



Internal Control and Risk Management

In the Board of Directors Meeting No.2/2020 held on February 24, 2020, with the complete attendance of all 3 members of the Audit Committee, the Board of Directors evaluated the internal control system through “Internal Control Assessment Report” provided on SEC’s website on 5 categories of internal control system of the Company which are:

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring Activities

The Board viewed that the Company’s internal control was adequate and effective. The operation was efficiently managed with sufficient numbers of employees and processes. In addition, the Company had sufficient internal control system to oversee the subsidiary’s operation to ensure that prevent the assets of Company and subsidiary from misuse or unauthorized use by the Board, as well as, transactions with persons who may have conflict of interests or connected persons. For other categories, the Board viewed that the Company’s internal control was adequate. Independent directors and the Audit Committee had no different view from the Board.

Details of 5 categories of internal control system are as follows:

1. Control Environment

Executives and employees have attitudes that are good and conducive to the internal control. Executives give much important on a corporate culture that focuses on integrity and ethics. Appropriate audits are being conducted based on the facts, with fairness and transparency.

Overall, company's internal control system is appropriate and helps promote adequate and effective internal control system for instance:

- The Board supervises the formulation of business goal that is clear and measurable to be used as guidelines for executives and employees.

- The Board supervises the Company to correctly delegate the roles and responsibilities of the Board and executives in accordance with the charter law.

- The Board consists of persons with company's knowledge and useful experience or are able to request for suggestions from the experts. Moreover, the board consists of independent directors who are knowledgeable, reliable and independent.

- The Company designed the organization structure that helps support the management to work efficiently and effectively.

- The roles and responsibilities of the Board, executives, management and employees have been appropriately specified, delegated and restricted.

- The Company revises staff performance goals to ensure that they were carefully set. There is performance appraisal process including incentive or reward program for good performance employee and the management of under target employee,

as well as, the communication of these process to executives and staffs.

- The Company prepared written Code of Conduct for executives and employees. It is considered to be appropriate guideline. There is a rule that prohibits management and employees from causing any conflict of interests and corruptions to the Company. In addition, there are penalties for violation and monitoring for compliance of such ethics.

- The Company prepared written "Anti-corruption Policy" to create guideline/ steps for practitioners to be understand and used. Together with, information communication both inside and outside the Company to show all stakeholders the Company's determination on Anti-corruption.

- The Company prepared written policy and practice on transactions with risks, for instance finance, purchasing and management, to prevent corruption and damage which may incurred.

- The Company has a clear operational control and monitoring system. The responsible department, as well as internal audit who is independent and reporting directly to the Audit Committee, are responsible for formulating plan based on important level of business risk, covering all important work processes of the Company and its subsidiary.

The Audit Committee supervised the internal audit by approving annual audit plan, acknowledging the audit results and giving opinions on concise internal audit, to prevent or reduce the possible risks. The Audit Committee also gave the guidelines on the report for rectification follow-up to ensure the appropriateness and effectiveness of internal audit work. In 2019, no significant deficient internal control was found.

2. Risk Assessment

The Company places important on risk management by establishing The “ Risk Management Team”. Type of risks were specified to cover business. There are regular evaluation and monitoring of risk management plan of each department, as well as systemizing report and monitoring to be up to date. Company’s executives evaluate situations of risks and situations that may affect or damage the Company by creating measures to prevent, solve and monitor the situations that are the causes of risks; as well as, measures to mitigate those risks. Moreover, Risk Management Team communicates risk management policy to all executives and employees to acknowledge and follow until it becomes a part of corporate culture.

The company follows the generally accepted accounting policies which appropriate with the business. The Company set the significance of the financial transactions based on important factors such as financial report users, size of transaction and business trend.

The company’s financial reports truly reflect the operating activities. The presentation of financial report is complete, showing rights or obligations of the Company correctly with appropriate values and information is correctly and completely disclosed.

3. Control Activities

Overseeing the operation of management is important. It assures the Company and shareholders that guidelines created by management are responded and followed by all employees.

- The Company clearly set the written authorities and payment authorization limited of each management level by specifying as payment authorization limited regulation.

- The Company segregates the duties into 3 duties which are

(1) Approval duty

(2) Accounting entries and information posting duty

(3) Asset custodial duty

To enable segregation of duty and cross checking.

- There are system and technology safety control, use level specification, access to information that is restricted only for responsible person, control of access to programs that are appropriated with duties of each staff level.

