






# **INDEPENDENT AUDIT INSPECTION ACTIVITIES REPORT 2016**



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	Executive Summary.....	02
	Quality Assurance Review Panel.....	04
	Activities for Enhancing Audit Quality.....	05
	Summary of Audit Inspection Results A. Firm Level..... B. Engagement Level.....	08 28
	Root Cause Analysis.....	42
	Framework and Focuses in 2017.....	44
	Essential Statistics.....	47

## Executive Summary

The quality of financial reporting plays a vital role in promoting and developing the Thai capital market as a major fundraising venue for both local and international businesses. Throughout the years, enhancing the financial reporting quality has always been an ongoing focus at the SEC, and the fundamental way to achieve such objective is to create and promote a well-balanced ecosystem for financial reporting.

Apart from promoting and developing the audit quality control system at the firm level and the individual engagement level, the SEC encourages all stakeholders to attain a better understanding and awareness of their roles within the ecosystem, from the beginning to the completion of financial reporting activities. Collaboration and support of all parties involved is also important for quality financial reporting of companies in the capital market, especially when it comes to the preparatory process under direct responsibility of chief executive officers, chief financial officers and accountants. Essentially, these professionals are the preparer of financial reports; thus, enhancing their competency would further support their role as the key driver of transparent, quality financial reporting.

Regarding the practice of auditors in the capital market, the SEC implements the procedures for increasing the quality of their work on a continuing basis. This includes regular inspection of audit firms' quality control system and random inspection of individual auditors' engagement. The overall results of the inspection conducted on 13 audit firms in 2016 during the third cycle, which is between 2016 to 2018, indicated continuous improvement from the earlier cycles, with significant progress in two key elements of quality

control: acceptance and continuance of client relationship, and human resources. On the individual audit engagement level, the inspection results showed "no findings" accounting for 15 percent of the total approved auditors, a notable rise from 6 percent in 2015. In addition, the number of auditors having significant deficiencies in need of improvement continued to decline. These positive facts reflect the overall quality improvement of audit firms and auditors in the capital market thanks to the continuous dedication and collaboration of audit firm leaders, auditors and personnel.

Nevertheless, some audit firms have yet to remove deficiencies in engagement performance and monitoring while they are revising their audit manual and audit procedures to be in line with the auditing standards. The improvement process also involves communication with their personnel to ensure that such manual and procedures will be applied appropriately in the audit performance. These firms are also revising the monitoring procedures to be more comprehensive, both at the firm level and the engagement level. This matter requires much time and efforts to complete.

Moreover, the 2016 inspection results of the auditors' engagement showed that most findings were in the substantive testing phase, with the audit of revenue, the audit of inventory and the cost of sales being the most frequently recurring themes. Many different factors may have led to such persistent deficiencies of some audit firms and auditors. This includes insufficient involvement of the auditors and the engagement quality control reviewers ("EQCRs"), the preparation for the appropriate implementation of the newly revised audit manual and audit procedures,

the lack of detailed, adequate monitoring processes, and human resources issues.

To address the deficiencies effectively, the audit firms should conduct root cause analysis to find out why their audit performance has fallen short and subsequently lay out a proper and timely rectification plan. The audit firm leaders should be a champion in raising the awareness of the deficiency issue and allocating appropriate resources for the rectification to ensure that their quality control system and their auditors' practice will be efficient and effective.

Looking ahead to 2017, the SEC will continue to implement the framework for creating and maintaining a robust and well-balanced financial reporting ecosystem. More efforts will be given to the development and quality improvement of all parties involved in the preparation of financial reporting. The SEC will also step up collaboration with international agencies, especially those in the ASEAN region to develop quality financial reporting of regional businesses to strengthen their competitiveness in the global market.

## Quality Assurance Review Panel

The responsibilities of the Quality Assurance Review Panel (QARP) include providing opinions and recommendations to the SEC on the audit inspection results both at the firm level and the engagement level. In 2016, the QARP comprised six non-practitioner members and three practitioner members. To maintain

the independence of the QARP and their opinions, the SEC requires that the number of the attending non-practitioner members in each session be greater than the number of the attending practitioner members and not have any relationship to or any interest in the cases being adjudicated.



- |                               |                                  |                             |
|-------------------------------|----------------------------------|-----------------------------|
| 01   Mr. Nontaphon Nimsomboon | 02   Prof. Thavach Phusitphoykai | 03   Mr. Natasek Devahastin |
| 04   Ms. Chongchitt Leekbhai  | 05   Mr. Pakorn Penparkkul       | 06   Mrs. Pranee Phasipol   |

## Activities for Enhancing Audit Quality

In our continued efforts to improve the quality of financial reporting of the listed companies in the Stock Exchange of Thailand (SET), the SEC, in strategic collaboration with other organizations such as the Federation of Accounting Professions (FAP) and other regulators, has focused on organizing activities that would increase awareness and understanding of the roles and responsibilities for all stakeholders, particularly the Chief Financial Officer (CFO) whose responsibilities include preparation of company's financial statements as well as those of audit committees and auditors. Furthermore, the SEC regularly participated in activities arranged by international regulators.

### Strengthening the Quality of Auditors and Audit Firms

The SEC continuously emphasizes the quality enhancement of audit firms and audit engagements by organizing activities such as symposiums and seminars for representatives of audit firms and auditors and related agencies. The activities held in 2016 included an experience-sharing session regarding the adoption of New Auditor's Report in Singapore, and a seminar on challenges and preparation for communication of Key Audit Matters (KAMs) in the auditor's report, which will be effective for the audit of financial statements ending 2016 onward. In these attempts, we aimed to enhance more understanding of the new auditor's report. This will ultimately lead to more useful, more accurate and more relevant financial information.

Moreover, the SEC circulated the findings arising from audit inspection, namely risk assessments and the audit of information technology general control (ITGC), as many medium-and small-sized audit firms had been identified by the results of inspection to lack

sufficient competent personnel in information technology. As such, the audits of complex entities encountered obstacles and needed assistance of experts in the field. The SEC, as a result, invited technological experts to instruct and share their experiences to support effective adaptation regarding ITGC issues for auditors to perform an audit of financial statements more efficiently.



### Strengthening Competency of CFOs and Audit Committees

Aside from the steadfast endeavor to enhance the quality of audit, the SEC promoted the insight and understanding of the CFOs and audit committees of listed companies about the issues concerning the preparation of the financial statements. CFOs and audit committees are expected to fully execute their responsibilities, which in turn will result in the quality financial information from its origins. In 2016, the SEC organized a seminar on the newly released international financial reporting standards and international standards on auditing to better equip and prepare the CFO and audit committees. The standards being discussed at the seminar are, among others, the new auditor's report and the communication of KAM in auditor's

report; the international financial reporting standard on financial instruments and lease; the impending impact in applying those standards with non-bank listed companies.

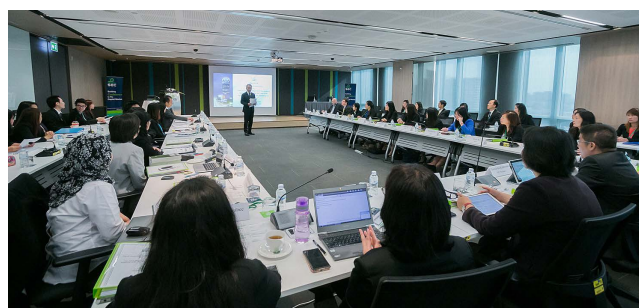
### Promoting SEC Effective Growth and International Recognition

The SEC is committed to improving the audit oversight system in the capital market to be in line with the international standards to promote audit quality on a continuing basis. The International Forum of Independent Audit Regulators (IFIAR) – a multilateral organization of audit oversight body established with the intention to exchange insight and experiences regarding audit and audit firm oversight, promote the collaboration among the regulators, and act as a channel for international agencies that are interested in regulation of audit inspection – has accepted



the SEC to be its member. The SEC is also a member of ASEAN Audit Regulator (AARG) established under the co-operation of its members, i.e., Singapore, Malaysia, Indonesia and Thailand. The AARG's objective is to build up the quality of audit and to mutually share knowledge, insight, and experience regarding the audit inspection in ASEAN nations. The AARG also encouraged the arrangement of workshop seminars as well as provided technicality aid to improve the potential

of the audit regulators of non-member countries to equally calibrate the quality of audit and audit inspection among the ASEAN region. Additionally, the SEC has co-operated with the financial information disclosure regulator in Singapore and Malaysia to exchange knowledge, insight, and experience regarding the audit and review of financial statements of member countries.



The SEC delegated its officers to attend the meetings and seminars that the IFIAR and the AARG annually organized to exchange knowledge, insight and practical issues arising from the audit inspection and audit of listed companies. The meetings and seminars also illustrated the audit techniques and the trending issues relating to the audit regulation, the audit quality control, and the audit of financial statements of global standards, e.g., data analytics in audit and the use of audit indicators to analyze the quality of audit firms. Furthermore, in 2016, the members of financial information disclosure regulator had an honor to attend lectures of experts from the International Financial Reporting Standard (IFRS) Foundation. The topics included the financial reporting standards on financial instruments and revenue from contracts with customers, to encourage members to learn and exchange the notion and experience regarding the adoption of financial reporting standards.

By continuously enhancing the system of audit regulation in the capital market and international acceptance, Thailand's system of audit regulation in the capital market has earned recognition from the European Commission (EC) in line with the standards of those countries in the European Union.

Moreover, the SEC is a member of the International Organization of Securities Commissions (IOSCO, an international organization of audit regulatory and capital market development agency. IOSCO granted the SEC an opportunity to delegate its officers to be representatives at the IFRS Advisory Council with the responsibility to provide counsel strategic plan and direct the operation of International Accounting Standards Board (IASB). The Council also endorses widespread collaboration to develop IFRS as an internationally accepted quality standard. The IFRS Advisory Council meeting is held annually. By attending the IFRS meeting, the SEC took part in the direction of the IFRS as well as proposed discussion on practical issues regarding application of the IFRS in the ASEAN countries. This is expected to ultimately lead to the revision and customization of the IFRS to meet its proper state.

As a member of the IOSCO, the SEC sent a nominee to be a member of IOSCO Committee 1 (IOSCO C1) in charge of the pursuance and improvement of accounting, auditing, financial information disclosure. The main responsibility of the IOSCO C1 is to provide counsel relating the revision of accounting standard, auditing standard, and ethical standards to be practically and effectively applied. IOSCO C1 meeting is held annually to encourage its members to exchange knowledge, provide its members with opportunities to give comments and feedback to the International Auditing and Assurance Standards Board (IAASB), the International Ethics Standards Board for Accountants (IESBA), and the Big-6 auditing firms regarding the issues and obstacles with the application of the standards and how to co-operate to resolve such issues.

### **Enhancing Efficiency of SEC officers**

The SEC prioritizes the continuous competency development of its officers as seen in the participation in the symposiums and seminars being held by various agencies throughout the year. The SEC also regularly organized accounting and auditing standards workshops for its officers, e.g., testing of information technology general control (ITGC), the essence of newly-revised financial reporting standards which address fair value measurement, business combination, consolidated financial statements, joint-operation and share based payment, for example.

# Summary Audit Inspection Results

## A. Firm Level

In 2016, the SEC assessed the quality control system of audit firms according to the pre-established schedule for the total number of 13 firms. As of 31 December 2016,

there were 197 auditors registered with the SEC and affiliated with 27 audit firms, as illustrated in Figure 1, 2 and 3.

