Securities and Exchange Commission

Independent Audit Inspection Activities Report

2013

THE ROAD LEADING TO GROWTH

Contact

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Executive summary

Thai capital market is one of the driving forces that help advancing Thai economy towards a stable and sustainable growth but to propel it forward requires considerable collaborative efforts from all stakeholders. As the integrity of financial information is the foundation of a strong capital market, accounting professions in Thailand, such as accountants and auditors, play a critical role in providing reliable financial reports to the stakeholders, and thus bolstering further confidence of both local and foreign investors in our capital market.

Due to the substantial effects of audit quality on the reliability of the available financial information, the SEC relies on its vigorous audit inspection system to provide regular oversights on the works of the auditors. After the effective date of the SEC Notification on the Approval of Auditors in the Capital Market on October 1, 2010, the SEC has continuously performed both firm-level inspections and engagement inspections of the auditors under its authority with major concerns and findings from these inspections regularly communicated to ensure timely rectifications of any deficiencies found. Through such efforts, the SEC is now widely recognized as a trustworthy and effective independent audit regulator for Thai capital market, as evidenced by an endorsement from the European Commission ("EC") given to the SEC in June 2013 to acknowledge the SEC's audit oversight system as being equivalent to that of the European Union ("EU") member states. This equivalence status has facilitated securities offering of Thai companies in the EU member states since Thai auditors are now exempted from registering with independent audit regulator of each EU member state. This reliable audit oversight has translated into better and more credible financial information. Similarly, the international recognition of such system has reduced overall costs of capital formation for Thai enterprises and increased competitive advantages of our auditors in both global and regional markets.

In 2013, the SEC has started its second-cycle audit inspection with a more robust inspection plan, in response to current audit environment and the deficiencies found during the first cycle. The results, thus far, have shown significant improvements on quality controls of audit firms with only few exceptions where the remedies of some deficiencies are unavoidably time-consuming due to the need to adjust the firms' audit manuals and staff trainings.

On the engagement-level inspections, the SEC has detected deficiencies in certain audit areas such as audits of revenue cycle and substantive analytical procedures. We have deduced that these shortcomings are caused by two major factors: the shortage of qualified audit personnel and the inability to react to changes of professional standards.

This shortage of human resources of audit firms has been an ongoing challenge, as a result of high turnover rates, coupling with low interests in this profession. With this concern in mind, the SEC and the Association of Chartered Certified Accountants (ACCA) conducted a survey on talent attraction and retention in Thai audit practices. Possible causes, identified from the survey responses from audit staff, were analyzed and shared with relevant organizations in a cooperative effort to formulate effective solutions. As an initiative to tackle this problem, the SEC has planned a study for possibly additional sources of high quality audit-career candidates but this issue will require much cooperation from other stakeholders for it to have a chance at succeeding.

As professional standards have constantly been amended and revised in an attempt to adapt to the ever-changing business environments and transactions that are becoming increasingly complex, it is crucial that accounting professionals, especially auditors, possess qualities that would allow them to promptly respond to these new developments. For example, competent auditors who are farsighted and passionate in their learning would be best equipped to adjust to any changes. Hence, to support the auditors on this front, the SEC has hosted various conferences and seminars for the auditors to update and clarify any concerns on the new developments of both accounting and auditing standards.

While the importance of the audit quality on the financial reporting process cannot be denied, the credibility of the financial information depends on responsibilities of other stakeholders as much as those of the auditors. Being well aware of this fact, the SEC has regularly communicated and emphasized this matter to the stakeholders through various kinds of activities. For example, the SEC hosted several seminars for audit committees on how to duly fulfill their duties in overseeing listed companies' financial reporting process, how to properly prepare for annual general meetings, and how to select high quality auditors. As for preparers of financial statements, this group of stakeholders will also be strengthened and supported through sessions of knowledge sharing on best practices of financial statement preparation.

