

The newsletter for Audit Committee members in Thailand

# On Board\*

Issue 5: February 2007

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## Editor's comments

Welcome to our 5th edition of On Board\*, the newsletter for Audit Committee members in Thailand.

**Our first two articles** take a year-end reporting theme. In the first, we look at how the Audit Committee can get more out of the relationship with the external auditors during year-end. The external auditor's work is a valuable source of assurance for the Committee and making the most of the relationship through greater communication and more robust discussions will help the Committee cover-off a number of its own obligations. In our second article, we look at what Audit Committees need to do to satisfy themselves that their year-end reporting to the Board and wider stakeholder community is based on a robust review of the financial reporting process and internal controls.

**In our third article**, we look at how Audit Committee members can become more effective in their roles. The question of effectiveness continues to surface in Thailand – many of our informal discussions with Committee members and regulators centre around this theme. Our article points to some straightforward ways in which your personal effectiveness can be enhanced.

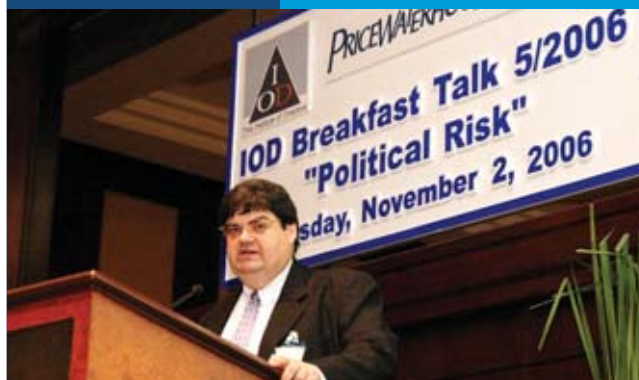
**Our final article** considers the impact of the Stock Exchange's revisions to its code of Good Corporate Governance. The Exchange's previous principles are now aligned with those set down by the OECD. They also pick up on recommendations from the World Bank's 2005 review of Thailand's governance framework. The revisions themselves are not particularly complex – our article focuses on the challenges of adherence and enforcement as these present the real difficulties.

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

**Khun Varunee Pridanonda**  
Partner

## Recent events

PwC and the  
Institute of Directors



PwC sponsored the Institute of Directors Breakfast seminar entitled "Political Risk" on 2 November 2006. The seminar (coincidentally made more topical by the events in Thailand), looked at the risks that companies face when they expand into new international markets. Changes in a country's political landscape can seriously impact the outcome and value of the investing company's economic actions. Political issues and actions are also ones over which the investing company is likely to have little control.

The seminar looked at what falls within the definition of political risk and where it sits within the overall risk universe. It also explored ways in which political risks can be better assessed and managed.

If you would like more information on this topic, please contact Marius Kunneke at [marius.kunneke@th.pwc.com](mailto:marius.kunneke@th.pwc.com)

## Noteworthy publications

**PwC's 10th Annual Global CEO Survey was launched on 23 January, at the World Economic Forum Annual Meeting, 2007 in Davos.**

Themed "Balancing the global equation", the survey examines the shift in the relationship between mature economy companies and those from rapidly developing economies. Supporting sub-themes are also addressed. They include: business opportunities and risks resulting from the globalisation of emerging markets companies; business opportunities and risks related to dispersed value chain strategies in a flatter world; and organisational competencies required to support globalising business models.

If you would like to download a copy of the survey, please visit [www.pwc.com/th](http://www.pwc.com/th)

Was:  
Within borders  
Is:  
Across borders  
Will be:  
Without borders?\*

As market forces rebalance the global equation, how are today's business leaders responding to change?

10th Annual Global CEO Survey



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## Audit Committee reporting - reporting the substance

December 2006 has come and gone and the Boards of Directors, management and external auditors of most of Thailand's listed companies are all now working hard to finalise their 2006 Annual Reports. Audit Committees are not spared either. In addition to reviewing the full year financial statements and fourth quarter financial reports, the chairman of the Audit Committee must also approve and sign the Audit Committee Report to the Annual Report. This report documents the Audit Committee's activities during the year, together with its performance.