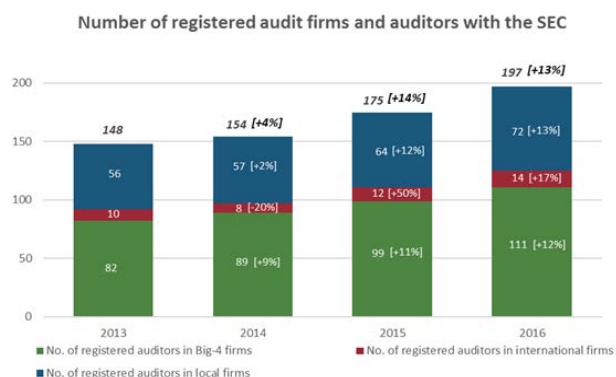
Category of audit firms	No. of audit firms	No. of registered auditors
Big-4 firms	4	111
International firms	4	14
Local firms	19	72
Total	27	197

**Figure 1:** No. of audit firms and auditors registered with the SEC.  
(More details at <http://market.sec.or.th/public/orap/AUDITOR01.aspx?lang=th>)

**Remark:** 'International firms' refers to audit firms which are member of international audit firms, share the same name or bare its name, consistently adopt and apply its policies and procedures, excluding the Big 4 firms.

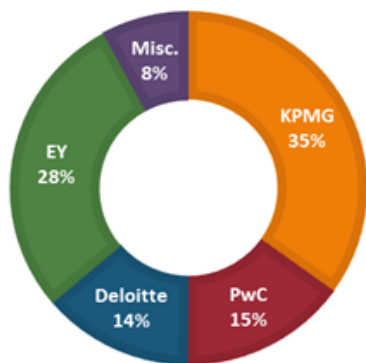
Year	No. of audit firms being assessed on quality control system
2557	12
2558	16
2559	13

**Figure 2:** No. of audit firms being assessed on quality control system according to the risk-based approach.



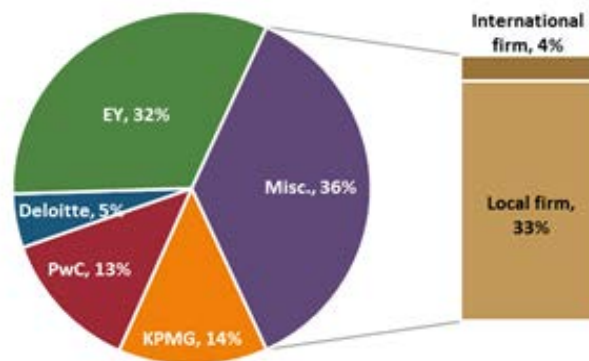
**Figure 3:** No. of registered auditors with the SEC from 2014 to 2016

**Remark:** The increase ratio of auditors in each tier "[+ increase/- decrease]" is derived by the number of increasing auditors in the given year compared with the numbers of auditors in the previous year.



**Figure 4:** The proportion of listed companies as audit firm's clients, categorized by market capitalization.

**Remark:** Market capitalization of total listed companies on the Stock Exchange of Thailand as at 30 December 2016

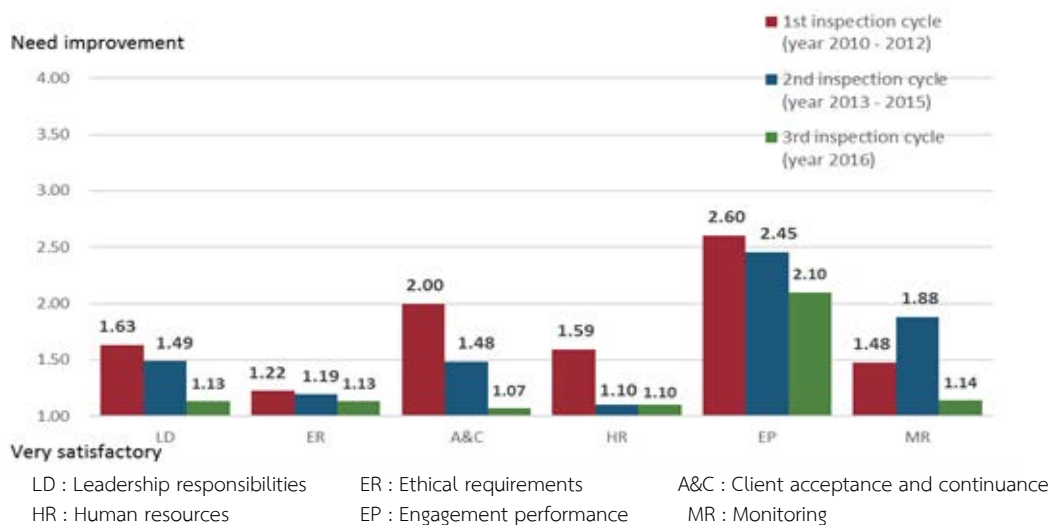


**Figures 5:** Proportion of each audit firm's listed company clients.

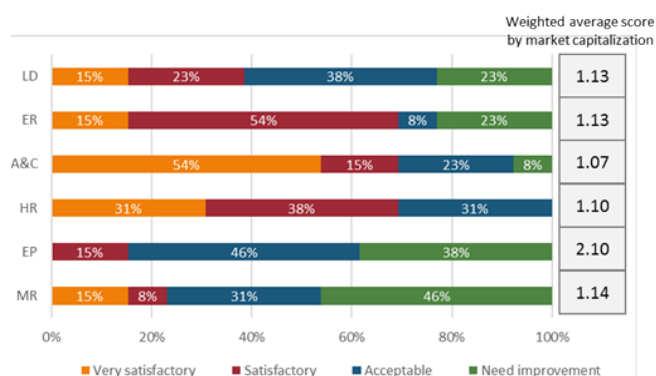
**Remark:** No. of total listed companies on the Stock Exchange of Thailand as at 30 December 2016

The evaluation result in most of the ISQC elements clearly manifest the sequent development in contrast to the second cycle (2013-2015) and the first cycle of inspection (2010-2012), as illustrated in figure 6. In some of the elements, namely acceptance and

continuance of client relationships, human resource, the evaluation results are profoundly satisfactory. It is the reflection of the perseverance and prudence of the audit firm's leader, as well as its personnel, to collaboratively remediate the findings raised by the SEC, which ultimately lead to the improvement of audit firms' quality.



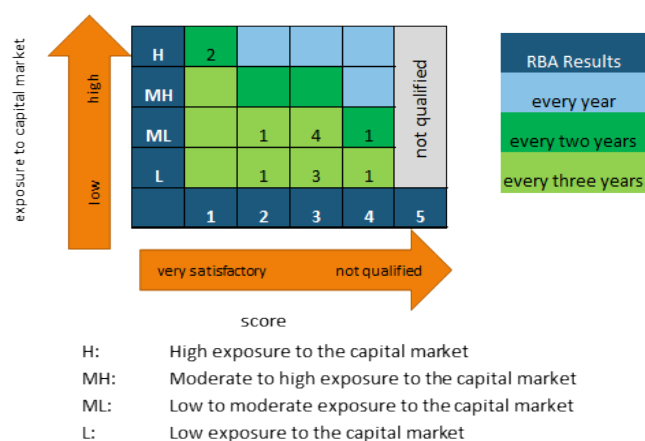
**Figure 6:** The weighted average score by total market capitalization of each element in the ISQC1, compared among three inspection cycles



**Figure 7:** Percentage of audit firms categorized by the evaluation result of each element in the TSQC 1

**Remark:** The 3rd cycle inspection result comprises 13 audit firms

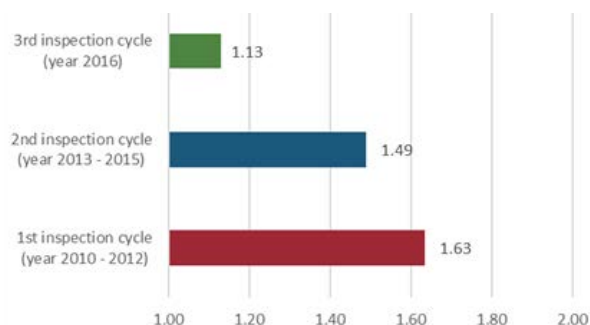
As shown in figure 7, when scrutinizing the number of audit firms in each scoring range as classified by the element in the Thai Standard on Quality Control 1 ("TSQC 1"), more than 50 percent of the audit firms achieve the 'very satisfactory' in the 'acceptance and continuance of client relationships' element. While more than 50 percent of the audit firms achieve the 'very satisfactory' and 'satisfactory' in the 'relevant ethical requirement' and 'human resource' element. It should be noted that none of the audit firms fall into the 'need improvement' description in the 'human resource' element.



**Figure 8:** The results of the inspection in the firm level according to the risk-based approach

In general, it can be concluded that most of listed companies' audit firms reached the evaluation results in each element of the TSQC 1 as 'acceptable.' Audit firms conducted root cause analysis and implement action plan to elevate the quality of quality control system in response to the SEC's findings. Some audit firms, however, bear the constraint which result in the inability to remediate and resolve the findings from the previous inspection cycle. Regarding this matter, the SEC proposes the following recommendation as a guidance to improve the quality in each element.

## 1. Leadership Responsibilities for Quality within the Firm



**Figure 9:** The weighted average score as defined by total market capitalization in the 'Leadership responsibilities for quality within the firm' element, compared in three inspection cycles.

In the 3<sup>rd</sup> inspection cycle, the evaluation result in this element shows improvement compared to the earlier cycle. The firm leaders maintain decent attitude towards elevating the quality control system. The overall evaluation results that steered in the 'better' direction suggest the leader's concentration and prioritization in the improvement of audit quality. The SEC found that several of the issues and findings in the preceding inspection cycle had been rectified and resolved. The details of the remediation from the previous inspection cycle are as follows.

Findings identified by the SEC	Remediation plan implemented by the audit firms
<p>In some cases, the firms assign audit engagements and other matters to some of the partners or some divisions in the substantial amount. Assign complex audit engagement which requires high judgment and skepticism to the partner or divisions with limited experiences, resulting in such partner or personnel in that division lacking an appropriate amount of time to execute and review professional work or suffer the failure to identify the discrepancies or the material misstatement in financial statements.</p>	<ul style="list-style-type: none"> <li>- Conduct proper resource planning prior to accepting the engagement to ensure that the human resource to deliver quality audit would suffice.</li> <li>- The firm's leaders constantly review the fitfulness of the engagement allocation to ensure that each partner and each division do not have assignment that would exceed their available potential and time. Also, the firm's leaders exercise due care in designating engagement with complexity or requires specific technical knowledge to the appropriate partners and divisions.</li> <li>- Some firms have rendered policies to not accepting new clients if it considered that the available human resources would not enable the firms to deliver quality audit.</li> <li>- The firm's leaders entrust the more experienced EQCR to conduct a review on the work of less experienced partners or auditors, which would decrease the risk of not being able to identify the discrepancies or the material misstatement in financial statements.</li> </ul>
<p>The firms have numerous deficiencies in other elements which require immediate remedy or the previous findings that are not yet rectified. Inevitably manifest the possibility of the leader's lack of appropriate care for mitigating the deficiencies in those elements.</p>	<ul style="list-style-type: none"> <li>- The firm's leaders prioritize rectification of the deficiencies from the previous inspection cycle. By doing so, the procedures, the manual, and related documents pertaining to quality control are revised as deemed appropriate; the financial reporting standards and auditing standards trainings were carried out to better equip staffs with necessary knowledge. Subsequently, the current cycle evaluation results in every element exhibit the improvement.</li> </ul>

Although most of the leaders would bear in mind the significance of developing the quality of audit and continuously mitigate and improve as recommended by the SEC, some of the deficiencies' rectification are underway and might require a length of time to successfully improve,,e.g., the remuneration plan of the

partners and executive officers that reflect the quality of the work performed. As the matter is sensitive, it might demand the communication with concerned parties and gradually resolve the findings. As such, the SEC will continue to raise the issues recommending the firm to devise additional remediation plan as follows.

