Audit Committee Institute
Sponsored by KPMG

Audit Committee Quarterly

Issue 03

BELGIUM

Welcome 1

How Budgeting and Forecasting can Affect your Bottom Line 2

Information Technology in the Board Room 4

Responsibilities and Liabilities of Audit Committee Members 6

Corporate Governance Compliance Survey 8

Informing Board Members: Integration of the Finance Function 10

Whistleblowing: Is Silence Always Golden? 12

ACI International Survey Results 14

U.S. Developments 15

Extended Content Annual Report Board of Directors 18

Resources 20

Events 24

Background

Audit committee and other board members occupy center stage today in the wake of corporate governance reforms. Their challenges are numerous, with perhaps their biggest challenge that of satisfying increased regulatory compliance requirements while maintaining their overall effectiveness.

The Audit Committee Institute (ACI) platform offers directors and audit committee members the opportunity to gain the additional knowledge, enhanced competencies and personalized assistance they need to fulfill their demanding oversight roles.

The ACI, sponsored by KPMG, has been communicating with board and audit committee members on an international level since its formation in 1999. In Belgium, ACI is in direct and regular contact with over 2.500 directors. Fundamentally, ACI programs support members by providing a focus on evolving issues, the sharing of best practices, and the opportunity to meet with their peers.

- The ACI publication ***Shaping the Belgium Audit Committee Agenda*** is the *Vademecum* for all Audit Committee members, providing them with knowledge, tools and techniques to help them better fulfill their demanding mission.

- The ***ACI Web site*** (www.audit-committee-institute.be) and the ***Audit Committee Quarterly*** periodical offer articles from ACI on regulatory and technical matters, feature audit committee "hot topics", and include other content from our extensive resources.

- ACI ***Roundtable Sessions*** and ***Seminars*** provide an opportunity to gain first-hand experience, and for an exchange with peers and Audit Committee Institute professionals.

Audit Committee members and other board members are looking for *focused knowledge* and the *sharing of best practices*. Registration at the ACI Web site provides them with this helpful range of tools *free of charge*.

Please refer to the ACI Web site (www.audit-committee-institute.be) for registration.

Welcome...

...to the latest edition of *Audit Committee Quarterly Belgium*, a publication designed to help keep audit committee members abreast of developments in corporate governance and related matters.

For those of you new to the Audit Committee Institute (ACI), and this publication in particular, a brief outline of the background to ACI is set out opposite.

As the European Union has made it mandatory for all listed companies to have adopted **IFRS**, it is time to take these changes into account in daily practice. The main considerations for your next **budgeting process** have been described on page 2.

Referring to our previous edition, we are grateful to those of you who participated in our **ACI International Survey** on audit committee practices. We have been able to query many of our member directors on several audit committee hot topics. Other European and international countries have been involved as well, and we have thus been able to compare Belgium to the rest of the world, with quite surprising results. A brief description of the findings can be found on page 14.

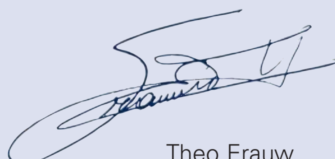
From this survey, and from personal reactions received during our Roundtable conferences, we learned that many of you are worried about your personal liability. In response to your concerns, we have included the article **Responsibilities and Liabilities of Audit Committee Members** on page 6 of this issue.

We remind you that those who design and implement internal controls –management– can also override or bypass internal controls. Appropriate action may help avoid this, but if not, it certainly will help to prepare for the obvious questions relating to audit committee propriety and skepticism. We elaborate further on what your actions could be, and have provided you with a practical article on implementing **Whistleblowing** programs on page 12.

We continue our Audit Committee Resources series (starting on page 20) where we bring you articles of interest from around the globe. In this edition, we include a piece **Women on the Board: A Business Case for Diversity**, stating that the presence of women on the Board of Directors has a positive impact on the bottom line results.

Many other topics are included, as well as our regular updates on specific international and financial reporting developments.

I trust you will continue to enjoy the ongoing benefits of ACI. Please contact us at info@auditcommitteeinstitute.be with any comments or suggestions of topics you would like to see covered, and do visit our Website at www.audit-committee-institute.be for further ACI information.



Theo Erauw
Chairman ACI Belgium

How Budgeting and Forecasting can Affect your Bottom Line

Not only can IFRS standards have a far-reaching effect on the consolidated statements of companies when compared to local accounting principles, IFRS also affects companies' budgeting, forecasting and management information requirements.

Some standards link specific accounting entries with the budget and mid- to long-term business plan by means of expected future profits and cash flows. For some companies, this switch to continuous planning and forecasting might involve changes to the primary management reporting package used before adopting IFRS.

In the following, we will discuss two areas where the accounting treatment conforming to IFRS standards is directly dependent upon the future cash flows derived from the multiple year budget, i.e., accounting for goodwill following IFRS 3 and IAS 36, and accounting for deferred taxes in accordance with IAS 12.

Goodwill Impairment

A major difference of IFRS when compared to local GAAP is that IFRS 3 requires the residual goodwill amount to be allocated to so-called “cash generating units” (CGUs), generally legal entities or divisions within the group.

CGUs are expected to benefit from the business combination. Goodwill is no longer amortised over a certain period of time, but is to remain on the balance sheet and be subjected to an annual impairment test in accordance with the IAS 36 standard. An impairment loss is recognised if the CGU carrying amount exceeds the higher of its “fair value less cost to sell” and “value-in-use”.

“Fair value less cost to sell” is the price obtained in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal (or a reliable indication of what could be obtained). Value-in-use is the net present value of future cash flows generated by the CGU.

Because specific market data for some businesses are not always available, a company must often rely more on the value-in-use calculation, and hence on management's forecast of future cash flows. Although IAS 36 demands that these cash flows be based on the most recent financial budget, it is clear that the annual calculation of the value-in-use according to this standard will force both group and CGU management to refine and continuously (or at least annually) update its mid- to long-term budget. IAS 36 suggests a five year forecast unless a longer period can be justified.

