INDEPENDENT AUDIT INSPECTION ACTIVITIES REPORT 2014

BUILDING BRIDGES

SEC

Securities and Exchange Commission, Thailand

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Independent Audit Inspection Activities Report
1 January – 31 December 2014

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Executive summary

In today's interconnected economies with an increasing regional economic integration and capital markets linkages, consistent practice of highly acceptable international standards among different capital markets is considered the driving force to stimulate cross-border investments, and thus propelling such integration and linkages forward. Being responsive of that development and aiming for Thailand to be the capital market powerhouse of emerging Asia, the Securities and Exchange Commission of Thailand ("SEC") has focused on sustainable improvements of market integrity and investor protection by raising professional work standards and capabilities of both entities and individuals involved with various functions of our capital market such as securities issuers, financial advisors, auditors, market intermediaries, and stock exchanges.

Both market integrity and investor protection could not be achieved without high quality financial information which in turn would only be possible with the support of a healthy financial reporting ecosystem. Striving to achieve such quality, the SEC has directed its efforts towards strengthening the various elements of the financial reporting ecosystem, from better education and training to more rigorous monitoring and enforcement. And it is only when the appropriate processes are in place and the people involved are capable and collaborative that the financial reporting system would yield the much needed result of high quality financial reports.

Being main contributors in the financial reporting process, both listed companies and audit firms ought to put in place proper work processes and internal controls to ensure the desired outcomes. Listed companies need a suitable internal control system and a well-functioned accounting department, equipped with competent staff, as well as a seasoned and independent audit committee to oversee the process. As the function that originates all types of the financial information, the accounting department is of a particular import, even though it is sometimes perceived as only a support function, and is often overlooked and understaffed. The SEC, therefore, has particularly encouraged top management to provide adequate resources for this function by highlighting its significance on the overall quality of the companies' financial information. Similar to the above necessities for listed companies, audit firms' focus is on the sufficient supply of able auditors and the implementation of and the compliance with the Thai Standard on Quality Control 1 ("TSQC1"), which is equivalent to the internationally known ISQC1, together with the periodic analysis of root causes and the effective execution of remediation plans for any deficiencies identified by the quality control system.

As TSQC1 consists of six elements, all of which are important for the system of quality control, deficiencies in one element inevitably affect the working of others and resolving a weakness in one element will simultaneously improve the other elements' effectiveness. Determined to solidify financial reporting and audit quality, the SEC aims to strengthen all elements of TSQC1 and has, therefore, raised our expectations of each element for the second-cycle audit inspections, in response of the deficiencies found during the first cycle. It was obvious from the 2014 inspection results that the audit firms share our views and objectives and have made much progress in resolving their deficiencies, with the exception of few findings whose remedies are time consuming in nature.

The mechanics of how audit quality affects financial reporting involves not only the quality control at the firm level, but also that at an engagement level. Our inspection results at the engagement level have shown improvements in several areas; for example, audit manuals and audit programs involving methods of sampling and substantive analytical procedure for the audits of revenues were tailored to be more situation appropriate, resulting in fewer deficiencies detected. There are, however, other areas in which further improvements are warranted such as audit planning and risk assessments, audit procedures in response to fraud risk, audits of revenue recognition based on the percentage of completion method, and assessments of the appropriateness of management's use of going concern assumption.

Our root cause analysis has revealed that the deficiencies found at both levels are a result of a few factors, such as shortage of human resource within the profession, improper job assignment, an audit planning that failed to respond to engagement risks, and ineffective participation from those involved in the financial reporting process. To mitigate these shortcomings, the SEC has initiated and participated in several ongoing seminars and workshops for our auditors, as well as for the auditors preparing to register with the SEC, as we seek to expand the pool of the SEC-registered auditors. Being well aware of the fact that the quality of financial reporting depends on the involvement of other stakeholders as much as it does on the work of the auditors, the SEC has also regularly addressed current financial reporting issues during seminars and knowledge-sharing sessions the SEC hosted for other stakeholders throughout the year. Some of these deficiencies and issues are common within the region and some are widespread beyond our region so to confront these challenges efficiently, we often share our experiences with our counterparts at both regional and international levels in an effort to find common solutions.

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Quality Assurance Review Panel (“QARP”)

1. Mr. Nontaphon Nimsomboon

Position :
- Expert Member – Board of Trustees, Walailak University
- Chairman, AMC International Consulting

Work experience :
- Auditor General
- Expert Member, Securities and Exchange Commission
- Member of the Court of Directors, Bank of Thailand
- President, Institute of Certified Accountants and Auditors of Thailand

Education :
- Ph.D. in Accountancy (Honorary), Thammasat University
- MBA, the University of Iowa, USA (Royal Thai Government Scholarship Recipient)
- Bachelor of Accountancy, Thammasat University
- Bachelor of Commerce (Honors), Thammasat University
- Certified Public Accountant (CPA Thailand)

2. Prof. Hiran Radeesri

Position :

- Honorary Member, Thammasat University Council
- Academic Member, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King
- Chairman, Tax Auditor Examination Committee, Revenue Department
- Specialist in Corporate Governance, Stock Exchange of Thailand
- Member, State Enterprise Directors Pool Committee

Work experience :

- Chairman, Price Waterhouse Co., Ltd.
- Member, Board of Governors, Stock Exchange of Thailand
- Academic Member, Accounting Professions Regulatory Commission, Ministry of Commerce
- President, Institute of Certified Accountants and Auditors of Thailand
- Chairman, Thai Institute of Directors Association
- Chairman, Board of Directors, Metropolitan Rapid Transit Authority
- Governor, State Railways of Thailand

Education :

- Ph.D. in Accountancy (Honorary), Thammasat University
- MBA, Wharton School, University of Pennsylvania, U.S.A.
- Higher Diploma in Accountancy, Thammasat University
- Bachelor of Commerce, Thammasat University
- Certified Public Accountant (CPA Thailand)

3. Prof. Viroj Lowhaphandu

Position :

- Advisor to the board, Central Plaza Hotel Public Company Limited
- Director, Centara Hua Hin Beach Resort Company Limited
- Director and Audit Committee Chairman, Srithai Superware Public Company Limited

Work experience :

- Deputy Permanent Secretary, Ministry of Finance
- Director General of Treasury Department
- Chairman, board of directors, Saving Bank, Ministry of Finance
- Chairman, Thai Telecommunication Council, Ministry of Communication
- Director, Civil Service Commission
- Director General of Revenue Department
- Director General of Customs Department
- Outstanding Civil Service Commission "Golden Garuda" Award – Year 1989
- President, Institute of Certified Accountants and Auditors of Thailand
- Director General of Excise Department
- Director, Thai Institute of Directors Association
- President, Thammasat University Alumnai - under the Royal Patronage of His Majesty the King

Education :

- Bachelor of Commerce, Thammasat University
- Higher Diploma in Accountancy, Thammasat University
- MBA (Taxation), American University Washington, D.C., U.S.A.
- Bachelor of Laws, Thammasat University
- Ph.D. in Accountancy (Honorary), Thammasat University
- Ph.D. in Business Administration (Honorary), Sripatum University
- Ph.D. in Art Program for Leadership in Society, Business and Politics (Honorary), Rangsit University
- Ph.D. in Art Program in Accountancy (Honorary), the University of the Thai Chamber of Commerce
- Certified Public Accountant (CPA Thailand)

4. Prof. Thavach Phusitphoykai

Position :
- Chairman, board of directors, Satien Stainless Steel Public Company Limited
- Member, Accounting Professions Regulatory Commission, Ministry of Commerce

Work experience :
- Director, Stock Exchange of Thailand
- President, Institute of Certified Accountants and Auditors of Thailand
- President, Asean Federation of Accountants
- Chairman, SGV Arthur Andersen, Thailand

Education :
- Ph.D. in Accountancy (Honorary), Thammasat University
- Executive Program in Business Administration, University of Columbia, New York, U.S.A.
- MBA, Thammasat University
- Bachelor of Accountancy, Thammasat University
- Certified Public Accountant (CPA Thailand)

5. Mr. Natasek Devahastin

Position :
- Advisor, the Auditing Standards Committee, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King

Work experience :
- Partner and Chairman, PricewaterhouseCoopers, Thailand
- Lecturer, Faculty of Commerce and Accountancy, Chulalongkorn University

Education :
- Fellow of the Institute of Chartered Accountants in England and Wales

6. Emeritus Prof. Supapun Ruttanaporn

Position :
- Emeritus Prof., Chulalongkorn University
- Audit Committee Chairman, Delta Electronics (Thailand) Public Company Limited
- Audit Committee, Glow Energy Public Company Limited
- Audit Committee, Charoen Pokphand Foods Public Company Limited

Work experience :
- Government permanent teaching staff, Faculty of Commerce and Accountancy, Chulalongkorn University
- President, Thailand Accounting Association
- Ethical Standard Committee, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King

Education :
- MBA (Accounting), Michigan State University, U.S.A.
- Bachelor of Accountancy (2^{nd} class honors), Chulalongkorn University
- Director Certification Program (DCP)
- Fellow member of Thai Institute of Directors Association
- Certified Public Accountant (CPA Thailand)

7. Ms. Chongchitt Leekbhai

Position :
- Associate Director of Academic Service and Training Center, Faculty of Commerce and Accountancy, Chulalongkorn University
- Member, Accounting Professions Regulatory Commission, Ministry of Commerce

Work experience :
- Lecturer, Faculty of Commerce and Accountancy, Chulalongkorn University

Education :
- Master of Accountancy, Thammasat University
- Bachelor of Accountancy, Chulalongkorn University
- Certified Public Accountant (CPA Thailand)

8. Mr. Pakorn Penparkkul

Position :
- Academic Council Member of a state university
- Visiting lecturer at state and private universities
- Subcommittee on Ethical Standard setting, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King
- Advisor, Thai Accounting Firms Association
- Advisor, Tax auditor Association of Thailand

Work experience :
- Partner of Price Waterhouse World Firm
- Secretariat and Member of various committees, Institute of Certified Accountants and Auditors of Thailand (ICAAT)
- Member of the Education and Accounting Technology Committee, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King, for two consecutive terms
- Audit Subcommittee, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King

Education :
- Ph.D. in Accountancy (Honorary), Rajamangala University of Technology Isan
- Bachelor of Accountancy, Chulalongkorn University
- Certified Public Accountant (CPA Thailand)