The Audit Committee Charter and the Notification of the Stock Exchange of Thailand on the "Qualifications and Scope of Work of the Audit Committees, No. 1 of 1999" establish straightforward reporting guidelines. The main question is how the Audit Committee members can satisfy themselves that they have done enough to sign-off on the Report confident that they have fulfilled their obligations and responsibilities.



So, which questions should the Audit Committee be able to answer to enable them to conclude in the following three areas:

- The accuracy and adequacy of the company's financial reporting process;
- The suitability and efficiency of the internal control system and internal audit; and
- The accuracy and completeness of the disclosure of related party transactions or transactions that may lead to conflicts of interest.

The following questions should form the backbone of the Committee's review and discussions:

### **Financial Reporting Process**

1. What are the current areas of greatest financial risk, and how are these being managed?
2. Are the accounting systems adequate and appropriate?
3. What significant recommendations have been made to management (by internal and / or external auditors) for improvements to the reporting process? How has management responded? Are there any significant areas that still require attention?
4. What evidence has management considered in order to satisfy itself that the business is a going concern (i.e. that it will continue to operate for the foreseeable future)?
5. Has the possibility of fraudulent reporting been considered?
6. What are the most significant accounting and reporting issues and what is their likely impact on the financial statements?
7. How many manual adjustments are required and are they valid?
8. If we rely on financial information systems, is the computer environment adequate?

### **Financial Statements**

9. Do significant accounting policies continue to be appropriate? Are the assumptions underlying them still valid? Did any accounting policies change this year? If so, for what reasons, and what were the effects of the changes?
10. Were there any disagreements between management and the auditors on accounting policies or principles? Were they satisfactorily resolved?
11. Were there significant financial statement variances between years? What caused these variances?
12. Were there any unusual transactions completed during the year that are not evident from the financial statements? How were these transactions accounted for? Did any of these transactions involve related parties?
13. Has the company invested in any "exotic" types of financial instruments?
14. Were there any critical judgments and estimates?

**Internal control**

1. Has management set the appropriate "control culture" by communicating the importance of internal control and the management of risk?
2. How is management held to account for the security of computer systems and applications, and the contingency plans for processing financial information in the event of a systems breakdown?
3. Which internal control recommendations made by internal and external auditors have not been implemented by management?

**Internal audit**

1. Is the internal audit mandate appropriate? Has it kept pace with the company's activities and information and control systems?
2. Does internal audit have adequate resources, both in terms of skills and funding?
3. Would the function be better resourced and delivered if it were outsourced to an external supplier?
4. How is the internal audit program determined?
5. Does internal audit investigate areas significant to the key operational and financial risks faced by the business?
6. Do the internal auditors have an effective working relationship with the external auditors?
7. Have they maintained its objectivity?
8. Has internal audit ever undergone an external assessment?
9. Has the internal audit plan been linked to the risk profile, and has external audit been able to rely on internal audit's work?

**Related parties**

1. Do you know all the related parties (e.g. holding companies, shareholders subsidiaries, joint ventures, associates, family businesses, etc.) with which the company is doing business?
2. How do we know that all related party transactions are identified and have been accurately and completely accounted for and disclosed?
3. Is there legal supporting documentation for all related party transactions to prove that they were carried out on an arm's-length basis and at market prices and in compliance with transfer pricing laws and regulations?

In addition, Audit Committees are finding themselves under mounting pressure to increase their responsibilities and to prepare best practice Audit Committee statements. These may also assist the company in obtaining the SET's Excellent Corporate Governance Report award.

Reviewing the sixteen winners of the 2005 awards, we observed best practices reporting on:

1. Effectiveness of risk management procedures.
2. Opinions and views regarding the appointment, termination, operating results, budget and personnel of the Internal Audit Department.
3. Audit Committee's self-assessment performance report presented to the Board of Directors, including measurement of achievement of Key Performance Indicators.
4. Compliance with Corporate Governance policies and procedures
5. Independence of the external auditors.

The quality and integrity of the Audit Committee Report will add to the perception that investors, financial analysts, the markets and stakeholders have in terms of how well a company is being run. A vague and noncommittal Audit Committee Report may contribute to a negative assessment of corporate governance in the company.



