Audit Committee News

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KPMG'S AUDIT COMMITTEE INSTITUTE

Editorial

Dear Reader,

Neglecting internal financial control mechanisms quickly leads to unpleasant surprises. The article "Substance over form – Financial controls that contribute to business" summarizes Swiss Re's experiences with internal controls in reinsurance.

In July 2006, Switzerland extended the legal principles on combating bribery with the enforcement of the Council of Europe Criminal Law Treaty. The article "Reforms in the Criminal Law on Bribery" highlights the extent to which these regulatory reforms impact internal organizational measures on the prevention and disclosure of corruptive acts.

The article "Cash Pooling / Loans to Affiliates" specifies the risks and legitimacy of group-related loans. Large groups often entrust one of their subsidiaries with the cash management for the whole group. This poses a severe risks during a financial crisis. Sound subsidiaries could suddenly lose all of their liquidity, such as with Swissair. Responsibility risks add to the dilemma because the granted loans might represent an offence against the prohibited return of capital contribution.

What is Corporate Social Responsibility? How does it relate to shareholder value? What monitoring tools are used? All of these questions and more are covered in the article "Corporate Social Responsibility as a Boardroom Topic".

IFRS and US GAAP Updates address the latest changes and trends in international accounting and round off this edition of the Audit Committee News.

Hope this edition provides for an interesting and inspired reading!

Günter Haag
Head KPMG's Audit Committee Institute

Substance over Form

Financial controls that contribute to business

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Internal controls of financial reporting may be unpopular but when they are neglected, unpleasant surprises could arise which managers dislike even more. To keep their financial reporting in check, companies need to view internal controls as they do their core business – by identifying the key risks, their potential for causing material financial misstatements and installing controls for their prevention or detection. An internal control system can only add value if management gets involved, understands and takes ownership of business processes and controls. Without such an approach, the work of the controller is unpleasant, with audits and control verifications especially difficult. This article summarizes the experience we have gained with internal controls in reinsurance.

Context

Negative events often have a disproportionate effect on share prices, which is not compensated by positive developments and prospects. The insurance industry is not immune to this and has experienced its share of accounting anomalies and financial restatements.

Accounting regulations have not simplified matters, while reinsurance transactions increasingly involve sophisticated structures, combining elements of risk finance, risk transfer, cross-border variable interest entities, layers of retrocession arrangements and securitization. All this in turn requires advanced accounting treatment and robust financial reporting operations. Consequently, the reinsurance industry has become increasingly dependent on specialized accountants and auditors.

There is also a rise in the need for talented individuals. The increased workload of compliance and financial controlling departments has led to the need for highly qualified financial and accounting professionals in an environment already under high pressure to cut costs.

All these factors are challenging to a reinsurance CFO, who has to maintain adequate controls while controlling costs and retaining top professionals.

A strategic look at controls

Any strategy aimed at establishing a strong financial control framework, in light of the above challenges, needs to start with a company delivering reliable financial information to its shareholders. An effective strategy requires a joint undertaking between a company's business and financial experts. We suggest that a strong financial control strategy has to start with transparent presentation of business and financial reporting processes.

- Business professionals – underwriters, client managers, claims and investment specialists – need to share and review their business processes and identify the key risks and controls for financial reporting;
- Finance professionals have to provide the oversight and capabilities needed in an efficient and low-maintenance manner.

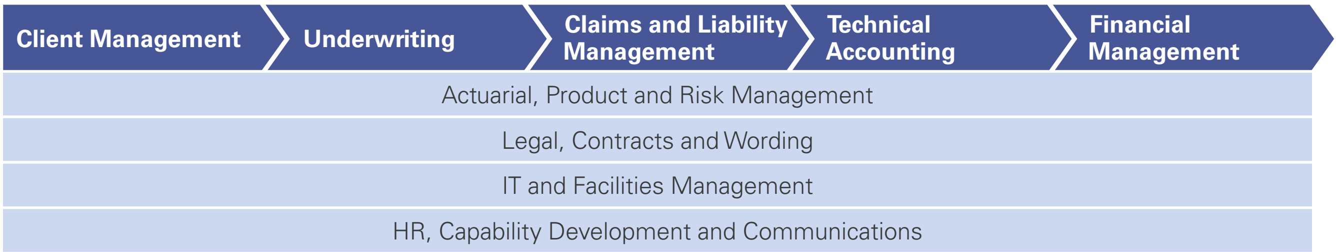


Figure 1: General summary of reinsurance value chain

Turning strategy into action

Aligning interests

Managers tend to be interested primarily in the financial figures that drive their performance evaluation. Reinsurance managers often focus simply on the underwriting result or, better, on "economic profit." If accounting according to GAAP[1] – the primary means of disclosing performance to investors – remains the sole language of finance, it will be challenging for a reinsurer to obtain a fully aligned interest in the published financials. This does not imply that all reinsurers have to become accountants; but it does mean that they need a basic understanding of how everyone in the firm influences accounting figures.

Common duty: think in terms of processes and not the organizational chart

How can managers view their financial-reporting work as a common duty, when most of them are still driven more by organizational charts than by business processes? Process owners and their performance metrics are often not hidden in the corporate hierarchy and reward schemes, with anything process related often associated with low-level administration.

However, if controls slow down a process, they become counter-productive. They should facilitate the orderly collection of premiums and payment of the client's claims, as well as the reliable production of financial statements for the investor. Therefore, any internal controls project should start by management identifying the key business processes in the value chain and how they contribute to the financial reporting process. The high-level reinsurance illustration in figure 1 "General summary of reinsurance value chain" distinguishes direct (core) from support processes, which can be a starting point for a review of business processes.

Knowledge sharing

Where an internal auditor is required to give an opinion on internal controls[2], forming that opinion relies heavily on the clarity of management documentation of end-to-end processes, from front office accepting a risk, through middle office and finance to reporting in the financial statements. Clear hand-overs are the critical points that hold the process chain together and they need to be transparent. Control documentation should be succinct enough to allow an independent, qualified person to understand it easily. Documentation will only be used if it is clear and will help mitigate the operational risk of relying too heavily on individuals with specialized knowledge. The professional in question should be provided with an incentive to share specialist expertise with others.

A selective risk-based approach

Managers often complain about the excessive effort and detail involved in documenting and testing controls. A principal cause of exaggerated detail and lack of focus tends to be the failure of management and business process owners to get involved from the outset. A sound risk assessment needs to be conducted by management and the appropriate experts from the beginning in order to provide direction for documentation and assurance teams. For example, management needs to intervene before a team gets lost in the tangle of accounting bookings by prioritizing the key reporting risks and focusing on the associated controls.

1 Generally Accepted Accounting Principles

2 The recently amended Swiss Code of Obligations ("Obligationenrecht"), Articles 728a and 728b, specify "the auditor's obligation to examine whether internal controls exist (…) and to submit to the board of directors a comprehensive report with findings on the internal control system." This will come into force for the reporting year 2008.

Account class	Complexity	Degree of estimation	Fraud risk	System dependency
Fixed income securities	H	M	M	H
Reinsurance claims expense reserves	H	H	M	M
Personnel expenses	L	L	M	M
Cash and cash equivalents	L	L	H	H

Figure 2: Risk assessment (high, medium, low)

Focus on material items

It is a common perception that effective control invariably involves detail, but this is false. Too much detail creates unnecessary bureaucracy and can lead to a loss of focus.

Proper focus starts by determining the material accounts and entities that form the majority of a company's financial statements. This is a management task and the best way to start is by analyzing the structure of the income statement and balance sheet to understand the relative materiality of each section of the accounts.

