

The newsletter for Audit Committee members in Thailand

On Board*

Issue 6: November 2007

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Editor's comments

Welcome to PricewaterhouseCoopers' (PwC) 6th edition of On Board, our newsletter for Audit Committee members in Thailand.

Our first article focuses on business ethics. It is based on the results of a survey which asked directors what was the worst position they thought a board could find itself in. Insider trading, lack of succession planning and unexpected crises were the top three.

In the second article, we look at the role of corporate leaders in setting the ethical culture of an organisation. Despite all the efforts made to establish a structured ethics and compliance programme, another survey reveals that its impact will be negligible if senior management does not "walk the talk".

In our third article, we question whether enterprise risk management has been successfully embedded in Thai organisations. Strengthening risk management looks to be accepted as a good thing, but there is a danger that it has been viewed as a "one-off" compliance event rather than a continuous process that can be improved upon year on year as an organisation's risk profile inevitably changes.

Our final article brings the results of a survey focussing on the best and worst features of audit committees, as observed by PwC audit partners. The survey looked at Audit Committee membership, behaviour, and operations. The results are not necessarily surprising, but they do reinforce the practices which both help and hinder the effectiveness of Audit Committees.

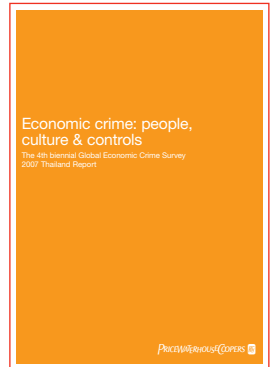
We trust you will find this edition helpful and we appreciate your feedback on how it might be improved or your suggestions for future articles.

Varunee Pridanonda
Partner

Noteworthy publications

Global Economic Crime Survey 2007 Thailand Overview

Based on the results of PwC's 4th biennial Global Economic Crime survey, this report takes an in-depth look at corporate crime in Thailand.



10 Questions and Answers on Enterprise Risk Management

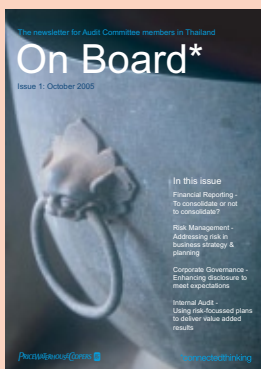
This publication provides key information and basic guidance on Enterprise Risk Management (ERM) for SET-listed companies and other organisations.



To download the above publications, please visit www.pwc.com/th

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October 2005



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Ethics and governance - what is most likely to worry company directors?

In 2006, *Corporate Board Member* and PwC teamed up to conduct the "What directors think" research report: a study based on the results of a survey of more than 1,300 corporate directors who answered nearly 70 questions on how they and their boards are meeting the challenges and demands of their jobs.

In this article, we highlight the key findings relating to the areas of Ethics and Governance – topics which are as relevant to Thailand as they are to the U.S. where the survey was conducted.

An ethics code is essential

Developing a robust code of ethics continues to be essential. Because board members make decisions on important and challenging issues, shareholders are demanding that the board explains its choices and takes steps to ensure that directors act as their representatives in all decisions affecting the company's success.

Worst-case scenarios

Directors don't need searing headlines like those generated by investigations, or high-profile, board-related court cases, to remind them that there are some situations no one wants to be in:

Which of the following characterises the worst position in which a board could find itself?

- 32%** Several company officers are being investigated for insider trading.
- 27%** The company suddenly loses its CEO without a succession plan in place.
- 25%** An unexpected financial or operational crisis has occurred without a company crisis plan in place.
- 12%** There is a hostile takeover bid that the company and the board have not anticipated and are not prepared to address.

Balance of power

Whether or not you believe – as some analysts do – that shareholder-motivated reforms are a good thing, institutional investors have made their presence known to today's boards:

Which of the following groups do you believe influence your board the most?

- 51%** Institutional investors
- 26%** Analysts
- 15%** ISS and rating agencies

Executive sessions

Board independence is an important issue. Most directors surveyed said they find executive sessions useful, but a number said they weren't sure their CEO understands the value of such sessions:

Which of the following best describes the value of your board's executive sessions, made up of independent directors?