## Engaging the external auditors - getting more value from the relationship at year-end

Regulations and stakeholder expectations are driving Audit Committee's to take greater ownership of the relationship with the external auditor. While this is likely to increase your workload, it also represents an opportunity to get more out of the external auditors, particularly during the year-end reporting process and the communication of audit results.

**Firstly, for this to work, the Audit Committee needs to be clear on the purpose and scope of the external audit.**

The external auditor's objective is to form an opinion as to whether an organisation's financial statements present a fair picture of its financial position and the results of its operations.

This is extremely valuable, particularly as, in arriving at the opinion, the auditor will assess the extent to which the financial statements are free from material misstatement. In practice this includes assessing the likelihood and impact of errors or fraud on the reported numbers (although detecting fraud is clearly not a primary audit objective).

However, the Audit Committee should appreciate that the auditor's work in Thailand does not extend to providing an opinion on the strength of the organisation's overall risk management processes or internal control environment. Neither does the opinion cover the effectiveness of the organisation's governance practices. As a result, the Audit Committee needs to include other stakeholders, such as internal audit, compliance and risk, or line management itself to provide assurance in these specific areas.

**So what should you expect and ask of the external auditors at year-end?**

The Audit Committee can and should gain considerable comfort on the robustness of the financial statements from the work conducted by a good auditor.

In addition, while noting that the auditor's formal opinion is limited to the financial statements, it is acceptable for the Audit Committee to seek the external auditor's view on related areas. The very nature of the auditor's work means that they should have had broad exposure to management during the course of their audit. Further, they should be able to comment on risk and control issues insofar as they relate to the organisation's financial reporting process.

So, with this in mind, the Audit Committee should (i) request a formal report and (ii) hold robust discussions with the auditor on the results of their work. Ideally, the reporting will follow through on issues discussed at the planning and interim audit stages.

**What are the areas that should be covered in the external auditor's report to the Committee?**

As a minimum, the formal report to the Audit Committee at year-end should include comments on the following:

- Major accounting policies which are considered to be overly conservative or aggressive;
- The impact of any significant changes in accounting policy, including the reason behind the changes;
- Areas of significant judgment or uncertainty and the underlying basis for management's decisions on quantification; and
- Areas of material control weakness and how management plans to address these.

In drafting the report, it is important for the auditor to clearly explain the issues, together with their actual or potential impact on the financial statements. This should include

comments on alternative treatment where relevant, and how the auditor assessed the reasonableness of management's position. Accounting issues are rarely black or white, and the auditor's views are a valuable source of assurance. They may even act as prompts for further investigation or follow up.

**In addition, be prepared to seek the auditor's feedback on areas which may not be explicitly covered in their report.**

Asking the auditor's views on the more sensitive and less tangible areas of good corporate governance may reveal issues that require follow up before the Committee can submit its own report to the main Board. It is also a good test of the auditor's independence and could even extend to the auditor's views on the Audit Committee itself. The questions could include:

- Did the auditor encounter any difficulties? If so, what were they, and how have they been resolved?
- Do any disagreements with management exist? If so, why is this, and what is the impact on the financial statements?
- What is the auditor's view of the overall quality of financial reporting?
- Is the auditor aware of any areas where improvements can be made and if so, how best should these be addressed?
- Were any significant adjustments made as a result of the audit?

It would be reasonable to expect the auditor to comment on the above insofar as they have a degree of reliable evidence on which to base their answers. It would not be reasonable to expect the auditor to make sweeping statements based on perception rather than fact. However, glowing references of people or processes, or an inability to provide comments on key audit risk areas should raise questions as to the auditor's objectivity or the depth and substance of their work.

## Personal effectiveness - becoming a better Audit Committee member

When PwC gets into discussion with Audit Committee members or regulators about what Audit Committee members in Thailand need most, the answer tends to revolve around them wanting to be more “effective” in their role. Becoming more effective probably sits in many people’s personal development plans, so what are the specific areas where Audit Committee members feel they are not yet reaching the mark?

From our experience in Thailand, and the feedback on global surveys and thought leadership papers prepared by PwC on this topic, we highlight five areas where practical changes will have an immediate impact.