An industrial company will obviously have more fixed assets on its balance sheet, while a financial institution will have predominantly financial assets. The accounting complexities and controls will thus differ. The key control areas of the industrial company will include inventory controls, the valuation of intangible assets and depreciation (see the example based on a pharmaceutical company, figure 2). Those of the financial institution will include the fair valuation of reserves and (financial) assets (see the examples based on a reinsurance company and bank). A percentage of pre-tax profit[3] is typically applied as an initial threshold to determine which accounts are material. Accounts above this threshold require their processes and controls to be documented and tested. Such a threshold (in the form of a percentage of total consolidated assets or revenue) is also commonly used to determine material entities[4] as shown in figure 3: "Three Swiss publicly listed companies: high-level comparative analysis of a summary of balance sheet positions as a percentage of total assets and liabilities".

However, quantitative measures of materiality and coverage need to be balanced by a risk assessment of financial misstatements. Risk factors include the complexity of calculations or accounting rules, the degree of estimates involved, the potential for fraud and the dependency on complex IT applications or interfaces. A risk assessment reviews material account classes against such criteria, as illustrated in figure 2 above "Risk assessment (high, medium, low)."

3 A common threshold is three – five percent of pre-tax profit. Accounts with balances in material entities (typically five percent or more of total assets or revenue) above that threshold are included in-scope.
4 A common threshold is five percent of the total consolidated group assets or revenues. Reporting entities at or above that threshold are includ-ed in scope.

Managers must get involved in risk assessment and keep their teams focused on relevant internal controlling. If the risk assessment is carried out in a competent and rigorous manner, it allows for more focus on those areas that matter and less focus lower risk areas. It is good practice to keep track of the number of controls identified by key segments of the business and to verify whether they commensurate with the materiality of these segments (see figure 4: "Number of controls by account class in relation to materiality").

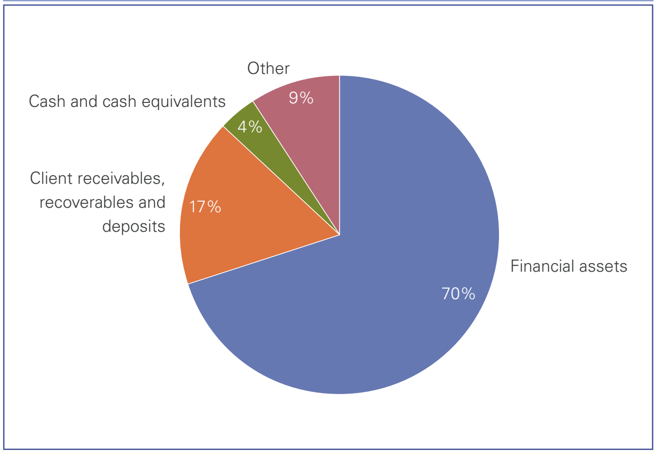
Evaluating control issues

How can you insure that your control system works? For an internal control certification, verifying the effectiveness of a company's control is a standard procedure. In reality, experience shows that the challenge lies in deciding how strict to interpret the testing results.

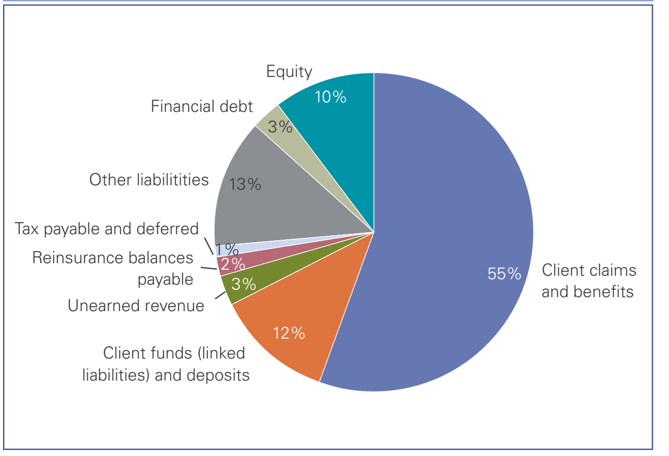
Take for example an airport x-ray machine that regularly fails to detect metal objects, compensated by subjecting one in three travelers to a manual search. Would this be accepted as a safe set of controls? Certainly not in today's environment. This shows that compensating controls (man-

Reinsurance company

Assets

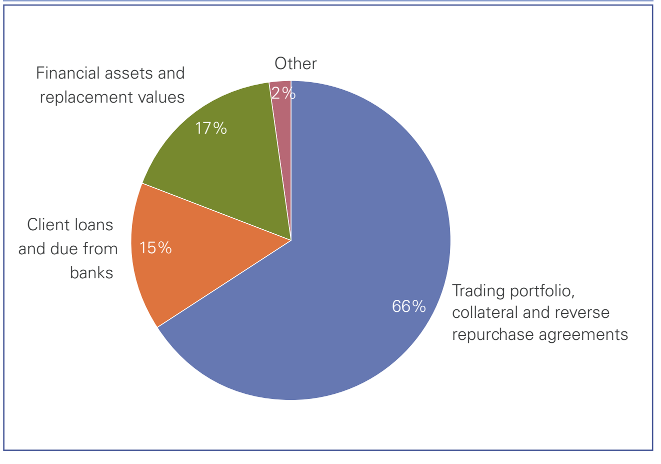


Liabilities



Bank

Assets



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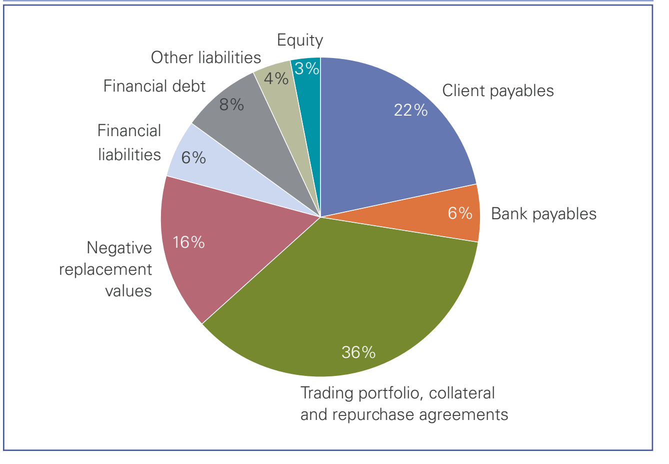
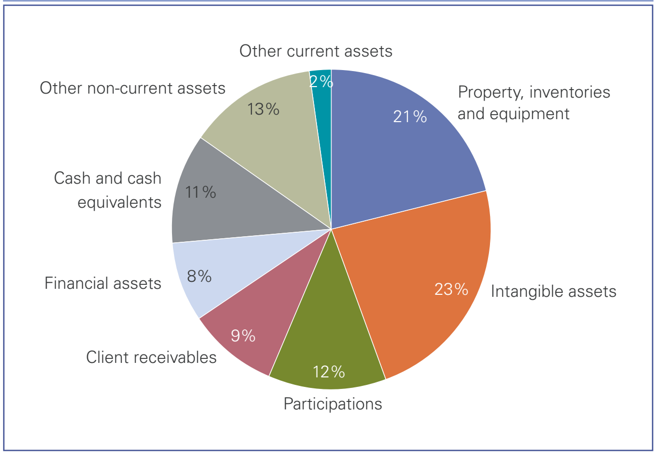


Pharmaceutical company

Assets



Liabilities

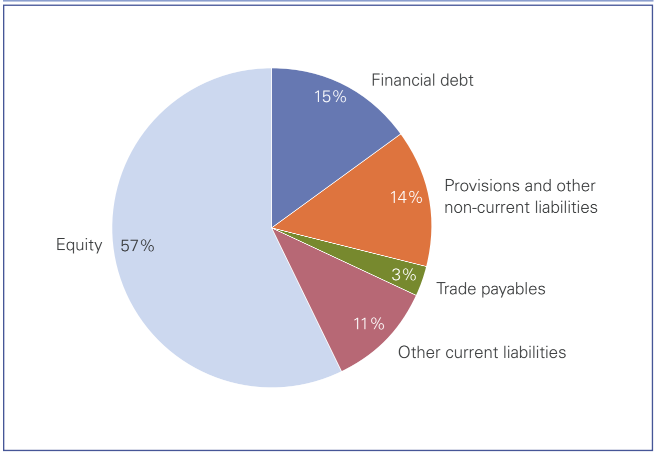


Figure 3: Three Swiss publicly listed companies: high-level comparative analysis of a summary of balance sheet positions as a percentage of total assets and liabilities.

ual inspection) cannot replace the failed primary control (x-ray machine). In financial reporting processes, primary controls are often of a transactional nature and include the verification of contractual documents or reconciliation procedures. Such controls may be compensated for by conducting periodic management reviews or meetings. However when certain controls fail, management needs to consider the context and determine whether the overall control environment is still adequate.

