 2005. In terms of the information disclosed, IFRS is likely to result in new or different information in a number of areas (for example, in subjects such as pension obligations, share-based payments and financial instruments). In addition, IFRS information should be readily comparable with a much wider population of companies, making peer-group analysis on a like-for-like basis far easier. Once again, adequate explanation of the newly-reported amounts will be essential if analysts are to understand their importance.

It will come as little surprise, that when analysts were asked whether they felt confident enough that they would be able to distinguish between changes that are the result of business performance and those due to accounting changes, 46 percent of the analysts in our survey expressed doubts.

The biggest knowledge gaps appear to be around the most crucial reporting areas. When asked how well they understood the possible impact of IFRS on different aspects of financial information, nearly two-thirds said they knew little about what effect the new standards will have on the way mergers and acquisitions are accounted for, and a similar proportion knew little about the treatment of financial instruments. More than half said much the same regarding how share options will need to be valued and presented in the accounts.

There is clearly a great deal for companies to do in helping demystify IFRS for the investment community, and without this help, there is a significant risk that some analysts will be insufficiently prepared.

Taking up the challenge

How should companies approach the communication challenge? While it is highly unlikely that a single approach will suit all, a preferred practice is beginning to develop. Several of the most advanced companies that have published quantified, initial IFRS information have chosen to do so clearly outside the normal financial reporting timetable (whether for a full year or as an interim). Such separation may help to differentiate the publication of new information on the performance of the business from the accounting effect of the transition to IFRS - i.e., from the re-presentation of the same business activity on a different basis.

For each business sector, the impact of IFRS will vary, and analysts are likely to look at different performance indicators according to the nature of the business. In planning their communication strategy, companies should factor this in, making visible those areas where the biggest changes may appear and explaining why, with an appreciation of how investors may then use these numbers.

Even those that have some way to go in their preparation should be considering their approach to communication; in particular, those companies that will adopt IFRS a little later (for example, those with June or September year-ends).

Clear and effective communication

As IFRS evolves, its widespread use should help investors to better understand and compare the relative performance of companies across geographies and industry sectors, and thereby properly influence their valuation decisions. But until that time, during this period of change, there is plenty of scope for misunderstandings and market volatility. Companies should help to share the burden of educating the markets in general, and analysts in particular. Communication on IFRS must be clear and effective, separating developments in the business from the effect of changes in accounting or disclosure. The winners, in investment performance terms, are likely to be those companies that can separate the real issues from the noise.

IFRS 2 : Share-based Payments

During 2004, the International Accounting Standards Board issued *International Financial Reporting Standard 2 (IFRS) - Share-based Payments*, a new standard dealing with financial reporting requirements for transactions of goods or services settled by share-based payments, including services of employees remunerated by means of share options or stock appreciation rights. Under IFRS 2, a company must reflect in its income statement the costs relating to such share-based payment transactions, whereas recognition previously under IFRS was a voluntary option not commonly adopted.

IFRS 2 becomes effective for annual periods beginning on or after 1 January 2005, and covers recognition and measurement in an area where no international standard previously existed.

The standard will highlight important differences between companies that frequently enter into transactions settled by means of share-based payments and those that do not. Previously under IFRS, results for both scenarios looked the same, as merely the nature and terms of the agreements were disclosed, in most cases, without actual recognition of the expense. IFRS 2 requires the fair value of the equity instrument to be expensed. This will mean a significant increase in both the frequency and value of expenses recorded for share-based payments in company accounts from 2005.

Application and transitional rules

IFRS 2 will affect Belgian listed companies preparing their first group financial statements under IFRS for periods beginning on or after 1 January 2005. Comparatives will require restatement meaning that IFRS 2 is to be already applied in the opening balances and in the 2004 financial statements under IFRS. The standard will apply to equity instruments granted after 7 November 2002 (issue date of exposure draft) that have not been vested at the effective date.

Companies are permitted to apply the standard to equity settled awards granted prior to 7 November 2002, only where they have previously published the fair value of those awards. In general, this will only apply to companies that also prepare financial statements under U.S. GAAP.

For cash settled awards that are recognized as liabilities at the effective date (e.g., share appreciation rights), retrospective application of the standard is required.