Findings identified by the SEC	The additional recommendation to the remediation plan.
<p>The remuneration plans to each partner of the firm do not reflect the performance evaluation which essentially referred to the quality of work.</p>	<ul style="list-style-type: none"> <li>- There should be the expected score, the criteria for performing evaluation, or indicators which are linked with the quality of work, and communicate them to the partners.</li> <li>- There should be the restructuring of the remuneration plan which would encourage the 'quality-of-professional-performance-over-the-commercial-profit' organization culture.</li> </ul>
<p>The documentation to support the adjustment, either upward or downward, of the performance evaluation by the firm's leader is absent.</p>	<ul style="list-style-type: none"> <li>- There should be the documentation to support the adjustment of the performance evaluation of the one being assessed, to stimulate the transparency of the evaluation, and to facilitate the assessor to better communicate the reason behind the consensus. All of which will lead to the effective improvement of the one being assessed.</li> </ul>

## 2. Relevant ethical requirements

The inspection result for the 3<sup>rd</sup> cycle on the 'relevant ethical requirements' element expresses that most of the audit firms developed and improved by considering the findings and issues raised by the SEC in the preceding cycle. The root cause analysis and the mitigation plan were executed to elevate the firm's quality control system as follows:

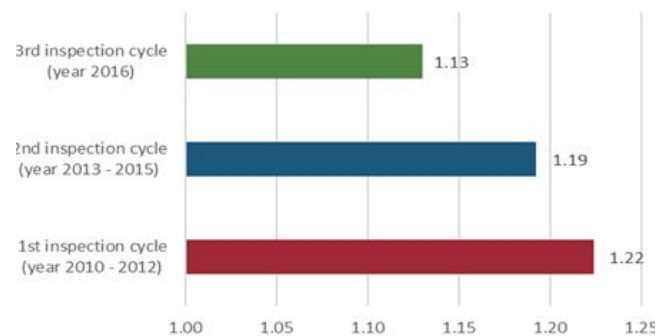


Figure 10: The weighted average score as defined by the total market capitalization in the 'relevant ethical requirements' element, compared in three inspection cycle.

Findings identified by the SEC	Remediation plan implemented by the audit firms
The process to evaluate the independence regarding the provision of non-assurance services may not sufficient to ensure that the independence will not be impaired upon the provision of such service.	<ul style="list-style-type: none"> <li>- Set out the policy to not accepting non-assurance service for the audit clients.</li> <li>- Establish the committee to consider the scope of non-assurance service when accepting such service from audit clients to ensure that it will not impair the independence of the firm.</li> </ul>
No clear definition of 'related entities.'	<ul style="list-style-type: none"> <li>- Precisely define the 'related entities' to enable the audit firms to completely disclose and consider the independence regarding related entities.</li> </ul>

Findings identified by the SEC	Remediation plan implemented by the audit firms
<ul style="list-style-type: none"> <li>- No defensive measures are in place when there is threat related to fees in relative size ('fee dependency').</li> <li>- No policies and procedures are in place when there is threat related to fees in relative size ('fee dependency').</li> </ul>	<ul style="list-style-type: none"> <li>- Require the supplementary review of the audit engagement which fee exceed the threshold designated by the firm before the issuance of the audit report ('hot review'), besides the review by the EQCR.</li> <li>- Communicate to the audit committee of the client regarding the potential risk to the independence owing to the relative size of the fee as well as the defensive measure deployed by the firm to decrease or limit the threat from fee dependency which might impair the independence of the audit firm.</li> </ul>
<p>No policies and procedures are in place when considering the independence if the firm having a close business relationship with a client.</p>	<ul style="list-style-type: none"> <li>- Set out the policies and notify the department in charge of the procurement to be aware that the firm shall not engage in business transaction with the clients.</li> <li>- Establish the committee to consider the independence when the firm engage in business relationship to ensure such the transaction will be scrutinized with proper evidence and documentation that there is no impact on the independence of the firms.</li> </ul>

However, the SEC still detected the deficiencies in some issues which might not yet be rectified. e.g., the procedures regarding the preservation of confidentiality and independence in case of the staff's employment with assurance clients; and the staff's personal assurance work. Most of the firms had already

deployed policies to address those matters; however, the policies may not be able to eliminate or reduce the threat to an acceptable level. As a result, the SEC proposes the additional recommendation to the firm to revise remediation plan, as follows:

Findings identified by the SEC	The additional recommendation to the remediation plan.
<p>No designated policies and procedures pertaining to the preservation of the confidentiality and independence in case of staff's employment with assurance client.</p>	<ul style="list-style-type: none"> <li>- Require the resigning staff with the employment with assurance clients to notify the firm in advance – usually in the wider timeframe than the resignation in normal circumstances – to enable the firm with the defensive measures to refrain the staff in question from being a part of audit team with which he or she will be employed.</li> <li>- In the event that the aforementioned staff had already engaged in the audit engagement prior to the notification to the firm, the firm might require that the work of the staff will be subjected to retroactive review; to ensure the completeness of audit work required by the audit standards.</li> </ul>
<p>No designated policies pertaining to the staff's personal assurance work.</p>	<ul style="list-style-type: none"> <li>- Specify the description of the personal assurance work that deemed as 'acceptable.'</li> <li>- Require the staff to self-declare his or her personal assurance work, the firm will be able to verify the appropriateness and evaluate both the ethical risks and the ability to perform work of the staff. Nonetheless, the SEC encourages the firm to set out the policies that limit its staffs' capacity to perform personal assurance work, to increase the quality offering to the firm.</li> </ul>

### 3. Acceptance and Continuance of Client Relationship

By comparing the evaluation result in each element, it can be concluded that the 'acceptance and continuance of client relationship' element achieved the best average score. In the 3<sup>rd</sup> cycle inspection, seven from thirteen audit firms inspected by the SEC bear no deficiencies in this element thank to the tool supporting the firm to perform risk assessment and the thorough independence evaluation before accepting audit engagement. The detail of the rectification to the previous inspection cycle's findings are as follows:

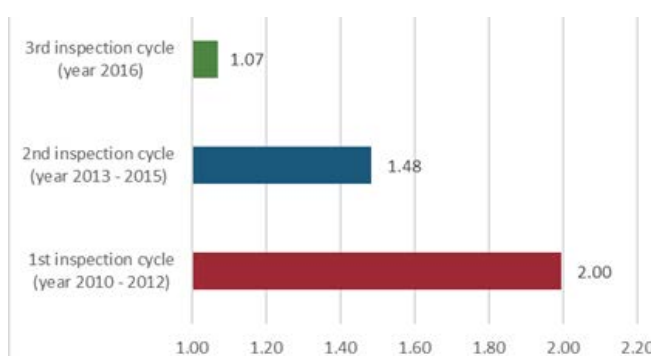


Figure 11: The weighted average score as defined by the total market capitalization in the 'acceptance and continuance of client relationship' element, compared in three inspection cycle.

Findings identified by the SEC	Remediation plan implemented by the audit firms
Some of the audit firms may not thoroughly document the information about the risk assessment when accepting the audit engagement or, as the case may be, the risk assessment factors do not include the significant matter that should be considered.	<ul style="list-style-type: none"> <li>Several audit firms developed more in-depth form and template as well as set up guideline and description about the risk factors and the criteria to risk scoring. This will encourage the assessor to better document the conclusion of risk assessment procedure and will also standardize the risk scoring within the firm based on the shared scoring matrix. Also, some firms deploy the system to analyze whether the information provided by the personnel is adequate with the proper supporting document before authorization of audit engagement approval.</li> <li>Exemplify the factors that should be used to considered when perform risk assessment to ensure that each acceptance had been meticulously scrutinized and well-documented.</li> </ul>

Findings identified by the SEC	Remediation plan implemented by the audit firms
	<ul style="list-style-type: none"> <li>- Communicate findings raised by the SEC to the personnel and organize the competency building course about risk assessment when accepting audit clients, namely the factor being used to perform risk assessment; the scoring matrix of each criteria; and the complete and precise response to risk identified by consider nature, timing and extent of the audit.</li> </ul>
In some cases, the firms did not evaluate the competency, the capability, and the sufficiency of its available time and personnel before accepting the audit engagement.	<ul style="list-style-type: none"> <li>- Most of the firms plan the human resource management based on the speculation of the future acceptance of new clients, resulting in the availability of personnel. This will ensure the firm will have sufficient resources to deliver quality and effective audit.</li> <li>- Some of the firms set out policies not to accept any new clients when it had reasons to believe that the current personnel may not suffice.</li> </ul>

However, the SEC would like to recommend some additional recommendation to the remediation plan, as follows:

Findings identified by the SEC	The additional recommendation to the remediation plan
The weighted score of some risk factors may not appropriate; e.g., to allow the score of risk of fraud equal other risk factors.	The audit firms should properly weight and rank the risk factors. The factors that associate more risk to the audit acceptance should be allocated more weight than those with lesser risk to ensure the appropriateness of risk assessment when accepting new engagement.

## 4. Human Resources

One of the major elements that determine the quality audit is the competent personnel, sufficient time to perform audit, and the commitment to abide by the ethical and professional requirements. The financial statements, as a result, will be more value-added and reliable to their users. From the evaluation result in the 3<sup>rd</sup> cycle inspection, it is found that most of the audit firms continuously exercised more improved human resources management system. In doing so, the firms rectified the deficiencies identified in the 2<sup>nd</sup> inspection cycle as follows:

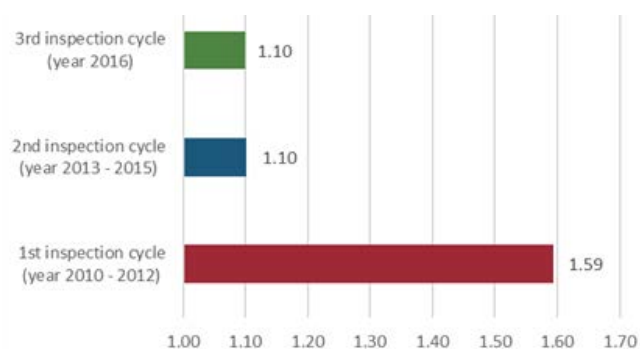


Figure 12: The weighted average score as defined by the total market capitalization in the 'human resources' element, compared in three inspection cycle.

Findings identified by the SEC	Remediation plan implemented by the audit firms
<ul style="list-style-type: none"> <li>- The planning and allocation of the human resources may not be able to guarantee the quality of performance.</li> <li>- The audit firms lack the senior officer, unavoidably followed by the relative interval between the partners and junior officers.</li> <li>- No succession plan to develop and promote the staffs to be middle and executive management.</li> </ul>	<ul style="list-style-type: none"> <li>- Optimize the job allocation system to the staffs in each level by considering the complexity of the job and estimate budget hours that would reflect more rationality.</li> <li>- Refrain from accepting new audit clients if the firm is not capable of increasing its personnel to ensure that the firm will have sufficient personnel to perform professional service.</li> <li>- Revise policies about remuneration and career advancement to attract and retain staffs.</li> <li>- Establish organizational culture that would create bond between the firm and its personnel as well as develop working environment to harmoniously match the new generation life style.</li> </ul>

Findings identified by the SEC	Remediation plan implemented by the audit firms
<p>The curriculum and the contents of the training may not be appropriate to each level of staffs. The tracking and the execution to the staff whom did not meet the minimum requirement are not well-established enough to ensure the competency of the staff with incomplete professional development.</p>	<ul style="list-style-type: none"> <li>- Assign the executive officer to consider the suitability of the curriculum and its content for staffs in each level. Provide supplementary training for the newly released financial reporting standards, or auditing standards.</li> <li>- Set out the policies to control and track the absent personnel or require the absent personnel to take the substitute course within the designated timeframe. To ensure that the staffs have necessary knowledge and competencies as expected by the audit firms.</li> </ul>

In this inspection cycle, the SEC discovered that some of the audit firms still bear the deficiencies about the employees' performance evaluation system which required improvement. The transparent and reasonable

employees' performance evaluation system will contribute to more effective human resources management system, leading to the ability to retain high potential staffs in the long term.

