

## **How to Fight Against Corporate Fraud**

Speech by Mr. Thirachai Phuvanatanarubala  
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Good Morning, Ladies and gentlemen

1. It is a pleasure for the Thai Securities and Exchange Commission to host this training program on how to fight against corporate fraud. Fraud is of course an important subject. No capital market can properly function unless investors have confidence about market integrity. And nothing destroys confidence as easily as corporate frauds.

2. There are a few important steps to prevent fraud. First, you must have clear rules of law that are enforceable. Second, you must build in checks and balances. The roles of independent directors, audit committee, internal audit functions and external audit functions have to be well defined. Third, you must ensure full disclosure. This applies not only to the financial accounts and annual reports, but also to information about deals and transactions that may open the venue for fraud. Most exchanges will have rules that require listed companies to make announcements in a clear and timely manner. And fourth, you must have a good system to police the rules.

3. The steps are so few that many of you may wonder why we need to have a training program on this. What are the challenges? Today, I shall highlight only three.

4. The first challenge is that those who are responsible to act as the check and balance sometimes fail to do so. In Thailand, cases involving independent directors failing to act their part were most common. They failed to raise probing questions, to demand full explanations or to vote against bad proposals. Some of the decisions were inappropriate and unfair to small shareholders, but stopped short of violating the law. We could not take legal action against these directors. To solve this problem, we therefore set up a committee. This committee is tasked with enforcing discipline on company directors. We will call the directors of the company that committed questionable transactions to face the committee for interview. If the committee finds the behavior to be substandard, it can issue a warning or even a temporary ban from holding a directorship in any listed company. We now maintain a registry of directors eligible to serve on boards of public companies. If one is taken off the list, he will be barred from serving for a period of time. To ensure fairness, the committee comprises members from various professions and backgrounds, including the President of the Institute of Directors in Thailand. If the feature of check and balance is important to have, one must make sure that the feature exists in substance and not just in form.

5. The second challenge is that in Thailand we found that in some cases the robbery occurred in broad daylight. In some companies, the board of directors voted on a transaction that unfairly favors directly or indirectly the majority owner. Then they proposed the transaction for approval in a shareholders' meeting. Unfortunately, not many shareholders in public companies are active. They fail to attend meetings, or they attend but do not study the issues deeply enough. They ended up voting for the transaction

without realizing that it was to their own detriment. We tried to solve this problem by demanding that whenever a company calls for shareholders' meeting to vote on a transaction connected to the majority shareholder, or connected to the company's top executives, it has to send a copy of the documents to us. If we see that the issue lacks adequate analysis, or it seems to be one sided, we shall order the company involved to conduct more third party assessment. We can also encourage stock analysts to comment on the deals, as well as getting the professional fund managers to become active on the issues. The best way to prevent daylight robbery is to force the thieves to go on stage, under spotlights, and be publicly criticized.

6. The third and perhaps the most difficult challenge must be on enforcement. The Thai SEC now monitors and analyses quarterly accounts of about a fifth of the companies listed. We selected those that we suspected may have weaker governance than the norm. This effort has been successful. We were able to identify transactions that were inappropriate. We then raised questions with the management and have been able to force - - either an amendment to the transactions so as to become fairer to the minority shareholders - - or for the transactions to be reversed entirely.

7. One problem that I noticed that was new to Thailand was that of listed companies conducting transactions with its affiliates. The listed companies would report profits from these inter-company deals. However, they tried to hide the fact that the two companies were affiliates. When a company sells to another in the group at inflated prices above arm length, normally the profit reported in one company in the group would be cancelled out by the loss of the other company when the accounts of the two companies are consolidated.

8. The problem encountered in Thailand is that they tried to hide the relationship so as to show only the profit without consolidating the accounts. This kind of problem is difficult to solve. External auditors who audit only the company in the stock exchange, and not the affiliate outside the stock exchange, would not have sufficient information to link up the two companies. This is when we have to exercise our power to investigate the flow of funds of all the parties. In some cases, we were able to establish a clear relationship that links the companies. After that, we either filed for prosecution or forced the listed company to restate the accounts, wiping away the fictitious profits. However, such investigation is very time consuming and difficult. Audit trails of fund flows often disappeared because they paid for transactions by cash instead of checks. But the efforts must continue.

9. Ladies and gentlemen. I have listed the challenges not to discourage you, but to show that regulators have to keep up to date with the latest technique about fraud. They need to share experiences and give advices to each other. This is why a training program like this is good in allowing experiences from many countries to be shared. I therefore encourage participants to be active in order to reap the fullest benefits.

Thank you.