Summary of requirements

Transactions with employees or other parties in which equity instruments (i.e., shares or share options) are granted are called “equity-settled share-based payments”. Transactions to be settled in cash or other assets (the amount of which is to be based on the price of the company's shares) are called “cash-settled share-based payments”.

Goods or services received are recognized when received, with corresponding entries in equity (for equity-settled transactions) or liabilities (for cash-settled transactions). The IFRS also addresses situations where there is a choice of settlement (by one of the parties), but these are not expected to be common, and the financial reporting can be complex.

For *equity-settled share-based transactions* with employees and others providing similar services, the value of the transaction is based on the fair value of the equity instrument granted. The value is measured at the grant date. For equity-settled transactions with other parties (e.g., consultants), there is a rebuttable presumption that the fair value of the goods and services received can be estimated reliably. If this presumption is rebutted, the transaction value is equally measured by reference to the fair value of the equity instruments at granting date.

The conditions attached to the share award will have an impact on the value of the services received. For example, a typical condition is where the employee is still employed at the date the award vests. If the employee leaves, the IFRS does not require an expense to be recognized. Rather, the requirement is to estimate the number

of shares that will ultimately be awarded, taking account of service and performance conditions. This estimate should be adjusted up to the vesting date, when the actual number of shares awarded is known.

There is an important exception to this general rule of revising the estimate to take account of service and performance conditions. This is where the conditions are "market-price based". This will include, e.g., a condition specified to vest if a certain share price is achieved, or if the share reaches a certain point relative to an index of other shares. Because the share price is predicted as part of the fair value calculation of the share option, this prediction can also be used to determine the likely number of shares to be awarded in due course at the outset. Where this type of condition is attached to a share award, no adjustment is therefore required for the amount of the expense if the actual number of shares differs when the final award is made.

For *cash-settled share-based transactions*, the goods or services acquired should be measured at the fair value of the liability incurred. The fair value of the liability is measured at each reporting date until the date of settlement, with any changes in the fair value going to the income statement.

Valuation

In the absence of a market price, it is complicated to determine the fair value of a share option at grant date. The application of well-established option valuation models–such as the Black-Scholes-Merton and binomial model–to share-based payment transactions appears not to be without risks. These models have been developed originally for stock exchange traded options on listed company shares, and using them, as such, for the valuation of employee stock options raises a number of pitfalls. Not correctly taking into account the specificities of share-based payment transactions might cause the Black-Scholes-Merton or binomial models to yield fair value estimates that are significantly different from what a third party would probably be willing to pay for the transactions. A good understanding of the models and the underlying hypotheses is therefore a necessary condition for determining share options' fair values.

Conclusion

Application of IFRS 2 will bring a significant increase in expenses recorded for share-based payments. This should be monitored by audit committee members and members of the board of directors. Terms and conditions of existing and planned share-based payment arrangements will have to be communicated, and the need for specialist valuation skills must be determined.

The Code Lippens: a New Code to Boost Corporate Governance Performance

Since the introduction of the Belgian Corporate Governance (CG) code in 1998/1999, applicable for listed companies, no major initiatives have been taken relating to Corporate Governance. Although progress could be noted, corporate governance was considered rather a trend than a behavioral approach for good governance.

An international study by Governance Metrics International rated Belgium as one of the three countries that failed in their survey on compliance to corporate governance rules.

However, since 2004, Belgium is catching up. First the *Code Lippens* was introduced, applicable to listed companies as of 01 January 2005. Also, an additional code, the *Code Buysse*, applicable to non-listed and small- to medium-sized companies, has currently been drafted, and will be finalized after a public inquiry period as of 01 May 2005.

Basics

In January 2004, at the initiative of the Banking, Finance and Insurance Commission, Euronext Brussels and the Federation of Belgian Enterprises, a committee was established under the presidency of Maurice Lippens to draft a code of best practice on corporate governance for all listed companies in Belgium. A first draft was published in June 2004 for public consultation, with the final version of the Code published on 09 December 2004.

The Code is based on a "comply or explain" system, allowing companies to deviate from the provisions of the Code when their specific circumstances so justify, subject to providing an adequate explanation.