Because value-in-use measures the cash flows that are generated by the assets of the CGU (including goodwill) in their current condition, the management forecast must be adjusted for any cash in-flows or out-flows arising from either the future restructuring of the business or the business' performance improvement. Moreover, the standard indicates that cash flows must be detailed and specific for the CGU, while stressing the importance of external evidence, i.e., the benchmarking of projections with the changing economic conditions of the market in which the CGU operates, as well as the evolution of the industry

to which the CGU belongs. Management should demonstrate the reasonableness of its projections and assumptions by analysing the causes of differences between past cash flow projections and actual cash flows.

Finally, the useful life of a CGU to which goodwill has been allocated tends to be infinite, which means that management will have to extend its forecast beyond the suggested five year period. In doing so, management should not exceed the long-term average growth rate for the products, industries or countries in which the CGU operates.

Deferred Tax Assets

Budgeting and management forecasts also need to consider accounting for deferred taxes in accordance with IAS 12, particularly when dealing with deferred tax assets. A deferred tax asset is recognised in respect of deductible temporary differences, only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. The assessment of whether a deferred tax asset should be recognised on the basis of the availability of future profits should take into account all elements related to the entity's expected future profitability, both favourable and unfavorable, and hence is very much linked to the assessment of maintainable profit levels in the budget approved by the Board.

The requirement to consider future taxable profit applies equally in assessing the recognition of a deferred tax asset arising from unused tax losses and tax credits. In this case, IAS 12 provides further guidance, i.e., in case the company has a track record of recent losses, a company should evaluate whether these losses arise from non-recurring elements, and a deferred tax asset should only be recognised if sufficient convincing evidence of future taxable profit will be available. Again, this refers to an internal due diligence on causes of differences between past forecasts and actual figures in order to further refine the budgeting process.

Conclusion

From the above, it is clear that specific accounting entries under IFRS should be based on detailed multiple-year management forecasts which are continuously updated. For some companies, this may change the existing management reporting, as the IFRS requirements force companies to integrate best practices such as external benchmarks, assessment of relative performance to peers and industry, comparison of annual budgets with continuous and rolling budgets, etc., into their budgeting and management information process.

Information Technology in the Board Room

Changing environment

The changing business environment increases management expectations of the results that information technology (IT) will bring to the company. Today, IT is required to maintain and support the company's compliance, as well as deliver concrete business benefits at growing rates, and all this has to be achieved at acceptable cost. This is new for some companies, where they regarded their IT department as a world on its own for many years, governed by a separate language and unfamiliar customs, and very much unlike the rest of the company.

In recent years, business and IT communities have come to the conclusion that IT and business are more closely interconnected than originally thought. Developments that occur in one of the two areas have strong implications for the other. We have seen this at the end of the last century, when the technology-led internet bubble brought grief to many companies. This taught us, among other things, that too much focus on the application of technology without proper attention to business requirements results in major business losses and even bankruptcies. Now, the pendulum has swung to the other side. Corporate scandals and the resulting legislation that focus on improving business governance, such as Sarbanes-Oxley, have stressed the dependency of good control over the company's processes and assets, and that most certainly includes IT.

IT Governance

The present momentum encourages companies to focus on improving their risk and compliance management, bringing it in line with the new regulations. Even though this is necessary in itself, one shouldn't lose sight of the primary goal of IT in companies, i.e., to bring benefits to the business that increase bottom-line results through efficient operations and effective support of business processes. Perhaps that is what good IT governance is all about: finding the sweet spot where there is a right balance between risk management and business benefits.

Internal Audit of IT

An instrument for the Board to use to encourage good IT governance is the internal audit of IT. The fundamental role of internal audit of IT is to independently inform the Board of the status in the company’s IT domain. Because of the significant investment that IT represents, and the importance of IT in supporting company successes, the audit of IT should receive sufficient attention by the Board.

Led by changes in the external environment such as legislation, the reporting by internal audit of IT has become more and more focused on the risks the company faces in its IT organization, and on the management controls needed to mitigate those risks. However, in the view of balanced IT governance, risks and controls do not tell the complete story.

It is business alignment and process efficiency that ultimately provide much of a company's value. For survival and growth of the company, the Board should also be informed of the company's efficiency and capability in delivering value and in grasping business opportunities.

For many business processes, it has therefore become regular practice to dedicate audit resources not only to the compliance aspects of the business, but also give proper attention to its operational aspects. Often these audits have a wider view than only risk and controls, and include assessments of process efficiency and cost effectiveness.

However, in the IT domain, this audit positioning is still relatively rare: IT audits remain largely focused on risks and controls. This leaves an important business domain that is not covered by internal audit: the efficiency and business alignment of the company's IT.

Changing the auditor's role

Apart from drawing IT management's attention to developing IT good practices indirectly, through targeting internal audit to the IT domain and subsequent reporting to the Board, internal audit can also be used to influence the behavior of organizations more directly, through face-to-face discussions with IT management, and by providing concrete recommendations for the improvement of management practices.

This requires a change in the mind-set and the skills of the company's internal (IT) auditors. Auditors can no longer simply point out the identified weak areas or areas of non-compliance. They are also required to work together with IT management to identify the opportunities to improve, and to explain the business sense of it. For this role, auditors need both a conceptual knowledge of the new insights into good practices and a thorough practical understanding of the IT environment and its processes.

Conclusion

By expanding the mandate of the internal audit of IT to cover both the risk management of IT and the business benefits that IT brings, the board promotes good governance over IT. The times when IT was regarded as an ivory tower are definitely over. The times of IT as an essential part of the enterprise that drives progress and maintains control have begun.

Responsibilities and Liabilities of Audit Committee Members

In a previous issue of the ACI Newsletter, we discussed the five basic principles for Audit Committees, and heavily stressed the responsibilities of the audit committee members in respect of these principles. In this article we will give a brief, but not inclusive outline of the liabilities of the audit committee members under Belgian law.

The audit committee within the legal framework of the Belgian Companies Code (BCC)

First, it is generally accepted that the audit committee can only consist of directors (the words "in its Midst" in Art. 522 seem to suggest that, in the mind of the legislature the members of the audit committee must all be directors). Also the respective corporate governance codes (for listed companies the "Code Lippens"; for non-listed companies the "Code Buysse") prescribe or imply that (at least the majority of) the members of the audit committee should be independent directors – please bear in mind that the corporate governance codes are soft law.