Account classes	Materiality as percent of total assets	Percent of total number of controls
Fixed assets	5%	25%*
Financial assets	70%	50%
Receivables	20%	20%
Other assets	5%	5%
Total assets	100%	100%
Reserves	65%	60%
Other liabilities	20%	15%
Debt	5%	10%
Equity	10%	15%
Total liabilities	100%	100%

Figure 4 : Number of controls by account class in relation to materiality

** Indicates a potential mismatch: disproportionately large number of controls for low materiality*

Keeping control

Sound controls and strong governance need to operate in a cost-effective and sustainable manner. Controls cost money and often lose momentum and discipline once instigated.

Keeping controls in order is the responsibility of management. Although control and operational risk teams and internal and external auditors provide support and conduct independent tests, management is ultimately accountable for adequacy and effectiveness.

We have four recommendations for a sustainable control environment:

Promote creative process thinking

Establishing internal controls is not the same as process re-engineering but can be the departure point for simplification and standardization. In the reinsurance industry, for example, how can the information flow be simplified between cedents and reinsurers who often process, re-enter, verify and reconcile the same financial and administrative data?

Offer incentives

Better control can equal more business. Large reinsurance and capital market transactions often bring additional reporting requirements vis-à-vis the regulator or investors. Having such processes and controls documented and in good order enables more agile transaction closing and avoids administrative or regulatory surprises after the closing. Originating teams should be offered incentives to consider reporting and control implications when closing large and complex transactions, particularly with regard to securitization transactions, where this reporting obligation may also extend to the capital markets.

Manage the relationship with your auditor

This has nothing to do with influencing the auditor's independence. Rather we suggest an open exchange with the auditor throughout the definition and maintenance of the control environment. This allows the auditor to validate the scope and approach early and to efficiently prepare a qualified audit team. Where relevant, this open dialogue may also extend to the regulator, such that rather than a rigid rules based system, principles apply that consider industry specific risks and control environments.

Rotate staff

The ideal person to introduce sound internal financial reporting controls has an audit and risk management background, solid finance and accounting skills, a deep understanding of the business and an aptitude for process analysis and reengineering. Unfortunately, the ideal mix of skills and knowledge rarely exists in one person. However, this problem can be overcome by actively rotating staff between business, finance and audit or (operational) risk management teams. This helps increase the acceptance of a control system across the firm and gain commitment to the joint task.

Conclusion

Most firms have an internal control system, however, one that can be understood and audited by a third party is a large undertaking. To ensure that such a system focuses on the essentials, executive management needs to actively supervise the management of such an initiative. This can lead to simplifying processes by thinking about the key controls. This is an ongoing and dynamic process, since a control environment needs to be maintained and adjusted to the firm's development. Work does not stop after the initial certification of controls.

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Reforms in the Criminal Law on Bribery

A brief outline

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Legal

In July 2006, Switzerland extended the legal principles on combating bribery with the enforcement of the Council of Europe Criminal Law Treaty. The reforms address the definition of private sector bribery in the Act against Unfair Practices (UWG) and the expansion of the Corporate Criminal Law. This gives companies a reason to revise their internal organizational measures on the prevention and disclosure of corruption.

Situation
Within the framework of international efforts on combating bribery, Switzerland has tightened its legal requirements over the past few years. The Swiss Criminal Law on Bribery was already standardized and revised on 1 May 2000. Since then, bribery awareness increased noticeably among state regulators, companies and the public sector.

In July 2006, the Criminal Law Treaty and the Council of Europe Supplementary Treaty on Bribery came into effect. They aim at harmonizing sanctions and further strengthening the collaboration between member states. The Criminal Law Treaty also requires the prosecution of private sector bribery, regardless whether the corruptive act is committed abroad or in Switzerland. The Swiss sanctions on bribery in the Criminal Code (StGB) and in the Act against Unfair Practices (UWG) were adjusted or extended accordingly on 1 July 2006.

The Criminal Law on Bribery is especially significant for companies, since bribery of officials or the private sector through staff members might cause liability for the firm, provided it has not arranged for all required and reasonable provisions to prevent such acts (Art. 102 para. 2 StGB).

Bribery

Overview
The legal provisions in the StGB and UWG distinguish between different types of bribery, depending on the act (active or passive), the aims and whether Swiss officials or foreign officials are bribed (see chart).

Bribery of Swiss officials
Those promising, offering or granting undue advantages for acts or favors in breach of their duty or for acts or favors to a Swiss official, incur a penalty for active bribery (Art. 322ter StGB). This definition is used if the advantage is granted with the aim of motivating the official to a "definable act" in favor of the bribing party or a third party. It is not required that the official actually accept the bribe or carry out the expected action.

Officials are prosecuted for passive bribery based on Art. 322^{quater} StGB, if they request, cause the promise of or accept undue advantages in breach of their duties. Also here, the bribery has to relate to a specific act in favor of the bribing party or a third party.

Swiss officials granting and accepting undue advantages

Also questionable is if a Swiss official is offered an undue advantage without having to render a concrete action. (Art. $322^{\text{quinquies}}$ StGB). Even if somebody only generally grants an advantage to an official in respect to his or her tenure, they can render themselves liable to prosecution. This catch-all element covers "goodwill offering", "baiting" and "friendly contributions". The Swiss Federal Council clarifies in its Message on the Criminal Code (p. 5535) that relevant actions are «those with the planned intent of influencing the official».

In other words: the advantage must be meant to affect the tenure of office of the recipient. The term «in respect of» clearly indicates that granting advantages have to be future-oriented. As an example: an electronic industry group paid a trip to Spain for decision-making councilors in the energy sector (Message, p. 5536). The criminal-political necessity of this offence is justified by the fact that bribery aimed at continuing dependency is often arranged for with vaguely dispersed gifts and goodwill payments (Message, p. 5534).

Officials requesting, accepting the promise of or accepting an undue advantage in respect to their position, render themselves liable to prosecution pursuant to Art. 322^{sexies} StGB.

Bribery of foreign officials

Active bribery of foreign officials is also punishable (Art. 322^{septies} StGB).

Since 1 July 2006, passive bribery of foreign officials is also listed as a punishable offence (Art. 322^{septie}s para. 2 StGB). Hence, a foreign official is punishable with a custodial sentence or penalty if she/he requests, expects a promise of or accepts an undue advantage for an act in breach of their duties. However, the StGB extends only to criminal offences pertaining to Switzerland.

This requirement is met if the offence is committed in Switzerland or if it is committed by a Swiss citizen abroad. This happens only rarely and the prosecution of foreign officials through Swiss penal authorities is hardly practiced.

If the granting of an undue advantage to a foreign official only takes place in respect of their tenure of office and not due to an expected definable consideration, neither the official nor the person bribing render themselves liable to prosecution pursuant to Swiss Criminal Law. The facts of the offence for granting an advantage or the acceptance of an advantage for foreign and international officials are not given.