9. Mr. Samart Buranawatanachoke

Position :
- Chairman of the Board of Directors, the Thai Credit Retail Bank Public Company Limited

Work experience :
- Chairman of Executive Board, Bangkok Asset Management Co., Ltd
- Chairman of Audit Committee, Secondary Mortgage Corporation
- Assistant Governor, Financial Institution Supervision Group, Bank of Thailand

Education :
- Master of Management, Sasin Insittute, Chulalongkorn University
- Advanced Management Program, Harvard Business School, U.S.A.
- Master of Accountancy, Chulalongkorn University
- Bachelor of Accountancy (Honors), Chulalongkorn University
- Certified Public Accountant (CPA Thailand)

10. Mrs. Pranee Phasipol

Position :
- Director of Audit Committee, Dusit Thani Public Company Limited
- Chairman of Audit & Risk Committee, Director of Nomination and Remuneration Committee, SCI Electric Manufacturer Co., Ltd.
- Chairman, Subcommittee on Ethical Standard setting, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King

Work experience :
- Deputy Director General, Department of Insurance, Ministry of Commerce
- Deputy Director General, Department of Business Development, Ministry of Commerce
- Chief of Inspector General, Ministry of Commerce

Education :
- Master of Science in Accounting, Thammasat University
- Bachelor of Business Administration, Major Accounting (2nd class honors), Thammasat University
- Certified Public Accountant (CPA Thailand)

02

Activities for enhancing audit quality

In our relentless efforts to improve the quality of financial reporting, the SEC, in strategic collaboration with other organizations such as the Federation of Accounting Professions ("FAP") and other regulators, has raised awareness among the stakeholders, focusing on auditors, accountants, and audit committees, of the importance of high quality financial reporting through initiations of and participations in various activities at both local and international levels. This goal, if achieved, will give Thailand a solid foundation to compete on the world stage to be one of the important financial centers, which will undoubtedly fuel our economies and eventually improve the living standards of Thai people and those of our neighboring countries.

Strengthening the audit professions

As lasting improvements start from within, the SEC deems it necessary for the audit firms to be self-reliant, which always starts with an adequate supply of competent audit staff who possess thorough understanding of both accounting and auditing standards, as well as their appropriate applications. Therefore, in 2014, we increased the frequency of our communications with the auditors on audit inspection findings, believing that more immediate feedbacks would minimize adverse effects of the deficiencies and lead to quicker improvements.

Results from the inspections during the first half of 2014 revealed prevalent deficiencies on the uses of substantive analytical procedures and audit sampling. The SEC, therefore, took immediate action by holding a seminar in the mid of 2014 on the topic of "Audit Quality: Audit Sampling and Substantive Analytical Procedure" to discuss with audit firms and their auditors to find proper and practical solutions

In the second half of 2014, the SEC held another seminar for the auditors and other relevant organizations, on the topic of "Audit Quality Inspections and Expectations for Future Improvements" to discuss common deficiencies found in the 2014 firm-level and engagement-level reviews. In addition, the SEC hosted a panel discussion with the representatives from large and small audit firms on audit planning and risk assessments, aiming to increase overall effectiveness and efficiency of audit processes.

In anticipation of the possible auditor shortage due to future market expansion, the SEC has partnered with the FAP and created the training program called "Developing Auditors for Thai Capital Markets", that covers both the theoretical and practical aspects of the audit works, for auditors and audit firms aiming to register with the SEC. Following the training program, the FAP will perform initial assessments on the quality control systems of those participating audit firms and provide feedbacks and recommendations regarding their compliance with TSQC1.

The SEC's participations on regional and international levels

The SEC regularly participates in various meetings, workshops and seminars with other audit and securities regulators, as well as several international organizations, to exchange ideas and experiences, and to strengthen cross-border relations for the benefits of current and future collaboration toward the common goal of high-quality audits and financial reporting. In 2014, our important participations included:

In May 2014, the SEC hosted the AARG annual meeting (AARG: ASEAN Audit Regulators Group). The AARG meetings are designed to be a platform for ASEAN audit regulators to share their experiences and deficiencies found during audit inspections and to hold a dialogue with representatives from Big-six audit firms about the practical issues and challenges faced in the course of their audits.

In February, June and October 2014, the SEC participated in three meetings of the International Organization of Securities Commissions-Committee 1 ("Committee 1") in Spain, Japan, and Belgium, respectively. Committee 1 aims to promote high quality professional standards, including the rigorous application and enforcements of those standards and these meetings, together with several conference calls in-between, give members opportunities to comment and discuss new developments in the international accounting and auditing standards, as well as professional code of conducts and other ethical requirements, and to share their practical experiences both among themselves and with the accounting/auditing standard setters. These meetings, therefore, are highly beneficial for the SEC in its progress toward high quality financial reporting.

In March and April 2014, the SEC participated in IFIAR's 8th inspection workshop and IFIAR plenary meeting in Malaysia and the United States of America ("USA"), respectively. Through these events, we shared and learned about new developments in audit regulatory environments, and this in turn helped us in the design and execution of our audit inspections to ensure the internationally acceptable audit quality of listed companies in Thai capital markets.

In August 2014, the SEC participated in the Public Accountant Conference ("PAC") on "Financial Reporting: Striking a New Balance" in Singapore. Participants were updated on new developments of financial reporting and discussed means to stimulate effective involvements from management, accountants and auditors in the financial reporting process.

In November 2014, the SEC participated in two important events: the International Auditor Regulatory Institute seminar and the World Congress of Accountants. The first event, hosted by the US Public Company Accounting Oversight Board ("PCAOB") in USA, addressed current issues faced by audit regulators and promoted discussions among the diverse groups of participants, necessary activities for consistent improvements of the audit quality across different markets.

The second event, hosted by International Federation of Accountants ("IFAC") in Italy, is held every four years with participants from the accounting professions around the world. Thus, it presents a good opportunity for participants to build connections and strengthen relations with representatives of various organizations from different countries. This conference focused on the dynamic roles and responsibilities of the accounting professions in driving businesses forward. It also highlighted on the upcoming innovations in the accounting professions. The SEC reflected these new developments in its planning of regulatory strategies related to the accounting professions.

Global acceptance

In addition to being the IFIAR member in 2010, and being recognized in 2013 by the European Commission ("EC") as being equivalent to those of the European Union ("EU") member states, in November 2014, the SEC received an opportunity to represent the International Organization of Securities Commissions ("IOSCO") on the IFRS Advisory Council for a term period of three years from January 2015 to December 2017. The IFRS Advisory Council is the formal advisory body to the International Accounting Standards Board ("IASB") that involves in the consultative process of the IASB and takes steps to encourage broad participation in the development of IFRS as high-quality, globally-accepted standards.

This opportunity not only enables the SEC to actively participate in the consultative process of the international accounting standard setter, but it also helps put the SEC in the forefront of any new developments in the accounting standards, giving us chances to respond to the changes in a timely manner. Through this new means of communication, the SEC now has a more direct channel for conveying our regional- and country-specific issues on the application and enforcement of the IFRS to the IASB. From these global participations, the SEC expects to further enhance the financial reporting quality of Thai capital markets toward international best practices, which consequently would facilitate capital markets linkages and cross-border securities offerings.

03

Summary of inspection results

A. Firm level

In 2014, the SEC assessed the firm-level quality controls for the total of twelve audit firms. Though progresses each of these firms made for each TSQC1 element might differ due to factors such as corporate cultures and their different strengths, we were fairly satisfied with the significant improvements observed in most aspects. This reflects the emphasis and determination of leaders of audit firms and their staff on improving the level of audit quality.

During this second year of the second-cycle annual audit inspection, the SEC focused particularly on the elements of ethical requirements and monitoring and to facilitate the firms' improvement process, we added a summary of high-impact deficiencies and the analysis of root causes in our firm-specific audit inspection reports, highlighting the more important deficiencies and their potential causes. However even with the root cause analysis being provided, the SEC still believes that the audit firms are in the best position to determine the real root causes of their deficiencies and to implement effective remediation plans

The following section provides key inspection findings as well as sample course of actions employed by some audit firms that we believe would be useful to other firms facing similar issues.

1. Leadership responsibilities

Leaders of audit firms are in a crucial position to promote internal culture that values audit quality and it is their attitude toward audit quality that would be a key factor to steer the firms in the right direction. The followings are common deficiencies found during our inspections for this TSQC1 element.

Performance evaluation and remuneration of audit partners

If a firm leader is striving for high audit quality, the SEC expects the leader to take into account and to give appropriate weight to the quality of the audits when considering audit partners' performance evaluation and remuneration.

From the 2014 inspections, the SEC observed that several audit firms, that did not previously consider audit quality, have now linked their performance evaluation and remuneration decisions to this factor and out of those that had already included audit quality, some now give greater weights to measures related to audit quality. Moreover, some audit firms have set penalties for engagement partners and Engagement Quality Control Reviewers ("EQCRs"), whose works were found deficient by internal reviewers or the SEC, and they would additionally be required to submit written explanations, describing causes of their deficiencies and future corrective/preventive courses of actions.

Nonetheless, this problem still persists in some audit firms. For example, we found that some firms compensated their audit partners based on a fixed amount and/or as a proportion of the partners' total audit fees and in other firms, the partners' compensations would totally be at a discretion of the firm leaders or senior partners without any explicit criteria linking pay to audit quality.

As reputation of high audit quality is considered the most valuable asset of any audit firms, it is indeed necessary that firm leaders clearly reflect its importance in the way that they compensate their audit partners.

Imbalance between human resources and workloads

Shortage of human resources in audit professions has been such a constant challenge for all audit firms that the head of each firm need to seriously contemplate both short-and long-term solutions to this problem. The severity of its effects, however, might be different to large and small audit firms. For instance, while large audit firms experienced insufficient audit staff in senior and manager levels, thus weakening the quality of the audits in areas that involved complex business transactions or those that required considerable amount of professional judgment, the smaller firms' shortage was instead at the audit partner level, resulting in some audit partners both holding quite a sizable audit portfolio as well as being the EQCRs and their firm's quality control committee which consequently led to insufficient involvements of both engagement partners and EQCRs within the audit process.