Findings identified by the SEC	The additional recommendation to the remediation plan
<ul style="list-style-type: none"> <li>- Lack of staffs competencies building plan.</li> <li>- Lack of communication to the staffs about the expectation – the significant factor when evaluate performance – from the firms.</li> <li>- Clear definition for each factor being used in performance evaluation is not available.</li> <li>- The promotion and remuneration are not associated with the quality-oriented performance evaluation.</li> </ul>	<ul style="list-style-type: none"> <li>- Devise the staffs competencies building plan and describe clear target for staffs in every level.</li> <li>- Determine and communicate the unambiguous expectation along with the definition for each factor being used in performance evaluation.</li> <li>- Establish the committee to consider the promotion and remuneration by referring to the quality of work. To enable the firms with more transparent performance evaluation system and to encourage the staffs to be aware of the importance of the quality of audit.</li> </ul>

The SEC has compiled the Audit Quality Indicators ('AQIs') for the propose of preliminary consideration of audit firms' quality. The AQIs of the 'human resources' exhibit the followings:

**(1) The average year of experience for non-partner audit staff is between 1.86 to 5.85 years (The mean is at 3.85 years)**

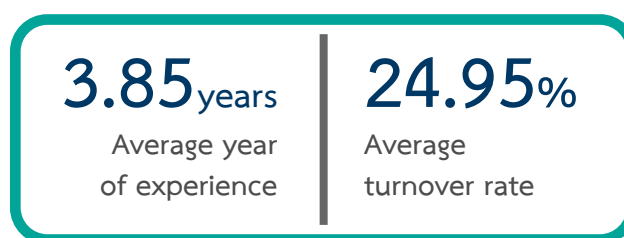
The above AQIs is used to assess how well-experienced the audit team members are. If the AQIs indicates the higher number of years, it would suggest the likelihood that the audit team members had gone through a variety of audit engagements and manifested more competencies as well as more professional skepticism. Fundamentally followed by more likelihood to detect material misstatements or better exercise of judgment when consider the sufficiency and appropriateness of audit evidence.

**(2) The staffs turnover rate is between 7 to 63 percent (The mean is at 24.95 percent)**

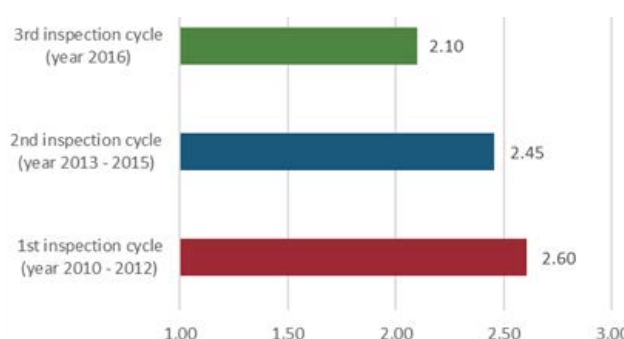
The above AQIs is used to indicate the necessity of an in-depth analysis if the turnover rate is high. The high turnover rate results in the scarcity of knowledgeable and competent personnel. The firm should immediately identify and resolve the issues. The evaluation result in the year 2016 suggest that the firms with low turnover rate will have higher average score in 'engagement performance' element. As such, if the firms can retain their staffs in the long term, it will influence the more quality audit.

It should be noted, however, that the high or low AQIs when compared with other audit firms may not be able to provide the ultimate consensus as to the higher or lower quality of the firm in question.

Because the high or low of the AQIs may stem from the surrounding factors of each audit firm. Notwithstanding that when consider the AQIs there should be other factors to be co-considered before applying the AQIs to consider the audit firm's quality. As the AQIs may not be able to single-handedly provide the conclusion to the firm's quality.



## 5. Engagement Performance



**Figure 13:** The weighted average score as defined by the total market capitalization in the 'engagement performance' element, compared in three inspection cycle.

The 'engagement performance' element still continue to be the element with more deficiencies than others. Despite the 3<sup>rd</sup> inspection cycle result, the audit firms had already rectified several of the significant findings, namely the involvement of auditors and engagement quality control reviewers ('EQCR'), and the qualification of the EQCR, as set out below:

Findings identified by the SEC	Remediation plan implemented by the audit firms
The auditors and EQCRs involvement is insufficient.	<ul style="list-style-type: none"> <li>- More appropriate assignment to the auditors and EQCRs by considering the complexity of the task, the competencies and experiences of the auditors and EQCRs, and by encouraging both auditors and EQCRs to be more engaged in every phase of the engagement starting from audit planning. In the year 2016, it is found that the ratio of auditors and EQCRs involvement increase from the year 2014 and 2015, as shown on figure 14 and 16.</li> </ul>
EQCRs may lack the necessary technical skills and experiences.	<ul style="list-style-type: none"> <li>- Revise the selection process and assign task to EQCRs based on human resource planning. Emphasize the person who is eligible to be EQCRs to possess experience and expertise in the industry to ensure that the EQCRs will have sufficient knowledge, competency, and experience to elevate the audit quality.</li> </ul>

Although in the year 2016, the audit firms had revised the audit manual and audit procedures to be in line with auditing standards in significant matters, some issues may require more duration to develop the audit manual and audit procedures. In addition, the implementation of audit manual and audit procedures

require the communication and training to effectively prepare the staffs to comply. Thus, in 2016, the audit firms may suffer the inconsistencies of applying audit manual and audit procedures in each engagement. The SEC will still raise some of the findings as additional recommendation to the firms as follows:

Findings identified by the SEC	The additional recommendation to the remediation plan
Some audit firms may lack the audit manual and audit procedures as required by the auditing standards.	<ul style="list-style-type: none"> <li>- Establish the working group to scrutinize the completeness and appropriateness of audit manual and audit procedures as required by the auditing standards.</li> </ul>

Findings identified by the SEC	The additional recommendation to the remediation plan
The engagement performance in some topic did not comply with the audit manual, audit procedures and auditing standards.	<ul style="list-style-type: none"> <li>- Communicate to the staffs and train the staffs when there are modification to the audit manual and audit procedures to facilitate the staffs to perform sufficient and appropriate audit as required by the auditing standards.</li> </ul>
EQCRs did not identify the insufficient of audit work because he or she did not involve in reviewing from the planning phase or their involvement in reviewing did not suffice.	<ul style="list-style-type: none"> <li>- Properly assign task to EQCRs with the reasonable time to thoroughly conduct the review.</li> <li>- Require the EQCRs to plan the engagement review in advance by allocating the time to conduct the review into each phase of the audit e.g., planning and risk assessment phase, or conclusion phase to facilitate the EQCRs to effectively conduct the review and the review would not be piled up at the end of period.</li> </ul>
Completion of the assembly of final engagement files in each engagement were not finished on as timely basis.	<ul style="list-style-type: none"> <li>- Most of the audit firms establish policies for engagement teams to complete the assembly of final engagement files accordingly; however, the execution when assemble the final engagement files still have some deficiencies. The audit firms should relay the precise policies and procedure to assemble the final engagement files to the engagement teams, along with the strict monitoring process and the consequence for those who did not comply.</li> </ul>

### The Involvement of Auditors

The adequate involvement of the auditors will reduce the audit risk – the risk that the auditor expresses an inappropriate audit opinion when the financial statements

are materially misstated – and will contribute to the more quality audit. In 2016, the involvement of the auditors increases from the preceding year. The average

of involvement ratio of the auditors per total audit hours is approximate 3 percent which is considered an acceptable ratio. Parallel with the audit firms' policies to emphasize more involvement of the auditors in audit engagement by prioritizing the allocation to each partner,

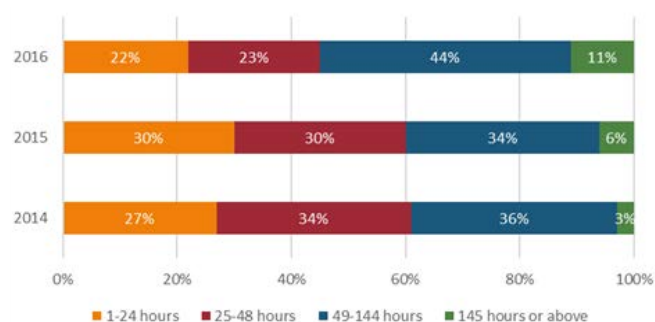


Figure 14: The proportion of auditors' involvement in number of hours.

### The involvement of EQCRs

The knowledgeable, competent and experienced EQCRs in the given industries combined with the adequate involvement to conduct the review will promote the quality of audit. Because the EQCRs will conduct supplementary review to identify risk and detect significant issues; and provide consultation to the engagement teams to timely revise the audit plan. From the inspection of audit engagement in the year 2016, we found that the number of hours and the percentage of the EQCRs involvement are like those in 2014 and 2015

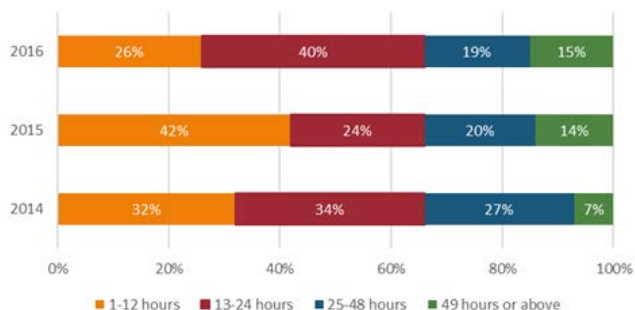


Figure 16: The Proportion of EQCRs' Involvement in number of hours.

ensuring that the auditor will have necessary timing resource to engage in the audit, especially the engagement with substantial risk and high complexity more than just the sizable engagement.

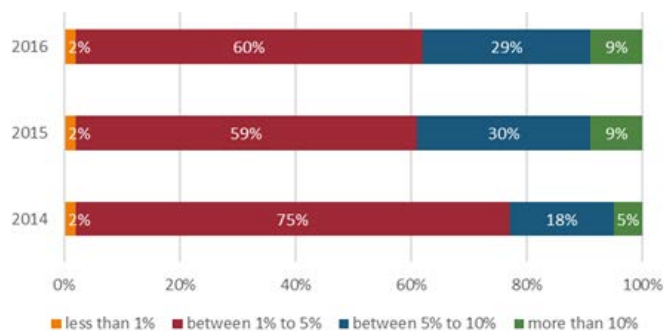


Figure 15: The percentage of auditors' involvement per total hours.

In the year 2016, the audit firms had improved the allocation of the engagement to the EQCRs to reflect the knowledge, the competencies and the experiences of the EQCRs. The EQCRs will be able to review with more effectiveness. Unfortunately, some of the audit firms still have the scarcity issue on the professional personnel, especially in the partner position, which cause the EQCRs to endure the massive responsibility and lack the adequate time to involve in some of the audit engagement.