Joint provisions

The joint attributes of Art. 322^{ter} to Art. 322^{septies} StGB consist of offering or accepting undue advantages. The law does not state any particular terms. The ruling doctrine defines advantages as "all free benefits of tangible and intangible value." An advantage is "undue" if the official is not entitled to its acceptance. "non-undue benefits" on the contrary, are legally permissible and small informal advantages (Art. 322^{octies} StGB).

The legislator does not detail as to what extent an advantage is considered informal or minor. The Swiss Federal Council

	Active	Passive	Purpose of criminal act
Swiss officials	Bribery Art. 322nd Criminal Code (StGB)	Accepting bribes Art. 322quater Criminal Code (StGB)	Advantage granted for certain acts or negilence thereof
	Granting advantages Art. 322quinquies Criminal Code (StGB)	Accepting advantages Art. 322sexies Criminal Code (StGB)	Advantage granted in respect of tenure of office without expecting a concrete contribution
Foreign officials	Bribery Art. 322septies Para. 1 Criminal Code (StGB)	Bribery Art. 322septies Para. 2 Criminal Code* (StGB)	Advantage granted for certain acts or negilence thereof
Private sector	Bribery Art. 4a para. 1 lit. a / Act against Unfair Practices* (UWG)	Accepting bribes Art. 4a. para. 2 lit. b / Act against Unfair Practices* (UWG)	Advantage granted for certain acts or negilence thereof

* in effect since 1 July 2006

states (p. 5550 et seq.), they are "gifts not causing bias based on social standards". Yet, there is the general principle that "each objectively measurable, legal, economic or personal betterment" for the receiver is considered an advantage (Message p. 5527).

Private sector bribery pursuant to UWG

Up to 1 July 2006, bribery in the private sector was only partially covered by the Federal Act against Unfair Practices (UWG) and remained largely unsanctioned. By implementing Art. 4a UWG, active bribery (Art. 4a para. 1 lit. a UWG) and passive bribery (Art. 4a para. 1 lit. b UWG) are now both considered acts of corruption. This provision will guide individuals towards objective decisions within the context of their duties or business activities which otherwise could cause prejudice for other individuals or affect the market.

As with the bribery of officials, offering, promising or granting an undue advantage to a person for acts or negligence in breach of their duties (Art. 4a para. 1 lit. a UWG) constitutes active bribery. Also in this case, the advantage has to be shown to cause a certain action. Unlike Art. 322ter StGB, the person bribed is not an official but an employee, shareholder, agent or assistant of a third party. Furthermore, the corruptive act has to be related to the tenure of duty or business activities of the bribed individual in the private sector. Typical examples are bribes or allowances in kind of suppliers to shareholders or employees of the purchasing company.

Passive private sector bribery applies for employees, shareholders, agents and assistants of a third party if they act in breach of their duty or request, accept a promise or accept undue advantages for themselves or for a third party (Art. 4a para. 1 lit. b UWG).

Ths categorization does not exist for the private sector because the line between private allowances and work allowances are not clear. However, as for official bribery, there are advantages in private sector bribery: non-undue advantages are advantages contractually approved by the third party and minor informal advantages (4a para. 2 UWG).

Corporate Criminal Law (Art. 102 StGB)

Deficient organization

Pursuant to Art. 102 StGB (in effect since 1 October 2003), companies can be prosecuted for deficient organization. The Corporate Criminal Law distinguishes between two groups:

- If the actual delinquent cannot be found due to deficient organization within the company, the company is liable for offences "while exercising business dealings in line with the company objectives" (subsidiary corporate liability, Art. 102 para. 1 StGB).
- With primary (competing) corporate liability, the company – apart from the delinquent – can be held liable (cumulative) under penal law. Punished is hence the failure of organization in certain offences listed in the law (partaking in or supporting a criminal organization, financing terrorism, money laundering, active bribery of local and foreign officials, granting advantages and active private sector bribery).

Organizational measures

The law requires that a company arranged for all "necessary and reasonable provisions to prevent such an offence", without giving more precise definitions. The question is, what type of action is required by the companies and how is a deficient organization reprimended pursuant to Art. 102 para. 2 StGB.

The required organizational measures mostly result from the bodies of rules and regulations outside criminal law. Provided state law regulates the issue or the organization (for example the prevention of money laundering through finance intermediaries), due diligence is substantiated. The rules set by private bodies (for example professional associations) are also taken into account, such as guideline for professional conduct or industry agreements. The industry specific facts and the company's size also need to be considered.

The requirements for an SMB only operating in Switzerland, in particular to prevent bribery, are different than those for a larger business dealing in bribery exposed regions worldwide. Yet according to ruling doctrine, three possibilities for clemency apply, i.e. the business is not liable if it used due diligence with the choice, instruction and monitoring of its employees.

Switzerland lacks state rules outside of criminal law in the area of bribery prevention. Therefore, legal sources are self-regulatory acts, for example the "Rules of Conduct to Combat Extortion and Bribery" of the International Chamber of Commerce (ICC) or the "Business Principles to Combat Bribery" by Transparency International. The following organizational measures are recommended for bribery prevention:

- Basic procedures are a compliance program set out in writing, including a Code of Conduct, regulatory statutes, raising employee awareness and providing training.
- These measures are completed by an Internal Control System (ICS) and an effective risk management system. The elements of effective risk management are organizational implementations in the area of prevention, cognitive systems and early-warning systems, as well as process planning in case of a presumed offense.
- One recommendation is to establish a contact point for employee questions (possibly combined with the setup of a whistle-blowing procedure).
- Another recommendation is to include an integrity clause in the contracts.

Practice shows that the biggest challenge for company management is to actually find out about cases of bribery. For a well-operating cognitive system, early-warning system and other control mechanisms, it is crucial that the staff are assured that disclosing information does not have negative consequences.

The importance of this is reflected in the experience made with the "whistle blower" hotline of Transparency International established about a year ago. The hotline callers are predominantly employees receiving no feedback or those turned down despite internal reports, along with former employees who remained silent during their employment for fear of reprimand.

Cash Pooling / Loans to Affiliates

Return of Capital Contribution – Legitimacy – Risks

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Reto Schumacher
Legal

It is common practice that large groups entrust one of their subsidiaries with the cash management for the entire group. When things go well this is an efficient management tool ensuring optimum liquidity control and investment strategy. It does not apply though in times of financial crises when subsidiaries suddenly lose all of their liquidity, as in the case of Swissair. Responsibility risks add to the dilemma because the granted loans might be in opposition to the prohibited return of capital contribution.

Situation

The cash management of a large group is often assigned to a subsidiary (cash pool corporation or CP corporation). All other group companies are then requested to make their financial transactions such as capital procurement, forward transactions, foreign exchange dealings and fundraising with the CP corporation as principle. Moreover, they must provide the CP corporation with their cash surplus.

An analysis, excluding tax risks and provision of sufficient funds and hidden profit distribution, needs to be performed to look at the legitimacy and liability risks for a full subsidiary company based in Switzerland (Swiss corporation) and integrated in a cash pool system. This is subject to the condition that the CP corporation is not a controlling company but an affiliate of the Swiss corporation. The focus is furthermore on the transfer of cash surplus positions from the Swiss corporation to the CP corporation.

Types of cash pooling

Cash pooling consolidates the credit and debit balance of the group companies' bank accounts, thus achieving an efficient liquidity management within the group and better terms and conditions with investing and borrowing money.