Even with this setback, the audit quality is still the necessary factor that cannot be compromised for any capital markets striving for stability and growth. The SEC, therefore, expects that the firm leaders make careful resource allocation such that the factor of human resources is considered during client acceptance stage to ensure sufficient resources and appropriate assignments of audit works to audit staff with the right capabilities and experiences. Audit firms could also approach this problem by setting the maximum number of engagements per audit partner, taking into account factors such as complexity of engagements, significant engagement risks and audit partners' other responsibilities.

According to the SEC's inspections, audit firms continuously put effort to resolve this problem in a variety of methods. For example, while one audit firm employed additional workers to perform simple audit tasks, i.e., ones not required extensive knowledge or professional judgments, leaving the audit teams with sufficient time to focus on the more complex and/or high-risk issues, another firm might assign the firm's quality control system to audit personnel who specialized in this area in order to allow audit partners more time to concentrate on their audit engagements.

Leaders’ responsibility to partners’ deficiencies

Being at the top of an organization, a leader of an audit firm is ultimately responsible for the firm’s quality control system and its effectiveness. Therefore, to fulfill that responsibility, he or she has to ensure that adequate resources are allocated and suitable policies and procedures are in place for the functioning of the quality control system. Consequently, the number of deficiencies found, their severity and any delays in resolving them would reflect poorly on the ability of the audit firm leaders to discharge their responsibilities successfully, resulting in the SEC lowering the score of their TSQC1’s leadership responsibilities element accordingly.

2. Ethical requirements

From our 2015 inspections, the SEC observed significant improvements in several areas within the element of ethical requirements, as evidenced by a number of issues raised during the first cycle inspections having been resolved. For instance, audit firms have seriously adopted measures to improve and ensure their independence against the undue influence of long association and high audit fee clients. Nonetheless, due to the more intense inspections of the second cycle, the following issues were identified.

Business relationships with audit clients

The SEC found that some audit firms procured goods and/or services from their audit clients but there was a lack of documentation on assessing whether the transaction was in the normal course of business and at arm’s length. This issue usually arises in an audit firm that has a separate purchasing function from the audit department but lacks proper procedures to notify the right persons and to initiate a process for independence assessment and proper documentation. Thus, it is important that audit firms actively communicate to their employees their policies and procedures on the required independence assessment and documentation for conducting business transactions with their audit clients.

Non-audit services

The SEC noted that the audit firms are quite committed in maintaining the independence of their firms and personnel, and hence have established the process through which potential conflict of interests would be evaluated before the acceptance of any non-audit services. Nonetheless, this process could be improved further with adequate consultations and proper documentation of judgments to demonstrate clearly that before providing such services, the firms had considered all relevant aspects and were certain that the nature and scope of the non-audit services provided to their audit clients would not jeopardize their independence.

The issues of providing non-audit services were unsurprisingly more prevalent with the audit firms, which belong to a network firm offering other services beyond the audit service, than they were with the small stand-alone audit firms.

Even with the established policies and procedures designed to provide the audit firms with reasonable assurance that the firms and their personnel remain independent where required by the ethical requirements, the independence of both the firms and their personnel might be called into question if the process lacks proper documentation. Therefore, to unquestionably demonstrate their independence both of mind and in appearance, the SEC strongly recommends that the audit firms improve their documentation to include all relevant aspects of non-audit services under consideration and their independence evaluation such as the substance of the issues, the details of any judgments made or discussions held, any safeguards set up to reduce threats to their independence, and the decisions made.

Audit staff personally providing assurance services

Some audit firms allow their non-partner audit staff to provide assurance services in their personal capacity, however the necessary processes for testing of ethical-requirement compliance were not in place. For example, some firms did not required their audit staff to notify the firms when providing such services or did not sufficiently assess the incremental risks associated with their staff providing personal services while other firms, which collected the necessary information, had no means to verify the reliability or the completeness of the information disclosed.

To maintain their level of audit quality and manage risks, audit firms began to set a policy for the audit staff to gradually reduce the staff's personal assurance services and to implement information collection and risk assessment processes. However, although with those processes in place, it is practically very difficult for the audit firms to ensure full disclosures by the staff. In addition, as the audit staff, who accepts outside engagements, would reasonably have less time to devote to the works in their professional capacity, their work quality could seriously come into question, especially when it involves those with high-level positions. The SEC, then, prefers that audit firms limit their risk exposures by progressively reducing the extent of personal assurance services provided by their staff because we believe that high quality audits could only be achieved with audit teams whose members possess in-depth knowledge and experience and devote adequate time in fulfilling their responsibilities. Thus, the right culture, suitable compensation schemes, and career planning for their employees needs to be carefully considered and implemented to be able to earn dedication from audit staff.

Related parties

From our previous inspections, the SEC observed that a number of audit firms had several related parties, resulting in quite a complex group structure, which could put their independence at risk. For the current cycle, the SEC, therefore, concentrated on verifying the completeness of audit firms' disclosures of their related parties and assessing the effectiveness of safeguards implemented by the firms to manage threats against the firms' and their auditors' independence. Results of the 2014 inspections showed that the incompleteness of the related-parties disclosures remains an issue because some firms have yet to set out clear definition of related parties. Not only does this issue affect independence of the auditors and the firms, but it also undermines the efficacy of the firms' client acceptance and continuance process.

The SEC believes that it is important that the audit firms establish a set of effective policies and procedures to collect information on conflicts of interests disclosed by shareholders and top management, as well as to verify and follow-up on completeness and accuracy of the disclosed information. Moreover, robust disciplinary actions should be set out against those who fail to comply with the firms' ethical requirements. In a long run, audit firms might consider revising their group structure to minimize these threats to their independence.

3. Client acceptance and continuance

In comparison with other elements of TSQC1, the improvement of client acceptance and continuance has been most noticeable. The results of the inspection clearly showed that all of the inspected audit firms have already established policies and procedures for the acceptance and continuance of client relationships in accordance with TSQC1. Some audit firms have developed and used databases and search engines to thoroughly verify information, such as related parties and management integrity, which undoubtedly fortifies these firms' quality control system. The SEC believes further improvement for this element is possible for the following issues.

Risk assessment during client acceptance and continuance process

The important findings arising from risk assessment occurred most frequently in following areas.

(1) Risk assessment did not covered all significant areas such as assessing the management integrity, identifying related parties of the potential audit clients, and extending the verification of audit independence to the immediate and close family members of the audit personnel.

(2) Criteria were unclear on risk assessment process, most noticeably when overall conclusion of the risk assessment was not supported by the corresponding detailed assessments. For example, the financial position of an audit client was concluded as normal although its liquidity was identified as poor without further explanation.

(3) Risk assessment and risk response were inadequate as the documentation was sometimes found to be insufficient in assessing potential risks and identifying appropriate responses for those risks.

The SEC expects audit firms to improve their risk assessment on client acceptance and continuance process by identifying all important factors, together with their corresponding weights, to be considered in assessing risks, and being thorough in the documentation of the risk assessment process. Also, the success of this process could only be ascertained by full understanding of the audit teams on the functions and processes of specific aspects of the firms' quality controls. Furthermore, it is expected that the firms appropriately respond to the assessed risks in all relevant aspects, including scope, timing and extent of audit works, since this would be the only approach to make sure that only audit engagements, for which the firms could execute with a high quality standard of work, are accepted.

New client acceptance before the completion of risk assessments

The SEC found that engagements were occasionally accepted before the completion of the risk assessment process. For example, new engagements were accepted before obtaining independence confirmation from key audit partners or before finalizing risk assessment forms. Even though the SEC's subsequent reviews showed that there were no unusual circumstances that might result in the firms not accepting the engagements, it is expected that the audit firms complete the risk assessment on client acceptance and continuance process before accepting or continuing engagements to ensure that the risks associated with each engagement remain within an acceptable level.

Improper assessment on the adequacy of human resources

The results from the SEC's inspections indicated that audit firms sometimes incorrectly estimated amount of work hours when considering accepting new audit engagements. For instance, an audit firm estimated an equal amount of engagement hours for a potential client as it did for the current client with comparable size and complexity although it is reasonable to expect that more hours would be required for new engagements due to lacks of prior knowledge and familiarity. The unfamiliarity means additional required steps in the audit process such as tests of opening balances, gaining understandings of client's business and internal control system. Not only would the insufficiency of estimated engagement hours lead to poor audit quality, but it would also result in the incorrect human resource planning and inadequate audit fees charged. Accordingly, before accepting any new audit clients, the SEC recommends that audit firms implement or improve the process to ensure sufficient availability of resources, in terms of audit staff and their capabilities, so that the firms would be able to deliver high quality audits for all their engagements.

4. Human resources

Human resource is essential for audit professions as it is a key driver for audit quality. The results from the first-cycle inspections clearly showed that most firms had implemented robust human resource management, and the results from the second cycle indicated continuous improvements. For 2014, the SEC focused on resource planning, career development policies of audit personnel, performance evaluation, and follow-up processes for audit personnel's capabilities and knowledge, which were the findings found during the first inspection cycle.

Human resource planning and allocation

Based on our inspections of audit firms' human resource structure, the SEC was concerned about both the current and future sufficiency of the firms' human resources. In particular, some audit firms had no human resource planning that corresponded with their business plan to ensure availability of the sufficient resources for both future and on-going audit engagements.

To ensure adequate supplies of audit personnel, audit firms have used various methods, such as recruiting new joiners earlier than before, cooperating with universities to promote audit professions, providing more training opportunities for students to gain audit experiences, and proactively recruiting and retaining those with talents.

However, some audit firms dealt with this problem by hiring a great number of temporary or outsourced staff whose roles and responsibilities were the same as their permanent counterparts. The SEC believes that this solution should only be used when it is absolutely necessary, and even then, it should serve only as a short-term measure to the problem. If used as a permanent solution, this action could potentially cause more harm than good as auditing of listed companies is considered more risky due to its complexity and impact to the public while supervising these temporary staff to comply with the firms' quality control systems would be even more difficult than supervising those with permanent positions. Furthermore, quality control features, such as performance evaluation and other disciplinary actions, would deem ineffective for these temporary or outsourced staff as they have other sources of income and would not be as invested in the firms' reputation or as ingrained within the firms' culture. Therefore, it is recommended that the firms concentrate more on recruiting and developing their own audit personnel who have competencies and capabilities to ensure adequate audit personnel for the amount of current and future audit works because the quality of assurance services truly depends on the capabilities of audit staff, obtained through appropriate trainings and experiences.