### 1. Clarify the scope of your Committee’s activities

The Audit Committee is a sub-committee of your company’s main Board. As such, its scope of activities should be formally delegated by the Board, and should be clearly specified in both the Board’s and the Audit Committee’s terms of reference. This is a vital starting point in terms of both avoiding any confusion over roles and also ensuring that the Audit Committee is not burdened with an unfair degree of responsibility.

In practice, the Audit Committee is likely to take oversight responsibility for financial reporting and internal financial control. It should also manage the relationships with both the internal and external auditors. Whether it also covers areas such as the oversight of enterprise wide risk management or compliance activities depends on whether another Committee or the Board itself is better placed to do this.

### 2. Prepare for, and contribute to, Committee meetings

Given that the majority of the Audit Committee’s work centres around meetings, it is critical that these are planned and run in an organised and disciplined manner.

Arriving late and only then opening papers you received a week before but have not yet read is not likely to enhance your contribution! Preparing for meetings means spending time reviewing the papers that support agenda items in advance. This will ensure you are sufficiently briefed and able to ask the right questions.

If one of your concerns is that you are not getting sufficient or timely information from management, work with the Board to change this. It is too risky to be forced into decisions without having adequate time to reflect on the issue in hand.

### 3. Enhance your ability to identify unusual trends, issues, and disclosures in the financial statements

As a key focus area for the Audit Committee is the financial statements, you need to be able to identify areas where results or disclosures are not consistent with other explanations or information available to you.

A good way to initiate your review is to request management to provide an analysis of the company’s results. For this to be of value, it must clearly explain the underlying cause of unusual fluctuations and trends in performance.

For example, stating that turnover has increased well beyond budget because “we sold more products” is stating the obvious. Quality analysis should highlight (in sufficient detail) reasons why the company has been able to achieve this level of sales. For example, was it due to a new, more capable sales team? Was it new or enhanced products? Was it changing market conditions or competitor positions? Was it a combination of all of these?

Meaningful explanations will enable you to “test” them against other information you have, your experience of the company, and your knowledge of the wider business environment.

### 4. Introduce greater “challenge” into meetings with management

Requesting management and executives to attend all or part of your meetings will enable you to ask questions and clarify your understanding of issues and results. However, for this to be effective, Audit committees need to adopt a more sceptical approach to the questioning of management’s actions and explanations.

This is not suggesting that management is in any way dishonest, it is just that

more direct questions, together with a degree of corroboration, are usually needed to get the full picture of more complex or sensitive issues. In addition, spending time with management outside of formal meetings will also be beneficial. Visiting key locations will provide you with another perspective on the company’s activities, operating culture, and business issues. While acknowledging that you may have limited time, getting out and “kicking the tyres” provides another layer of comfort.

### 5. Take greater ownership of internal audit

A strong internal audit function provides valuable support to the Audit Committee, in particular its assurance over the company’s risk management framework and the effectiveness of its internal controls. For this to work, the internal audit function must have the right profile within the organisation and be sufficiently independent of management.

Historically, this has not always been the case. In many organisations, the Finance function played a key role in setting scope and monitoring internal audit’s findings. This is no longer appropriate and Audit Committees should work with the Board to transfer ownership of internal audit away from management. This will help strengthen internal audit’s independence and increase its value proposition. This in turn will help you to better discharge your responsibilities.

In summary, clarifying your remit, being prepared and more organised for meetings, understanding financials better, engaging with management, and strengthening internal audit’s proposition will all help enhance your effectiveness. These should be within the ability of most Audit Committee members and for those who need some help, there are many excellent publications and best practice guidance and courses available. However, the main issue is likely to be time – do you really have enough to do the job properly?

## The SET's new principles of good corporate governance - the challenges ahead

The year 2006 was a turbulent one, and it tested corporate governance in Thailand. The political uncertainty that reached a peak in 2006 is set to continue in 2007. The introduction of a reserve requirement on short-term capital inflows and the new capital and investment restrictions on foreigners have also contributed to a loss of foreign investor confidence in Thailand.

Over the past five years, regulators such as the Stock Exchange of Thailand, the Ministry of Finance, the Securities and Exchange Commission and the Bank of Thailand have spent considerable time developing regulations and guidelines, and providing continuous education to Directors, Audit Committees and Management.