1 Quality Assurance Review Panel ("QARP")


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1. Mr. Nontaphon Nimsomboon

Position:

- Expert Member, Securities and Exchange Commission
- Member of the Court of Directors, Bank of Thailand

Work experience:

- Auditor General
- President, Institute of Certified Accountants and Auditors of Thailand

Education:

- Ph.D. in Accountancy (Honorary), Thammasat University
- MBA, University of Iowa, USA (Government Scholarship Recipient)
- Bachelor of Accountancy, Thammasat University
- Bachelor of Commerce (Honors), Thammasat University

2. Prof. Hiran Radeesri

Position:

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

Work experience:

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

Education:

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

3. Prof. Viroj Lowhaphandu

Position:

- Advisor to Board of Directors, Central Plaza Hotel Public Company Limited
- Honorary Member, Department of Accounting, Faculty of Commerce and Accountancy, Thammasat University
- Audit Committee Chairman, Srithai Superware Public Company Limited

Work experience:

- Director General of Treasury Department
- Director General of Revenue Department
- Director General of Customs Department
- Director General of Excise Department

Education:

- MBA (Taxation), The American University Washington, D.C., U.S.A.
- Higher Diploma in Accountancy, Thammasat University
- Bachelor of Laws, Thammasat University
- Bachelor of Commerce, Thammasat University

4. Prof. Thavach Phusitphoykai

Position:

- Chairman-Board of Directors, Satien Stainless Steel Public Company Limited

Work experience:

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

Education:

- Ph.D. in Accountancy (Honorary), Thammasat University
- Executive Program in Business Administration, University of Columbia, New York, U.S.A.
- MBA, Thammasat University
- Bachelor of Accountancy, Thammasat University

5. Mr. Natasek Devahastin

Position:

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

Work experience:

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

Education:

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

6. Emeritus Prof. Supapan Ruttanaporn

Position:

- Emeritus Prof., Chulalongkorn University

Work experience:

- Government permanent teaching staff, Faculty of Commerce and Accountancy, Chulalongkorn University
- President, Thailand Accounting Association

Education:

- MBA (Accounting), Michigan State University, U.S.A.
- Bachelor of Accountancy (2nd class honors), Chulalongkorn University
- Certified Public Accountant (CPA Thailand)

7. Ms. Chongchitt Leekbhai

Position:

- Associate Director of Academic Service and Training Center, Faculty of Commerce and Accountancy, Chulalongkorn University

Work experience:

- Lecturer, Faculty of Commerce and Accountancy, Chulalongkorn University

Education:

- Master of Accountancy, Thammasat University
- Bachelor of Accountancy, Chulalongkorn University

8. Mr. Pakorn Penparkkul

Position:

- Academic Council Member of 2 state universities
- Visiting lecturer at state and private universities
- Audit Subcommittee, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King
- Advisor, Thai Accounting Firms Association
- Advisor, Tax auditor Association of Thailand

Work experience:

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

Education:

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

9. Mr. Samart Buranawatanachoke

Position:

- Chairman of the Board of Directors, the Thai Credit Retail Bank Public Company Limited
- Audit Committee Director, Energy Regulatory Commission

Work experience:

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

Education:

- Master of Management, Sasin Institute, Chulalongkorn University
- Advanced Management Program, Harvard Business School, U.S.A.
- Master of Accountancy, Chulalongkorn University
- Bachelor of Accountancy (Honors), Chulalongkorn University

10. Mrs. Pranee Phasipol

Position:

- Advisor, Federation of Accounting Professions of Thailand under the Royal Patronage of His Majesty the King
- Audit Committee Director, Dusit Thani Public Company Limited