The Code contains three sets of rules:

- *Principles*: Nine in total, considered as pillars of good governance, which all companies should apply without exception
- *Provisions:* Detailing how to apply the principles (based on a "comply or explain" system)
- *Guidelines*: Providing interpretation of the provisions.

The Code's nine principles are:

1, The company shall adopt a clear CG structure.
2, The company shall have an effective and efficient board, taking decisions in the corporate interest.
3, All directors shall demonstrate integrity and commitment.
4, The company shall have a rigorous and transparent procedure for the appointment and evaluation of the board and its members.
5, The board shall set up specialized committees.
6, The company shall define a clear executive management structure.
7, The company shall remunerate directors and executive managers fairly and responsibly.
8, The company shall respect the rights of all shareholders and encourage their participation.
9, The company shall ensure adequate disclosure of its CG.

An essential ingredient to the Code is disclosure, leading to transparency, by means of two different documents: the Corporate Governance Charter, posted on the company's Web site and the Corporate Governance chapter in the annual report.

The *Code Lippens* has been in force since 01 January 2005, and has a dual compliance time-line:

- Corporate governance should have been on the agenda at the 2005 General Meeting of Shareholders for information and consideration, and, where possible, as a statement in the annual report for the year 2004.
- As from 01 January 2006, listed companies should have made their CG charter public, and a specific chapter related to CG activities will need to be included in their annual report for the year 2005.

Impact on Audit Committees

The fifth principle of the Code states that the board of directors shall set up an audit committee to assist in its monitoring responsibilities in respect to control in the broadest sense, including the disclosure of the committee's Terms of Reference (roles, composition and operation) in a specific Corporate Governance Charter. The principle further recommends that the audit committee be composed of at least three members; that the committee is entitled to seek external professional advice at the company's expense after informing the Chairman; and that after each committee meeting, the Board shall receive a report on each of the committee's findings and recommendations.

The Code devotes Appendix C to the composition, functioning and role of the audit committee. Some highlights from the Appendix are:

Composition

- The audit committee has non-executive directors exclusively, with a majority of independent directors.
- The chairman of the board should not be the chairman of the audit committee.
- The board should make sure that the audit committee has sufficient relevant expertise (e.g., financial expertise).

Functioning

- The audit committee should meet at least three times a year.
- The audit committee should decide who attends its meetings (i.e., the CEO, CFO, internal and external auditors, etc.) and should be entitled to meet with any relevant person without any executive manager present.
- Internal and external auditors should be guaranteed free access to the board. To this effect the audit committee should act as the principal contact point.
- At least twice a year, the audit committee should meet the external and internal auditors to discuss matters relating to its terms of reference and any issues arising from the audit process.

Role

The audit committee's main responsibilities include the monitoring of the following:

- Financial reporting process
- Internal audit process
- External audit process
- Internal control and risk management.

The full text of the final version of *Code Lippens* can be downloaded from the following Web site: www.corporategovernancecommittee.be.

EU Developments

In 2004, the European Commission published proposals for EU requirements on risk management and internal control in the form of the proposed Directive on Statutory Audit, and through proposed amendments to the Fourth and Seventh Directives. These proposals contain requirements for the audit committee, as a public interest entity, to monitor the effectiveness of the company's internal controls, its internal audit where applicable, and its risk management systems. Overall responsibility remains collectively with the management and the board.

The explanatory memorandum states that an effective internal control system minimizes financial, operational and compliance risks, and enhances the quality of financial reporting. Such a system requires the maintenance of appropriate policies and processes that ensure a prompt dissemination of reliable information and compliance with applicable laws and regulations, and safeguard the proper use of the company's assets. The function of the audit committee is to monitor and ascertain whether the control activities are performed, and that communication and reporting processes are in place for breaches of internal control policies and applicable laws and regulations.