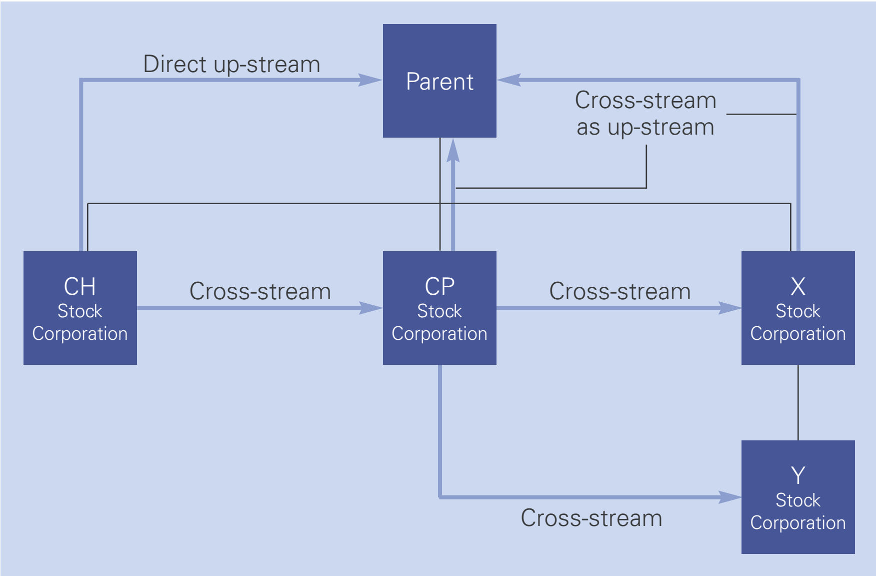
Basically two types of cash pooling are practiced: zero balancing and notional pooling.

Zero balancing (physical cash pooling) implies physical money transfer from the accounts of the individual group companies to the CP corporation. The actual money transfer causes a balance-of-account concentration in the cash pool. The funds deposited by the affiliates can then be invested jointly or used for financing with other affiliates (compare Thomas M. Kull, "Cash Pool – Crash Pool?," Festschrift Karl Spühler, p. 184 and Oliver Blum, "Cash Pooling: gesellschaftsrechtliche Aspekte" in: AJP 6/2005, p. 705 (cit. Blum).

With notional pooling the credit balance of the individual affiliates remains on their own account and the credit and debit balance of all group accounts are only consolidated calculatory to credit or debit the corresponding interest on the net position.

The following details only refer to zero balancing cash pooling.

Up-stream loans / Cross-stream loans
The transfer of cash positions from the Swiss corporation to its parent company constitutes an up-stream loan.



The transfer of a cash position to the cash-pool account of the CP corporation legally leads to a loan position of the Swiss corporation as lender and the CP corporation as borrower, i.e. to a cross-stream loan between the Swiss corporation and the CP corporation. If the funds circulate from the CP corporation to the other affiliates of the Swiss corporation (or third parties outside the group), the loan between the Swiss corporation and the CP corporation also qualifies as a cross-stream loan.

However, if the funds (directly or indirectly) flow from the CP corporation into the parent company of the Swiss corporation, the cross-stream loan leads to the same result as an up-stream loan.

Difficulty
From a legal point of view, it is problematic that funds of the Swiss corporation are used – directly with up-stream loans and indirectly within the framework of this cross-stream – in the cash pool of the CP corporation in favor of other group companies or the parent company. With this constellation, potential funds of the Swiss corporation outflow in favor of other group companies (and thus possibly indirectly in favor of the Swiss corporation shareholder). In case their return is not guaranteed and if the loan leads to an underfunding of the equity blocking quota (capital stock, statutory reserves), it might cause an illegitimate return of capital contribution pursuant to Art. 680 para. 2 OR.

It also presents a difficulty that the Swiss corporation – irrespective of capital stock cover, bound reserves or free reserves – as a lender in the case of insolvency of the borrower risks not even be accepted with a third-class receivable for the loan. It might be requalified as capital invested due to the precarious financial situation of the borrower according to a ruling of the Canton Zurich supreme court from 19 January 1993 in: *Aktienrecht (Stock Corporation Law), Kapitalersetzende Sanierungs-Darlehen im Konzern, Schweizerische Zeitschrift für Wirtschaftsrecht* 1993, p. 299 et seq.

Return of capital contribution warranty (Art. 680 para. 2 OR) / Legitimacy of loans to group companies
The doctrine and legal practice regarding shareholders loans (up-stream) for the legitimacy of up-stream loans or cross-stream loans must be more closely examined. Hardly any information can be found on the treatment of cross-stream loans.

Loans to shareholders (up-stream)

Doctrine
According to part of the doctrine, loans to shareholders are basically not permissible if the represented corporate assets therein belong to the locked-up funds, irrespective of whether the loan was granted at market conditions or not. The legality of loans to shareholders is only turned down, if the shareholder has a controlling interest in the corporation and if the loan exceeds approximately ten percent of the balance-sheet equity. Another less restrictive option is that such loans are permitted if they meet with market conditions and are covered by free reserves on the liabilities side of the balance sheet.

In virtue of a more liberal part of the doctrine, loans to shareholders are legitimate – even if assigned to the blocking quota share capital and statutory reserves – provided there are market conditions. This means the shareholder's credit rating is sound, with a return of capital to be expected when due, the payment of interest is customary in the market and securities may be created.

The doctrine also conveys that the related article in the statutes should explicitly allow the granting of loans in favor of other affiliates. Based on the practice of the federal court that only considers the corporation's performances as null and void if there are literally excluded due to the purpose, this is not an overriding aspect for the permissibility of the granting of a loan.

Jurisdiction
Pursuant to the federal court's practice, the granting of a loan (to a principal shareholder) may not represent a cluster risk. It should take place within the framework of a reasonable risk distribution. The corporation's conduct on granting a loan to shareholders should not be different than towards any third party (at arm's length principle or market conditions; BGE 113 II 52 et sqq.).

Legal consequences
An infringement of the return-of-capital contribution ban leads to the absolute invalidity of the respective transaction. The return creates a sustained non-versé, and the shareholder's contribution obligation becomes reinstated immediately (BGE 109 II 129). For this reason, the board of directors should promptly arrange for reclaiming. The limitation period and the limitation time are debatable.

Discussion, doctrines and new trends
As previously mentioned, there are different doctrines to judge the reliability of up-stream loans. The majority favors the liberal opinion; however, these publications came out before the Swissair case.

There is no higher court ruling. Since the Swissair incident, the tendency for a more restrictive judgment of loans associated with cash pooling has increased. Therefore, it has to be expected that a court does not judge the reliability of an up-stream loan according to liberal doctrines but rather according to restrictive doctrines.

Requirements of the restrictive doctrine
Pertaining to company law, up-stream loans are acceptable as long as the following criteria are meet:

- the maximum risk of a definite funds flow does not exceed the free reserves of the corporation at any time;
- the borrower is willing to pay back;

- the loan could also have been concluded at these conditions with an independent third party (at arm's length), i.e.:
  - an independent third party would have also granted such a loan;
  - the corporation receives adequate consideration for the loan (interest, collateral);
  - the corporation like an independent third party continuously reviews the solvency of the shareholder or of the pool participants upon setting up the cash pool and also afterwards;
  - the loan does not form a cluster risk;
  - the purpose article of the corporation explicitly provides for loans in favor of other affiliates (cp. Blum, p. 707).

Thus, there is a loan limit on the free reserves whereas in practice a possible agio is included, provided it exceeds the fifty percent limit pursuant to Art. 671 para. 3 OR.

Market conditions
A criterion is whether a third party would grant a loan at the same conditions. This is a difficult question since the conditions for granting a loan have to be compared with conditions obtainable in the market for similar transactions. Hence, the conditions for a fiduciary bank loan to a borrower would have to correspond to the same rating as the shareholder or the CP corporation would have to correspond to the conditions for the loan of the Swiss corporation.

Cluster risk
Whether a situation constitutes an objectionable cluster risk depends on the individual circumstances. There is not generally applicable ratio. The decisive factor is whether the amount of the loan, in comparison with the overall assets of the corporation, (including still reserves) affects the interest of the corporation and its creditors. In a ruling from 25 May 1981 (E. 3b published in *La Semaine Judiciaire* (SJ) 104, 1982, p. 226 et seq.) the Federal Court declared a loan in the amount of sixty percent as illegal, since it did not agree with the statutory objectives and harms the interest of the corporation and third parties.