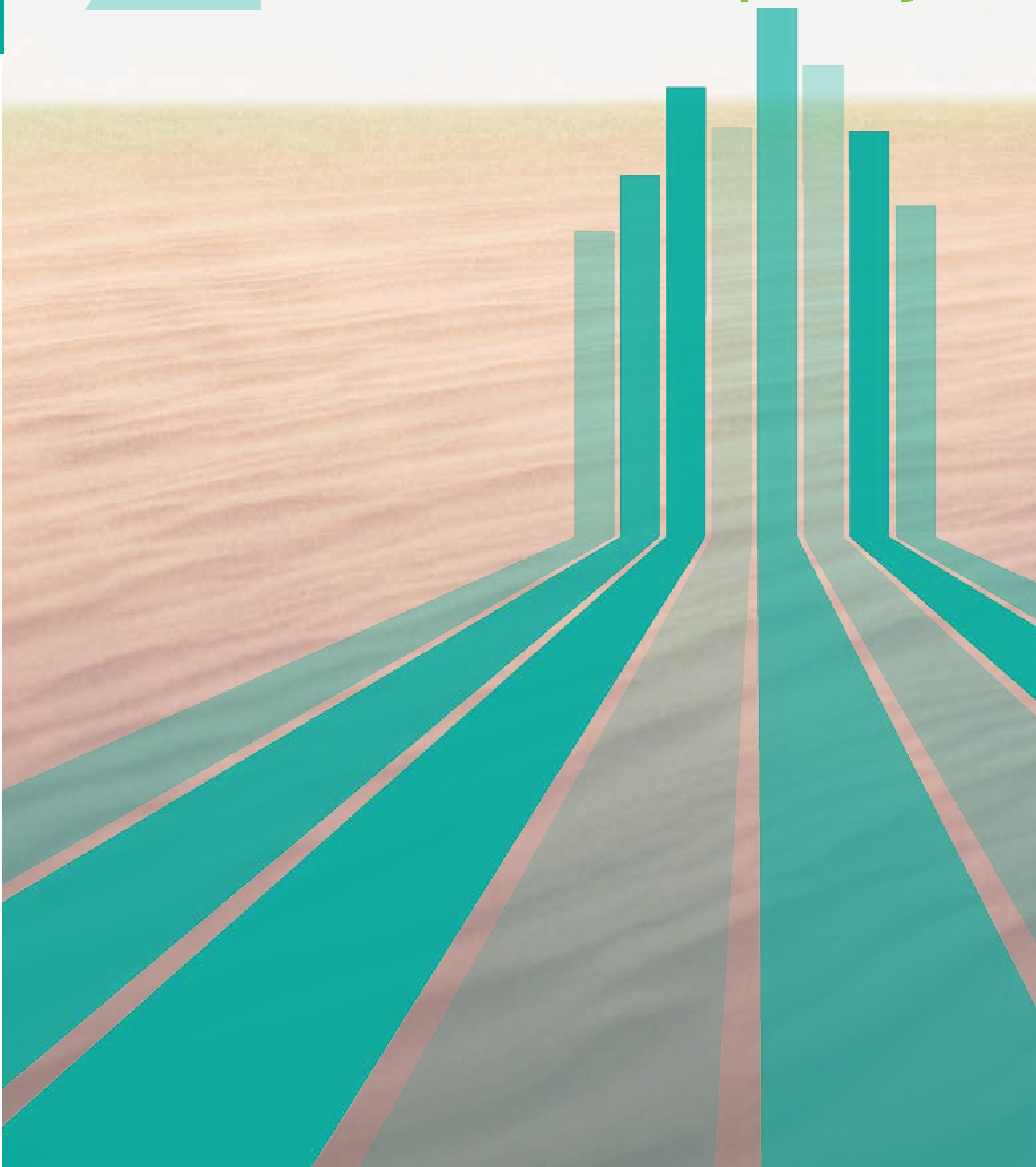
Work experience:

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

Education:

- Master of Science in Accounting, Thammasat University
- Bachelor of Business Administration, Major Accounting (2^{nd} class honors), Thammasat University

2 Activities for enhancing audit quality



Participation at the regional and global levels

In January 2013, the SEC participated in AARG Audit Inspection Workshop (AARG : ASEAN Audit Regulators Group) in Kuala Lumpur, Malaysia. The AARG was established by the collaboration from the Audit Oversight Board ("AOB") of Malaysia, Accounting and Corporate Regulatory Authority ("ACRA") of Singapore and the SEC, all of which are independent audit regulators in ASEAN region, to ensure and enhance the quality of audits and financial reports. The AARG was created to be a forum where knowledge and experiences obtained from audit inspections are shared through regularly held meetings and seminars. These efforts to promote comparable standards of high quality financial reporting within the region are expected to facilitate plans for the ASEAN capital market linkage and cross-border securities offerings. Moreover, the SEC, together with the Securities Commission of Malaysia and ACRA, has initiated the Financial Statement Surveillance Workshop to be a platform for sharing of knowledge and experience from conducting reviews of audited financial statements.