- In the case that the Company has a connected transaction, the Company has a restrict measure to monitor that the transaction is under the process set by the authorities and for the maximum benefit of the Company, and treated on arm’s length basis.

- In the case of transaction approval with related person in the form of long-term binding, the company regularly inspect and monitor the abidance of agreed terms.

- In the case that the Company has an investment in subsidiary, the Company constantly analyze and evaluate the performance of the subsidiary.

- The Company has measures to ensure that the Company is abiding by relevant laws to mitigate the business risks and maintain company’ s reputation.

4. Information and Communication

The Company has continuously developed its information and communication system, by providing effective and efficiency system and channels for communication to both inside and outside the Company, to be comprehensive, accurate in a timely manner whatever it is a financial information or other information. For internal communication, the Company provide adequate and in- time important information which every employee receives through intranet system. For communication with third party, the Company communicates information via company's website (www. autocorpgroup. com) , as well as, reports required by institutes. The Company has the system controlling the data transmission or data input. There is a segregation of work, and appointment of responsible person including a clear specification of authorities of person and department that are relevant to communication of information. Moreover, the Company gives access to responsible person only.

5. Monitoring Activities

The Company monitors and evaluates performance of internal control and work quality by setting the work procedures and continuously monitoring the results. This is a part of normal works of management, supervisors and relevant person.

In addition, the Company evaluates performance of internal control from internal audit's report which is independent and reporting directly to the Audit Committee. In the event or suspect event of serious fraud which may significantly affect the reputation and financial position of the Company, management will immediately report to the Board of Directors/Audit Committee with guidelines of solutions to consider within appropriate time frame.

There were 4 Audit Committee meetings in 2019 to constantly consider and monitor financial position and operating performance and to periodically give important suggestions that have effects on organization to executives. There was a monitoring of targeted operation, continuation of internal control system review. Adjustments were made to be consistent with the changed situations. Furthermore, the external auditor of the Company, KPMG Phoomchai Ltd. by Mr. Natthaphong Tantichattanon who is the auditor of 2019 Financial Statements, did not express an opinion about deficiency of internal control system in auditor's report. The Company also appointed independent third party internal audit, BK IA & IC Ltd. by Miss Boonnee Kusolsophit, an internal auditor and a certified public accountant, who possess knowledge on accounting internal control system to perform risk and unusual transaction elimination. From qualification and experience on accounting and business operation, the Company deem the appropriate for BK IA & IC Ltd. to appropriately and adequately conduct aforementioned duties.

Appointment, demotion and rotation of the Company's head of internal audit must be approved (or agreed) by the Audit Committee.

Risk Factors

1. Risk in the business operations

1.1 Risk on the investment in expanding the branches not complying with the plans

The group has a business expansion plan by investing in the showroom and service center of Honda in accordance with the strategy on the branch expansion to cover all regions. The investment in the branch expansion of each showroom and service center can make the ACG group to have a risk from the improbable operations as planned, e. g. the revenue from sales and services do not meet the projection as calculated. While the company has a cost, land lease, depreciation cost and fixed financial cost, if the branch operations in the future do not comply with the established plans, it may have an impact on the operations of the ACG on the net revenue and profit are reduced.

The ACG has prioritized this risk issue using circumspection in a branch expansion by making a project feasibility study to analyze the financial status of the ACG, the investment budget and remuneration from the investment, including the time for the return on investment. The selection of a location of each branch shall consider the market suitability based on the potential and marketing gap, location of the showroom and service center. It includes the size and the budget on the suitable investment of each location.

Nonetheless, in 2019 the core company invested in opening a branch in Phuket province with the high potential for business operations. It has adjusted the format of investment and built a sales and service team for the opening within a few months to realize the revenue and reduce the risk from the investment in the branch expansion. Moreover, in each investment to expand a branch shall be approved by the board of directors to present the investment plan for Honda to approve in the next stage.

1.2 Risk of dependence on the Honda car manufacturer

The ACG depends on the business operation as a dealer and service of Honda car brand by purchasing the goods from Honda Automobile (Thailand) Ltd. (“Honda”) as the manufacturer to the ACG. Honda shall consider allocating the goods depended on the market condition and the number of goods in existence, also it shall consider helping on sales promotion, customer service, including the allocation of spare parts to the dealer at its own discretion for each one. The customer service included the allocation of spare parts to the dealer at its discretion to each distributor, and Honda shall approve a branch expansion in the future of the ACG. It includes approval to open a branch for all dealers based on the candidates with potential and complete qualifications. However, the selection of the dealer has no limitation on creating a competitor under the same brand. That said, each area can have more than one dealer depending on the size of the market and various factors at the time. The whole things have the risk to impact the business continuity significantly.