To be able to address the potential liabilities of audit committee members, we should first consider the legalities pertaining to the audit committee. Art. 522 §1 Par. 3 BCC provides that the Board of Directors of a public limited liability company (*Naamloze Vennootschap* or NV, *Société Anonyme* or SA) can establish one or more advising committees "in its midst" and under its responsibility, with one being the audit committee. In Article 522, the audit committee is considered to simply advise the Board of Directors; it is the latter group that will ultimately take the necessary decisions.

However, Art. 133 Par. 6 BCC grants real powers to the audit committee, namely the power to decide on exceptions to the One-to-One Rule. As some observers have pointed out, this is difficult –if not impossible– to reconcile with Art. 522 BCC, or with the exclusive decision powers of the board of directors constituted as a whole. The corporate governance codes Lippens and Buysse stress the fact that an audit committee can have only an advisory competence. Below, we address the question as to whether or not the legal decision authority granted to the audit committee results in a liability issue for its members (exceeding the liability as a director).

Do the liabilities of the audit committee members exceed those of the board of directors as a group?

The first assumption to be made in answering this question is that the audit committee is entirely composed of directors (please refer to above). As long as the audit committee performs its advising role under Art. 522, §1, par. 3 BCC, only providing advice to the board of directors, the answer to the above question seems to be negative. As the board of directors takes subsequent decisions as a collegial body, the board of directors therefore is, and remains, liable for its decisions, even if the board based its decision on the advice provided by the audit committee.

This does not mean that the members of the audit committee are not responsible for their actions within the audit committee, but one could state that their liability as a member of the audit committee does not exceed, in this case, their responsibility as a member of the board of directors. However, it can not be excluded that a member of the audit committee could be held liable in his capacity as a member of the audit committee, while performing only an advising role.

What if the audit committee takes actual decisions under Art.133, Par.6 BCC? Some observers hold that only the directors which are also members of the audit committee should bear responsibility and thus be subject to liability regarding the decision(s) taken by the audit committee. The board of directors would not bear responsibility or a liability risk in this regard, at least not directly. This means that, should liability be assigned to a member of the audit committee, he or she could only revert to the other members of the audit committee for their part in the event that led to the liability, and not to the members of the board of directors who were not members of the audit committee.

However, it can be posited that the board of directors bears responsibility nonetheless, since the board of directors remains liable for the true and fair view of the annual accounts. As one author has pointed out, by making decisions under Art.133, Par. 6 BCC, the audit committee has expressed itself on the impartiality of the auditor, and thus on the credibility of the annual accounts. One could therefore claim that even when the audit committee takes a decision, the board of directors remains additionally liable. Further, as the audit committee is a part of the board of directors and not a body of the company (Art. 133 Par 6 BCC refers expressly to the fact that the audit committee is formed within the board of directors), the decisions it takes, even when within its legal competence, are eventually decisions with possible consequence to the board of directors as a whole, albeit this point of view is not to be considered generally accepted.

Conclusion

Essentially, audit committee members in an advising role, as determined by Art. 522, §1, Par. 3 BCC, are limited in their liabilities as are other members of the board of directors. The board of directors is liable for the decisions it takes, whether or not based on the advice of the audit committee.
Generally speaking, members of the audit committee are solely liable for the decisions they take in application of Art. 133, Par. 6, 1° BCC, i.e. excluding other board members who are not members of the audit committee as well. Though liability issues must be considered on a case-by-case basis, it seems reasonable to assume that the real liability risks resulting from taking a decision in application of Art. 133, Par. 6 BCC are low.

Corporate Governance Compliance Surveys

Code Lippens – Transparency Principles

In December 2004, the Corporate Governance Committee under the presidency of Maurice Lippens introduced a set of corporate governance (CG) principles applicable to all Belgian stock-listed companies. One of the transparency principles of what became known as **Code Lippens** included a guideline for these companies to publish a "Corporate Governance Charter" (CG Charter) on their Website by 01 January 2006.

The *Code Lippens* issued the following guidelines for this charter document:

- The company should state in its CG Charter that it follows the corporate governance principles laid down in the Code (Principle N°9.2).
- The CG Charter should be updated as often as necessary so to reflect the company's current corporate governance. It should be available on the company's Web site, and specify the date of its most recent update (Principle N°9.3).
- Whenever price sensitive information or changes in shareholders' rights occur in relation to corporate governance, the company should disclose it immediately (Principle N°9.5).
- The Corporate Governance Charter should, at the least, include: (Principle N°9.1/1)
    - A description of the governance structure of the company, with the terms of reference of the board.
    - The policy established by the board for transactions and other contractual relationships between the company (and its related companies) and its board members and executive managers, which are not covered by the legal provisions on conflicts of interest.
    - The measures taken by the company in order to comply with Directive 2003/6/EC on insider trading and market manipulation (market abuse).
    - The terms of reference of each committee (Audit Committee, Remuneration Committee, Nomination Committee, etc.).
    - The terms of reference of executive management.
    - The remuneration policy.
    - The shareholding and control structure of the company, and any cross-shareholding exceeding five percent of the total shareholding or voting rights, insofar as it is aware of them, and as soon as it has received that relevant information.
    - The identity of its major shareholders, with a description of their voting rights and special control rights, and, if they act in concert, a description of the key elements of existing shareholders' agreements.
    - Any other direct and indirect relationships between the company and major shareholders.

Studies' results

The first study by KPMG Advisory and Corgo, published in their *Corporate Governance Barometer* issued mid-January 2006, indicated that 58 of the 101 listed companies investigated (the quick scan was based on the national indices Bel 20, Bel Mid and Bel Small) had already published a CG Charter on their Web sites as of 7 January 2006. The quick scan survey also indicated that it should be considered as a snap-shot, as it was clear during the survey period that new charters were being made public virtually on a daily basis.

A second quick survey was made on 1 February 2006 by the Federal Organization for Belgian Enterprises (VBO). Their results confirmed the first study's trend: All nineteen Bel 20 companies disclosed their corporate governance charter as of 30 January 2006; almost 80 percent of the Bel Mid and 50 percent of the Bel Small companies did the same.