Opportunity for career advancement

The SEC's past inspections suggested that some audit firms had difficulties implementing their succession plan due to their unbalanced human resource structure. This unbalanced structure, either from the shortage of senior staff or from the large number of short-term hires, has caused obstacles for the audit firms in developing and promoting their audit staff to the mid- and high-level management positions.

In addition, firms with unclear career advancement would discourage their staff from staying invested with the firms in a long run and thus, would likely experience the aforementioned issues.

For 2014 inspections, the SEC found an improvement in this area as audit firms had started to implement clear succession plan and policies to attract and retain competent audit personnel. The fundamental tools for talent attraction and retention are transparent performance evaluation and fair compensation schemes because they would clearly communicate the firms' expectations and foster trust within the organizations. Some audit firms also encourage their high-potential staff by offering more opportunities for career advancement such as secondment offers or more challenging responsibilities to serve the young generation's need.

Inappropriate performance evaluation

The SEC observed that in some audit firms, audit quality had yet to be a key factor in performance evaluation process while in other firms, the results of performance evaluation were still not reflected in staff compensation. These findings usually result in obscure performance evaluation process and eventually the firms' inability to attract and retain competent audit professionals. If the firms expect their staff to give the highest priority to quality, they should unequivocally communicate such to their staff by setting the audit quality as a key factor in the performance evaluation and reflecting the results of such process clearly through fair compensation and promotions. The SEC believes that doing so will give due importance to staff's commitment to audit quality.

Ineffective monitoring for staff trainings

Monitoring process to ensure the staff's fulfillment of training requirements has been increasingly more important due to the fast-changing business environment and professional standards. Thus, the majority of our audit firms implemented monitoring tools such as a database tracking staff's training hours, which could be used by the staff themselves to self-monitor as well as by the firms to monitor their staff's trainings. Some audit firms additionally set disciplinary actions for staff who fail to meet the requirements. However, there remained some audit firms that did not have neither monitoring process to follow up on the staff training, nor effective policies outlining necessary actions for those who failed to complete their trainings. To avoid their audit staff's capabilities being called into question, audit firms should have effective monitoring and follow-up measures in place to ensure that their staff are sufficiently up-to-date with the important changes to remain capable at their works. And it is even more important that the audit firms embed within their culture the importance of learning and staying current in the knowledge necessary to perform high quality audits.

5. Engagement performance

Our 2015 inspections revealed much improvement on the previously detected deficiencies within this element and the SEC commended audit firms in their determination to enhance the quality of their engagement performance. There are, however, remaining issues that are yet to be resolved, which are discussed in the following details.

Low level of involvement in audits by engagement partners and EQCRs

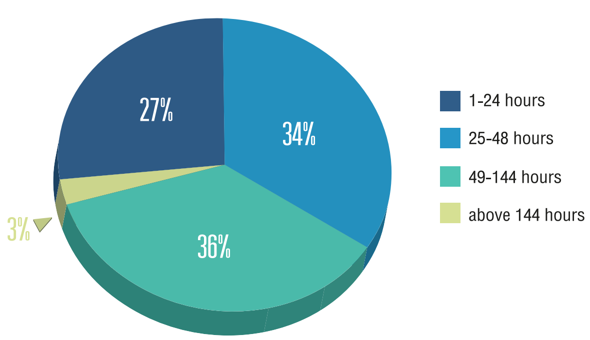


Figure 1 : time recorded by engagement partners

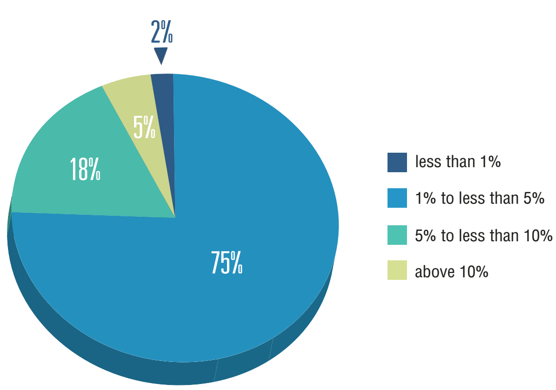


Figure 2 : % of engagement partners involvement

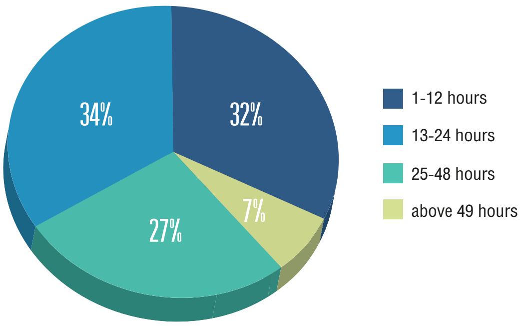


Figure 3 : time recorded by EQCRs

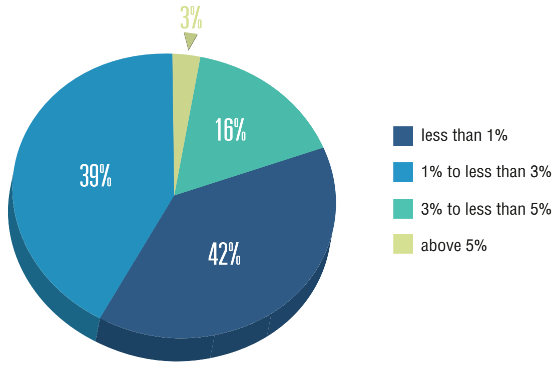


Figure 4 : % of EQCRs involvement

Remark : This information is based on the engagements reviewed by the SEC in 2014

The charts presented above showed that the majority of engagement partners spent around 49 to 144 hours on each engagement or about 1-5% of total engagement hours while the majority of EQCRs spent around 13 to 24 hours per engagement, with about 42% of EQCRs involved with audit engagements less than 1% of total engagement time.

In order to assess the sufficiency of partner involvement, the SEC considers both the actual hours and percentage of time spent to the total engagement hours, in relation to risks and complexity of audit engagements.

According to the 2014 inspections, the SEC detected that some engagements had a low level of engagement partner and EQCR involvement, which was particularly worrisome when it involved high risk engagements or when the low partner involvement occurred at the planning stage. The SEC also found that for some engagements, key audit partners rarely involved in the planning stage. Regarding EQCRs' working papers, one of the repeated findings was that they were prepared as a checklist for compliance purpose, rather than as a detailed documentation of works performed by EQCRs for the objective of attaining high audit quality. As a result, it became very difficult to assess whether the actual EQCR involvements were sufficient and effective as a quality control measure. In today's complex business environment and with even more complicated business transactions, sufficient supervision by highly experienced members of an engagement team becomes essential to audit processes to lower the risk of material misstatement to an acceptable level, as well as to enhance of the overall audit quality of the engagements. During 2014, we were pleased to observe that more audit firms had started taking actions toward more involvements from both engagement partners and EQCRs throughout the audit processes.

Audit manuals and audit programs

Incomplete audit manuals and audit programs remain an issue for some audit firms. The number and severity of deficiencies found at each audit firm mainly depended on the skills and availability of its human resources who were responsible for updating and improving the audit manuals and audit programs. Those instances include the followings:

- Incomplete audit manuals and audit programs as required by auditing standards;
- Inadequate guidance in the audit manuals to ensure sufficient documentation in audit working papers;
- Inadequate audit evidence and incomplete working papers which were not prepared in accordance with the audit firm's audit manuals; and
- Inadequate documentation on consultation process, particularly about the process and the conclusion reached.

Nevertheless, in 2014, the SEC found that a number of audit firms had significant development in several areas, especially for audit manuals and guidance detailing substantive analytical procedures and audit sampling, which led to fewer deficiencies detected during our 2014 inspections, as compared the prior year.

6. Monitoring

In the second-cycle audit inspection, the SEC sets higher expectation for this element, using a more detailed inspection program to review the design and implementation of the firms' monitoring process at both firm level and engagement level. According to our 2014 inspections, we noted that several audit firms effectively improved and developed their monitoring process by, for instance, establishing clearer and more robust policies and procedures and revising their monitoring manuals to include more details. Nonetheless, further improvements were still needed for the following deficiencies.

Documentation of monitoring process

The results of the SEC's inspections showed that some audit firms lacked proper documentation on monitoring procedures for the firms' quality control system at both firm level and engagement level. The SEC repeatedly found that documentation throughout the monitoring process mostly involved answering yes/no questions on standardized forms without any meaningful explanations or any references to other working papers, which was not very useful in determining the effectiveness of the firms' monitoring process. Other specific findings include issues such as:

- lack of documentation on scope of works and sample sizes of monitoring activities performed for each element of TSQC1 and for the engagement files chosen for reviews;
- no documentation on the significance level of deficiencies and their potential impacts; and
- no written summary of detected deficiencies from the monitoring process.

The SEC suspects that one of the main reasons for these shortcomings is the incomplete manuals for monitoring activities, which would also lead to ineffective monitoring of the quality control systems. Consequently, to ensure effective monitoring and full TSQC1 compliance, audit firms should revise and improve their monitoring policies and procedures by providing more details and explanations in their monitoring manuals and keeping them updated.

Assignment of monitoring team

The monitoring system would be useful and effective only when it is performed by qualified audit personnel, in terms of expertise and experiences, who invest enough of their time in the monitoring activities. However, some audit firms assigned these responsibilities to either unqualified personnel or qualified but unavailable audit staff, which undeniably led to ineffective monitoring process. The SEC noticed that some audit firms approached this problem by assigning these activities to a group of qualified staff who focused specifically on monitoring or by reducing other responsibilities of the qualified but previously preoccupied teams currently performing such duties.

Corrective actions and communication

The results of the SEC's inspection demonstrated that some audit firms did not set appropriate timelines for corrective actions, in response to the significant deficiencies, while other firms failed to include all important deficiencies in the monitoring reports that were communicated to relevant parties, resulting in deficiencies not being completely resolved in a timely manner. Therefore, the SEC expects the audit firms to carefully plan their monitoring procedures, which includes clearly identifying the objectives, scopes, and timing of the monitoring activities, and to properly communicate the findings and remediation plans to those involved, and finally to follow up promptly on progresses of the corrective actions. Serious root-cause analysis for the deficiencies identified and the corresponding trainings would also help the audit firms to strengthen this element of the TSQC1.