In February, June and October 2013, the SEC participated in three meetings of International Organization of Securities Commissions Committee 1 ("Committee 1") in Washington, D.C., Paris and Mauritius, respectively. Committee 1 is committed to promoting high quality professional standards, including rigorous application and enforcement, where members of Committee 1 seek to further its mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting.

In March 2013, the SEC participated in a seminar with International Forum of Independent Audit Regulator ("IFIAR") on topic of "IFIAR's 7th Inspection Workshop" in Zurich, Switzerland. Then, in April 2013, the SEC participated in IFIAR plenary meeting in Noordwijk, Netherlands. The SEC has regularly participated in IFIAR seminars and meetings since the start of the membership in 2010. The IFIAR is an international cooperation, focusing on sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity, promoting collaboration and consistency in regulatory activity, and providing a platform for dialogue with other international organizations that have an interest in audit quality.

In May 2013, the SEC participated in Singapore Symposium on the topic, "ASEAN Capital Market: The importance of a strong financial reporting environment", hosted by ACRA and other organizations, such as International Federation of Accountants and Global Public Policy Committee. During the Symposium, representatives from the Big-Four audit firms from Malaysia, Singapore and Thailand, shared their experiences and challenges on their audits while the audit regulator shared their expectations on the audit quality.

In August 2013, the SEC participated in Public Accountants Conference on the topic, "Financial Reporting Value Chain – A Collective Responsibility", organized by ACRA in Singapore.

SEC Initiatives to strengthen capital market professions and stakeholders

In January 2013, the SEC announced the results of the survey that was designed by IFIAR, revealing the global audit inspection findings, including those from the SEC which have served as a useful reference in identifying areas for improvements to advance the audit quality in Thailand to the global level.

In February 2013, the SEC hosted a seminar for audit committees on the topic, "Audit Committee: How to best prepare for the Annual General Meeting" to raise awareness on the roles and responsibilities of the audit committees in providing effective oversight over listed companies' financial reporting and audit process. During the seminar, the audit committees discovered selection methodologies for high quality auditors, illustrated with case studies where auditors encountering frauds while assisting the work of the audit committees

In March 2013, the SEC hosted the second CEO Forum "IFRS and Financial Reporting for Investors," to update participants from listed companies and other organizations on the future directions and changes of both the International Financial Reporting Standards (IFRS) and Thai accounting standards. The event featured Mr. Hans Hoogervorst, Chairman of the International Accounting Standards Board (IASB), as the keynote speaker, and other important guest speakers, including the representatives from Thai Accounting Standards Committee, an IFRS expert from the Association of Chartered Certified Accountants ("ACCA"), and the president of Securities Investors Association (Singapore). The presentations and discussions that followed imparted the significance of full IFRS adoption and related practical issues in applying the IFRS.

In April 2013, the SEC published an independent audit inspection activities report for the 1st cycle (1 October 2010 – 31 December 2012), providing insights into the SEC's audit oversight system in terms of its transparency and its compliance with the international standards. Hence, it demonstrated the reliability of our financial reports and the continued developments of the audit oversight system.

In May 2013, the SEC presented the results of the online survey on "Talent Attraction and Retention in Thai Audit Practices" to representatives from audit firms, universities and relative organizations. The survey was the collaboration between the SEC and ACCA to gather opinions of audit-firm personnel to identify retention factors and analyze any causes of resignation for future improvements. After the presentation of the survey results, several panel discussions were held for various key audit concerns, namely group audits, fair value measurements, and going concerns.