In the past Honda would set the standards for the operations of the “dealer,” including the assessment of the work product of the dealer to measure the sales standards and service of each one. They include satisfaction on providing the service and compliance with the plans or marketing target jointly planned. In addition, the company also set up its own business operations to make the ACG to receive the evaluation score at the good level and received a reward on such the assessment continuously.

The ACG has received approval from Honda in the expansion of eight showroom and service centers, which approved as mentioned above. The ACG had to present to the Honda group in the stages later.

Furthermore, since Honda car is the main goods of the group, so if there is a problem from the goods, so Honda shall recall it and can have an impact on the revenue and reputation of the ACG group. Nonetheless, from the experience of dealership and the service centers of Honda car brand over 25 years, it has never had such an event to impact the ACG.

Furthermore, if there is an incident that Honda has to decide to cancel a production and sales of goods in Thailand shall have a continuous impact on the future business operation significantly. Nonetheless, Honda was established in Thailand since 1983 and had the growth rate all along. Japan considered Thailand as a country with potential on the production and purchasing power of the consumers, so they decided to build a production base for car and spare parts to support the growth of the Honda car consumers sold in Thailand and exported to other countries. There is no other essential reason to cause Honda to terminate the production and sales of its goods in Thailand in a near future.

1.3 The risk from not renewing the dealership contract and service of Honda car or terminated from a breach of the agreement of the dealership agreement

Honda Maliwan Ltd. is a subsidiary and is a contractual party with Honda Automobile (Thailand) Ltd. by the contract appointing the dealership and service of Honda is for year-to-year (The current contract expires on 31 December 2021). The contract has the limited term that may cause a risk to ACG, in the case the contract is not renewed, or there is a change of the terms and conditions in the contract that may result in the company cannot continue the business, for example, the termination is conditional upon;

- The contractual parties can make a joint agreement at any time for the contract can be terminated.

- The dealer and Honda reserve the right to terminate the contract by notifying the other party in writing by designating the effective date on termination. However, if not stipulated otherwise the party given a notice or the dealer has paid any money owed Honda in full (if any).

- The dealer cannot maintain the license to operate the business as stated in the contract, or the license is not renewed, suspended or revoked by whatever reason.

- The dealer abandons/ cannot open the workplace for the consecutive days exceed the agreed days.

- The dealer moves the workplace or changes the business characteristics without prior consent in writing from Honda.

- The dealer cannot repay any money owed to Honda within the specified schedule from the request in writing from Honda.

- The dealer submits or participates in submitting to Honda a statement or document, so as to have a false payment is a fraud.

Such the above-mentioned conditions the ACG can comply with them all along throughout the business operation without breaching the contractual conditions.

Moreover, in the past the ACG has operated the business under the contract with Honda for a long time and the company management has experience on the business management for a long time, so the ACG has expertise on the business management and knowledge on the operations from setting a business policy, personnel training and selling of the goods under the framework and contractual conditions of Honda excellently all along. It has received an award from the evaluation of the operations as a Honda dealer with the good operating results, efficiency and is consistent with the target and guidelines of Honda on the operations and customer satisfaction.

Since Honda is a leading brand at the world level and one of the top leaders of Honda car in Thailand, which gives priority to the care of customers very much, so the high standards on selecting the dealers. Thus, to qualify as a Honda dealer must have been selected very well.

Although the term of contract is year-to-year, but it is a policy of Honda to treat all dealers in the whole country, the ACG is confident that it still can be renewed of the contract in the future due to no breach of contract to cause a breach of the contract appointing the dealership and service as such.

1.4 Financial risk

1.4.1 Risk on dependence on the loan from a financial institution

As of 31 December 2019 the ACG has borrowed money from a financial institution as the principle in doing the business. The group has a debt burden that is short-term and long-term loans from financial institutions totaling 712.5 million Baht, divided into the short-term loan with a financial institution of the promissory note (P/N) with the contractual term of three months for 670 million Baht. The long-term loan to be due within one year for 30 million Baht, and long-term loan remains 12.50 million Baht, which will be due by the end of May 2021. As a result, on 31 December 2018 the company has the liquidity ratio equals to 0.88 times and the debt ratio to equity equals to 1.40 times (calculated from the total debt) or equals to 1.09 times (calculated from the debt with interest-bearing debts). In 2016-2018, the company had the financial costs of Baht 32.80, 28.39 and 27.82 million respectively.