Corporate Governance Barometer - Main results

The quick scan survey performed by KPMG Advisory and Corgo, focusing on the compliance of the listed companies with the recommendation by *Code Lippens* to publish a corporate governance charter, generated the following additional results:

- The 58 listed companies surveyed were not only formally complying by publishing their CG Charter, but were also working in the spirit of corporate governance as intended by Code Lippens. Several of the survey results support this argument:
  - A number of companies were already publicising a second version of their corporate governance charter, demonstrating that they are continuously updating the charter.
  - A number of companies announced their first charter publication on a short-term basis, it was clear that new CG Charters were being made public almost daily, and several companies had previously disclosed corporate governance-related information on their Web site, but had not yet bundled it into a specific charter format.
  - Some companies indicated in their charter their current percentage compliance with the *Code Lippens*' transparency recommendations, including its intention and motivation to improve. In this regard, it should be emphasized that the *Code Lippens* does not focus on full compliance, but rather on a continuously-maintained spirit of corporate governance.
  - A number of companies indicated that they would not yet disclose some corporate governance-related elements in their charter, but would publish them in the specific Corporate Governance Charter in their 2006 annual reports.
- A vast majority of the Belgian listed companies' boards of directors have installed several subcommittees. The main subcommittees are: the audit committee, the remuneration committee and the nomination committee. Also, other subcommittees such as strategic committees or supervisory committees are increasingly being established.

Informing Board Members: Integration of the Finance Function

The current environment

For organizations that must comply with them, IFRS, the Sarbanes-Oxley Act of 2002 and Basel II – and other international and local regulations – pose challenges and drive varying business priorities. Indeed, such mandates have resulted in a number of persistent challenges for those managing their organizations' financial infrastructures.

These challenges include:

- Excessive, perhaps redundant, financial reporting costs.
- Problems in meeting and expediting reporting deadlines.
- Limited time for data analysis due to the amount of time needed for data collection and consolidation.
- Differences in content between internal and external reporting, requiring labor-intensive reconciliations.
- Excessive manual "work-arounds" resulting from too few automated processes, driving concerns about information quality and auditability.
- Lack of transparency of financial reporting processes and data.
- Need for reliable, timely, meaningful information for board members or for corporate transactions.

These challenges often create "imbalances" in the execution of financial and managerial reporting requirements at many organizations, in areas including planning, budgeting, forecasting, management reporting, and external reporting to legal and regulatory bodies as well as to shareholders.

If allowed to persist, this imbalance between compliance and performance can result in missed opportunities to deliver sustainable value through an integrated finance function.

Addressing today's challenges

Financial leaders and board members need to assess their finance functions so they can begin to determine how to improve the balance between compliance and performance. An important aspect of this assessment is an analysis of the relationship between the finance function and the organization overall.

For example, in a highly integrated group with strong centralized management, the finance function generally has an enhanced ability to drive organizational change. By contrast, a finance function in a financial holding group, with legal entities operating with a high degree of independence, may face greater challenges in addressing imbalances organization-wide. Once the relationship between the finance function and the organization overall is understood, finance leaders with the support of the board can begin to consider how the finance function should evolve. As it matures, the finance function should begin to spend less time on transaction-processing activities and spend more time on value-driving activities.

Key Questions

A number of important questions can help board members assess the level of integration of the finance function:

- Is our organization able to sustain compliance with changing regulations?
- Do we meet reporting deadlines on a timely basis?
- To what degree do we produce high quality, accurate reporting?
- Are our stakeholders able to understand our organization and performance based on our reporting?
- Can we further standardize and simplify our systems and processes?
- Can we improve our degree of automation?
- Do we have a group-wide chart of accounts?
- Are data sources consistent for multiple types of reporting?
- Can we use shared services to improve aspects of our finance function?
- Do we have the right staffing levels?
- Do we have the right people with the right skills to address complex accounting and reporting requirements?
- To what degree does our finance staff have an in-depth knowledge of the business?
- Can we create better and faster management information?

Making the change

Organizations have differing structures, systems, and industry-specific circumstances, which prevent a one-size-fits-all approach to an integrated finance function. In addition to strategic decisions concerning, for example, modifications to existing systems or whether to purchase or to develop new systems, management will need to consider tactical issues, including:

- The most appropriate method to harmonize internal and external reporting
- Whether changes are made at the group, company, or the source-system levels
- How to deal with dual-reporting requirements
- How to deal with the conversion approach from a general ledger under one GAAP to a general ledger under another GAAP
- How to manage the risks of model-driven solutions.

Addressing these issues today can help enable leaders to better address the impacts on systems, processes, and people, as well as limit unnecessary costs resulting from duplication of effort or changes in approach at a later stage.
The strategic and tactical decisions relating to an integrated finance function should be conducted within the organization's governance framework to closely align any significant changes with the organization's strategic business goals. Closing the gap between compliance and performance can help reduce costs and facilitate a transition to a single platform for all financial reporting needs.

Conclusion

Financial leaders and board or audit committee members need to assess their finance functions so they can begin to determine how to improve the balance between compliance and performance. An integrated, well-balanced reporting environment that achieves compliance and also supports overall business goals is a result that would help drive value for all stakeholders.

You can read more about the background, methods and results of integrating the finance function by downloading the full KPMG Advisory white paper on Finance Integration free of charge in the "Other Resources" caption of our Web site www.audit-committee-institute.be.

Whistle-blowing: Is Silence Always golden?

The number and deep impact of recent corporate scandals has propelled whistle-blowing back into the spotlight as a means for identifying wrong doing. If there is one thing that the collapse of Enron and Worldcom has shown, it's that by the time these frauds came to light – by the actions of whistle-blowers on both counts – they were so far advanced that it was simply too late to stop a corporate meltdown.

These events demonstrated that either it was possible for fraud to be so well covered-up and internal controls so loose that they just weren't spotted until the eleventh hour, or, there was limited scope for individuals aware of the problems to make their voice heard.

The whistle-blowing concept

The well-known objective of whistle-blowing is to allow internal venting and resolution of concerns relating to fraud or other criminal activity by employees without the need for external disclosure. It is based on the principles that silence should not be the only safe option for employees. It puts a safe framework into place for workers to raise concerns about misconduct in an organization, and provide information about illegal or underhanded practices.