However, in 2006 there was an increase in the incidence of share manipulation cases, insider trading, nominees, misleading financial statements and accounting fraud. These events clearly challenged the effectiveness of existing regulations and good corporate governance practices.

### Facing the challenges to Corporate Governance – the Stock Exchange steps in

At the end of 2006, the Stock Exchange published an updated version of the 15 Principles of Good Corporate Governance for Listed Companies (March 2002). More principles have been added to make this version more comprehensive and comparable to the Principles of Corporate Governance of the Organisation for Economic Cooperation and Development (OECD). This version also incorporates the recommendations made by the World Bank in its Report on the Observance of Standards and Codes related to corporate governance in Thailand. The Stock Exchange has received a considerable amount of valuable input from listed companies, both through their self assessments and by their comments during panel discussions.

The new Principles of Good Corporate Governance for Listed Companies issued by the Stock Exchange are divided into two parts: the principles and the recommended best practices.

The principles and the recommended best practices are presented under five categories, namely:

1. Rights of Shareholders
2. Equitable Treatment of Shareholders
3. Role of Stakeholders
4. Disclosure and Transparency
5. Responsibilities of the Board

The principles cover the key issues relating to good corporate governance, whilst the content in the recommended best practices section offers supplementary descriptions or methods to enable companies to implement the principles.

The Stock Exchange recommends that the Boards and management teams of listed companies comply with the principles to bring their systems of corporate governance to an international level. The principles can be adapted by each company to best fit the individual company's needs. If they choose not to comply with any principles, they should provide a thorough explanation of their reason for not doing so.

Listed companies have also been requested to start disclosing details on their implementation of the principles in their 2007 Annual Statements (Form 56-1) and their annual reports. The first reports are due in March and April 2008 respectively.

### Facing the challenges to Corporate Governance – the Government acts

The current government is also trying to improve corporate governance. In January 2007, the Thai cabinet approved a bill against corruption designed to help root out conflicts of interest between politicians, state officials and their associates. The bill aims to prevent the abuse of power to gain personal and vested interest.

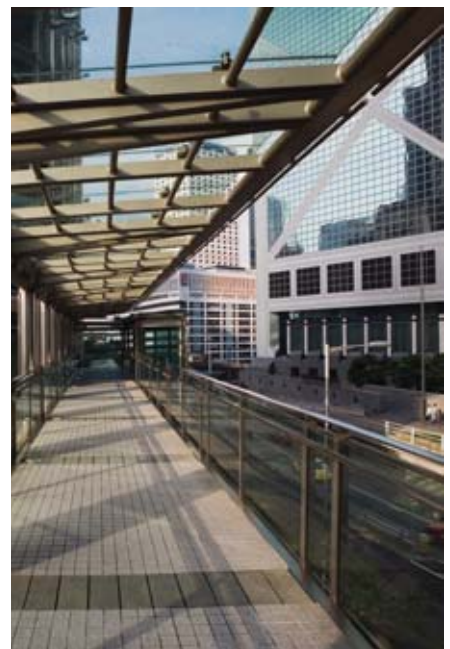
The biggest driver for multi-national companies in Thailand to improve governance comes from outside Thailand by way of the Foreign Corruption Practice Act (FCPA) and other international anti-bribery legislation, e.g. the International Anti-Bribery Act of 1998 or the anti-bribery conventions of the OECD.

These acts require companies with publicly traded stock to comply. The companies falling under the scope of these laws with operations outside their borders have to ensure that all entities and associates comply. This may require some companies operating in Asia to change their way of doing business, including local companies in Thailand. Such companies may have to amend their business ethics and practices or lose business for themselves, and even Thailand.

Implementing, complying with and living by good corporate governance principles should be a core value of any organisation, irrespective of the example set by peers, or the political and business environment in which it operates.

In summary, the main challenges for the government, regulators, companies and organisations are likely to be:

- Adopting the OECD conventions on bribery and introducing laws similar to the FCPA;
- Monitoring compliance with good corporate governance and assessing its effectiveness; and
- Finding the appropriate sanctions through laws and regulations to reward and penalise directors if their company or organisation does not have, or comply with, good corporate governance principles.



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