In December 2013, the SEC held a seminar on the topic, "Audit Deficiencies and the SEC's Expectations" to discuss prevalent deficiencies found during the audit inspections to audit firms and their auditors in order to enhance audit quality and avoid the repeat of these deficiencies.

Global acceptance

In June 2013, the European Commission ("EC") announced its decision to recognize Thailand audit oversight under the SEC's supervision as being equivalent to those of the European Union ("EU") member states. This equivalence status entails mutual reliance on the audit inspection systems between Thailand and the EU member states, as well as reaffirms both local and foreign stakeholders of our audit quality and the integrity of Thai companies' financial reporting. Specifically, it exempts Thai auditors from having to register with the EU audit regulators, thus facilitating foreign listings in the EU and reducing costs for Thai companies.

3 Summary of inspection results

A. Firm level

	Elements	Assigned weights (%)	
		1^{st} inspection cycle	2^{nd} inspection cycle
1	Leadership responsibilities	20	20
2	Ethical requirements	20	15
3	Client acceptance and continuance	15	15
4	Human resources	15	15
5	Engagement performance	15	20
6	Monitoring	15	15

During the 1^{st} audit quality inspection cycle (1 October 2010 – 31 December 2012), deficiencies were found in most audit firms, especially in the element of the engagement performance. This was partially due to the then-newly adopted auditing standards, for which the firms' audit manuals, audit programs, and staff training had still been under adjustments.

Consequently, in the 2^{nd} audit quality inspection cycle (1 January 2013 – 31 December 2015), the SEC has implemented a more intense inspection program and has given greater weight to the engagement performance element from 15% during the first cycle to 20% in the second cycle. Ultimately, the SEC expects that the audit firms consider and carefully analyze the findings to determine root causes of the deficiencies and employ measures that would contribute to higher audit quality. As the element of leadership responsibilities is as essential to the overall audit quality as it had been during the first cycle, the weight given to this element has remained unchanged at 20%.

In 2013, the SEC performed the firm-level reviews for the total of 8 audit firms, as planned, and observed significant improvements in most aspects, especially in client acceptance and continuance. However, the deficiencies in the engagement performance continue to persist in a number of the audit firms.

1. Leadership responsibilities for quality within audit firms

Leaders of an audit firm are in a crucial position to set the tone at the top as they could set an example to the rest of the firm. By reinforcing the importance of audit quality and its underlying factors such as the firm's quality control procedures, the firm leaders would influence their staff to concentrate on similar key aspects to ensure further improvements of the firm's overall audit quality. From our reviews of the firms' quality control processes, the inconsistencies of the execution of the quality control procedures and deficiencies found on engagement performance reflect a range of opportunities for the firm leaders to use their leadership skills to positively change the quality control environment, and thus eventually improving the overall audit quality of the firms. Considering how essential audited financial statements are to users, especially those of listed companies, it is evident that the quality of the engagement performance requires special attention from the leaders of the audit firms. In particular, root causes of any shortcomings found on the audit quality should be properly identified and corresponding plans for adjustments should also be implemented in a timely manner. The SEC has observed the following examples of factors affecting the quality of engagement performance of the listed companies:

- Improvements needed on the firm leaders to create consultation culture and working environments that would properly encourage and facilitate audit staff in seeking technical consultations whenever necessary;
- Insufficient involvement of engagement partners and EQCRs in the engagement performance, such that their level of involvement does not correlate with level of audit risks, and thus resulting in the low audit quality; and
- High ratio of listed audit clients to audit personnel, leading to incomplete audit works, inadequate supervision, non-compliance with the firms' policies and procedures, and eventually failures in detecting misstatements of financial statements.

Moreover, as high-risk engagements require equally competent audit staff to deliver the audit works with sufficiently high quality, it depends on the heads of an audit firm to ensure that the pool of engagements is delegated accordingly. Also, in an effort to cope with the size and complexity of today's offered services, the audit firms usually belong to a group of firms or a large network firm, which could lead to situations where the auditors' independence could have been impaired had the firm leaders not been cognizant of this issue. The SEC has noted instances of both kinds, particularly where the competency of the audit teams did not correspond with the risk levels of the engagements and where the audit firms were ineffective in monitoring their staff's compliance with the ethical requirements.