The generally accepted *Micelli and Near* definition of "whistle-blowing" is the "*organizational members' disclosure of illegal, immoral or illegitimate practices under the control of their employers, to parties who may be able to effect action*". In this context, some countries have issued whistle-blowing arrangements defining: (i) the circumstances where employees can alert external parties of irregularities, and (ii) how the whistle-blower is protected against reprimands. Such general whistle-blowing arrangements do not exist in Belgium. That said, some Belgian companies may nevertheless be subject to regulations imposing a whistle-blowing program, and it could well be that a whistle-blowing program is a valuable instrument for any company.

The Regulatory Framework

The Sarbanes-Oxley Act, to which a number of Belgian companies are subject, contains references to whistle-blowing programs. In Section 301, it is stipulated that the audit committee must provide: (i) a mechanism for employees to remain anonymous when reporting concerns about accounting or audit irregularities, and (ii) a process for the receipt, retention and treatment of complaints regarding financial irregularities. When implementing such whistle-blowing programs, companies should evaluate whether anonymous reporting as defined in the Sarbanes-Oxley Act – implying that the whistleblower does not have to reveal its identity – is acceptable under the Belgian Privacy Law, as this is still a point of discussion among legal practices. In some countries, Privacy Law indeed requires the revealing of the identity of the whistle-blower to the accused person eventually proved innocent. Recent legal cases in Germany and France, for example, demonstrated that anonymous reporting is not legal in those countries.

The Belgian Code on corporate governance does not include the notion of anonymity when referring to whistle-blowing programs. It states that "*The audit committee should review the specific arrangements made, by which staff of the company may, in confidence, raise concerns about possible improprieties in financial reporting or other matters*". The notion of "in confidence" implies that the whistle-blower must reveal his identity toward the reporting instance, but not to other parties.

A Whistle-blowing Program

Even if they are not subject to one of the above-mentioned regulations, Belgian companies could still consider the implementation of a whistle-blowing program. Indeed, various international surveys indicate that one of most important means of uncovering fraud is notification by employee, and that considerable amounts are lost due to fraud. A whistle-blowing program thus constitutes a valuable fraud prevention and detection system.

A solid whistle-blowing program consists of three elements:

- Fraud Hotline
- Training
- Whistleblower Protection.

The existence of an *internal fraud hotline* encourages employees from immediately going public with their accusation. The company has then the opportunity to deal with the problem internally and to avoid damage to its reputation. Various parties could fulfil the role of fraud hotline, for example the Internal Audit department, the Audit Committee, the Ethical Committee or the Forensic Audit department. It is of the utmost importance that a party is selected that is regarded throughout the complete organization as being independent. Therefore, it might even be considered to outsource the internal fraud hotline to an external company.

[1] The full document offering guidance to Audit Committees relating to whistle-blowing may be downloaded at no charge from the AICPA website http://www.aicpa.org. Browse to the "Audit Committee Effectiveness Center" and find the document "Anonymous Submission of suspected wrongdoing (Whistle-blowers) - Issues for Audit Committees to consider."

An effective whistle-blowing program can only be implemented when all employees receive the necessary training on ethical behaviour and fraud. First of all, employees should be trained on what behaviour is expected within the company. This could be realized through the implementation of a code of conduct. Secondly, employees should be able to determine what can be considered as fraud and when the fraud hotline should be alerted. Finally, the function of the fraud hotline should be communicated throughout the complete organization.

One of the most important parts of a whistle-blowing program is the *protection of the whistle-blower*. It should be avoided by any means that a whistle-blower in good faith becomes the victim. One could therefore argue for implementing anonymous alerts, but the downside of this approach would be the opportunity to misuse the fraud hotline. A more realistic approach would require the whistle-blower to identify themselves to the fraud hotline, who then guarantees the confidentiality of the whistle-blower. Furthermore, the whistle-blowing program should also make clear that misusing the fraud hotline for personal objectives could result in the sanctioning of the whistle-blower.

The AICPA (American Institute of Certified Public Accountants) has developed a tool[1] which enables audit committees to evaluate the whistle-blowing program by assessing: (i) the design effectiveness of the hotline, (ii) whether management is actively promoting the existence and use of the hotline, and (iii) the processing of the received communications.

Apart from the direct advantages of fraud prevention, fraud detection, and control of damage to reputation, the implementation of a whistle-blowing program provides some supplementary advantages to a company. Even if an accusation appears to be incorrect, it might still reveal weaknesses in the existing processes or internal controls that were at the basis of the suspicion. As such, the whistle-blowing program can also provide additional support for companies' own internal risk control frameworks. The implementation of a whistle-blowing program that encourages employees to report problems in good faith might in the long run create a desirable change of culture in the company motivating employees who "only want the best for the company".

Tone At The Top

Having some process by which employees can report matters is only part of the solution to the problem. Equally important is that employees trust such channels of communication. A whistle-blowing/reporting channel will only work with the appropriate infrastructure in place and the clear, honest and open commitment of the organization. This, like so many other matters of organizational culture, must originate from the very top of the entity. Such channels can fail. This can lead to the issue not reaching the right people, or employees being victimized for speaking out. Nor will it increase the chances of individuals using such a channel in the future. Employees must have absolute integrity in the system and see appropriate actions taken for it to work.

The Next Step

After the implementation of an internal whistle-blowing program, a company might consider opening up its fraud hotline towards external parties such as suppliers or clients. This could be a valuable next step, as the various fraud surveys also indicate that a large number of frauds are uncovered through notification by clients or suppliers.

Conclusion

Carried out properly, with the support of the Board of Directors and the Audit Committee, a whistle-blowing program – consisting of a fraud hotline, training and whistle-blower protection – provides an essential early warning system for companies, and encourages issues to be voiced internally rather than externally.

ACI International Survey Results

First of all, many thanks go to all who participated in our International Survey, as requested in our previous Audit Committee Quarterly and Roundtable Series.

Participants in the ACI International Survey, held from November 2005 through January 2006, were drawn from the ACI memberships, and were members of at least one audit committee. Not only do the results therefore reflect real daily experience, they also allow comparison to current practice from all over the world. Not only members of ACI Belgium participated; members of the ACI in the Americas, Asia, Africa and Australia provided input, along with important European countries such as The Netherlands, France and Germany.