- 69%** Executive sessions are very useful to the board and the CEO clearly understands their value.
- 22%** Executive sessions are very useful to the board, but I'm not sure the CEO appreciates their value.
- 7%** Executive sessions are not particularly valuable to the board.
- 1%** Executive sessions are not particularly valuable to the board and have strained the CEO-board relationship.

Explaining tough ethical decisions

There is no doubt directors are sometimes forced to make tough ethical decisions – such as the choice between increasing shareholder profits and supporting retired employees.

Both groups are constituents to whom the director owes a fiduciary responsibility, and a decision either way will most certainly create fallout on one side or the other. Yet the bottom line tends to outweigh employee concerns in most situations. Several companies have already begun to cut benefits for retired employees, sometimes granting a generous CEO pay package in the same period.

Adding weight to this trend, 71% of directors in this year's study predicted that most companies will alter or eliminate pension plans to improve future earnings.

Quality of earnings

On a positive note, most responding directors (98%) are comfortable with their company's quality of earnings – the degree of conservatism versus aggressiveness in accounting policies, accounting judgments, and accounting estimates.

To summarise, the crises that directors rated as the worst all represent significant compliance and operational problems. They point to a need for a highly ethical culture, with management living the values, and an effective enterprise risk management process, including robust crises plans.

For more information on this survey, please visit www.pwc.com

Strengthening business ethics - the critical role of company leaders

Good ethics is good business

It is becoming increasingly clear that there are many benefits to ethical behaviour. Company leaders are now placing as much value on intangibles, such as ethics, trust, and values, as they do on the obvious tangible areas of profitability, earnings growth, market share, and employee benefits.

Recent studies support this view. **The Institute of Business Ethics** in London noted that organisations demonstrating a leadership commitment to ethical behaviour performed better in economic value added, market value added, and price/earnings ratio volatility than did their peers who had no clear ethical stance. An earlier study conducted by DePaul University in Chicago drew the same conclusions.

So how do you strengthen ethical and compliance management?

For many organisations, the move towards strengthening ethical and compliance management takes the form of drafting an ethics mission statement, and implementing codes of conduct of business ethic that require employees to behave in an ethical manner.

These activities are undoubtedly positive steps, however this approach alone will not be enough to achieve the desired outcome.

While a company can advocate appropriate employee conduct in its mission and ethics statements, and require mandatory ethics training, the adage that says the behaviour emanating from the corner office is what drives the company's values still holds true.

As a result, companies that apply best practices require their leaders to set the tone for the company. They are expected to visibly demonstrate ethical business behaviour, and to set an example of the type of behaviour that is expected from all employees, from top to bottom.

If leaders do not embody the company's values, statements and ethics training have little impact - written codes of conduct rarely carry as much weight as do the actions of those in charge. Employees are generally more inclined to follow their leaders' good examples.

Driving a change in ethical culture - key steps

The challenge for boards and senior management is to ensure that they live by the code and carry out effective enforcement actions that support ethical behaviour, including:

- Emphasising leadership's dedication to ethics and compliance through regular communications to employees and key stakeholders;
- Instituting agreements that require executive leaders to abide by the company's ethics policies and objectives;
- Establishing integrity as a primary value through a code of conduct for leaders;
- Regularly evaluating the ethics and compliance competencies of leadership;
- Establishing responsibilities for the board to oversee ethics and compliance management; and
- Positioning behaviour as a criterion when evaluating the performance of executive leaders and all members of management.

The role of the Audit Committee

As an Audit Committee member you will want to ensure that your organisation has a strong compliance programme in place. Such a programme should include:

- Written standards or codes for ethical conduct and ethics training;
- A mechanism for seeking ethics-related advice or information;
- A mechanism for reporting misconduct anonymously;
- Disciplining employees who violate the standards of the organisation or law; and
- Ethical conduct as part of employee performance evaluation.

In summary, it's about the behaviour of leaders.