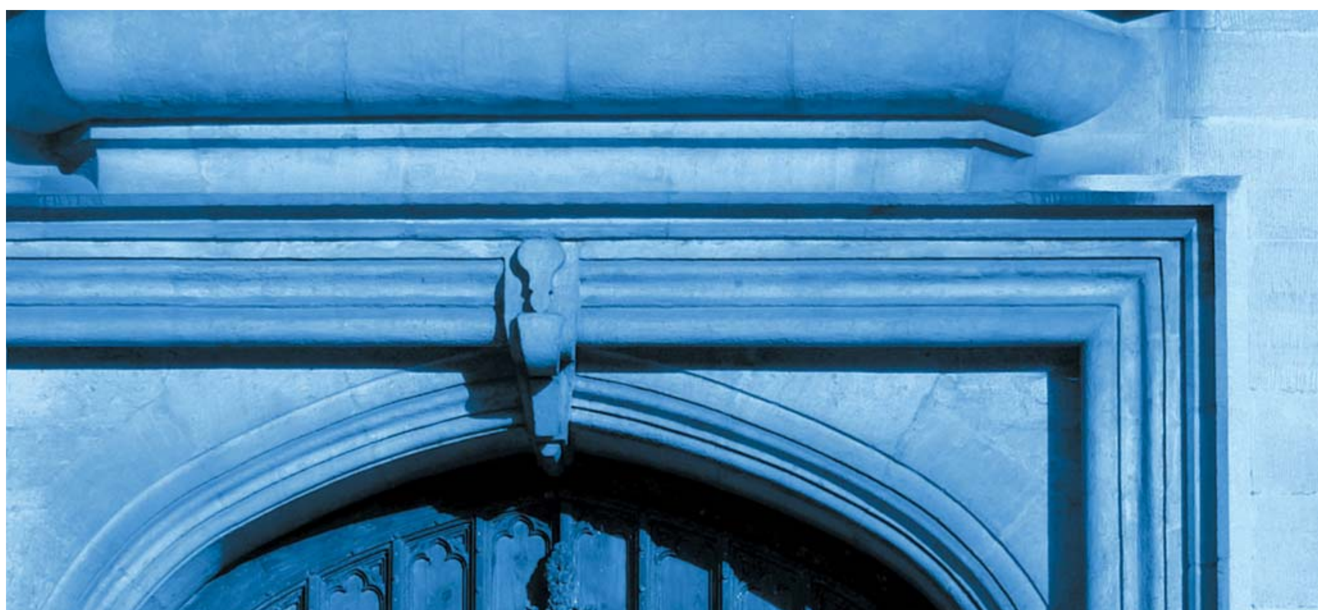
The proposed directive would require the audit committee to manage the following risks correctly: the financial reporting risks, the compliance risks and the operational and strategic risks. This means that the audit committee should identify and evaluate these risks, respond adequately, and conclude on the effectiveness of the measures put in place.

The proposal to amend the Fourth and Seventh Company Law Directives includes a requirement for all listed EU companies to provide a corporate governance statement in their annual report which would contain a description of the company's internal control and risk management systems. The scope seems to be limited to financial reporting, rather than to compliance, operational and strategic matters. High-level criteria for companies to facilitate consistent reporting should however be identified.

The mechanisms to guide companies to adopt more demanding standards of risk management and disclosure can only be successful where shareholders have effective power through company law to bring about change and influence management and the board of directors. These changes should not be underestimated. Often, major organizational changes will be required before a company will be able to support a statement that it manages its financial reporting, compliance and strategic risks. The company-wide adoption of a framework and language for considering risk and control issues is likely to be a prerequisite for any formal system of risk management and internal control.

Tax in the Boardroom

A corporate role for tax and tax governance



A changing tax environment

Tax has changed significantly in recent years. Its public profile has become much more conspicuous. It has acquired moral, ethical and social dimensions that have never been discussed before. For these reasons, the business management issues associated with tax have become more complicated, more subtle, more steeped in risk and much more challenging.

External developments, such as the Sarbanes-Oxley Act in the U.S. and growing public scrutiny of tax are forcing tax departments to come out of their "splendid isolation" to which business professionals have condemned them due to their perceived technical and support nature.

A corporate role for tax

What does tax do for the business?

At the heart of good tax risk management is a high level decision on the overall position the company takes on tax–its tax philosophy. Once this has been decided by the board, the tax department can be left to develop an action plan, deal with risk areas and achieve the strategic goals which have been set. Having established its tax philosophy, the board must then decide what the company wants tax to "do" for the business–what is its overall strategy for tax?