The following are some of the significant international facts established by our survey:

- Members of Audit Committees are, for the most part, largely satisfied regarding the effectiveness of their Audit Committee practices (95 percent).
- They are quite worried about their roles and personal liabilities; 77 percent consider the liability of audit committee members to be greater than that of other directors.
- On average, they serve on 2.4 different audit committees and devote 6.5 meetings per year (8.6 in the Americas) to each. Some 50 to 100 hours of their time is given on an annual basis.

Comparing Belgium to the rest of the world reveals some equally significant findings:

- Members of Belgian audit committees are generally far less satisfied about the effectiveness of their audit committee practices.
- One out of three is dissatisfied with their current audit committee self-evaluation. (Internationally, only one out of ten were dissatisfied in this respect.) According to Appendix C of the *Code Lippens*, an annual self-evaluation is crucial to audit committee effectiveness.
- Regardless of the above concerns, members of Belgian audit committees appear to be less worried about their roles and personal liabilities.
- On average, they serve on 2.1 different audit committees, and devote 5.3 meetings to each committee on an annual basis.

The conclusion may be obvious: given their relatively recent establishment, audit committees in Belgium are probably less experienced compared to their American peers. However, members of Belgian audit committees are becoming more aware of their roles and liabilities as they gain experience, and are cognizant that their personal commitment and audit committee practices must stand the tests of legislative standards and peer comparisons.

You can read more about the background, methods and results of our ACI International Survey by downloading the full results free of charge in the “Other Resources” caption of our Web site www.audit-committee-institute.be.

U.S. Developments

U.S. and International Standard Convergence

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) announced their intention to work together more closely when they entered into the Norwalk Agreement in 2002. The primary goal was to reduce differences between U.S. generally accepted accounting principles (U.S. GAAP) and international financial reporting standards (IFRS). This goal is primarily referred to as "convergence".

During 2005, cooperation between the two standard setters took three forms. First, there were the short-term convergence projects that were more narrowly focused than major projects. Second were the major projects that seemed likely to fundamentally change both U.S. GAAP and IFRS. Third, the two standard setting groups coordinated their work on other projects that were specifically designated as joint projects.

The short term convergence projects are intended to arrive at a high-quality solution by selecting guidance from recently established U.S. GAAP and IFRS. From a U.S. perspective, the short term convergence projects on inventory, non-monetary asset exchanges and accounting changes were a move closer to IFRS. From an IASB perspective, the short term convergence project on discontinued operations moves IFRS closer to U.S. GAAP. Other ongoing short term convergence projects will address aspects of accounting for income taxes and accounting for research and development expenditures.

The major joint projects that are under way include business revenue recognition, the conceptual framework and financial performance reporting. These projects are in various stages of active development. The FASB and IASB jointly issued exposure drafts on business combinations and on consolidated financial statements that include accounting and reporting of non-controlling interests in subsidiaries.

The business combinations exposure drafts illustrate the degree of fundamental change these projects are likely to create. The proposed requirements differ significantly from both existing U.S. GAAP and IFRS. However, the proposed changes will be much more significant for those applying U.S. GAAP.

The coordinated projects are where the Boards are working together outside of the short-term and major projects due to the agreement that convergence would be considered in all projects undertaken by either Board. The ongoing level of cooperation outside of the short-term and major convergence projects will add to the influence the two standard setters have on each other going forward.

The status of current projects of the European Financial Reporting Advisory Group may be consulted at their Web site www.efrag.org.

Section 404 Compliance: Planning for next year

While everyone wants to reduce compliance costs related to the Sarbanes-Oxley Act of 2002, specifically Section 404, subsequent compliance years are shaping up to be years of incremental improvement.

First, board members should have management taking a hard look at the number of controls they classified last year as "key controls", at their testing scopes, at their deployment of internal and external resources, and at the specific testing tools and techniques. This self-examination is expected to increase the efficiency and reduce the cost of testing.

However, this self-examination alone will not drive substantive improvements in the financial reporting process and in the underlying control environment. Without using more than a narrow compliance focus, companies may indeed end up designing their compliance process around an already high-cost internal control structure.

Board members should strive for further opportunities when planning for subsequent years of SOX 404 compliance. Yet, during the annual budget cycle, they should examine the value proposition of increasing quality, compressing time and reducing costs within their business processes, while simultaneously reducing financial reporting risk.

Indeed, those opportunities may always have been within reach, but now with SOX 404 data being available, the hours required to perform testing of manual detective controls can be added up, priced out and costs can be projected. Those costs should be broken down into meaningful components to be able to understand the impact of improving process performance on compliance cost effectiveness.

The greatest opportunity for redirecting the compliance process lies in reducing manually driven areas which are data-intensive and high-volume in nature, while optimizing automated controls, and improving process-level monitoring controls and financial process effectiveness.

More details and other ideas to consider can be found by going to the "Resource Center" section of www.boardmember.com, double-clicking "Board Governance" followed by "Audit Committee" to find and double-click the article entitled Section 404 Compliance: Planning for next year.

SEC proposes sweeping compensation disclosure reforms

Responding to shareholder criticism of inadequate and confusing executive pay information, the Securities and Exchange Commission (SEC) has proposed sweeping changes to its executive compensation disclosure rules.

The proposals would, among others, require companies to provide a total compensation figure for top executives, as well as a new report discussing how their executive compensation programs are structured and implemented.

Some of the proposals, such as the enhanced disclosure of executive retirement benefits, severance, etc., are likely to be quite controversial, and may therefore change before final adoption. Public comments have been solicited by the Commission until the end of March, with final rules planned for adoption by the end of 2006.

More information can be found in the "Press releases - First quarter 2006" section of the SEC Web site www.sec.gov, by scrolling down and double-clicking 2006-10: SEC Votes to Propose Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters.

Extended Content Annual Report Board of Directors

Significant contingent liabilities and key performance indicators to be disclosed

Articles 96 and 119 of the Company Code relating to the minimum content of the annual report of the Board of Directors have been amended in January 2006. The annual report should now include a description of the principal risks and uncertainties the company faces. To the extent necessary for understanding, the required analysis of the company's development, performance or position should now include both financial and, where appropriate, non-financial key performance indicators. In its update of circular FMI/2003-02 of January 2006, the BFIC has included recommendations on the use of "alternative performance measures".

The Law of 13 January 2006 (Belgian Official Gazette of 20 January 2006) has amended Articles 96 and 119 of the Company Code (Directors' Report) and Articles 105, 144 and 148 of the Company Code (Statutory Auditors' Report). The new requirements of the Law apply to all Directors' Reports and Statutory Auditors' Reports issued after 30 January 2006.