On the other hand, the Zurich supreme court considered the granting of a loan in the amount of nine percent of the assets of a corporation as legitimate due to its considerable and quickly liquidable still reserves.

Requirements of the liberal doctrine
Pursuant to the liberal doctrine, similar criteria apply to up-stream loans. Only the criterion of the maximum amount to the extent of the free reserves does not apply. This means that the extent of the loan may comprise all reserves and can even include and exceed the share capital. In other words, the situation on the liabilities side has no significance; the legitimacy is merely based on the compliance with market conditions.

Criticism
According to this doctrine, an immediate repayment of the share capital is possible even with the establishment of a corporation, provided market conditions for the loan are met. However, it is questionable if this agrees with the distinct idea of capital protection throughout the Swiss Code of Obligations.

Loans to affiliates (cross-stream loan)
Do the guidelines for up-stream loans also apply to affiliates? There is no clear answer. There are many opinions, according to which the rules in granting loans to shareholders also have to be applied for loans to affiliate. For example *Der Darlehensvertrag mit einer Aktiengesellschaft aus gesellschaftlicher Sicht*

(Glanzmann, Diss. St. Gallen 1996, p. 104; Blum (p. 706 and 712) treats up-stream securities and cross-stream securities or loans alike.

In our opinion, there are two different cases for the treatment of loans to affiliates:

- funds indirectly get to the parent company through the affiliates (case 1).
- funds do not indirectly get to the parent company through the affiliates (case 2).

Case 1: cross-stream loan as up-stream

Such a loan to affiliates receives the same legal treatment as if granted to the shareholder. In this case, the funds of the Swiss corporation are indirectly paid to the parent company through the affiliates, which leads to the application of the (restrictive or liberal) rules on the loans to shareholders.

Case 2: cross-stream loan as cross-stream

The estimated risks are lower in this case. In particular, the extent of the loans may exceed the free reserves of the corporation; this means the criteria of the liberal doctrine – compliance with market conditions – are applicable.

Consequences of an infringement in case 1

If funds of the Swiss corporation – by offending Art. 680 para. 2 OR – are transferred to the parent company or to the affiliates (case 1), and then get lost, the parent company of the Swiss corporation can become indemnifiable through reinstatement of the payment-in-full duty. Moreover, the top group company (as key decision-maker) will probably arrange for an obligation to indemnify for responsibility reasons to the extent of the loss.

Auditors will proceed carefully in today's environment and will have to refer to Art. 680 para. 2 OR in the audit report pursuant to the restrictive doctrine.

Corporate Social Responsibility (CSR) as a Boardroom Topic

What does Corporate Social Responsibility imply? Which areas are typically affected by CSR activities and what is the company's position? How is CSR monitored?

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Is social responsibility part of corporate operations and ethics or is it just a compulsory exercise? Does a company only react to outside pressure and current trends? The truth is that proactive commitment and reporting may turn corporate social responsibility (CSR) into an added shareholder value.

Overlapping definitions

Since not all social and environmental issues can be efficiently coped with in regulatory procedures, the European Commission requires optional corporate responsibility. The EC Green Paper 2001 defines corporate social responsibility as a concept for voluntary integration of social and environmental issues into business operations and stakeholder relations.

However, in looking at the actual implementation of corporate social responsibility among businesses, in practice, the interpretation often differs. Content and focus vary while pursuing other targets besides corporate social responsibility. For example, the term corporate citizenship usually refers to a location-related commitment outside actual business operations, such as corporate giving and corporate foundations or corporate volunteering. As compared to corporate social responsibility, the term corporate sustainability or the overall concept of sustained development exceed present needs and also look at the requirements of future generations.

An issue for the capital market and status report

The strongly increased interest in social and environmental aspects is now also reflected in the capital market. Apart from this, individual companies are required to provide information. For instance, fund managers from investment companies – partly pressured by large-scale investors – often take social, environmental and ethical guidelines and practices into consideration in their investment decisions. Meanwhile, the credit services sector – in addition to different initiatives of their own on promoting public welfare through sponsoring cultural affaires and sports events – increasingly considers environmental criteria with funding requests. Altered requirements for the corporate policy of a borrower might therefore affect the standards for extensive credits.

Many companies opened up to the CSR issue in the past years. More than one third of the one hundred biggest firms in Germany and France now publish their own corporate social responsibility report; in Great Britain – to be seconded only by Japan – the figure has reached almost three quarters. It cannot be ruled out that in some instances the ulterior motive is to boost a company's image. The United States, however, is showing a drop in quota to less than one third.

Integration of corporate social responsibility in corporate guidelines
Between public pressure and the still open discussion on how a corporation should address corporate social responsibility, it might be advisable to consider integration in the corporate guidelines. "Corporate values," "basic values," "values statement," "vision" or "mission" are all commonly used terms. The code of conduct might already contain part of the concept. Because of the diversity of the guideline values set forth in the corporate social responsibility aspects, it is questionable whether standardized regulations are useful.

Besides financial statements and website settings, own publications serve as a means of presentation – for example the "Program for Legal Compliance and Corporate Responsibility" at Bayer or the "Environmental Guidelines" at TUI.

Typical areas of corporate social responsibility

The most common activities in the diverse corporate social responsibility programs relate to labor relations, social commitment, promotion of cultural affaires, environment and sustainability. This list of activities though, can certainly not be applied as a rule for all companies. A globally operating group with multi-cultural subsidiaries in many countries needs another focus than a locally based business without contractors.

Furthermore, industry specifics and corporate freedom of decision on where to apply social responsibility usually lead to individually designed corporate social responsibility concepts. As a rule, CSR reports highlight the areas of significance to the individual companies and indicate the key figures and annual rates of change. The following summary shows frequent aspects of discussion. Not every listed subject may be relevant for each company, a further subcategorization might apply, as outlined below.

Labor relations
A large number of practices and responsibilities are regulated by law. Although legally standardized, many of these aspects can also be found in the corporate social responsibility reports. Voluntary activities within labor relations are driven by the fact that staff members represent the most valuable potential of a company. Satisfied employees are more motivated and creative, thereby enhancing corporate success.

Special aspects have to be taken into consideration for corporations with subsidiaries or permanent establishments abroad – in particular in threshold countries or in developing nations – or with suppliers with production sites abroad. First and foremost, the legal requirements of the host countries apply. At the same time though, it is not always sure that the local practice comply with internationally accredited setup standards. Threshold countries or developing nations often obtained production processes through lower labor costs and view higher work standards as a threat to their competitive edge (see figure 1).

Frequently discussed aspects in labor relations

- Promoting equal opportunities and treatment for women and men
- Promoting maternity leave, including return after parental leave
- Integrating employees from different nationalities, cultures and religions
- Respecting all age groups (including work-life-balance programs)
- Encouraging equal participation of disabled persons in working life and removal of barriers
- Promoting education and training to increase qualification level
- Allowing employees the right to complain without negative ramifications
- Allowing employees freedom of association and organized representation through unions
- Respecting human rights and abolishing child labor, even in the supply chain
- Committing to fair wages and adequate working hours in foreign subsidiary companies
- Implementing and monitoring workplace safety

Figure 1

Social commitment

Social commitment for the most part, focuses on the employees' environment and, apart from fringe benefits for dependants, also comprises facilities on the company site. Local activities for healthier living conditions and unemployment prevention in regions close to the company office are also included. Social commitment can also have an international focus, such as donations and other solidarity contributions in case of natural disasters or epidemics. Contributions are often transferred to international relief organizations or sometimes to local institutions of the beneficiary country (see figure 2).