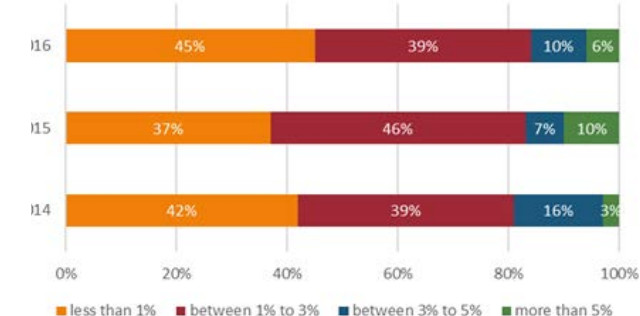


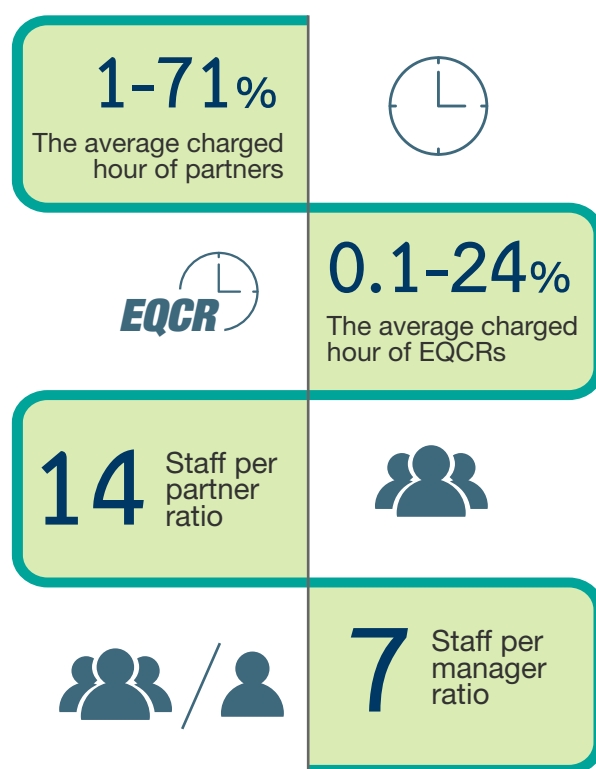
Figure 17: The percentage of EQCRs' involvement per total hours.

The AQLs of the 'engagement performance' element for the year 2016 exhibit the followings:

(1) Partner level's charged hours are between 3 to 1,202 hours per engagement, accounted for 1 to 71 percent of the total hours. The managerial level's charged hours are between 16 to 3,010 hours per engagement, accounted for 3 to 65 percent of the total hours. These AQLs is used to assess the adequacy of the auditor's and reviewers' involvement. When compare the size and the complexity of the engagement if the partners or the managers involvement are high, it will increase the possibility that the review is adequate, and the audit has quality. If the engagement teams fail to obtain sufficient appropriate audit evidence, the partners and the managers should be able to identify the issues before finalizing the audit report and should be able to notify the engagement teams to resolve the issues as well as obtain more audit evidence. Furthermore, if the partners and the managers are engaged in the planning phase accordingly, the audit will be more effective and excellent. As the effective planning will enable the engagement team to systematically perform audit; appropriately response to the risk and the partners and managers to manage the engagement more efficiently.

(2) The number of EQCRs' charged hours are between 2 to 212 hours per engagement, accounted for 0.1 to 24 percent of the total hours. This AQL is used to assess the adequacy of the EQCRs' involvement to be able to identify significant risk and issues, as well as to provide consultation and recommendation to the engagement team in due time. Theoretically, the EQCRs should be more experienced than the audit

assistants and also should possess more professional skepticism, particularly in the significant judgment and accounting estimates with high uncertainty. Therefore, the audit quality will vary in relation to this AQL.



(3) Staff per partner ratio is between 4 to 33 (the mean is approximately 14), and staff per manager ratio is between 3 to 13 (the mean is approximately 7). These AQLs provide aid when analyzing the structure of human resources of the audit firms. The optimization of the two ratios may vary from firm to firm which depends on the size of the firm, the complexity of audit engagement, and the job assignment policy to each

level. Nonetheless, if the staff per partner ratio or staff per manager ratio are unusually high or low, it might indicate the concern about the structure of human resources. The firms should emphasize to resolve the concern in due time. To exemplify, if the staff per partner ratio or staff per manager ratio is uncommonly low, it would suggest the high turnover rate of the firm.

Thus, the consideration of the aptness of these ratios require the use of other information, e.g., the turnover rate. We found that some of the middle-and small-sized firms are still short of the personnel in managerial and senior assistant level, as shown in figure 18. The firms should prepare for and address the issue by hiring more managerial and senior assistant level, formulate the succession plan to develop personnel for those position, and set up the measure and policy to retain the staffs.



Figure 18: The human resource structure of middle-and small-sized audit firms

## 6. Monitoring

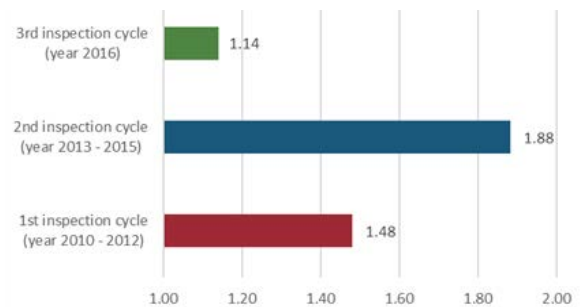


Figure 19: The weighted average score as defined by the total market capitalization in the 'monitoring' element, compared in three inspection cycle.

In 2016, the evaluation result in this element signify the improvement from the 2<sup>nd</sup> inspection cycle. This is because most of the audit firms had improved its monitoring process by the setting up of the policy and the more detailed monitoring procedure, the appointment and the assignment of appropriate EQCRs and the rectification of the deficiencies, communicate with the concerned individuals on a timely basis. The monitoring process supports the firm to effectively and timely remedy the deficiencies and findings, subsequently followed by more quality audit. From the inspection in the year 2016, the SEC found that the 'monitoring' element score is in line with the firm's overall scoring, as shown on figure 20.

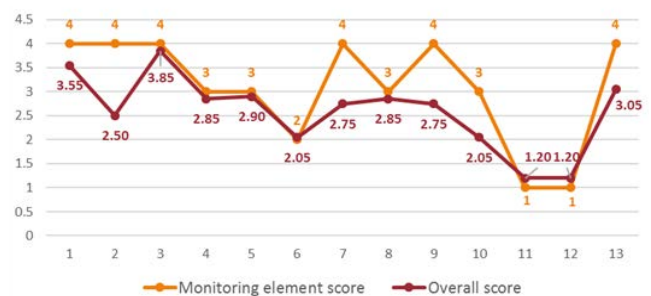


Figure 20: 'Monitoring' element score of the 13 audit firms, compared with its overall score counterpart.

In general, the audit firms had remediated its deficiencies from previous inspection cycle as follows:

Findings identified by the SEC	Remediation plan implemented by the audit firms
The monitoring manual does not specify the guidelines or the factors that should be considered such as how to select the engagement and line of transactions to conduct the review along with the properly specified scope of inspection.	<ul style="list-style-type: none"> <li>- The audit firms had revised the scope and contents of the monitoring manual to be more detailed and more specific. The guideline or the factors to be considered when selecting the engagement are risk-based, e.g., the listed audit engagement, the complex entity, the higher risk accounting transaction.</li> </ul>
Some of the audit firms with the limitation about human resource hired the external individuals to act as the person in charge of monitoring. With the person in question is not properly qualified in audit field and does not use ample time to effectively perform monitoring.	<ul style="list-style-type: none"> <li>- The procedure to choose the person in charge of monitoring had been set up. By considering the qualification, experience in auditing field, the competencies, the capabilities, and the available time to appropriately perform monitoring.</li> </ul>

The constraint on time and human resource in some of the audit firms accounts for partially-resolved

deficiencies and/or the resolving is underway, as follows:

Findings identified by the SEC	The additional recommendation to the remediation plan
The guideline, the template, and the checklist used in monitoring did not cover some significant issues.	<ul style="list-style-type: none"> <li>- The audit firms should review the guideline, the template, and the checklist used in monitoring and revise accordingly so that they contain necessary topic and cover every substantial issues as required by TSQC1, with specific detail to perform the work effectively.</li> </ul>

Findings identified by the SEC	The additional recommendation to the remediation plan
<p>The criteria to assess the impact, the effect and the significance of the findings are not set out, which are necessary to consider whether the findings are systematics or repetitive and the rectification of the issue should be the priority.</p>	<ul style="list-style-type: none"> <li>- The audit firms should illustrate the criteria or the guideline to assess the impact, the effect and the significance of the findings, to prioritize the rectification of the findings and precisely response in time.</li> </ul>
<p>The person in charge of monitoring did not sufficiently and appropriately perform monitoring, both at firm-level and engagement-level. Resulting in the significant issues are not identified.</p>	<ul style="list-style-type: none"> <li>- The audit firms should review the job assignment policy to ensure that the monitoring function is assigned to the individual with knowledge, competency and experience in audit with ample time to identify the issues, if any.</li> <li>- The audit firm leader should emphasize the allocation of the time to monitoring function to enhance the effectiveness and efficiency of the monitoring.</li> </ul>

## B. Engagement level

In 2016, the SEC inspected 100 audit engagements of 65 registered auditors in the capital market, which comprised 39 auditors renewing the license and 26 new approval requests. The inspection results (as shown in figure 21) represent the registered auditors with the SEC in 2016 with 'no findings' accounting for 15 percent of the total registered auditors, higher than the percentage in 2014 and 2015, which only accounted for 4 and 6 percent respectively.

Moreover, the portion of registered auditors with 'need improvement findings' constantly declined. As the portion in 2016 accounted for 48 percent, while that in 2014 and 2015 accounted for 74 percent and 48 percent respectively. The above information reflects the continuous improvement of audit quality, which stems from the perseverance and the collaboration of the auditors and their audit firms for the development of audit quality.

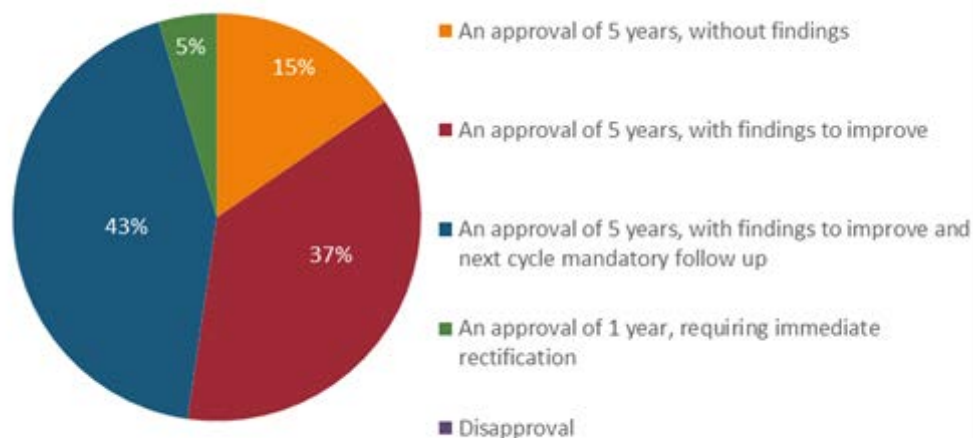


Figure 21: The inspection results of individual audit engagement, separated by the type of approval in 2016.

Compartmentalizing the findings in each phase of the audit, as shown in figure 22 shows that the findings identified in substantive test phase are responsible for 86 percent of the total findings. The most mentioned findings are the audit of revenue account, the audit of inventory and the cost of sales account.