The Ethics Research Centre Survey

queried employees about their views on ethics and compliance standards in their companies. The results showed that 15% of employees felt they witnessed far less misconduct because top management acted ethically, but 56% felt top management only talked about ethics and did not exhibit the appropriate behaviours.

So the message is clear: ethics and compliance programmes do make a difference, however the impact depends on the culture in which they are implemented. Culture in turn, is heavily dependent on the behaviour of the board and senior management. Without the appropriate "tone at the top", you are unlikely to see a significant change in employee behaviour, nor a move towards a more "ethical culture".

While formal programmes are on the rise, says a survey by The Ethics Research Centre in the U.S., outcomes are at best unchanged.

Enterprise risk management - a “one-off” event or part of your company’s DNA?

Strengthening risk management practices

Driven by a combination of regulatory and market expectations, many organisations in Thailand have been encouraged to take a look at what risk management really is, and whether they need to do something about it.

As a first step, this has meant placing risk management best practices in context. By this we mean thinking about what type of risk framework and approach is right for an organisation given the nature and scale of its operations. For example, should the framework be formal and structured, or could management rely on a less formal, and perhaps more intuitive, approach?

In deciding what is right, organisations undertook reviews of their risk management practices. These reviews aimed to identify gaps and address them based on a prioritised action plan.

Organisations also considered some simple questions based around the needs and requirements of their key stakeholders. For example, could senior management respond (with confidence and supported with underlying substance), to questions such as:

- How do you identify, assess (measure), and respond (manage) to the risks and opportunities facing your business?
- How do you gain sufficient, independent assurance that all key risks, at both a corporate and process level, are being identified and controlled in an effective manner?

But are we really there?

The above paints a positive assessment of the state of risk management in Thailand. There is greater disclosure on risk management, and many annual reports now state that risk management is a management priority, and describe the key risks facing the organisation and how these are being managed.

However, there is a danger that risk management has been viewed as a “one-off compliance event”, rather than a continuous process.

Common to other emerging markets, the lack of a deep technical understanding coupled with an inability to link risk management to tangible value creation (such as enhanced revenues and/or better cost management), can lead to a “downgrading” of the overall process in terms of effort and budget.



This contrasts with a risk process that can support good governance and improve business performance over the longer term based on a stronger “risk culture” throughout the organisation.

How does this affect the Audit Committee?

From the Audit Committee’s perspective, a less than robust risk management framework increases the likelihood of “surprises”, particularly those which will have significant negative consequences.

Such surprises are not acceptable. Not only do they usually require intensive care from senior executives, they also raise questions from the wider stakeholder community as to why the Audit Committee was not aware of the issue, or the indicators leading up to it.

With this in mind, a good test of the robustness of your organisation’s risk management practices is to take a look at the more recent “crises” it has faced. With the benefit of hindsight, consider whether the matter could have been better handled, achieved a better outcome, or even been prevented if the organisation had had stronger risk management in place?

The results might reveal just how well risk management has been embedded into the operating culture and management activities of your organisation. It may also help identify what needs to be done to address any weaknesses.

Useful reading

To help you focus your efforts, you may find the recent joint publication between PwC and the Stock Exchange of Thailand helpful. This publication, entitled “10 Questions and Answers on Enterprise Risk Management” can be accessed at www.pwc.com/th

Audit Committee benchmarking survey

Earlier this year, PwC conducted a survey in the UK aimed at providing an overview of the best and worst features of audit committees, as observed by PwC audit partners.

The strong features included the number and behaviours of the members, the calibre of the chairman, challenging interaction with others and well-run meetings all of which are considered critical for the effective operation of audit committees.

Equally, the lack of detailed knowledge of technical accounting matters, the prevalence of a tick-box attitude regarding compliance and the voluminous nature of audit committee briefing papers continue to feature as the main factors hindering the effectiveness of audit committees.

The specific findings were as follows:



What membership features make an effective Audit Committee?