Promotion of education and cultural affaires

Within the broad range of corporate social responsibility commitments the degree of voluntarary engagement with in education and cultural affaires is probably the highest. In many cases, the activities concentrate on the key corporate locations and engage in local events and organizations. Nowadays, the majority of international cultural festivals and local events are no longer feasible without a local business as main sponsor. At the same time, sponsoring is often used as a marketing tool and is only seemingly indicated as an expense item in financial reporting. Hence, when used effectively, sponsoring does not run contrary to profit maximization (see figure 3).

Environment and sustainability

Many environmental aspects are incorporated in legal regulations. The marginal values are set rather low, for the "weakest link in the chain" to comply with the regulations. An orientation simply based on admissibility therefore leaves many opportunities for environmental protection unused. A commitment to the environment depends on the industry. Many indicators can be placed as measurements or key figures and updated on a regular basis. Next to direct commitment, like emissions reduction within the company, indirectly effective measures such as considering environmental aspects with the extension of a credit or the portfolio strategy of mutual funds (see figure 4) are worth consideration.

Frequently discussed aspects in social commitment

- Health insurance scheme beyond employment
- Help with emergencies such as natural disasters or individual distress
- Support of initiatives to promote underprivileged children and teens
- Support of local integration projects and self-aid initiatives
- Support of initiatives to establish affordable housing
- Support of welfare services such as daycare and hospitals
- Support of projects on employment provision and research
- Support of athletic pursuits in case of a conflict between training time and working hours

Figure 2

Frequently discussed aspects of promotion in education and cultural affairs

- Projects to promote educational and improve educational facilities
- Scholarships programs to support gifted students
- Support of orchestras, theaters, opera houses and exchange programs
- Support of artists and sponsorship of concerts, exhibitions and art events
- Promotion of cultural exchanges for international dialog

Figure 3

Corporate Social Responsibility: Key figures and increased rating relevance

Communicating comprehensive corporate social responsibility requires the setup of a CSR program with concrete targets and measurements. It is helpful to identify or develop key characteristic figures for individual engagements. On the one hand, activities become more comprehensible and clear and, even more important, progress becomes noticeable over time, thereby strengthing and implementing improvements. But this is a challenge to the board of directors. First of all, it has to press for the use of suitable key figures. Secondly, it has to carefully watch and possibly question the progress. A comprehensive program supported by key figures is the best proof of a responsible company and its social and environmental actions.

Which key figures are actually appropriate depends on the industry. The following examples from typical corporate social responsibility commitments represent only a selection of common or significant key figures, without being fully applicable to all businesses:

Key figure examples from labor relations

- Ratio labor cost/training and continuing education cost
- Ratio trainees/overall headcount
- Frequency of occupational accidents per one million working hours
- Costs for employment protection and safety protection
- Percentage part-time employees

Key figure examples from social commitment

- Donations to emergency aid
- Benefit payments for childcare and welfare
- Benefit payments for creating affordable housing

Key figure examples from promotion in education and cultural affairs

- Benefit payments for education and science
- Total amount of scholarships for gifted students
- Sponsorship amount for concerts and exhibitions
- Grants for cultural events

Frequently discussed aspects of environmental issues and sustainability

- Establishing an environmental management system
- Informing the public about possible side effects of business activities on the environment
- Setup of contingency plans to avoid environmental damage and health problems in case of failures
- Developing, using and distributing environmentally friendly technologies
- Reducing CO_2 emissions and other emissions, as well as noise exposure from operational processes
- Reducing dependence on fossil fuels
- Reducing the consumption of resources such as water, electricity and paper
- Training staff towards more responsible environmental awareness

Figure 4

Key questions to be posed by the board

- Does a corporate CSR program already exist and is it reported on?
- Are there strategic considerations for a basic social or environmental commitment?
- In which concrete areas is the commitment to take place?
- Are there problems that the company does not want to report on in public?
- Can the commitment be sustained? In many cases, specific CSR commitments and the respective reporting cannot be stopped without damaging the company's image. Thus, the presentation of a sustainability report is not just a single edition, but rather the beginning of a steady commitment on regular publishing.
- Is the reporting concept strong? Chosen areas and types of presentation should not be changed without plausible reason.
- What is the procedure for declining commitment or for deteriorating ecological key figures?
- What are the chances that the reporting raises the company's vulnerability? For example, only data used for a complete and reliable measure concept and a verifiable documentation should be considered.
- Do the CSR commitment and the CSR reporting add to shareholder value?

Figure 5

Key figure examples from environmental issues and sustainability

- Waste incurred in thousand tons
- Recycling quota for individual types of waste
- CO_2 emissions in million tons
- Percentage breakdown of vehicle fleet according to emission categories
- Water consumption in million cubic meters
- Specific energy consumption per produced product unit
- Paper consumption in thousand tons
- Amount for ongoing environmental investments and ongoing environmental protection

Nowadays, even though a large number of businesses worldwide publish their social and environmental commitment within the context of their financial reporting on their website or in separate publications, it is often difficult to judge whether the commitment is sufficient. As opposed to external accounting, there are no generally accepted standards (e.g. Swiss Code of Obligations, IASB Standards or US-GAAP) for voluntary engagement. As the capital market tends to use comparative parameters for its approach, a market for corporate social responsibility ratings emerged in the mid nineties.

Primarily independent rating agencies, inhouse research teams of financial institutions and mutual funds, as well as security indexes engage in this field. Independent analysis techniques are used to transfer the specific corporate data to a corporate rating with absolute figures or processed for a relative positioning in a rating scale.

Since corporate social responsibility ratings have a major impact on consumer behavior and capital market costs increasingly depend on the rating results, corporate social responsibility has reached a strategic significance. The board of directs has to define if the management focuses on activities which are appreciated by consumers and rating agencies, thus eventually leading to an increase in returns.

Aspects to be taken into account with corporate social responsibility commitments and reporting

Companies increasingly meet with the growing transparency requirements for their social and environmental conduct. The following aspects need to be taken into account when following these mostly positive trends (see figure 5).

All of the above examples already show that corporate social responsibility activities are not an affordable one-off expense factor but rather result in long-term commitments. When looking at corporate social responsibility plans, the board of directors needs to take a closer look at the long-term practical use for the company and its shareholders and assess the related risks.

Release of the IFRS draft for small and medium-sized corporate entities (SME-IFRS)

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On 15 February 2007, the International Accounting Standards Board (IASB) released a draft on the use of IFRS for small and medium-sized corporate entities (SME). The draft was issued to provide these companies with adequate accounting standards.

The SME-IFRS draft specifically gives simplified accounting principles designed to comply with SME requirements. It represents a complex body of rules and regulations based on the full IFRS. The standard draft reduces the volume of the accounting standards applicable for SME by more than eigthy-five percent through canceling options, eliminating regulations less relevant for SME and simplifying entry methods and assessment procedures.

Coverage
The SME-IFRS applies to companies publishing their accounts for general purposes and which are not subject to public duty of accounting.

A company is subject to public duty of accounting and, therefore according to the IASB, should apply all of the IFRS if it:

- has issued liability or equity instruments through a public market or
- holds trust assets for a wide group of outsiders, like banks, insurances, stockbrokers/traders, pension funds, mutual funds or investment banks.

Three types of modifications
Compared to the entire IFRS principles, the SME-IFRS draft reflects three types of modification to take SME requirements and cost-value into consideration in the following three situations.

1. Non-regulated facts
In relation to the existing IFRS principles, subjects without any relevance to SME were not included in the draft. These non-regulated facts basically consist of:

- share-based remuneration with settlement through equity capital instruments;
- interim reporting;
- balancing of capital lease contracts in the accounts of the lessors;
- result per share; and
- segment reporting.

This refers to respective IFRS in the complete body of rules and regulations.