If the overall position is closer to the "social duty" end of the tax philosophy spectrum, the company's tax strategy can be expected to focus on compliance–on ensuring returns are filed correctly and on time, for example. There is a risk, however, that unless this can be reconciled to the company's responsibilities to its shareholders, management could be accused of lax financial management. Many companies adopt a position closer to the "duty to shareholders" end of the spectrum and see tax as a cost to be managed, albeit responsibly. A decision therefore needs to be made about how aggressive management should be, and consequently, what would be an acceptable level of risk.

External stakeholders

Non-owner stakeholders, including governments, pressure groups and society at large, are becoming more

strident in their demands on, and criticism of, companies. Boards are acting under growing pressure to oversee their tax affairs in ways that reconcile their obligations to shareholders with the expectations of other interested constituencies.

Boards should realize that although so-called "aggressive" tax planning strategies are creating value for shareholders in the short-term, they may destroy value in the long term by damaging the reputation of the company in the eyes of the interested external parties.

Striking a balance

Striking the right balance between what is and is not industry preferred practice has become more critical. In the past there was a clear distinction between legal tax avoidance and illegal tax evasion. This distinction remains clear in law, but has become blurred in the minds of governments, regulators and the public.

No consensus has yet emerged about how companies and their tax functions can or should accommodate the issues now associated with tax. Before a common understanding of what is, and is not acceptable is reached between each stakeholder group, board-sanctioned philosophies for tax need to provide tax departments with clearly defined parameters within which to assess and devise the overall strategy to achieve their goals and help manage tax risk.

Tax governance and preferred practice guidelines

A common framework should be developed to underpin the company's tax strategy, whatever tax philosophy it adopts. Preferred practice indicators that give shape and substance to a company's tax management style and strategy should be supported by appropriate behavior patterns that we suggest should be promoted and exemplified by the board.

An established "tone at the top" –the tax philosophy

Boards are responsible for setting philosophical and ethical principles, and overseeing the establishment of a strong and well documented control environment which is regularly and rigorously applied.

Clear attitude towards deviations from procedures

The discipline imposed by a control environment can depend as much, if not more, on the way breaches of the rules are treated, as on the rules themselves. It is the board's duty to ensure, through the way it mandates how deviations from established rules and procedures are treated, that the control environment actually controls.

Active oversight of tax strategy

Boards should oversee the articulation of tax risk policies that are not unduly conservative, and ensure that risks worth taking are taken in the interests of the business.

Insightful and timely reporting to the board

Boards should be informed about tax issues that have, or can have, a material impact on the company's financial statements. The method and frequency of communications can vary, but the process should normally include a regular annual report on the state of the company's tax affairs.

Appropriate reporting lines for the tax function

Senior management should take responsibility for defining reporting relationships and communication arrangements for tax at both group and operational level.

Appropriate staffing of the tax function

A tax function is only as good as its people. Senior management should ensure that high standards of tax management are achieved and sustained, that the tax function has the resources it needs, training is suitable, targeted and coordinated and that tax staff are motivated and appropriately assessed.

Appropriate controls within tax function

Companies need to be sure their compliance processes are effective, that their reporting processes are prompt and that their relationships with the tax authorities and auditors are being managed appropriately.

Independent reviews of the tax function

On a regular basis the board should consider having an independent review organized of their tax processes.

Conclusion - Tax as a strategic issue

Being “tax compliant” is a state to which companies should aspire and boards should seek to achieve. To be compliant not only means (as some assume) to be pliable, submissive or acquiescent, but also means adapted to the environment, and there is little that is pliable about that. Companies need to find ways to comply with the legitimate demands of their shareholders, as well as the legislative and regulatory demands of the societies in which they operate. Boards should set their tax philosophy, picking their way through the minefield of the modern business environment, acquiescing here, being adamant there, as they search for that value-maximizing state of compliance with the different, often conflicting demands of a range of interest groups.

Audit Committee Oversight on the Internal Audit Function

Companies must often weigh the benefits and costs of internal controls, with a typical consideration being whether to establish an internal audit function. The new Belgian corporate governance guidelines, *Code Lippens,* applicable to listed companies as of 01 January 2005, requires an independent internal audit function to be established. If no such function exists, the audit committee should review whether to establish one at least annually.