Best membership features	Worst membership features
<ul style="list-style-type: none"> • Quality of audit committee members <ul style="list-style-type: none"> - Sound understanding, experience and knowledge of the business and industry - Application of common sense - Good knowledge of technical financial matters • Quality of audit committee chairman <ul style="list-style-type: none"> - Strong, effective chairman - Driving audit committee operations towards best practices - Appropriate focus on significant issues - Energy and experience - Ensuring open communication channels • Appropriate succession planning (with transition period where new chairman works alongside outgoing chairman) • Small enough size to ensure effective dialogue • Mix of different skills and backgrounds • International diversity of members 	<ul style="list-style-type: none"> • Quality of audit committee members <ul style="list-style-type: none"> - Lack of technical competence in accounting issues leading to weak challenge and debate in these areas - Limited knowledge of the business / insufficient briefings on topical issues - Limited understanding of the regulatory environment • Quality of audit committee chairman <ul style="list-style-type: none"> - Weak and inactive audit committee chairman - Audit committee chairman being significantly more technically competent and experienced compared to the other committee members, causing problems over pacing the dialogue within the meetings - Over reliance on the chairman to go through the papers and lead the debate with management and auditors - A new chairman coming into an experienced committee can be overwhelmed by more senior non-executive directors

How should an Audit Committee behave?

Good behaviour	Bad behaviour
<ul style="list-style-type: none"> • Openness in considering different perspectives • Balanced judgements • Engagement, enthusiasm, wanting to get issues right • Appropriate time commitment and dedication • Taking responsibilities as audit committee members seriously • Able to take a more rounded view on the balance between the 'cost of compliance' and the 'need for profit' 	<ul style="list-style-type: none"> • Tick-box mentality regarding mundane compliance matters, rather than focus on what really matters • Low degree of engagement (a worrying indication is how often key divisional management have never met the non-executive directors on their main board) • Excessive formality, stifling discussion • Reluctance by members to challenge management and to tell them what they really think

How can Audit Committees operate effectively?

Best operational features	Worst operational features
<ul style="list-style-type: none"> • Agenda and meetings <ul style="list-style-type: none"> - Robust agenda for audit committee meetings - Preparation in advance of the meetings - Broad executive attendance at the meetings - Focus on essential issues, dismiss trivial areas - Emphasis on accountability and compliance - Rigorous debate of issues in meetings, not dominated by management • Resources and supply of information <ul style="list-style-type: none"> - High quality papers supplied to the audit committee on a timely basis - Communications from management and external auditors: short, focused and tailored for the audit committee - No undue filtering of information by executive management - Strong company secretary supporting the audit committee's operations - Business units reporting periodically to the committee on key risks and their management • Interaction with management <ul style="list-style-type: none"> - Challenging management and pressing of necessary changes - Management acknowledging the significance of the audit committee - Ensuring audit committee has adequate opportunity for interaction with management • Interaction with auditors <ul style="list-style-type: none"> - Regular communications, both formal and informal - External auditors engaging in regular private discussions with audit committee chairman - Clear explanation of scope of audit, including what is excluded - Alignment of areas of audit focus to the audit committee priorities - Open discussion about what is required, rather than a 'rubber stamp', to enable focus on the right issues - Many opportunities for both external and internal auditors to present findings and views 	<ul style="list-style-type: none"> • Agenda and meetings <ul style="list-style-type: none"> - Full board attendance, with the audit committee meeting becoming a postscript of the board meeting - Overcrowded audit committee meetings due to the attendance of non-board members - Fatigued audit committee members (particularly in the afternoon sessions) - Lengthy meetings - Ordering of the agenda such that the accounts are discussed at the end of the meeting - Inappropriate/inconsistent level of attention to different issues • Resources and supply of information <ul style="list-style-type: none"> - Excessive volume of papers hampering ability to do the job properly - Late delivery of papers - Content and presentation not tailored to the needs of the audit committee - Insufficient briefing on topical issues • Interaction with management <ul style="list-style-type: none"> - Dominance of meetings by the Company Chairman - Other management dominating the meetings - Close proximity of audit committee to management - Debate around issues which do not fall within the remit of the audit committee • Interaction with auditors <ul style="list-style-type: none"> - Insufficient support from the audit committee in challenging management - 'Hand holding' relationship sought by audit committee members

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