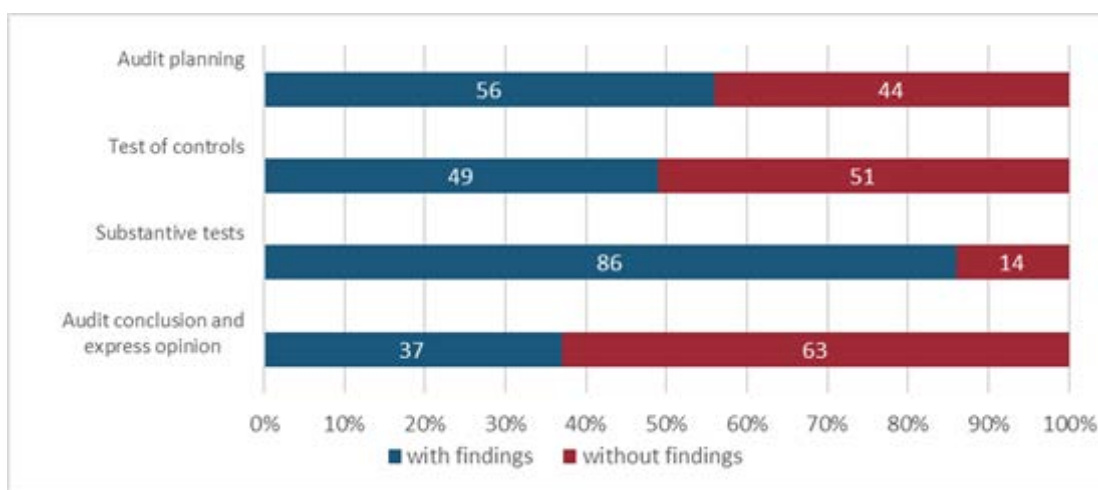


Figure 22: The portion of audit engagement with 'need improvement' findings, characterized by the phases of the audit for the inspection in 2016.



Figure 23: The portion of audit engagement with 'need improvement' findings, characterized by the types of deficiencies for the inspection in 2016.

Additionally, The inspection results as shown in figure 24 represents the frequently identified findings by the SEC, which are: the risk assessment of material misstatement due to fraud, the audit of inventory and the cost of sales account, the audit of revenue account and the tests of controls.

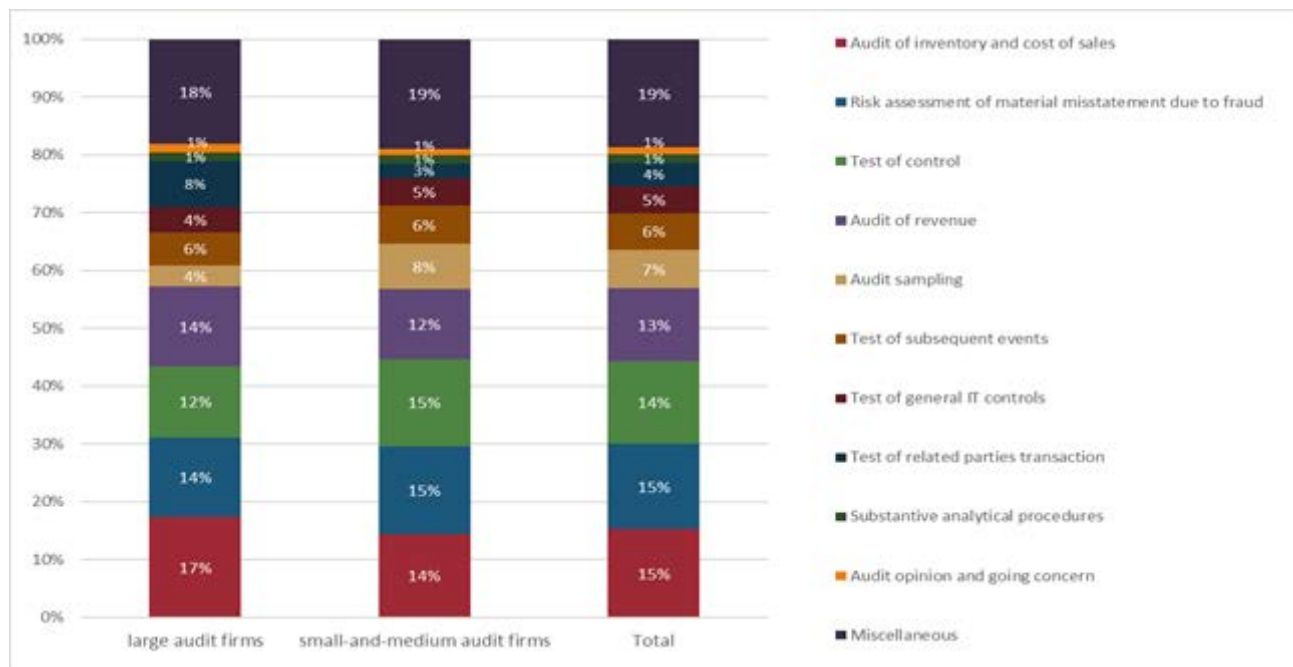


Figure 24: The portion of deficiencies found in 2016, characterized by the inspection of large audit firms and small-and- medium-sized audit firms.

From the inspection of the engagement of the registered auditors, the SEC found the significant findings as follows:

Identified findings	Recommendation
<p>1. The risk assessment of material misstatement due to fraud ("fraud risk") and the responses to such risks.</p> <ul style="list-style-type: none"> <li>- The auditor assessed that the revenue recognition is related with the fraud risk and identified the fraud risk at the assertion level. However, the auditor did not precisely relate those risk with 'what can go wrong' as to how the management may commit fraudulent financial reporting, and how the management may organize the schemes to conceal it. To exemplify, the auditor only narrated in the work papers that "the management attempt to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability."</li> <li>- The auditor did not consider, as required by ISA240, whether there are fraud risk factors associated with the account other than revenue.</li> <li>- The auditor did not sufficiently and appropriately response to the assessed risk of fraud. As the procedure for response is a general audit procedure used in the normal audit of revenue account.</li> </ul>	<p>For the auditor to properly design audit program to detect the material misstatement due to fraud, he or she should assess the various information obtained during risk assessment phase whether there are surrounding factors that would lead to motivation or pressure to commit fraud or the opportunities to do so. The auditor will be able to identify and evaluate which accounts or which assertions would be exposed to fraud and precisely document in work papers as to how the management would commit fraudulent financial reporting ('what can go wrong') and how the management may organize the schemes to conceal it.</p> <p>The professional skepticism is crucial to identify and evaluate fraud risks as well as to design procedures in response to those risks. The auditor should exercise his or her professional skepticism throughout the audit because the situation could always change. Furthermore, the auditor should assign the experienced personnel to be involved with the audit of significant issues, consider the necessity of electing the person with expertise within audit team, e.g., forensic experts or IT experts.</p>

Identified findings	Recommendation
<p>2. Tests of controls</p> <ul style="list-style-type: none"> <li>- The auditor obtained an understanding of controls that are relevant to the audit to evaluate the design and implementation of control only by inquiry of the entity's personnel.</li> <li>- The auditor did not obtain a sufficient understanding of some controls, which result in the inability to evaluate the design of controls and appropriately respond to the assessed risks, as well as the inability to consider the necessity to evaluate the effectiveness of controls.</li> <li>- The auditor chose source document to be used in tests of controls that are not related to the identified risk at assertion level, which might give the auditor a deviated conclusion about the effectiveness of internal control.</li> </ul>	<p>The understanding of entity's environment and internal control is the critical procedure which should specially be taken care of. Because the sufficient understanding will be beneficial to identification and risk assessment of material misstatement, both at financial statements and assertion level. Also, the auditor should obtain an understanding of audit objective and consider the use of proper source document to appropriately respond to the identified assertion.</p> <p>In order to obtain an understanding of controls that are relevant to the audit, the auditor should evaluate the design of the control and consider which are key controls and whether such controls are implemented accordingly. To accomplish the above, the auditor should perform the audit procedure other than inquiry of the entity's personnel, e.g., the observation or walkthrough of the controls.</p>
<p>3. Audit sampling</p> <ul style="list-style-type: none"> <li>- The auditor determined a sample size in tests of control in revenue cycle for each revenue type altogether, even though the control activities of each type of revenue may differ. The sample size for each revenue type, as a result, are not sufficient to conclude the effectiveness of internal control related to revenue cycle.</li> </ul>	<p>If the auditor determines the sufficient sample size and use appropriate sample selection methods, he or she will obtain the reasonable conclusion of the entire population. As such, the auditor should consider the audit objective when determine the sample selection method. When determine the sample size of tests of controls and tests of detail, the auditor</p>

Identified findings	Recommendation
<ul style="list-style-type: none"> <li>- When determining the sample size to perform substantive test, the auditor did not consider the factors that may impact the sample size of the test of detail for both transactions and balances. The sample size therefore may not be sufficient to provide appropriate conclusion.</li> <li>- When performing a test of detail for transactions and balances, the auditor selected only high value transactions to be tested and (1) neglected the remainder amount; which the amount in question are higher than overall materiality or (2) did not perform alternative procedures for the untested amount.</li> </ul>	<p>should thoroughly consider the factors that impact the sample size as required by ISA 530, e.g., risk of material misstatement, the amount of misstatement in the population would not exceed the tolerable misstatement, and the tolerable misstatement.</p> <p>The auditor should obtain an understanding of control environment related to the population to be tested. If there are multiple control environment within the population, the auditor should separately determine the sample size of tests of controls for each population with different control environment to help the auditor properly draw a conclusion of control effectiveness for each population.</p> <p>When performing tests of details of transactions and account balances, especially when the auditor decides to use specific selection method and the remainder population is material, the auditor should consider selecting the sample in the remainder to perform tests of details or consider using alternative procedures to obtain sufficient appropriate audit evidence to draw conclusions of the population.</p>

Identified findings	Recommendation
<p>4. The audit of construction revenue according to percentage of completion method.</p> <p>4.1 The audit of 'percentage of completion' assessed by the project engineer.</p> <ul style="list-style-type: none"> <li>- The auditor did not obtain sufficient understanding of the entity's internal control related to the assessment of percentage of completion which includes the method to assess the percentage of completion by the project engineer.</li> <li>- The auditor did not verify the reasonableness of the percentage of completion assessed by the project engineer before using the figures to calculate construction revenue.</li> </ul> <p>4.2 The audit of budget cost</p> <ul style="list-style-type: none"> <li>- The auditor did not obtain a sufficient understanding the entity's procedure to prepare and adjust budget cost, including the method and assumption to prepare the budget cost.</li> <li>- The auditor did not review the reliability and the reasonableness of the method and assumption the entity used to prepare/adjust the budget cost, the significant information to determine the percentage of completion.</li> </ul>	<p>The construction entities usually recognize revenue under percentage of completion method of which the accounting standard states that the entity may determine the stage of completion of a transaction by a variety of methods, using the method that measures reliably the service performed. Depending on the nature of the transaction, the methods may include: (1) The proportion that costs incurred to date ('actual cost') bear to the estimated total costs of the transaction ('budget cost') (2) Surveys of work performed or (3) The surveys of service performed to date as a percentage of total services. All of the above require the use of massive data and the assumption in estimation; therefore, when auditing the construction revenue, the auditors should obtain an understanding of the procedures and related internal control about the assessment of percentage of completion and assess the appropriateness of those procedures and controls. To exemplify, if the entity recognizes construction revenue by using the proportion of actual cost and budget cost, the auditor should obtain an understanding and assess the control related to the procedure to collect the actual cost data, along with the procedure to prepare and adjust budget cost. The understanding and assessment of the effectiveness of internal control will provide aid to properly identify risk and to respond to those risks. The response to risk of project engineer's</p>