B. Engagement level

In 2014, 138 engagements signed by 46 auditors, mainly from Big-Four audit firms, were inspected as a part of the SEC's individual auditor approval processes. Out of these 46 auditors, 15 of them newly applied to be the registered auditors while the remaining were in the process of renewing their SEC-registered. It should also be noted that out of the 138 engagements being inspected, 17 of them (12%) had no deficiencies found. Deficiencies found from inspections were classified into the following audit processes: (1) 77 inspected engagements with deficiencies found in audit planning process (2) 119 inspected engagements with deficiencies found in audit execution process, and (3) 65 inspected engagements with deficiencies found in completion and forming an audit opinion process.

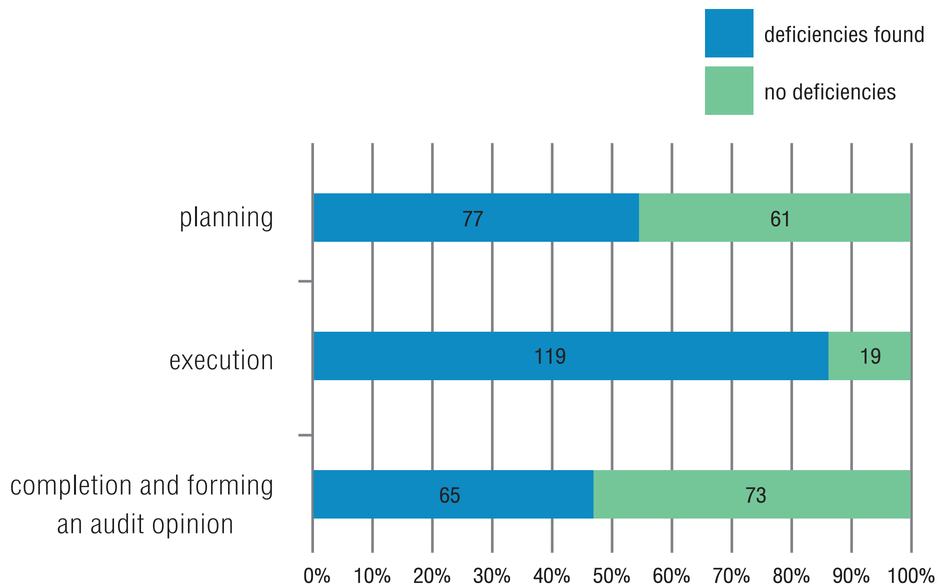


Figure 5 : the number of engagements with deficiencies found categorized by audit processes

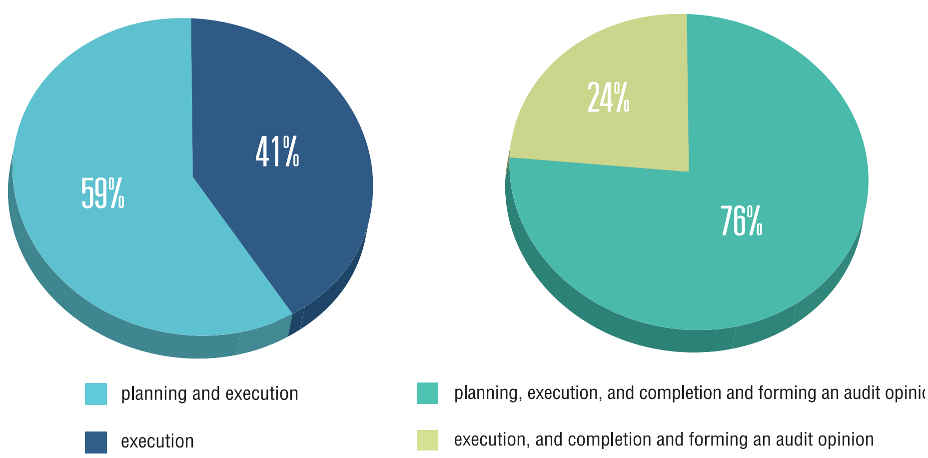


Figure 6 : the percentage of inspected engagements with deficiencies found as a result of inappropriate audit planning

From Figure 6, 59% and 76% of the deficiencies found in execution process, and in the areas of both execution and completion and forming an audit opinion processes, respectively, have arisen due to inappropriate audit planning. This indicates that the audit planning process has significant impact to audit quality. Appropriate risk assessment allows auditors to appropriately identify audit procedures that are responsive to the assessed risks and to sufficiently gather appropriate audit evidence to support conclusions reached. Also, the appropriate audit planning process helps auditors perform audit works more effectively and efficiently. From the engagement inspections in 2014, the audit firms appeared to pay more attention to the audit planning process. For example, non Big-Four audit firms have modified their audit manuals to ensure that their audit works comply with applicable auditing standards, and provided the training in relation to their audit manuals to audit staff. The audit firms have also established necessary audit procedures in the audit planning process mainly in the areas of risks assessment and of determining materiality procedures. Additionally, more audit procedures, for instance, the process of understanding client's environment and the process of kick-off meeting among engagement team, have been designed to ensure the understanding of the engagement team regarding the client's business and environment and the ability to identify the potential risks appropriately.

However, the SEC has still detected some deficiencies in both of the execution process and completion and forming audit opinion processes which have been arisen from inappropriate and inadequate audit planning process, particularly in risk assessment procedures which ultimately lead to audit procedures being not responsive to the assessed risks of material misstatements. Examples of the audit deficiencies in each audit process are discussed below.

Audit planning process

Identification and assessment of the risks of material misstatement due to fraud

According to Thai Standard on Auditing ("TSA") 240, auditors shall recognize the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management. This is because management has ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls. Assessment of the risks of material misstatement due to fraud, thus, is especially important process, which could affect the appropriateness of audit procedures to respond to the assessed risks. With respect to the engagement level inspections in 2014, the SEC found that auditors have increasingly placed an importance on identification and assessment of the risks of material misstatement due to fraud. A clear example is that auditors have identified and assessed fraud risks as significant risks irrespective of companies' size and complexity. However, the inspections still revealed the following deficiencies on fraud risk identification and assessment in some engagements:

- Some auditors incompletely identified and assessed the accounts that potentially associate with material misstatement due to fraud;
- Some auditors presumed that there were risks of fraud in revenue recognition but failed to evaluate which types of revenue transactions, or assertions give rise to such risks;
- Some auditors failed to relate identified risks of fraud to what can go wrong at the assertion level

Due to such deficiencies, audit procedures designed were not actually responsive to the risks of material misstatement due to fraud. It is necessary for auditors to obtain sufficient understanding of the entity's business and internal controls before identifying and assessing the risk of fraud so that the auditors could appropriately identify and assess the risks of material misstatement due to fraud at financial level, and at assertion level for classes of transactions, account balances and disclosures.

Determining materiality in planning and performing an audit

Materiality, if determined appropriately, could help auditors appropriately assessing the risks of material misstatements and determining the nature, timing and extent of further audit procedures. During the SEC's inspections in 2014, it can be seen that deficiencies previously found in this area have been significantly improved. An instance in that engagement teams revised the materiality for the financial statements as a whole once there was substantial difference between the anticipated period-ended financial results used to initially determine materiality and actual financial results in order to determine whether the nature, timing and extent of the further audit procedures remain appropriately. However, the SEC still detected the following deficiencies:

- Inappropriate benchmark used for determining materiality by disregarding whether the selected benchmark was item on which the attention of the users of the entity's financial statements tends to be focused, for example, some auditors determined materiality for the profit-oriented company listed in the Stock Exchange which has had profit from operations during the past several years by using other benchmark that made higher materiality, i.e. using total assets as a chosen benchmark to determine materiality instead of using net profit before tax which would be the item on attention of the users;
- Insufficient documentation of auditors' judgments when selecting benchmark for determining materiality, for instance, no documentation on auditors' judgments, particularly when using different benchmarks from the previous year, or when using other benchmarks rather than profit before tax for the profit-oriented entities.

It is crucial for auditors to consider factors that may affect the identification of an appropriate benchmark used to determine materiality to ensure the appropriate determination of materiality for the financial statements as a whole. To do so, auditors would be able to set audit planning and perform audit works properly. The examples of the key factors which should be taken into account by auditors are the items on which the attention of the users of entity's financial statements tends to be focused, the relative volatility of the benchmark and the nature of the entity.

Audit execution process

Audits related to fraud risks

According to TSA 240, risk of material misstatement due to fraud is a significant risk because there is possibility that a material misstatement due to fraud could exist even though auditors have past experience of the honesty and integrity of the entity's management and those charged with governance. This is because management is in a unique position that can override controls that otherwise appear to be operating effectively. The risks of material misstatement due to fraud at the financial statement level are usually involved in the preparation of the financial reporting process through recording inappropriate unusual transactions and/or adjustments in journal vouchers, and making biased accounting estimates to manipulate financial statements. Audit tools used for detecting unusual transactions which may relate to fraud have been implemented by a certain number of audit firms so as to facilitate auditors to assess and design audit procedures in response to the risks of material misstatement due to fraud. However, our inspections still discovered the following deficiencies:

- In an audit procedure of reviewing journal vouchers, there was a lack of understanding of the nature of journal vouchers whether they are routine or non-routine journal entries. Consequently, some auditors inadequately determined the nature, timing and extent of testing journal entries and other adjustments to detect unusual items which might be relevant to fraud.
- Some auditors did not perform audit procedures to select the journal entries and other adjustments made at the end of reporting period when fraudulent entries are often made. Furthermore, some of them did not consider whether it is necessary to test journal entries and other adjustments throughout the period.
- Some auditors did not evaluate the reasonableness of the assumptions used for making significant accounting estimates and failed to perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year to determine whether there were indicators of possible management bias that could represent risks of material misstatement due to fraud.

Audit works in response to the assessed risks of material misstatement due to fraud should be assigned to audit staff who have sufficient knowledge, skills and experience. High level of professional skepticism should also be employed. Additionally, in the audit procedure of testing journal entries and other adjustments, it is necessary for auditors to obtain proper understanding of the nature of journal entries and other adjustments in order to properly identify and select journal entries and other adjustments for testing by focusing on the unusual items and significant accounting estimates which are possibly involved in fraudulent financial reporting.