2. Acceptance of the simplifed financial accounting methods in the entire IFRS if accounting voting rights exist

The board decided that for the accounting voting rights available in the complete IFRS body of rules and regulations, only the more simple option should be included in the SME-IFRS. The more complex accounting possibilities are applicable as appropriate by referring to the respective IFRS. The simplified options in the SME-IFRS are basically as follows:

- The focus is on the historical principal in case of yield realty and fixed assets, and the fair value or revaluation method is not applied.
- The activation option is not used in case of financing costs, and only the direct entry of expense-as-incurred is shown.
- The indirect method is required to issue the cash flow analysis, and the direct method is not applied.

3. Simplification of carrying value and assessment

For certain subjects, simplifications are used for carrying value and assessment. The following list features some of the most important simplifications:

- Instead of an annual diminution-in-value test on the goodwill, the diminution-in-value indicators are used.
- A SME user has the option to enter all research and developments costs as expense instead of activating certain costs.
- In addition to the equity method, shares in associated companies and joint ventures can also be valued at historical cost or fair value through profit or loss.
- Within the range of the financial instruments, the SME user can either choose to fully apply IAS 39 or use simplifications in the SME-IFRS. Basically all financial assets and liabilities can be set at fair value through profit or loss pursuant to the SME-IFRS, with some exceptions.
- The draft provides for strongly simplified hedge accounting rules.
- For the entry of pension obligations, principles rather than detailed rules are given. There is no option on distributing actuarial profit and loss pursuant to the corridor regulation; all profit and loss resulting from the implementation, change, shortening of or compliance with a performance-oriented plan have to be entered in the profit and loss account when they occur.

Comments on the draft can be sent to the IASB until 1 October 2007. The passage of the final standards is scheduled for mid 2008.

US GAAP Update

Overview of current developments in the United States

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The Securities and Exchange Commission (SEC) issued rules covering when a foreign private issuer may terminate the registration of a class of equity securities under the Securities Exchange Act of 1934.

The SEC plans to issue a request for comment on rule changes that would give foreign private issuers a choice between using International Financial Reporting Standards (IFRS) or U.S. GAAP in their filings. This would eliminate the need for reconciliation to U.S. GAAP for those issuers using IFRS for their primary statements.

The SEC staff has also provided guidance on assumed perfect effectiveness of a hedging relationship.

The Financial Accounting Standards Board (FASB) issued FASB Statement No. 159, which permits entities to choose to measure many financial instruments at fair value. This is expected to have a broad impact on the accounting of companies in the financial services industry.

Easier deregistration for foreign private issuers

Newly issued SEC rule 12h-6 permits a foreign private issuer of any size that meets other specified requirements to terminate its Exchange Act registration and reporting obligations if the average daily trading volume of the class of equity securities in U.S. markets has been five percent or less of the worldwide average daily trading volume (including off-market transactions) during a "recent" twelve-month period.

For the purposes of this criterion, "equity security" excludes convertible debt and other equity-linked securities, such as warrants. A "recent" twelve-month period is defined as a period of twelve calendar months that ended no more than 60 days before filing the new deregistration Form 15F. Worldwide and U.S. average daily trading volumes should include off-market transactions if the information is reasonably reliable and does not duplicate other trading-volume information applicable to the same class of equity securities.

In order to qualify for the trading-volume test, the foreign private issuer must also have maintained a listing on an exchange in a foreign jurisdiction that constitutes the primary trading market for the class of securities and the listing must have been in effect for at least the twelve months preceding the Form 15F filing.

A foreign private issuer can file new Form 15F to deregister under Rule 12h-6 whenever it passes the average worldwide daily trading volume test and complies with all additional conditions, provided it publishes a notice in the U.S., such as a press release, that discloses its intent to terminate its Section 13(a) or 15(d) reporting requirements.

The public notice must be filed with the SEC using a Form 6-K on the same date or before filing Form 15F. At the date of filing Form 15F, a 90-day waiting period begins, during which the foreign private issuer's Exchange Act reporting requirements are suspended. If the SEC has no objection at the end of the waiting period, the suspension automatically becomes a termination of registration and reporting requirements.

SEC announcement on IFRS in filings

The SEC announced plans to issue a Proposing Release requesting comments on rule changes that would give foreign private issuers a choice between using IFRS or U.S. GAAP in their filings and a Concept Release to obtain comments on whether the same choice should be made available to U.S. issuers. The potential rule changes could eliminate the requirement for foreign private issuers to reconcile their IFRS financial statements to U.S. GAAP beginning with 2008 calendar-year financial statements.

Relief from the reconciliation requirement would be available only to companies that apply IFRS as issued by the IASB and may not extend to those applying jurisdictional standards that are based largely on IFRS. The proposal on filings by foreign private issuers is expected to be published some time this summer, with comments from interested parties due in the fall.

SEC Chairman Christopher Cox said that the new plans, subject to public comments on the proposal, are consistent with the overwhelming support for ending the required reconciliations that was voiced in March at the SEC round table on the International Financial Reporting Roadmap. The second element in the SEC's plans is a Concept Release on whether U.S. companies should be permitted to elect either IFRS or U.S. GAAP when preparing their financial statements.

SEC staff guidance on assumed perfect effectiveness of hedge relationships

A recent SEC announcement clarified the SEC staff's position on issues that were raised in a speech in December 2006. Companies that previously assumed hedge ineffectiveness was de minimus due to a hedge relationship's timing differences will not be required to correct or discontinue their accounting for the relationship if they support their assumption by applying two procedures.

The speech further asserted that perfect effectiveness could not be assumed if the timing elements are imperfectly matched and that "intuition" alone is rarely sufficient to prove that ineffectiveness is de minimus. The position taken in the speech differed from many preparers' practices. Many had evaluated hedging relationships only for terms that created more than de minimus ineffectiveness qualitatively, and may not have documented their assessments.

The SEC staff will not object to the past or continued use of hedge accounting if the two procedures confirm a reasonable basis to assert that the terms match sufficiently for the relationship to be highly effective and the de minimus nature of any ineffectiveness.

FASB issues statement on fair value option

On February 15, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115,* which permits entities to choose to measure many financial instruments at fair value.

The Statement allows entities to achieve an offset accounting effect for certain changes in fair value of certain related assets and liabilities without having to apply complex hedge accounting provisions, and is expected to expand the use of fair value measurement consistent with the Board's long-term objectives for financial instruments.

This Statement is effective as of the beginning of an entity's first fiscal year after November 15, 2007 although early adoption is permitted. Ret-rospective application to fiscal years preceding the effective date (or early adoption date) is prohibited.

Events organized by KPMG's Audit Committee Institute

As an Audit Committee Institute member you will receive an invitation for the following events in due time. Details of these events and electronic registration options will be posted on: www.auditcommittee.ch

Audit Committee Roundtables
KPMG's Audit Committee Institute will offer another series of roundtables in the German speaking part of Switzerland in Autumn 2007. These Audit Committee roundtables are targeted towards board members of Swiss companies.

ACI Roundtables Autumn 2007
All members will be informed early about the topics, dates and venues.

Internal Control Systems event series by KPMG Switzerland
This event series provides an exchange platform for ICS projects. After introducing the required project phases and a company's field report, the discussion is carried on in various roundtable groups. These events are targeting towards CEOs, CFOs, Audit Committee members and controllers. The following dates and venues have been organized:

- Wednesday, 26 September 2007
  Zug
- Thursday, 04 October 2007
  Zurich
- Tuesday, 09 October 2007
  Basel
- Monday, 15 October 2007
  Berne
- Tuesday, 16 October 2007
  Lucerne
- Wednesday, 24 October 2007
  St. Gallen
- Thursday, 25 October 2007
  Lugano (in Italian)

Internal Control Systems event series in the French speaking part of Switzerland
- Thursday, 04 October 2007
  Morat
- Tuesday, 16 October 2007
  Geneva
- Tuesday, 23 October 2007
  Lausanne

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On the Audit Committee Institute's homepage, you will find ongoing, up-to-date information to support your audit committee projects.

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