Identified findings	Recommendation
	<p>estimation may include the review of reasonableness of percentage of completion by the engineer compared with the proportion of actual cost and budget cost. If the suspicion pertaining to the reasonableness of completion by the engineer arises, the auditor should consider obtaining more information from the engineer/ expert and/or the entity's management as well as obtain sufficient appropriate audit evidence to draw a conclusion. Additionally, in the event that the entity estimates a stage of completion by using engineer's or expert's judgment, the auditor should consider the necessity in hiring the auditor's expert to evaluate the reasonableness of a stage of completion used by the entity in recognizing the construction revenue.</p>
<p>5. The audit of inventory and cost of sales.</p> <ul style="list-style-type: none"> <li>- The entity sold the inventory with the gross profit, the auditor thus did not calculate the net realizable value ('NRV') for each of the inventory or each of the class of inventory to consider the necessity to adjust cost of inventory to the NRV. Notwithstanding that when assess the relevant information there might be indicators that the net proceeds from some of the inventory may be lower than its cost. To exemplify, the selling price for each house in different areas in the same project may have different selling price and cost. If the auditor assessed the NRV only by the analyze</li> </ul>	<p>The inventory and cost of sales usually are the material accounts for the manufacturing and trading entities. To ascertain that the inventory and cost of sales are represented in the financial statements with the correct amount, the auditor should obtain an understanding about inventory accounting policies, e.g., the policy of inventory valuation, the policy to set up provision for obsolete stock, and the methods the entity used to allocate variances (in case the use of standard costing). The auditor should also consider the reasonableness of those policies, to enable the auditor to properly design audit procedures.</p>

Identified findings	Recommendation
<p>of gross profit margin of every housing projects, it might not be able to provide appropriate conclusion that every house in every project carry net selling price higher than cost.</p> <ul style="list-style-type: none"> <li>- The auditor did not consider the appropriateness of the methods the entity used to allocate the variances to the inventory and cost of sales accounts when using standard cost; and whether they are in line with the costing method of the entity; e.g., first-in-first-out. In some cases, it is observed that the auditor did not test the allocation of the variances to the inventory and cost of sales accounts.</li> <li>- When performing the purchase cut-off test of raw material and inventory, both domestically and internationally, the auditor determined scope of cut-off test by identifying number of working days before and after period end (e.g., five working days) without any clarification as to how the selected period would cover the timing that affect the risk from recognition of purchase in the wrong period. Also, the international purchase and domestic purchase may take the different timings; and the international commercial terms ('incoterms') are not considered when performing purchase cut-off test.</li> </ul>	<p>Moreover, for the audit of provision for obsolete stock, the auditor should consider relevant information and assess whether the entity should set up the provision individually for each inventory or the stratification of the inventory would be more appropriate. The NRV calculation should reflect the net proceeds, if the entity reassesses the NRV in each subsequent period and found the circumstance that previously caused inventories to be written down below cost no longer exist, the auditor should consider the correctness and appropriateness of reversal of the write-down.</p> <p>As for the purchase cut-off test of raw material and inventory, the auditor should obtain an understanding about the timing that the entity would be exposed to the risk from recognition of purchase in the wrong period as well as the understanding of incoterms of the purchasing item that are being tested to enhance the effectiveness of purchase cut-off test.</p>

Identified findings	Recommendation
<p>6. The understanding of information technology system and the test of general IT controls pertaining to audit of financial statements</p> <ul style="list-style-type: none"> <li>- The auditor only inquired the entity's personnel when performing test of general IT controls effectiveness and did not perform any additional procedures, e.g., the observation of control or the selection of the control to be tested.</li> <li>- The auditor did not test general IT control and application control of the entity. Although the entity may deploy the complex IT system to support the numerous significant transactions, e.g., the investment or the insurance companies.</li> </ul>	<p>Nowadays the listed companies tend to execute their transactions in the fashion of more information technology involving. The transactions are numerous and the accounting record are supported by IT system, resulting in the companies' massive size of financial information database as well as the integration of critical accounting record in each application or system. The understanding of general IT control and application control are thus important, as the sufficient understanding of those controls will assist the auditor in appropriately identifying and assessing risk from material misstatements and effectively planning the audit.</p> <p>To obtain an understanding of the above controls, the auditor should perform additional procedure rather than mere inquiry of the entity's personnel. The sufficient complete information will be beneficial to assessing the risk of controls and to considering the necessity of the test of effectiveness both for general IT control and application control, especially the financial audit of entity with highly complexed IT and accounting system. Subsequently, manually-tested procedure alone may not provide sufficient audit evidence to the auditor. The auditor should thus assess the requirement to use the experts to obtain an understanding and test the effectiveness of general IT control and application control for those entities.</p>

Identified findings	Recommendation
<p>7. Group audit</p> <ul style="list-style-type: none"> <li>- The auditor identified the significant component within the group by considering only financial significance to the group and not the likelihood to include significant risks of material misstatement of the group due to its specific nature or circumstances.</li> <li>- When perform group audit, the auditor audited the significant components operated overseas which may have different nature, regulatory environment, and the language than those in Thailand. The auditor's team may lack expertise in each of those areas, e.g., the legal expert or tax expert. The auditor also did not consider hiring and using the work of expert when performing audit on financial statements of those components.</li> </ul>	<p>In group auditing, the group engagement partner should obtain an understanding of the group, its components and their environments, which include the industrial and regulatory environment, the political and economic environment. This will enable the auditor to appropriately assess the risk of material misstatement, identify the significant components, determine the scope and timing of work on the components.</p> <p>In case the group engagement partner decides to perform an audit on the financial statements of the components, the auditor should assess whether the team members possess the knowledge, competencies and expertise that are necessary to perform the audit. If not, the auditor should consider the necessity of hiring the experts to support in the audit, or assess the use of the work of management's expert in other area other than accounting or auditing to obtain the sufficient appropriate audit evidence as the basis for expressing an opinion in the group financial statements.</p>

Identified findings	Recommendation
<p>8. The use of work of a management's expert</p> <ul style="list-style-type: none"> <li>- In case the entity recognized the provision for employee benefit for the year 2015 according to the actuary report for three years period (2014-2016), the auditor did not review the assumption and model used by management's expert whether they are still reasonable and conforming with entity's current situation.</li> </ul>	<p>In preparing the financial statements of multiple listed companies, the management generally engaged the expert to calculate and estimate the valuation of complex transactions, e.g., the provision for employee benefit. The auditor should obtain an understanding of the work of that expert, e.g., the assumption or the model used by management's expert. The auditor should also assess the appropriateness of that expert's work for the auditor's purpose as audit evidence.</p> <p>In case the expert estimates the provision for employee benefit several years in advance, the auditor should review the reasonableness and appropriateness of the assumption used by the experts, e.g., the salary increase rate, the discount rate. As those assumptions are significant factors which may affect the valuation of the provision for employee benefit.</p>
<p>9. The audit of accounting estimates</p> <ul style="list-style-type: none"> <li>- The auditor did not sufficiently obtain an understanding and evaluate the reasonableness of the policies pertaining to accounting estimates, e.g., the allowance for doubtful account, the provision for stock obsolescence, and the provision for goods return.</li> </ul>	<p>The accounting estimates require the use of management's judgment. Each accounting estimates may have a different level of uncertainty. Thus, to obtain sufficient appropriate audit evidence to conclude that the accounting estimates, including fair value accounting estimates are reasonably recognized or disclosed, the auditor should obtain an understanding of the data related to the accounting estimates as well as the management's judgment, reference, and model.</p>

Identified findings	Recommendation
	<p>Moreover, the auditor should assess the reasonableness of accounting estimates and related disclosures in the financial statements which may include the challenge to the management regarding the estimates. Especially, the significant assumption should be reasonable. This is because if such the assumption is unreasonable, it will materially affect the valuation of accounting estimates.</p>
<p>10. The audit of going concern</p> <ul style="list-style-type: none"> <li>- The auditor did not evaluate the reasonableness of the management's assessment of the entity's ability to continue as a going concern as well as the feasibility of the management's business plans and the likelihood that the plans would improve the situation; the appropriate disclosure related to the material uncertainty about the entity's ability to continue as a going concern when there are events or conditions that may cast a significant doubt on the entity's ability to continue as a going concern.</li> <li>- The auditor requested a written confirmation from the third parties pertaining to the terms and conditions of financial support to the entity. However, the auditor did not evaluate the financial competency of those third parties to provide aid and financial support to the entity to continue as a going concern.</li> </ul>	<p>In general, the entity will prepare the financial statements based on the going concern assumption, the auditor should perform audit to obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and to conclude whether a material uncertainty exists related to the entity's ability to continue as a going concern. If the auditor identifies the events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, he or she should perform additional audit procedures which may include:</p> <ul style="list-style-type: none"> <li>- Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.</li> <li>- Where the entity has prepared a cash flow forecast for the evaluation of management's plans for future action, the auditor should evaluate the reliability of the underlying data</li> </ul>

Identified findings	Recommendation
	<p>generated to prepare the forecast and determine whether there is an adequate support for the assumptions, e.g., the prospective financial information for the current period with results achieved to date, the prospective financial information for recent prior periods with historical results. In addition, where management's assumptions include a continued support by third parties and such support is important to an entity's ability to continue as a going concern, the auditor may need to perform additional audit procedures to obtain audit evidence that those parties can provide financial support to the entity, aside from requesting written confirmation.</p>
<p>11. The audit of derecognition of liabilities</p> <ul style="list-style-type: none"> <li>- In case the entity derecognizes liabilities with no proper supporting evidence from the financial statements and recognize it as revenue, the auditors perform only reviewing approval of the board of directors meeting's consensus. The auditor did not consider the necessity to consult a legal expert regarding the appropriateness of the derecognition.</li> </ul>	<p>To obtain sufficient appropriate audit evidence to support the derecognition of liabilities with no proper supporting document from the financial statements, the auditor should design and implement sufficient appropriate procedures. When assessing the appropriateness of such derecognition, the auditor should consider the related legal issue to ensure that lawfully the entity has no other obligation to the liabilities and to evaluate the legal risk which may associate with the derecognition. The auditor will be able to use the above information to assess the necessity of additional audit procedures. If the auditor possesses no expertise in the law, he or she should consult a legal expert in such matters.</p>

## Root cause analysis

The audit inspection results in 2016 during the 3<sup>rd</sup> inspection cycle – the SEC began to supervise the quality control system of the audit firms in 2010 – showed that both the audit firms and the auditors had put in continuous efforts to improve and develop their quality control systems. By implementing prudent procedures for analyzing the root causes of the findings, the audit firms were able to identify such causes and subsequently lay out a rectification plan to tackle the deficiencies in an appropriate and timely manner.

However, there were recurring findings from the previous year that had not been properly rectified. After analyzing the environment and factors related to the audit firms, the SEC viewed that the following matters may have contributed to the failure of a certain number of audit firms and auditors to address their deficiencies effectively:

- **Involvement of auditors and EQCRs**

The overall review of the 2016 inspection indicated that most audit firms placed more emphasis on the involvement of auditors and the engagement quality control reviewers (EQCRs); however, the level of involvement was still relatively low at some audit firms, in which case it was more challenging for the auditors and the EQCRs to identify and communicate significant findings to the audit teams so that a timely rectification could be proceeded.

Over the years of audit inspection and observation, the SEC has found that the root cause of insufficient involvement of auditors and the EQCRs was usually inappropriate job allocation and assignment. This created a time constraint for the auditors and the EQCRs to properly get involved with the core elements of the audit.

Thus, it is advisable for the audit firms to consider revising their improvement action plan to include such measures as manpower reassessment before accepting new audit engagement, and a regular review of job allocation to prevent work overloads on certain partners or work divisions having limited resources.