Substantive analytical procedure

Substantive analytical procedure could be an efficient and effective means to detect material misstatements for large volumes of transactions that tend to be predictable over time. Our findings on the inspections in 2014 suggested that a number of auditors have greatly put effort into improving the audit procedures in respect of substantive analytical procedure to ensure the compliance with TSA 520. For example, before designing the substantive test, the auditors started to assess the appropriateness whether performing substantive analytical procedure method as a part of substantive procedure helps detect material misstatements or not. Such auditors have also taken into account both internal and external data that affect accounting transactions when setting the expectations. Yet, the SEC has encountered the following instances where performing of substantive analytical procedures were ineffective and inefficient to detect the assessed material misstatements:

- Some auditors only used the data prepared by the entity, for instance, using the forecast of profit and loss and forecast of sales volume growth to set the expectations without assessing the reliability of such data. To assess the reliability of the data performed by the entity, auditors shall test the operating effectiveness of controls over the entity's preparation of data, evaluate the relevance of data, review the assumptions prepared by the entity, and asses the reliability of source of data.
- The assumptions used by some auditors to set expectations were not covered by all of the key factors that would actually affect the expectations.
- There was a lack of documentation on auditors' rationales that supported the assumptions used in setting expectations.
- Once there were different types of revenue impacted by different factors, some auditors failed to set expectations separately for each type of revenue.
- Some auditors did not adequately consider the relevant factors, such as, materiality and the desired level of assurance when they set tolerance thresholds and the acceptable discrepancies.

To assess whether substantive analytical procedure is appropriate method to detect material misstatements, auditors should obtain intensive understanding of client's business and its industry as well as evaluate the reliability and the availability of relevant data. Furthermore, the chosen method will be more effective if it is applied to a certain level of data aggregation than others. Thus, the level of aggregation used should be carefully thought out to enable auditors to reap the most benefits from these procedures. To clarify more, auditors should separately set expectations for each type of revenue based on the natures and risks of each type of revenue, for instance, developing expectations separately for revenue from sales and revenue from services, or developing expectations of revenue from sales separately by the types of products. Furthermore, in order to develop sufficient precision of the expectations to detect material misstatements, auditors should consider both internal and external sources of data. They should also set tolerance thresholds and the acceptable discrepancies within which further investigation would not be warranted by considering the materiality level, the required assurance level and the probability of material misstatements.

Audit Sampling

An appropriate design for determining sufficient sample size and sampling approach could provide reasonable basis for auditors to draw conclusion on the population from which the sample is selected. Most of the larger audit firms have implemented the proper audit manuals in respect of audit sampling procedures. However, the SEC has observed the opposite circumstances in a number of small and medium audit firms that are in the process of revising their audit manuals. The deficiencies were found in the following areas:

- When performing tests of control and substantive tests, some auditors insufficiently took into account all relevant factors influencing the determination of sample sizes, and inappropriately designed an approach for audit sampling. This resulted in the selected samples being not representative of the entire population. A common deficiency on this issue is that some auditors only selected the items with larger amount to perform the tests. Hence, the selected samples could not provide a reasonable basis for the auditors to draw conclusions about the remaining population.

- When there is a wide range in characteristic of population, the population should be stratified into sub population, each of which is a group of sampling units that have similar characteristic. However, some auditors did not stratify populations which contain different risks of misstatement and control activities so that the sampling units had significant difference in characteristics. As a result, the number of sampling units was insufficient to be a representative of each particular characteristic of population, and the audit procedures were inadequately designed for each population, contributing to the inability of auditors to use such audit sampling as a reasonable basis to draw conclusions on the entire population.

- In the circumstances where auditors found misstatement from audit sample, some auditors lacked in investigating the nature and cause of the misstatements as well as considering to use other audit procedures that might be required before drawing a conclusion that the misstatements discovered are anomaly.
- When a misstatement found in the sample was a non-anomalous misstatement, some auditors did not project such misstatement for the population to obtain a broad view of the scale of misstatement.

It should be noted that auditor shall consider factors influencing the determination of sample sizes and use an appropriate sampling approach to select a representative sample in such a way that each sampling unit in the population has a chance of selection. When auditors specifically select sampling units and the remaining unselected population is material to financial statements, the auditors should also select the items from this remaining population for testing in order to obtain a reasonable basis for conclusions on the entire population. In addition to the selection of audit sampling, auditors should investigate the nature and cause of the misstatements discovered in the sampling items to consider whether the misstatements are anomalous or non-anomalous misstatements. The auditors could, thereby, use such information to draw conclusions on the population from which the sample is selected and consider whether it is necessary to revise the nature, timing and extent of further audit procedures.

Audits of revenue recognition under percentage of completion method

As regards revenue recognition under the percentage of completion method, management of an entity is required to use his or her judgment on the preparation of contract-cost estimations. This means that such management must have sufficient specialized expertise in the business so as to ensure that the estimations of contract costs is precise and appropriately prepared. Most of the entities, therefore, engage the specialized engineers or those who have specialized expertise to make the estimations. Similarly, an auditor of such entity is also required to exercise his or her judgment to assess whether the percentage of completion of the audited entity is reasonably and appropriately prepared. This leads the SEC to cast doubt on whether auditors possess the specialized skills or sufficient knowledge to evaluate the reasonableness and the reliability of the stage of completion of the entity which is used as a basis to recognize contract revenues and the associated costs. Our inspections in 2014 detected instances where a certain number of auditors failed to perform audit procedures related to revenue recognition under percentage of completion method as follows:

- There was a lack of understanding of the client’s internal controls in relation to the entity’s process of reviewing the appropriateness and reasonableness of percentage of completion.

- There was a lack of understanding of the process of the determination of percentage of completion prepared by management's experts in order to assess the reliability and the reasonableness of the stage of completion.
- There was a lack of reviews on the reasonableness of methods and assumptions used by management's experts for making the contract-cost estimations which are essential to determine the percentage of completion.

To ensure the reasonableness and the reliability of percentage of completion, auditors need to consider whether it is necessary for them to employ auditors' expert or otherwise the auditors themselves could perform other audit procedures to obtain reasonable assurance on the appropriateness of the contract-cost estimations and the stage of completion. In the audit planning stage, auditors need to obtain an understanding of both the processes and the internal controls in relation to the determination of percentage of completion to be able to design appropriate audit procedures. Besides, auditors should evaluate the appropriateness of methods and assumptions used by management for preparing the contract-cost estimations, and carry out the comparison between the estimated contract costs with actual contract costs for the finished project.

Using the work of a management's expert

Management of an entity may engage an individual or organization who possess expertise in a field other than accounting and auditing to assist the entity in preparing the financial statements which are generally involved in the calculation and/or the estimation of accounting measurementfor complex transactions such as the estimations of fair value of assets and the calculation of employee benefits. To prepare such calculation and/or such estimation, not only sources inside and outside the entity are used by the management's expert, but assumptions and methods for making the accounting estimates are also employed. As a result of the SEC's inspections in 2014, a number of auditors used the work of management's expert as their audit evidence and designed audit programs for evaluating the appropriateness of the expert's work. Still, the SEC found the following deficiencies:

- The audit procedures that some auditors used to evaluate the competence of the management's experts is insufficient because they assessed the competence of the experts by only checking whether such experts are approved by or have the registration with the relevant regulators without evaluating the suitability of the competency of the expert based on specialized expertise and the past experience of such experts.
- There was a lack of understanding of the process of the determination of percentage of completion prepared by management's experts in order to assess the reliability and the reasonableness of the stage of completion.

- There was a lack of reviews on the reasonableness of methods and assumptions used by management's experts for making the contract-cost estimations which are essential to determine the percentage of completion.

To ensure the reasonableness and the reliability of percentage of completion, auditors need to consider whether it is necessary for them to employ auditors' expert or otherwise the auditors themselves could perform other audit procedures to obtain reasonable assurance on the appropriateness of the contract-cost estimations and the stage of completion. In the audit planning stage, auditors need to obtain an understanding of both the processes and the internal controls in relation to the determination of percentage of completion to be able to design appropriate audit procedures. Besides, auditors should evaluate the appropriateness of methods and assumptions used by management for preparing the contract-cost estimations, and carry out the comparison between the estimated contract costs with actual contract costs for the finished project.

Audits of going concern assumption

It is widely known that stakeholders of financial statements place an importance on the entity's ability to continue in business for the foreseeable future. In particular, investors need such information for investment decisions. Auditors, therefore, ought to appropriately and sufficientl design audit procedures for evaluating the appropriateness of management's use of the going concern assumptions in the preparation of the financial statements. A number of auditors have performed preliminary assessed the entity's ability to continue as going concern by considering whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, such as net current liability position, negative operating cash flows, and substantial loss of key customers. However, the SEC noted the deficiencies on audit procedures to respond to the assessed risks associated with the going concern issues as follows:

- There was a lack of evaluation of the reliability of the underlying data generated to prepare the cash flow forecast and determine whether there was adequate support for the assumptions used by management when preparing the forecast
- There was a lack of investigation of the significant differences not only between the cash flow forecast for the previous period and the actual outcome of that period, but also between the cash flow forecast for the current period and results achieved to date. Besides, some auditors did not take such circumstances into their consideration to assess the reliability of the estimations made by the management.

- There was a lack of evaluation of management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans was likely to improve the situation and whether management's plans were feasible in the circumstances.
- There was a lack of review of the financial positions and the operation results the parent company or major shareholders who provide financial support to the entity to assess their financial ability.

Evaluating management's assessment of the entity's ability to continue as going concern is a challenging task for auditors. As a cash flow forecast prepared by the entity for supporting the management's use of going concern basis is based on future events and/or management's plans for the future action, the auditors ought to evaluate the appropriateness of assumptions underlying the forecast and the feasibility of management's plans.

Audit completion and forming an audit opinion

Audits of subsequent events

Auditors shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the end of the reporting period and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements. The results of our inspections in 2014 have shown that on the one hand most of the auditors have properly designed audit procedures for subsequent events review. On the other hand, some auditors failed to perform subsequent event reviews up to the auditor's report while there was a significant gap between the review date and the report date. Such auditors neither assessed risks relating to subsequent event issues nor documented their considerations whether the determinations of nature, timing and extent of subsequent events review covering the date of the auditor's report were sufficient for the auditors to draw reasonable conclusions on subsequent events.