Internal audit functions, when effectively designed and deployed, can have a positive impact on the control environment of a company, and on the efficient design and operation of internal controls. As an important aspect of its mandate, internal audit can provide the audit committee with a means of monitoring whether the controls that management has put in place are reliable, are functioning properly, and are sufficient to address the risks in the financial reporting process.

The Belgium Audit Committee Institute publication *Shaping the Belgium Audit Committee Agenda* is based on international best practices, and is adapted to *Code Lippens.* It provides guidance on the internal audit oversight role of the audit committee. Some of the topics covered are:

- Developing and approving the internal audit department's mandate, goals and mission
- Reviewing the (re)appointment, promotion, or dismissal of the head of internal audit, and the determination of their qualifications, reporting hierarchy and compensation
- Monitoring whether the internal audit function has adequate resources
- Follow up on the internal audit department's scope, the results of its operations and recommendations, and of management's responses thereto
- Regular evaluation of the internal audit department's objectivity and independence of judgment
- Monitoring and assessing the role and effectiveness of the internal audit function in the overall context of the company's risk management system
- Reviewing and assessing the annual internal audit work plan.

The publication also includes some practical tools, such as an example of an internal audit plan, and a framework which audit committees can use when reviewing the effectiveness of the internal audit function.

If you are interested in receiving this publication, please return the enclosed registration card or go to our Web site www.audit-commitee-institute.be and register free of charge.

SOX 404: Responding to an Adverse Report

Recently the AICPA has issued a checklist designed to assist the audit committee of a company that has received an adverse report on the effectiveness of its internal control over financial reporting.

The first part of the checklist contains an overview of the legal and regulatory requirements concerning internal control over financial reporting, and defines some of the key terms. The remainder of the checklist identifies steps the audit committee might take when faced with an adverse report on internal controls.

A copy of the checklist is available on the AICPA Web Site: http://www.aicpa.org/index.htm. Once at the site, select "Audit Committee Effectiveness Center" in the column on the left, and then select the checklist under "Spotlight Area" on the right.

Evolving issues providing additional insight

Our ACI website includes additional resources that we believe may be useful to audit committee members in providing oversight to the financial reporting process. Examples are: a white paper helping leaders to reduce compliance costs and risks by means of a structured evaluation of their organizations, a white paper highlighting the management of tax risks in recent business environment and an Economist white paper *Corporate Governance, Business under Scrutiny* stressing that corporate governance is still a front-burner issue for senior executives: http://www.audit-committee-institute.be

European Corporate Governance Forum

The European Corporate Governance Forum, which examines best practices in Member States in the field of corporate governance, held its second meeting in Brussels on 20 June 2005. The aim of the meeting was to discuss a number of current issues in the field; in particular shareholders' rights and internal control.

The Forum concluded that an appropriate balance has to be found between managerial entrepreneurship and shareholder control. It considered the facilitation of the cross-border exercise of shareholders' voting rights. It equally considered the area of internal control and risk management which aims at ensuring that companies manage their risks efficiently and safeguard shareholders' investments. The increase in disclosure requirements and the requirement to establish audit committees that will be introduced by the forthcoming modifications of the 4th, the 7th and the 8th Company Law Directives are viewed by most as important steps towards improving corporate governance. However, further legislative measures in this field should be taken.

At the next meeting of the Forum, which is planned for November 2005, the "comply-or-explain" principle, which obliges companies to justify any deviations from corporate governance codes will be discussed, and the exchange of views on shareholders' rights and internal control will be continued.

More information on this subject and on corporate governance at the European level, including guidance of the Commission on directors' remuneration and the roles of independent directors, can be found by accessing the Web site of the European Union:

http://europa.eu.int/comm/internal_market/company/index_en.htm

IASB exposure draft on IAS 37 Provisions, Contingent Liabilities and Assets

The International Accounting Standards Board (IASB) end of June 2005 published for public comment proposed amendments to *IAS 37 Provisions, Contingent Liabilities and Contingent Assets* (to be re-titled *Non-financial Liabilities*) and complementary limited amendments to *IAS 19 Employee Benefits*.