- **Audit manual and audit procedures**

Although some audit firms had already revised their audit manual and audit procedures to be more in conformance with the Thai Financial Reporting Standards and the Thai Standards on Auditing, the implementation of such manual and procedures were inconsistent.

Part of the reason for such slow progress was that the audit firms may have failed to organize sufficient training sessions on the revised audit manual and procedures for the staff at all levels. Without sufficient knowledge and understanding, it was unlikely that the staff would be able to apply the audit manual or the audit procedures to the audit engagement as accurately and appropriately as it should have been.

To address this issue, the audit firms should adjust the rectification action plan. This could include revising the training courses and materials to be more suitable for the staff at each level and the situations at hand. For example, organizing additional training sessions when new Financial Reporting Standards or Standards on Auditing have been issued, or when the audit manual has been revised or numerous common deficiencies have been identified. Moreover, staff communication could help to stress the importance of ongoing professional development, especially upon revision to the audit manual or the audit procedures. This is to ensure that the audit staff will be able to perform their work adequately and properly in compliance with the auditing standards.

- **Monitoring process:**

A robust monitoring process will support the audit firms in developing the overall audit quality effectively. However, some audit firms have yet to improve their monitoring plan to be more suitable for the function. The issues of insufficient resource allocation to the monitoring tasks and the lack of clear and timely communication with concerned parties regarding the identified deficiencies have not been addressed properly.

Moreover, certain audit firms overlooked the benefits of root cause analysis on their deficiencies, the appropriate prioritization of the issues to be rectified, and the allocation of sufficient resources to handle the findings. A rectification plan, therefore, could not have been laid out and implemented efficiently and effectively. Not to mention insufficient staff communication to raise the awareness of the importance of performance quality.

The audit firms with such circumstances tend to experience recurring deficiencies and thus should consider revising their rectification plan to include assessment of each finding and prioritization of deficiencies to manage key risks in a proper and timely manner. In addition, a competent and knowledgeable person should be assigned to oversee the monitoring function and a reasonable timeframe should be allowed for the monitoring team to perform their work efficiently.

- **Audit profession manpower:**

In recent years, most audit firms have experienced shortage of audit profession manpower due to many factors, including younger generations' declining interest in the profession and the increasing turnover rates, especially at the managerial levels (i.e.,

senior officers and managers). Such situations have led to transfer of workloads to the existing staff whose work-life balance may have been compromised as a result of excessive responsibilities; this issue of work overload has been one of a major reason for audit staff resignation.

Furthermore, a certain number of small-and medium-sized audit firms have yet to materialize, clearly and adequately, strategies to empower their audit staff through competency improvement, and mid-to high-level executives through succession plans.

In the long run, such human resources shortcoming could weaken staff motivation and loyalty. This could also make it difficult for audit firms to find the right candidates for replacement or succession in a timely manner, which could in turn affect the overall audit quality.

To tackle this manpower issue, audit firms should lay out a comprehensive rectification plan that includes remuneration and career path improvement, staff competency building, clear-cut performance checklists for staff at each level, promoting corporate culture that values staff loyalty and commitment. Working environments and tools conducive to younger generations' lifestyles should also be taken into consideration.

Shortage of audit profession manpower is a serious issue and creating effective solutions requires long-term efforts and cooperation from stakeholders from all sectors. Over the years, the SEC has worked with related entities, e.g., the Federation of Accounting Professions to attract more recruits and strengthen audit staff competency for the benefit of ongoing developments of the audit professions.

## Framework and focuses in 2017

The SEC is progressively pressing on the goal to develop a balanced financial reporting ecosystem to ensure sustainable improvement of listed companies' financial reporting quality. In so doing, the SEC supports those involved in the preparation of financial reporting, e.g., chief executive officers, chief financial officers, accountants, directors, auditors and the audit committees, by facilitating efficient and effective performance of their respective duties.

In 2017, the SEC strategic framework will continue to focus on strengthening the competency of all parties, especially the primary preparers of financial reports from the beginning to finish. Concurrently, training and knowledge transfer will be carried out to enhance the efficiency of directors' and audit committees' oversight of listed companies. In addition, more regular training, knowledge sharing and effective communication with audit firms will be incorporated into the SEC's audit quality oversight. The framework for improving the capacities of key parties involved in the financial reporting preparation is summarized as follows:

### Framework for strengthening the preparer

1. Specify the qualifications of the CFOs and the accountants of the companies filing the application for approval of an initial public offering (IPO companies), in terms of educational background, work experience and professional development. These IPO company-related qualification rules will become effective in 2018. Moreover, the SEC will collaborate with the Stock Exchange of Thailand to further require the CFOs and the accountants of listed companies to develop their accounting knowledge on a continuous basis, while

the accountants in particular must be a lawful bookkeeper pursuant to the Accounting Law. The listed company-related qualification rules will become effective in 2019;

2. Issue guidelines for considering significant accounting issues of IPO companies, listed companies, auditors, and financial advisors to be consulted with the SEC during the IPOs pre-consultation procedure or when listed companies have queries about accounting issues. The SEC has provided a channel for IPO and listed companies to seek consultation on complex and complicated accounting issues since 2015. The guidelines may be applied for bookkeeping and preparation of financial reporting in accordance with the accounting standards;

3. Collaborate with relevant agencies in organizing training sessions regarding the accounting standards, especially those to be effective in the near future including the Thai Financial Reporting Standards 9 Financial Instruments to be effective in 2019. In addition, seminars on accounting issues found in the reviews of IPO companies' financial statements will be organized for the benefit of future IPO companies;

4. Coordinate with the Thai Listed Companies Association and the Financial Statements Preparers Club, which are the centers for sharing information and experiences and rendering mutual assistance on relevant matters, e.g., practical issues on, and solution guidelines for, bookkeeping for certain businesses. Such collective efforts will help to promote more efficient and effective duty performance of financial statements preparers;

## Framework for strengthening company directors and audit committees

Company directors and the audit committees play an important role in promoting and developing the sustainable growth of listed companies. The SEC therefore will launch the Corporate Governance Code (CG Code) in 2017 to provide guidelines for the board of directors to ensure that the listed company under its oversight operate with social and environmental responsibility, which would in turn create sustainable value to the company. The Code contains guidelines for establishing appropriate internal control and risk management system, preparing accurate financial reporting and disclosure, and promoting active participation and communication with shareholders. Additionally, the SEC will continue to organize training sessions for directors and the audit committees to raise their awareness of the significance of their roles and to support their duty performance to ensure effective oversight of listed companies.

## Framework for strengthening the auditor

1. The SEC closely oversees the work quality of individual auditors and their employing audit firms. In 2017, the inspection of quality control system will emphasize the monitoring activities, especially the root cause analysis of the findings. A proper root cause analysis procedure will enable audit firms to lay out an appropriate and timely rectification plan, and support

the building of stronger organizational capacities from within;

2. The SEC organizes training sessions for auditors on a regular basis. Topics include results and issues arising from implementing accounting standards, as well as the soon-to-be-effective accounting and auditing standards. In addition, the SEC plans to support small-and medium-sized audit firms in various areas to facilitate individual auditors of those firms to perform audit work efficiently and effectively. For example, open discussions are organized for small-and medium-sized audit firms to share information and opinions with the SEC to jointly analyze root causes of the findings from the audit quality control inspection, and to explore possible solutions and approaches that could address the problems more efficiently. Other training and seminars are held to prepare the audit industry to adjust to the ever fast evolving technological trends, which are likely to have an increasing impact on auditing work;

3. The SEC cooperates with relevant agencies in creating guidelines for auditors to perform their work more efficiently. For example, a synergy with the Federation of Accounting Professions is made to identify and conduct an in-depth analysis on key audit matters (KAM) in the auditor's report for the year 2016, the results of which may be used to improve the auditors' communication on KAM and allow users of financial statements to apply KAM to their decision making more appropriately;

4. The SEC cooperates with the AARG to reduce at least 25 percent of deficiencies found in the inspection of listed companies to promote audit quality in the regional capital markets. The AARG works with big audit firms in the region onto analyze the root causes of the recurring findings as well as implements several measures to monitor the progress in alleviating deficiencies from the findings on a continuing basis.

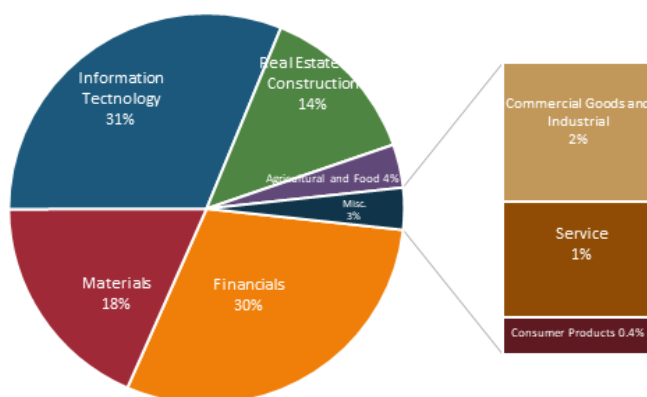
5. The SEC revises the procedure for granting faster approval to capital market auditors affiliated with audit firms which receive good or very good score from quality control system inspection (fast track approval); besides, the average score of the latest inspection and the score in Engagement Performance and Monitoring categories are also satisfactory or very satisfactory. This is to promote a sufficient increase in capital market auditors for listed companies and encourage audit firms to further improve their quality control system.

## Essential Statistics

### Approval of auditors in the capital market

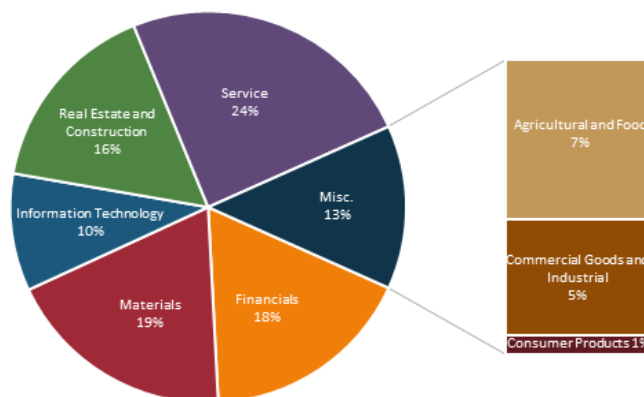
Year	Number of applicants	Number of approved auditors		Number of rejections
		New applications	Renewal	
2557	46	15	29	2
2558	34	21	11	2
2559	65	26	39	-

Proportion of the average total market capitalization of the inspected financial statements in 2016, categorized by industry



Remark: Market capitalization of the total listed companies on the Stock Exchange of Thailand as at 30 December 2016.

Proportion of the total market capitalization of the listed companies on the Stock Exchange of Thailand, categorized by industry



Remark: Market capitalization of the total listed companies on the Stock Exchange of Thailand as at 30 December 2016.

## Mandates to rectify listed companies' financial statements, categorized by type of issues

Unit: company

Issues	2014	2015	2016
Qualified opinion in the auditor's report due to management-imposed limitation or the financial statements not in accordance with Thai Financial Reporting Standards.	1	2	1
Disclaimer of opinion in the auditor's report due to management-imposed limitation.	2	2	2
Provision for liabilities	1	-	-
Property, plant and equipment (The transfer of revaluation surplus did not comply with accounting standards).	-	1	-

## Misconduct in 2016

Unit: person

Category	Demeanor	Measures	
		Enjoining	Warning
Auditors	Failure to comply with the requirement of professional standards.	1	-

## CONTACT INFORMATION

- This report can be downloaded from [www.sec.or.th](http://www.sec.or.th)
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