Auditors shall assess the relevant risks and consider the information provided by the entity so as to set proper audit procedures for subsequent events review. The auditor shall also perform the audit procedures designed covering the period from the end of the reporting period to the date of the auditor's report, or as near as practicable thereto. In particular, where the accounting records are not up-to-date, and accordingly no interim financial statements have been prepared, the auditor should consider whether it is necessary to take the form of inspections of available books and records to obtain sufficient audit evidence supporting the conclusion reached.

04

Root cause analysis

During the audit inspection in 2014, the SEC appreciated the efforts of audit firms and auditors to continuously move towards higher audit quality of both in firm level and engagement level. Audit firms have also conducted root cause analysis and implemented their remediation plans in order to prevent themselves from the redundant deficiencies. In addition, the SEC conducted overall root cause analysis and strongly believe that in order to effectively solve the problems and to build up sustainable quality of financial reporting, it is required to get full cooperation from other stakeholders other than audit firms and auditors. The SEC has identified some significant root causes as follows:

- The shortage of audit staff has been an ongoing issue on account of high turnover rates, coupling with lower interests in audit professions, particularly for young generation, whereas the number of new graduates in accounting has remained stable for decades. This situation contrasts with an increase in demand of audit firms for new additions of young professionals in response to the growth in the number of audit clients. To tackle this problem, audit firms have been attempting to analyze possible needs of audit staff and modify their strategies relating to human resources management, such as reconsidering staff compensation, and emphasizing on career development by, for instance, providing scholarships, and offering overseas secondment opportunities to their talents. Likewise, some audit firms with fewer audit staff have resolved this challenge by shortening the power distances and reducing the gap among firm leaders, partners and audit staff, potentially leading to enhancing organizational commitment of audit staff. Besides, audit firms have created open-door policy and responded to employees' needs by improving working environment in accordance with young professional's lifestyle.
- Despite inadequate audit staff, new audit clients are still being accepted by audit firm, resulting in deficient audit works. Moreover, insufficiency of qualified audit staff together with the lack of supervision, particularly in key audit process, by engagement partners EQCRs and experienced reviewers, leads to the inability of these reviewers to timely detect and resolve issues arising from performing audit works.
- Inappropriate human resource planning and allocation considerably affects audit quality. In particular, for some cases, complicated areas, for instance, the areas that require professional judgment, are assigned to inexperienced team members, combining with low quality of reviewing process which includes inexperienced reviewers and/ or low involvementof engagement partners and EQCRs. Besides, poor audit planning as well as lack of communication among engagement team members entails a failure to focus on significant risks and prioritize audit works properly, resulting in inappropriate response to significant areas.

- Inadequate understanding of stakeholders on their roles and responsibilities relevant to quality of financial reports can also affect the reliability and the quality of financial reporting. For instance, preparers and management have limited knowledge on financial reporting standards or overlook their responsibility in preparation of financial statements. In addition, auditors insufficiently understand of the entity’s business or exercise low level of professional skepticism during planning and performing of audit work. Also, there is a lack of oversight by audit committee whose essential roles contain overseeing of the implementation and operation of effective governance and internal control systems, and high quality financial reporting processes which includes selecting a qualified auditor.

05

Our focus for 2015

The results of the SEC's inspections during the first two years of the second cycle have indicated that audit firms and auditors are determined to continuously strengthen their quality control system for the purpose of improving the quality of assurance services provided. Seeing the audit firms' resolve, the SEC is emboldened that the audit firms' effective quality control system will help yield high audit quality, which will in turn nurture and sustain a strong and well-functioning financial reporting ecosystem that would foster public trust in capital markets.

For the time remained for this second cycle inspection, ending in 2015, the SEC will continue to focus on improving engagement performance, particularly in the areas where deficiencies were found. These shortcomings, although associated with audit engagements, occurred most probably due to failed quality control system. The SEC believes that the two elements of the quality control system that would help reinforce the quality of engagement performance are the leadership responsibilities and monitoring. Like chiefs of any organizations focusing on and moving toward their objectives, audit firm leaders who aspire to enhance audit quality are responsible for implementing straightforward strategies and allocating necessary resources, which inevitably includes enabling sufficient involvement of engagement partners and EQCRs with the audit engagements. Then to ensure success of the objectives, audit firms would be expected to establish monitoring and evaluation system to ascertain that any important issues arisen would be handled appropriately in a timely manner and that these issues are analyzed for root causes to prevent future incidents.

With respect to quality control at the engagement level, the SEC expects auditors to focus on quality of audit engagements, which would most likely be achieved through effective risk assessments and audit planning in responding to those risks, and given the increasingly complex business environment, it is necessary that auditors adequately and properly exercise their professional skepticism. Also, high quality audits could never be uninterruptedly achieved without proper staff, thorough documentation, and sufficient knowledge sharing such that the SEC expects the firms to make certain that all these elements of success are in place.

In addition, since the beginning of 2015, we have observed that audit regulators in other jurisdictions give special attention to monitoring process, root cause analysis, and remediation plan. To stay abreast of these new developments, the SEC, therefore, plans to introduce the following tools to support audit firms' efforts in strengthening their quality control systems.

- Audit quality indicators ("AQIs"): this innovative tool has been widely used by international audit regulators as a common benchmark to assess the quality control system. In 2015, the SEC will start to employ this tool to monitor quality control of the firm. The SEC believes this information would also be useful to audit committee when evaluating the quality of audit works.

- Robust follow-up process: to closely monitor the analysis of root causes and remediation actions of each individual audit firm, the SEC will rely on a more vigorous follow-up process, particularly for monitoring progresses the audit firms made in relation to their root cause analysis and remediation plans to resolve significant deficiencies.

Likewise, to reinforce a strong financial reporting system, the SEC will initiate further collaboration with other organizations in our collective effort to strengthen audit quality:

- Working with the FAP to hold seminars for those interested in becoming SEC-registered auditors, which started in 2014 and has continued into 2015;
- Publishing guidelines for audit committees on expected cooperation between audit committees and their auditor as well as providing audit committees a set of questions that the audit committees could ask auditors in exchanging of information;
- Holding seminars for top managements of listed companies, particularly for chief financial officers, to emphasize the importance of their roles and responsibilities within the financial reporting process;
- Collaborating with other organizations, such as Bank of Thailand and Office of Insurance Commission, to discuss strengths and weaknesses of financial institutions and sharing these discussions with auditors in order to facilitate auditors of financial institutions into being more effective in their audit planning; and
- Collaborating with international organizations, such as AARG and IFIAR, to exchange information and to resolve issues, particularly the policy-level issues arising from network audit firms.

Lastly, the SEC firmly believes that the collaboration from all stakeholders to strengthen quality of financial reporting will be a key factor in developing Thai capital markets to be one of important financial powerhouses of the region and of the world and hence, we have been and will be working closely with these stakeholders to attain the mutual goal of providing relevant and reliable information to investors.

06

Significant statistical information

Registration of audit firms and individual auditors as at December 31, 2014

Audit firms	Number of audit firms	Number of auditors approved by the SEC
Big-4 firms	4	89
International firms*	3	8
Local firms	18	57
Total	25	154

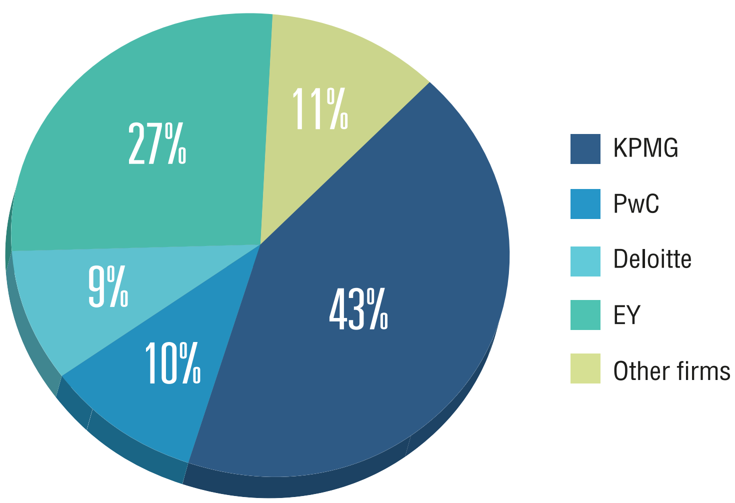
Note : International firms include non Big-Four audit firms that are full members of international network firms, use their policies and procedures, and are monitored regularly by the network firms.

More information is available on **http://market.sec.or.th/public/orap/AUDITOR01.aspx?lang=en**

Number of audit firms inspected by SEC using risk-based approach (RBA)

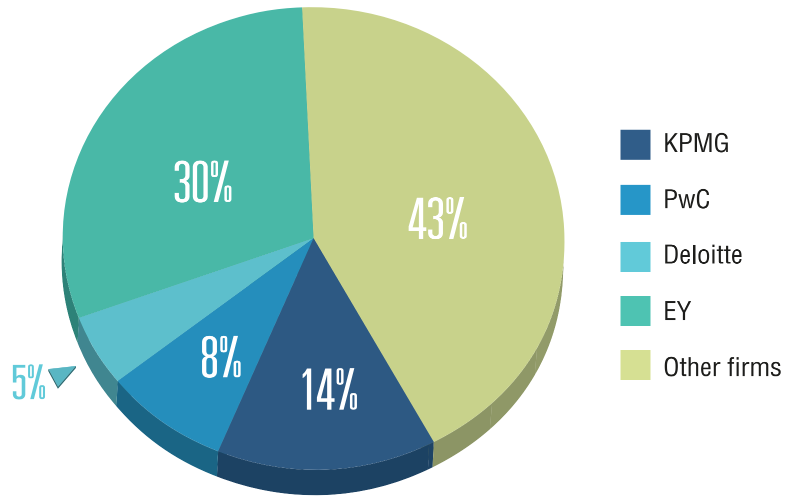
	Number of audit firms
2012	13
2013	14
2014	12