Paragraph 1 of Article 96 (Directors' Report on stand-alone financial statements) is replaced by the following text, and the second paragraph of Article 119 (Directors' Report on consolidated financial statements) has been amended accordingly:

> "The annual report shall include at least a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces. The review shall be a balanced and comprehensive analysis of the development and performance of the company's business and of its position, consistent with the size and complexity of the business.
>
> To the extent necessary for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.
>
> In providing its analysis, the annual report shall, where appropriate, include references to and additional explanations of amounts reported in the annual accounts."

Article 96 Paragraph 8 and Article 119 Paragraph 5 had already been amended in July 2004 to require the Directors' Report to disclose significant financial instruments used by the company. As for the interpretation of the amendments of January 2006, no framework or further regulation reference has been made by the Company Code at this time. Directors might, however, refer to IFRS principles, for example, to bring these new disclosure requirements into practice.

Relating to the newly-imposed disclosure requirement of "significant contingent liabilities", it is worthwhile to note that no exception is provided, as included in Article 96 Paragraph 3 "to the extent that the disclosed information could aversely affect the company". Interpreting the amended Article 96 Paragraph 1 and Article 119 Paragraph 2, it will be the final responsibility of the board of directors to decide what information to include in their annual report to fully comply with the Company Code. Articles 144 and 148 of the Company Code have also been amended, among others, to enable the independent auditor to report on this aspect of Directors' Report compliance.

In respect of the use of financial and non-financial key performance indicators, audit committee or board members could refer to the updated BFIC circular FMI/2003-02, where "alternative performance measures" are defined as "any measurement concept not reflected in the audited financial statements". The BFIC updated circular FMI/2003-02 refers to the recommendation 05-178b of the Committee of European Securities Regulators (CESR) which, relating to the appropriate use of alternative performance measures, suggests to:

- Define the alternative performance measures being used.
- Use only alternative performance measures in combination with concepts used in the audited financial statements, and explain the differences between both elements.
- Also, present the comparative alternative performance measures following the same definition.
- Avoid highlighting alternative performance measures rather than concepts used in the audited financial statements.
- Disclose why alternative performance measures have been presented and how these measures are being used for internal purposes.

Please further note that the BFIC circular FMI/2003-02 includes useful comparisons between the minimum periodic financial information content as provided in Belgian GAAP concepts by the Royal Decree of 31 March 2003, and the related IAS/IFRS concepts, as well as ample reference to the Belgian Corporate Governance Code and the use of Web sites to fulfill publication requirements of financial information.

The full text of the updated circular FMI/2003.02 can be found at the Web site of the Banking Finance and Insurance Commission (www.cbfa.be) under the "Listed Companies-Information" caption by selecting "Circulars" followed by "FMI/2003-02".

Management Override of Internal Controls: The Achilles' Heel of Fraud Prevention

Many instances of fraud have been perpetrated following the intentional override of controls by senior management; otherwise, internal controls appear to be effective. At this point the question is: "Where was the audit committee?"

The risks of fraud as a result of management's ability to override internal controls are present in every entity. Although management override is very difficult to detect, an audit committee can take actions to address the risk of management override of controls.

The American Institute of Certified Public Accountants (AICPA) recently issued a guidance document for audit committees outlining several specific actions intended to prevent, deter and detect fraudulent financial reporting caused by management override of internal controls:

- Maintain an appropriate level of skepticism.
- Strengthen Audit Committee understanding of the business.
- Brainstorm to identify fraud risks.
- Use the Code of Conduct to assess financial reporting culture.
- Cultivate a vigorous Whistleblower Program.
- Develop a broad information and feedback network.

Those who design and implement internal controls – management – can also override or bypass internal controls. Appropriate action may, however, help to avoid this, and if not, it certainly can help to prepare for the obvious, subsequent questions such as "Did the Audit Committee's actions demonstrate an appropriate level of skepticism?"

The full document offering guidance to Audit Committees in addressing the risk of fraud through management override of internal controls may be downloaded at no charge from the AICPA Web site www.aicpa.org. Browse to the "Audit Committee Effectiveness Center" and find the document *Management override of internal controls: The Achilles' Heel of Fraud Prevention.*

Board Compensation and Firm Performance: The Role of "Independent" Board Members

The link between firm performance, board structure and top executive pay has been examined by the European Corporate Governance Institute and the Portuguese Catholic University.

The examination uses a panel of firms who have a single-tier board that includes the CEO as well as executive and non-executive members. The results of this investigation confirm that there is a large effect of firm size on top executive compensation. However, there seems to be no relationship between board remuneration and company performance.

The paper further examines whether the governance structure of companies is relevant in influencing top executive pay. Specifically, the role of non-executive board members as mediators of the management and shareholder relationship has been considered. The results suggest that firms with more non-executive board members pay higher wages to their executives.

The working paper can be found by going to the "Publications" section of the ECGI website www.ecgi.org, and searching by title Board Compensation and Firm Performance.

Board independence: Striking the Right Balance

How can boards maintain their independent posture and guard against overstepping their role?

Boards nowadays must recruit directors that meet the tightened definition of independence. At the same time, board turnover has increased as directors continue to pare back the number of board commitments they make.

Currently, the demand for new directors that will add the greatest value to the company vastly outpaces the supply of the most experienced and knowledgeable corporate leaders. In response to this shortage, boards are turning to retired executives as well as non-traditional board candidates such as academics. These new sources of directors have the consequence that they are highly experienced, but potentially less current on the critical business issues of today.

As meeting agendas become more packed with compliance related issues, boards also risk having less time to engage in strategic discussions and counsel with the CEO. On the other hand, directors exercising more vigilance over the business must guard against moving beyond active management oversight to active management.

To ensure that the benefits of governance reform continue to outweigh the consequences, boards should make sure they have the right composition, guard against overstepping their role, and maintain an independent, but collaborative posture with management. They can do this by following specific strategies such as attracting and keeping the right people, managing the board's time effectively, leveraging the lead director, and offering ongoing director education.

By adopting those strategies and acting with integrity, boards could achieve the benefits of governance reform without falling victim to the aforementioned unintended consequences.

