Internal Control and Audit System

1. Internal Control

Internal control is a crucial process assisting the organization in achieving targets. SCG prioritizes this process by stipulating the duties of the Audit Committee to include review of internal control systems, internal audit activities, and risk management to ensure that they are strict, appropriate, cutting-edge, and efficient. The Company uses enterprise risk management (ERM) as a management tool to strengthen the risk management process and internal control activities. SCG has upgraded internal control systems to comply with international standards according to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), a joint committee with members from five professional institutes in the United States. SCG has already incorporated into its business operations five components of enterprise risk management, including internal environment, risk assessment, control activities, information and communication, and monitoring. Likewise, three additional COSO risk components have been integrated, as follows:

1. **Objective setting** Management defines objectives for reporting and regulatory compliance at both strategic and operational levels. Employees use these objectives as policies in carrying out their duties.
2. **Event identification** The risk committee of each business unit regularly meets to identify major external and internal factors affecting business operations in order to ensure complete coverage of risk factors signaling difficulties. Such risk factors are managed and monitored cautiously.
3. **Risk response** The management and the risk committee of each business unit collaborate to devise strategies to control risks to the acceptable level. The results are consistently satisfactory.

During 2010, SCG has developed, in addition to the abovementioned controls, various systems and procedures in order to achieve efficient and effective internal controls contributing to sustainable development. Such developments are summarized as follows:

1.1 Fraud prevention programs for major business functions

Preventing risk of fraud is now one of the Company's internal control priorities. Strict risk controls diminish the potential for fraud to occur and reduce its potential impact. With this in mind, SCG has stipulated preventive measures, audit activities, and corrective measures. The Company instills ethical values in employees at all levels beginning with our employee orientation program. SCG regularly trains staff on compliance with its code of conduct. The Company has
established a sound oversight system. In addition, the Board of Directors acts as a role model to employees.

The Company has developed fraud prevention manuals for all major business functions in order to raise employees’ awareness and standards of ethics in performing duties. The manuals define objectives, principles, potential circumstances involving risk of fraud, and prevention guidelines for use in daily work. In addition, SCG has stipulated the use of control self assessment (CSA). The Internal Audit Office conducts a fraud audit whereby employees can inform it about non-compliance with regulations, rules, and laws, and suspected fraudulent activities via a whistle-blower system. When fraudulent activities are suspected, an investigation committee is appointed to ensure fairness to all concerned parties. Each particular instance of fraud is recorded for use as a case study and lesson learned, allowing specific preventive measures to be developed.

**1.2 Development of information technology control self assessment system (IT CSA)**

Based on successful use of control self assessment systems in several applications, the Company has applied the same principle to information technology. The objectives are: to make the system efficient, effective, reliable, secure, and able to deliver timely information; to ensure compliance with rules and regulations; and to create an efficient IT governance system. The Internal Audit Office collaborated with relevant business operations to develop work procedures for prevention and self assessment of contract arrangement and various computer systems, and to create IT control self assessment forms in such critical areas as hiring of contractors to enhance computer systems, computer system security, user rights assignment, and evaluation of computer system efficiency.

**1.3 Integration of preventive systems for sustainable development**

SCG conducts business by bearing in mind its responsibilities to the economy, society, and environment, in order to achieve sustainable development. Important preventive systems, i.e., good corporate governance, risk management, and control self assessment, have been integrated to synergize internal control and audit systems. The process commences from evaluation of weaknesses arising from non-compliance with corporate governance principles. Next, risks are assessed and prioritized according to impact levels. The most significant risks are identified in order to further develop control self assessment according to priority levels. The results are monitored; causes of difficulties are examined; and relevant corrective processes are developed. This contributes to the formation of a stock
of knowledge capital that is shared with responsible persons on an ongoing basis.