Percentage of market capitalization audited by the Big-Four firms



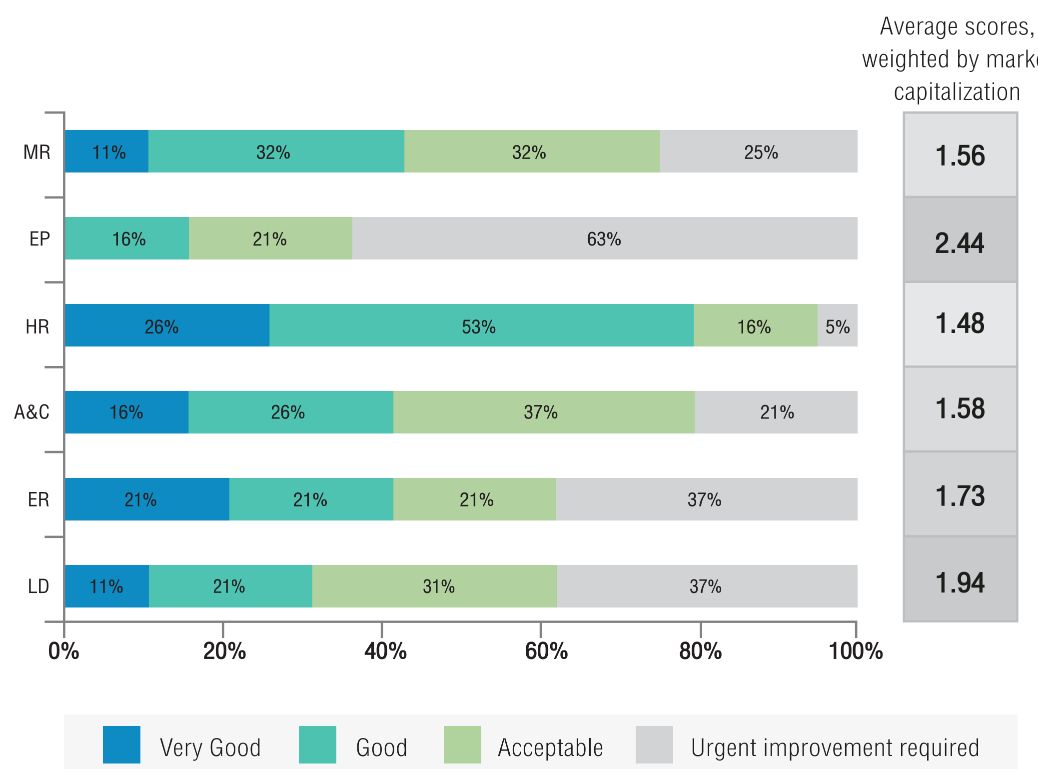
Note : Total market capitalization of the listed companies in Thailand as at December 30, 2014

Percentage of the number of listed companies audited by the Big-Four firms



Note : Number of listed companies in Thailand as at December 30, 2014

Percentage of the number of audit firms based on inspection scores received for each of the TSQC 1 elements and the average scores, weighted by total market capitalization



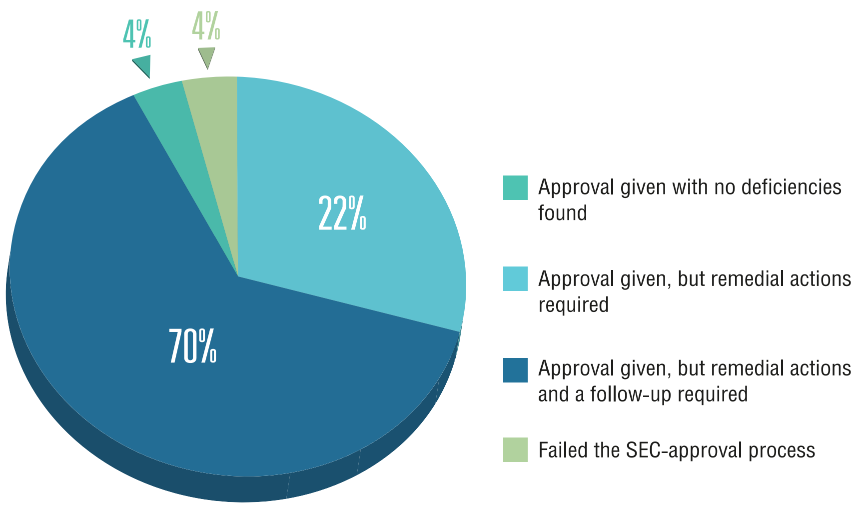
LD : Leadership responsibilities
ER : Ethical requirements
A&C : Client acceptance and continuance
HR : Human resources
EP : Engagement performance
MR : Monitoring

Note : The 2nd cycle firm-level inspection results are based on the inspections of 19 audit firms

Comparison of weighted average scores for each of the TSQC 1 elements from the 1st and the 2nd cycles of firm-level inspections

Note : The firm-level inspection results from the 1st and the 2nd cycles are from 19 audit firms

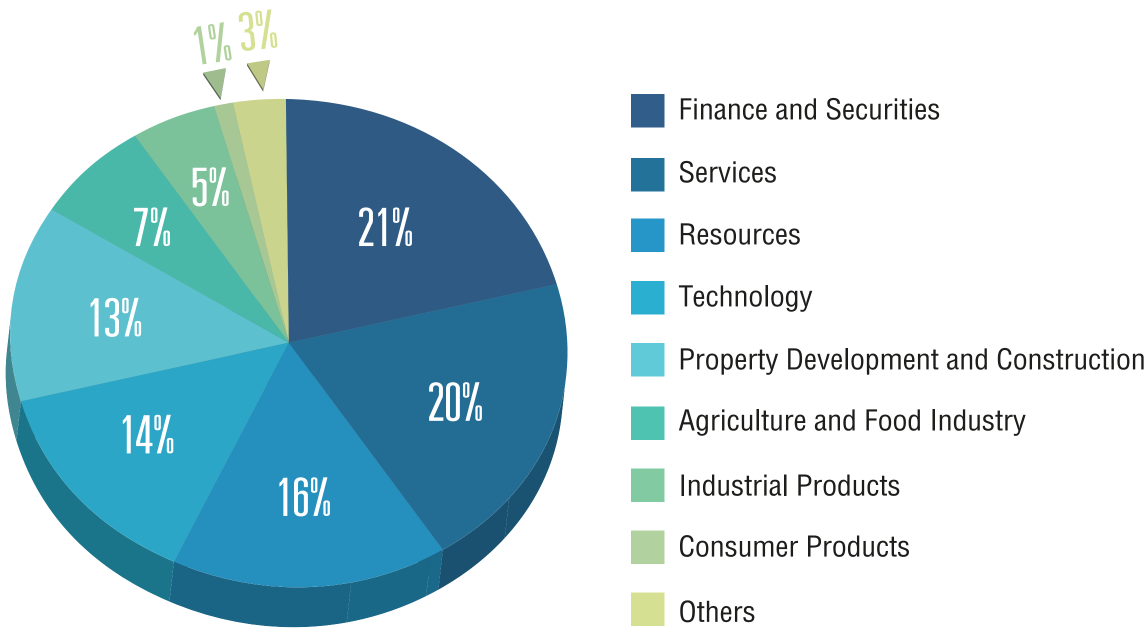
Engagement-level inspection results



Number of individual auditors approved by the SEC

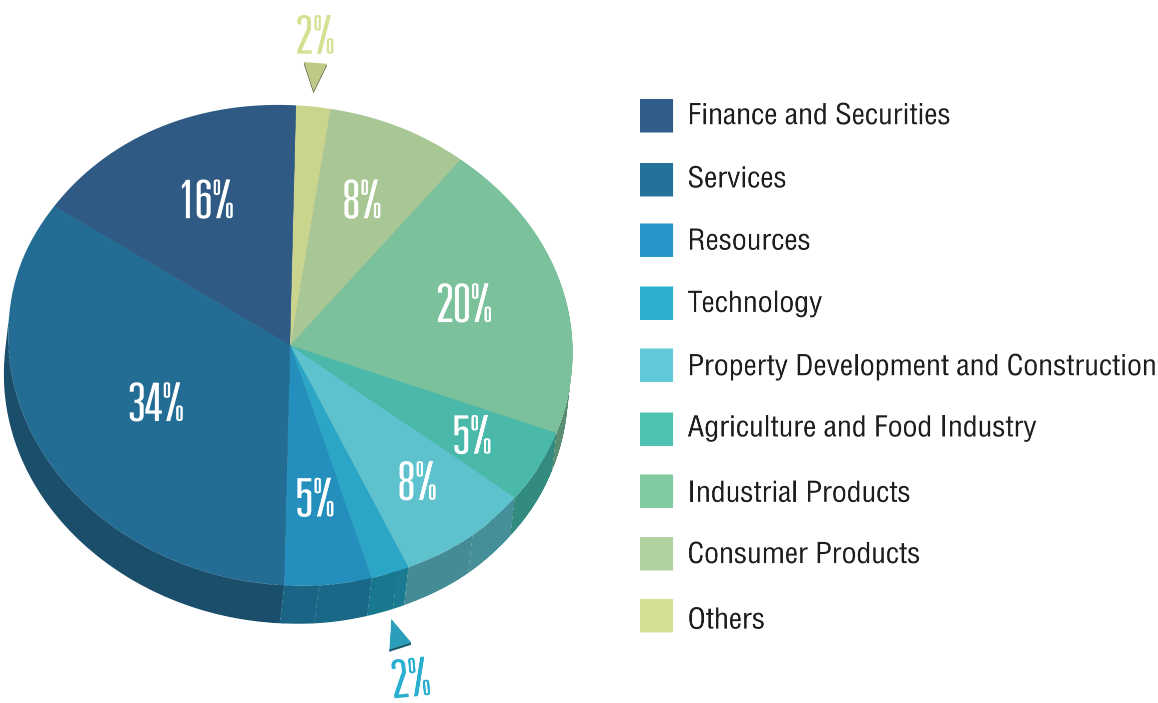
	Number of inspection	
	Newly registered auditors	Renewed registered auditors
2012	9	34
2013	9	20
2014	15	31

Percentage of market capitalization of the listed companies in Thailand by industries



Note : Total market capitalization of the listed companies in Thailand as at December 30, 2014

Percentage of market capitalization inspected by the SEC by industries



Note : Total market capitalization of the listed companies in Thailand as at December 30, 2014

INDEPENDENT
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ACTIVITIES REPORT
2014
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