You can read more about these strategies by going to the "Resource Center" section of www.boardmember.com, double-clicking "Board Governance" followed by "General Governance" to find and double-click the article entitled *Board independence: Striking the Right Balance.*

Good Practice in tackling Public Sector external fraud

The Federation des Experts Comptables Européens *(FEE) recently published a position paper concentrating on tackling external fraud perpetrated within the public sector.*

Public sector entities or organizations face a wide range of different risks from external fraud, such as dishonest businesses or individuals – even organized crime groups – taking money either by obtaining payments to which they are not entitled, or keeping money they should pay over to the department.

Organizations should consider whether there is a need to develop a package of measures specifically tailored to each type of fraud; there will not be one size that fits all approaches. In developing countermeasures, there is much virtue to promoting a wider understanding of how others tackle fraud, and the best practices found successful elsewhere.

The FEE paper gives an overview on the strategic approach that should be followed to understand and manage the risks of external fraud, and how to deter, detect and prevent external fraud. It is meant to be a useful source of reference for public sector directors in demonstrating the experience and good practice of others.

You can retrieve the position paper by going to the "Publications" section of the FEE Web site www.fee.be, selecting "Position Papers" and browsing to find *Good Practice in Tackling External Fraud.*

Gradual abolition of bearer securities

All your bearer securities must be converted into registered or "dematerialized" securities

The Belgian Legislator has recently passed a Law establishing a gradual abolition, in essentially four phases, of bearer securities in Belgium.

From 2008, the issuance of bearer securities will no longer be possible. Only registered securities or "de-materialized" securities will be allowed. "Dematerialized" securities are those that exist only as a record with an authorized institution. Share issuers have until 2013 to convert existing bearer shares, i.e., to adapt their bylaws and enter into contracts with an accredited institution should they wish to issue dematerialized securities.

However, for listed companies, the adaptation of bylaws should be performed before 1 January 2008 as their bearer securities deposited in an account will, as of that date, be automatically converted into dematerialized securities.

To learn more about the timing and practical consequences relating to the abolition of bearer securities, follow the link to www.kpmg.be, select the "Topics" heading, double-click the "Belgian Newsletter" on your left, and browse to the February 2006 edition.

Women on the Board: A Business Case for Diversity

Gender diversity for many of us is certain, indisputable, natural and, of course, the right thing for a firm to do. The practice would, however, gain much more acceptance if someone could point to numbers suggesting that women as Board of Directors members are having a positive impact on bottom line results.

In Issue 10 of their quarterly newsletter, the INSEAD business school has put forward a business case demonstrating that the more a firm diversifies its sources of knowledge and culture at every level, the greater its ability to anticipate and respond to changes in its environment and markets, thus gaining competitive advantage.

Some remarkable analysis results presented in the article are that:

- Firms with a higher proportion of women on their Board score higher on corporate governance.
- Top performing companies have 20 percent of women in management positions, whereas the bottom performing companies only 2 percent.

Many books have been written on the particular capabilities and sensibilities of men and women. If properly valued and employed, these specific capabilities could also confer a competitive advantage. Women directors are said to have a positive impact on board decision-making thanks to their "fresh" views on such out-of-the-box concerns as environmental and ethical issues.

You can read the full article by following the link to the INSEAD Web site www.insead.com, selecting the *INSEAD Quarterly* heading and double-click the "IQ10" edition of their newsletter.

ACI Events

Roundtable Series

ACI facilitates interactive audit committee roundtables twice a year. The last Audit Committee Roundtable series was over lunch on 29 November 2005 with Mr. Luc Van Nevel, Chairman of Board of Directors Picanol & Pinguin, Chairman AC LSG as guest speaker, and on 5 December 2005 with guest speaker Baron Hugo Van Damme, Chairman of the Board of Directors of Roularta and Kinepolis.

The next Roundtables will be held this Summer.

Every Roundtable features a guest speaker, and provides for an exchange of views and insights on topics of interest to members of boards and audit committees for a limited number of professionals.

The ACI roundtable sessions can provide you with knowledge you will find helpful in your increasingly responsible oversight role through a focus on current topics, enhanced competence by the sharing of best practices, and personalized assistance by providing opportunities for interaction with your peers.

Seminars

Professional development of board members is becoming increasingly important as corporate governance evolves. ACI seminars are designed to update members of boards and audit committees on current best practice by reporting on recent developments in accounting, company law, corporate governance and other regulatory matters. Any material used is focused and professionally presented, and adapted to the particular needs of members of boards and audit committees. Registration is free of charge.

For more information on ACI events or to register, please visit our Web site www.audit-committee-institute.be, or contact us via e-mail 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.

The professionals of the ACI are:

Theo Erauw, *Chairman*
KPMG
Sophie Brabants, *Senior Manager*
KPMG Bedrijfsrevisoren, Certified Accountant
Mike Boonen, *Manager*
KPMG Bedrijfsrevisoren, Certified Accountant

Contributing editors of this quarterly newsletter are:

Jorn De Neve, *Director*
KPMG Advisory
Els Hostyn, *Partner*
KPMG Advisory
Anthony Huyghebaert, *Manager*
KPMG Tax and Legal Advisers
Wouter Lauwers, *Director*
KPMG Tax and Legal Advisers
Patricia Leleu, *Partner*
KPMG Bedrijfsrevisoren
Peter Leyman, *Assistant Manager*
KPMG Advisory
Guido Moetewiel, *Senior Manager*
KPMG Advisory
Coert Scholte, *Senior Manager*
KPMG Advisory
Henri Vandermeersch, *Director*
KPMG Advisory

Contact us

Sophie Brabants
Audit Committee Institute
Bourgetlaan - Avenue du Bourget 40
1130 Brussel - Bruxelles

www.audit-committee-institute.be
e-mail: info@auditcommitteeinstitute.be
Tel +32 (0) 3 821 18 66
Fax +32 (0) 3 825 20 25

The information contained herein is of general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received, or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2006 KPMG Support Services ESV/GIE is a Belgian firm providing services to local members firms of KPMG International, a Swiss cooperative. Responsible editor: Theo Erauw, Avenue du Bourget- Bourgetlaan 40, 1130 Brussels. All rights reserved. April 2006 - Printed in Belgium.