In a scenario that the business operations with the sales and services do not meet the set target the dependence of the capital from a financial institution can cause a risk to the financial stability and the ability to repay the interest and principal from the financial institution. It includes a breach of some conditions, which may affect the business operations of ACG significantly.

Moreover, the company group has the short-term loan ratio about 94 percent out of the total loan for use in buying goods and investment in a new branch. In the case the company is not renewed of the loan or the bank recalls the short-term loan may affect the company group to lack financial liquidity or working capital. However, the company still has good relations with the three financial institutions all along, and has never defaulted on the interest repayment. Thus,

the group is confident that it shall be supported from the financial institutions continuously. Moreover, the group can find a capital source from other financial institution or can request for a long-term loan due to there is a piece of land that is free from being used as a guarantee.

1.4.2 The risk from the subsidiary breaches the contract on maintaining the financial ratio in the loan contract.

The subsidiary company has borrowed from a commercial banks since 2015 with a condition that it needs not cause a debt obligation or burden for the debt-to-equity ratio exceeding 3.5 times in 2017-2018, and not exceeding 2.50 times for 2019. Also it has to maintain the debt service coverage ratio (DSCR) by no less than 1.1 times (calculated from the profit before interest expense, income tax, depreciation and amortization divided by current portion of long-term debt plus entire interest expenses) The conditions on the financial ratios by the bank are referenced to the annual financial statement of the subsidiary company on 31 December 2018. The subsidiary company had the debt ratio to equity and the DSCR equals to 2.1 times and 1.5 times respectively.

However, as of 31 December 2018 the core company had the D/E and the DSCR equals to 1.4 times and 2.2 times respectively, which means it can maintain the ratio according to bank conditions due to the better operation results. Nonetheless, if in the future the subsidiary cannot maintain the financial ratios in this requirements, it is confident that the financial institution shall give leniency on such the matter as in the past due to the subsidiary has not defaulted on the interest and principal and still has the guarantee with the financial institutions.

1.5 Other risks

1.5.1 The risk from depending on the large shareholder with the power to set the managerial policy.

At present the Rangkakulnuwat family is the major shareholder of the company or 74 percent of the paid-up capital, Mr. Phanumast and Mrs. Hathairat Rangkakulnuwat are still almost completely able to control the resolution at the shareholder meeting, regardless of on the appointment of the directors or the resolution on other matters to use a majority vote of the meeting. However, only the matter that the law or regulations of the company requires to receive three-fourths (3/4) of the votes in the shareholder meeting, e.g. the increase of the capital, capital reduction, sales or transfer of the business partially or entirely, etc. Thus, other shareholders cannot gather the votes to audit and apply checks and balances when the major shareholder proposes.

Nonetheless, the board of directors has appointed four independent directors with three audit committees and one chairman out of the total of 10 directors to attend the board meeting to audit and use the checks and balances of the board and the management. It includes the consideration on approval of the various items before presenting to the shareholder meeting is for confidence to the shareholders that the management inside the company shall be transparent.

Moreover, the ACG has depended on Mr. Phanumast Rungkakulnuwat as the CEO, who is the major shareholder of the company and has managed the business all along. If the ACG loses the main management may cause damage to the company. Nevertheless, Mr. Phanumast and family as the major shareholder is expected the company to be still able maintain the management with the company in the future.

1.5.2 The risk from the investment in other company

The company is a holding company, currently investing in Honda Maliwan Co. , Ltd. , which is the core company and doing the business of sales and service in the automobile industry and the related businesses at the ratio of 99.74 percent. While the company has not operated other business by itself results in the operating results of the company depends on the operating results of subsidiary entire, and the dividends come from them. Thus, if the subsidiary has good operations will result in the company having good operating result as well. However, on the other hand, if the subsidiary has poor operating result, it will send a negative impact to the company as well.

However, the company realizes the risk from the investment in such the subsidiary, it shall analyze the possibility and consider the potential of the future project, including the risk factor from the investment in a new branch and present the investment plan of the subsidiary to the company board consider, including an advice to reduce the investment risk that can happen. In addition, in the supervision of the subsidiary the company shall send a director or the management with the suitable qualification and experience to the business as the representative in the management of the business of such the subsidiary to designate the important policy and control the business operation of such the subsidiary.