2. Internal Audit

As per its charter, the Audit Committee supervises the Internal Audit Office to ensure that it works with independence, integrity, and proper ethics. It does so by assessing the sufficiency and efficiency of internal control systems and enterprise risks so as to guarantee that operations are in line with SCG’s vision and the changing business environment. In 2010, the Committee implemented the following actions:

2.1 Audit enhancement to create sustainable value-added

To create sustainable value-added, the Internal Audit Office emphasized the preventive audit approach, which is based on four generally accepted concepts: control self assessment (CSA), advisory system, assessment of risk management, and good corporate governance. The Internal Audit Office applies these four concepts on a continuous basis to develop efficient and effective audits.

The Internal Audit Office’s first vision statement, issued in 2005, focused on the “innovative preventive audit” approach, identifying key issues to audit each year in alignment with its vision. This year, the Audit Office has set its vision for 2011 to 2013, again supporting SCG’s company-wide vision, as an “innovative proactive audit in order to create sustainable value-added in domestic and overseas operations”. The Internal Audit Office’s five key mission statements are as follows:

- Advance from preventive auditing towards professional proactive auditing, to create value for clients.
- Create significant and sustainable value in the audit work itself, and in the work being audited, by collaborating with all business units of SCG.
- Leverage auditors’ skills to gain competencies for continuous advancement.
- Implement methodology and information technology for internal control, control self assessment (CSA), and risk management to insure that overseas units and affiliates achieve the same standard as SCG.
- Insure that the quality of audit work attains international standards.

In order to achieve the mission statements, the Internal Audit Office has developed annual action plans in pursuit of “global auditing excellence”. Accordingly, the Office will benchmark SCG audit practices against those of leading professional internal audit firms, perform audit work that brings high value-added to clients, and support auditors’ development to gain competencies
for continuous advancement. Moreover, the Internal Audit Office developed IT systems to support the internal control process while also integrating good corporate governance principles, assessment of risk management, and control self assessment (CSA) to accomplish operational efficiency.

2.2 Auditors’ competency development

To increase each auditor’s knowledge to reach compliance with international standards, the competency management and development system is used as a tool for determining an individual development plan for each auditor. Competency is defined in two ways:

- Common competency is the major ability supporting the audit mission. It is considered in terms of knowledge and behavior.
- Functional competency is the ability necessary for specific audit tasks. It is considered in terms of knowledge and skill.

The competency management and development system requires auditors to firstly perform self-assessment according to the established model. The Human Resources Committee of the Internal Audit Office then considers the self-assessment results of each auditor. The Committee then provides recommendations to each individual auditor for use as guidelines for continuous improvement in each competency level. Monthly in-house training sessions enable auditors to become more effective and efficient while adhering to uniform standards. Self-study and self-assessment activities are provided using e-learning, with a focus on key audit tasks and a systematic management of methods. In addition, the Internal Audit Office supports its auditors’ efforts to attain audit certification at the international level.

2.3 Development of IT audit

In 2010, the IT Development Department developed IT audit systems to improve IT workflow and become more effective in preventive terms. The Department developed several programs such as an SAP authorization audit system in order to audit right granting; electronic control self assessment system for inventory management; e-CSA for accounting, and e-CSA for credit management. The three e-CSA programs increase effectiveness in managing and following up inventory transactions, accounting transactions, and credit management.

The Department also conducted information system (IT) assessments for overseas units and affiliates to improve their operations to be effective and in compliance with SCG’s standards. In addition the Department is developing other IT applications to increase the effectiveness of the internal control system and internal audit, especially in terms of preventive action. When the external auditor
or Internal Audit Office discovers any weakness or problem in operations, it will be examined in coordination with the relevant department to determine measures for correction and systemic improvement.

2.4 Development of audit procedures using total quality management (TQM)

In order to increase the effectiveness and efficiency of audit work, keeping it up-to-date and relevant to ongoing change, the Internal Audit Office is implementing the total quality management (TQM) principle. SCG has been applying this concept as a guideline to improve the productivity of all departments. When applied to auditing, TQM means to audit with integrity, reasonableness, and awareness of value-added. The objective is to create value and benefit for every department. In 2010, the Office developed a new audit work procedure manual to be more up-to-date and relevant to the vision and work. This manual will follow the same standards for both audit work and ethics so that auditors will act consistently. Auditors can use the manual both for self-study, regarding theory, and for consultation in actual use.