2. Ethical requirements

To ensure compliance with the independence and ethical requirements, the majority of the audit firms have policies and procedures that are complying with the Thai Standard on Quality Control 1 ("TSQC 1") in place. During the first cycle, we have noted that some audit firms and their group of network firms tend to have a complex holding structure that could put their independence at risk while other firms have utilized outsourced audit staff without any established procedures to ascertain their compliance with the ethical codes. Due to these observations, the second-cycle inspection was specifically planned to address such issues.

Areas where improvements are warranted are highlighted below:

- Inadequate independence compliance testing for non-audit services providing to audit clients
- Incomplete independence compliance testing for non-audit services provided by other firms within the same network or belonging to the same group
- Insufficient compliance testing to ensure both independence and confidentiality where the audit staff providing assurance services in their own capacity

3. Client acceptance and continuance

In the second cycle, there have been significant improvements on audit firms' compliance with TSQC1 on client acceptance and continuance procedures. Few exceptions are noted as follows:

- Inappropriate client acceptance assessments which resulted in the audit firms accepting engagements with risks that went beyond an acceptable levels;
- Lack of documentation on the background search of potential clients' management, especially in terms of their trustworthiness;
- Insufficient documentation of detailed responses to the engagement risk assessments before accepting new clients; and
- Issuance of engagement acceptance letters before the engagements were authorized and before the independence requirements were satisfied by obtaining appropriate documents from the network firms and their staff.

4. Human resources

Considering the importance of high quality personnel on audit quality, it becomes necessary for audit firms to maintain a robust system, ensuring that their staff at least meets the required levels of both competency and ethical standards. Focusing on the firms' ability to fulfil the training needs of their staff and performance evaluations in our second-cycle inspections, we have encountered the following instances:

- Improper human resource allocation
- Ineffective monitoring mechanisms for staff attendance of the necessary training sessions
- No policies implemented for the quality control of outsourced audit staff such as the lack of performance evaluation and of the linkage between performance and compensations of this type of staff
- Weak linkage between staff performance evaluation and audit quality indicators

5. Engagement performance

In the SEC's firm-level reviews of audit firm's compliance with relevant accounting and auditing standards as well as with the firm's policies and procedures, we noted several inconsistencies, mainly in the areas of the adequacy of audit manuals and audit programs, levels of details of performed audit procedures, and documentation of audit works, all of which were a result of ineffective quality control system implemented by audit firms. Specific instances include the followings:

- Low level of involvement in audits by engagement partners and EQCRs
- Incomplete audit manuals and audit programs as required by the new auditing standards.
- Incompetent EQCRs in the aspects of technical competency and level of relevant experiences
- Certain deficiencies in engagement performance with respect to the auditing standards, e.g., substantive tests of revenue accounts, audits of high fraud risk areas, group audits, procedures addressing going concern issues, and professional skepticism
- Inadequate documentation of audit works
- Insufficient supervision in certain high-risk areas
- Incomplete audit workpapers

6. Monitoring

All audit firms have implemented the relevant policies and procedures of monitoring element with some firms being more effective than others. The areas where improvements would be valuable include the following instances:

- Insufficiently detailed, and sometimes incomplete, monitoring programs in the level that would facilitate effective follow-ups
- Unclear timelines for conducting the monitoring reviews to ensure that any remaining issues are resolved properly and in a timely manner

B. Engagement level

For the second audit inspection cycle in year 2013, engagements signed by twenty eight auditors were inspected as part of the SEC's individual auditor approval process. Out of these twenty eight auditors, nine of them newly applied to be the registered auditors while the remaining were in the process of renewing their SEC-registered status. All of the newly applied auditors, except one, received the SEC's approval. It should also be noted that out of the twenty eight auditors being inspected, twenty of them were approved with conditions, requiring both remedial actions and a mandatory follow-up. Deficiencies were mostly found in the following areas: audits of revenues, substantive analytical procedures, tests of controls, audits related to fraud risks, audits of accounting estimates, group audits, audits of inventories, reviews of audit work, audit evidence, audits of related party transactions, using the work of a management's expert, audits of going concern assumption and professional skepticism. Examples of the audit deficiencies in each area are discussed below.