The amendments to IAS 37 would require entities to recognize in their financial statements obligations that satisfy the definition of a liability in the IASB's Framework, unless they cannot be measured reliably. Uncertainty about the amount or timing of the economic benefits that will be required to settle a liability would be reflected in the measurement of that liability, instead of determining whether it is recognized. This change would enhance financial reporting because some liabilities previously disclosed only in the notes to the financial statements will now be included in the balance sheet.

Further, the proposals would require liabilities for costs associated with a restructuring (e.g., termination benefits) to be recognized only when the IASB's Framework definition of a liability is met. This would improve the comparability and representational faithfulness of financial information because like transactions would be accounted for similarly, regardless of whether they are associated with a restructuring. More generally, the amendments would align the recognition principles in IAS 37 with those in more recent FASB standards on liabilities.

The IASB invites comments on the Exposure Draft by 28 October 2005. The text of the Exposure Draft is available on the IASB's Web site:

http://www.iasb.org/

Study Links Audit Committee Rating and Stock Price

A study by Roman L. Weil, a professor at the University of Chicago, concludes that shareholders benefit from a company having a more financially literate audit committee.

As part of the study, Weil rated the financial literacy of audit committees at the 200 largest and the 100 smallest companies in the Fortune 1000 list, and tracked the ratings for 2000 and 2003 to see how the ratings changed. He also tracked stock prices for the 300 companies during the same period. From the beginning of 2000 to the end of 2003, the study found that the companies that increased their audit committee ratings experienced a stock price increase of 4,6 percent more per year than companies whose audit committee ratings did not increase.

A copy of the article, *Audit Committee Financial Literacy: A Work In Progress*, is available on the University of Chicago Web site (http://gsb.uchicago.edu/). Once at the site, select "Faculty" on the left, select "faculty pages," select Roman L. Weil, select "view unrestricted research," and select the second item.

Study on expenses related to Corporate Governance reforms

Recently the law firm of Foley & Lardner LLP released the results of its study, titled *The Cost of Being Public In The Era of Sarbanes-Oxley*.

The study was designed to measure attitudes toward current corporate governance reform among top executives, as well as a comprehensive review of proxy statements filed in 2005 by certain S&P Small-cap, S&P Mid-cap and S&P 500 companies. Among the study's findings:

- The average cost of being public in 2004 for a company with annual revenue of less than $1 billion was $3.42 million, which represented a 33 percent increase over 2003 costs and a 223 percent increase since the enactment of Sarbanes-Oxley.
- In 2004, the average cost of being a public company with annual revenue of more than $1 billion was $14.24 million, a 45 percent increase over 2003 costs.
- A vast majority (82 percent) of respondents felt that corporate governance and public disclosure reforms are too strict, an increase of 15 percent compared to the 2004 survey.

A copy of the study is available on the Foley & Lardner Web site (http://www.foley.com/) under "Latest News."

ACI Events

Roundtable Series

ACI facilitates interactive audit committee roundtables twice each year; in the spring (May/June) and autumn (October/November). Each features a guest speaker, and provides for a limited number of professionals an exchange of views and insights on topics of interest to members of boards and audit committees. The ACI roundtable sessions can provide you with additional knowledge (focus on topics), enhanced competence (sharing of best practices) and personalized assistance (individual contacts with your peers) you will find helpful in your increasingly responsible oversight role.

The *Belgium Autumn 2005 Audit Committee Roundtable* series will be held in October. Members of audit committees and boards of listed (and other large) companies will receive a personal invitation to participate.

Seminars

The professional development of board members is of increased importance and focus as corporate governance evolves.

The ACI seminars are designed to update members of boards and audit committees on current best practice, along with recent developments in accounting, company law, corporate governance and other regulatory matters. The material will be focused and presented at a high level, adapted to the particular needs of members of boards and audit committees. Registration is free of charge.

The next half-day seminar will cover an IFRS update, and will be held on 22 November 2005.

For more information on the ACI events, or to register, please visit our Web site www.audit-commitee-institute.be, or contact us via our email at info@auditcommitteeinstitute.be.

About us

The Belgian Audit Committee Institute (ACI) was established with the purpose of providing members of audit committees and other board members with the knowledge required to carry out their responsibilities. ACI follows developments in the field of governance, audit issues, accounting, and financial reporting, both in Belgium and internationally.

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