Audits of revenues

Given the significance of revenues to users of financial information and high fraud risks associated with these accounts, it is expected that the planning and execution of the audits be thorough and careful. However, several instances found during our inspections seemed to suggest otherwise, especially regarding the insufficiency of audit evidence to support its conclusions, inappropriate procedures for testing revenue recognition, and improper sales cut-off. The common errors made by the auditors are discussed below.

Construction and property development

- An auditor failed to detect that an expense should have been recognized from the expected excess of total contract costs over total contract revenue because such comparison was not carried out.

- Audit procedures were not performed to assess the reasonableness and reliability of the stage of completion used as a basis to recognize contract revenues and the associated costs.
- Underlying causes for the differences in the percentage of completion used for accounting and construction purposes were not identified.
- An auditor failed to consider whether construction contracts should be treated as combined contracts or separately as required by the Thai Accounting Standard No. 11.

Finance lease

- Substantive tests of revenues for finance lease contracts were insufficient. Relying on the client's internal controls, the auditor performed substantive tests of revenues by merely cross checking the amounts of revenues recognized against those generated from the computerized system for the samples selected for both the test of controls and the substantive test when nothing in the audit program suggested that the sample would be chosen for such dual-purpose tests.
- Accuracy of interest incomes recognized was not tested to ensure whether clients actually ceased to recognize interest income after the three consecutive periods of non-payments as per their stated accounting policy.

Common findings

- No procedures were performed before concluding that the revenue recognition was free from material misstatements from fraudulent transactions.
- Audit procedures were not responsive to the assessed risks of material misstatements. For example, results from risk assessment procedures had identified the revenues account as being associated with high risk of material misstatements and fraud risks but the procedures performed were limited to tests of controls, substantive analytical procedures, and sales cut-off.
- The lack of professional skepticism was evident in some cases involving unusual sales transactions with fraud potential that should have warranted the auditors' special attention had they been sufficiently skeptic to spot the strangeness of these items.
- Auditors failed to understand their clients' businesses, and thus not realizing that the revenue recognition methods used by their clients were inappropriate. For instance, an audit client earned its revenues by acting as an agent for another entity but the gross sales amounts were incorrectly used for revenue recognition instead of the net amounts.

- Tests of details of sales transactions were not adequately documented to reflect the audit trail that would ensure that such procedures had actually been performed.

- Inappropriate timing and documents were used to test sales cut-offs, rendering this procedure ineffective, and sometimes inefficient. Specifically, the SEC noted the use of short cut-off period for the business with long lead time, and vice versa. Also, there were instances where Incoterms were not identified before selecting the documents to test sales cut-off, resulting in the auditors vouching to the wrong documents.

Substantive analytical procedures

Substantive analytical procedures, if used appropriately, could be an efficient means for auditors to obtain relevant audit evidence and to ensure that an overall conclusion are consistent with the auditor's understanding of his/her client. The planning and performing of these procedures, whether alone or in combination with tests of details, should be in accordance with the requirements of the relevant Thai Standards on Auditing (TSA 520), yet our findings suggest that the auditors' use of these procedures could be improved in following aspects.

- To use the substantive analytical procedures, it is crucial for the auditors to suitably develop an expectation of the recorded amounts, sufficiently evaluate the reliability of data from which the expectation is developed, and determine an acceptable difference of the recorded amounts from the expected values that would not call for further investigation. However, in several cases, the auditors either did not assess the reliability of such data or simply performed the tests without determining any expected values and/or the acceptable discrepancies.

- Often, the methods chosen will be more effective if applied to a certain level of data aggregation than others. Therefore, the level of aggregation used should be carefully thought out to enable the auditors to reap the most benefits from these procedures.

- During the design of the substantive analytical procedures, auditors need to consider the assessed risks of material misstatement, together with the results of the associated tests of controls, before they can properly determine whether these procedures could be utilized alone or in combination with tests of details. On the contrary, the SEC noted certain occurrences where the uses of the substantive analytical procedures were not designed accordingly.

Tests of controls

As prescribed in TSA 330 The Auditor's Responses to Assessed Risks, if the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures or if the substantive procedures alone are not sufficient, then the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of those relevant controls. However, the inspections revealed aspects for which improvements are needed, including: insufficient tests of controls and documentation; revisions of the nature, timing or extent of further audit procedures not being responsive to the deficiencies found, and improper design and execution of dual-purpose tests. Important findings include the followings.

Sufficiency and appropriateness of audit evidence

- Incomplete documentation of the audit procedures performed and audit evidence obtained
    - General observations:
        - Before performing the tests of controls, the auditor must obtain an understanding of controls relevant to the audit, including evaluating the design of those controls and considering whether the controls are effective in preventing or detecting and correcting material misstatements, as well as determining whether they are properly implemented. Although the form and extent of documentation for this audit procedure are influenced by several factors such as the nature, size, and complexity of the entity's operations and its internal controls, instances were found where the documentations were obviously insufficient, e.g., no documentation of key control activities and important personnel and documents involved. With the deficiencies found, the SEC questions whether the auditors had adequately obtained the understanding of their clients' internal controls before designing and performing the tests of controls, and thus possibly making these tests of controls useless.
        - When performing the tests of controls, the auditors were found to be lacking in their documentation of several key pieces of information, including: no records of the sources of documents and information used; no evidence of the auditors' verification for the accuracy and completeness of the data obtained; the lack of basis for determining a sample size that would be sufficient to reduce sampling risk to an acceptable level; no stratification before sampling for a population with various characteristics; and no verification of accounting records for the selected items.

- Specific observations for the revenue cycle:
  - No testing of significant key controls for sale prices such as price approvals, tests of price lists used, and approvals of sale transactions;
  - No examination of appropriate cut-off documents, i.e., documents that demonstrate the transfers of risks and rewards from sellers to buyers, when testing the accuracy and timing of revenue recognition;
  - No separate tests of controls performed for different types of sale transactions with possibly different patterns of revenue recognition and control points; and
  - No revisions of further audit procedures after the auditor discovered that sales revenue and inventory stock cards were recorded with different transaction dates.
- Specific observations for the purchase and disbursement cycle:
  - Generally, inquiry alone is not sufficient to test the operating effectiveness of controls. Yet, the SEC encountered an instance where the auditor merely made an inquiry to the client's accounting manager even after observing the lack of audit trail in this operating cycle.
  - An auditor's risk assessment had identified labor costs account as having high risks of material misstatement for the objective of completeness but the planned and performed audit procedures for both tests of controls and substantive tests of this account were not responsive to the assessed risks.
- Specific observations for the inventory and warehousing cycle:
  - From the lack of documentation, it was believed that an auditor did not obtain the necessary understanding of a company's internal controls related to the inventory and warehousing cycle, especially when it was rather complex with its manufacturing processes locating in several provinces. Also, tests of controls were not performed on the inventory movements among the factories in different locations.
- Specific observations for the information system:
  - Due to the lack of evidence, it became questionable whether the auditors had sufficiently obtained an understanding of the client's operations and IT systems and appropriately tested the relevant controls in their process of identifying and assessing the risks of material misstatement in the financial statements.

Adaptation of audit procedures due to deviations detected

- After detecting deviations from controls upon which the auditors intend to rely, the auditors did not appear to consider whether the performed tests of controls provide an appropriate basis for reliance on these controls and whether it is necessary to perform any additional tests of controls.

Design of dual purpose tests

- An auditor may concurrently perform both tests of controls and test of details using same transactions. However, as these two types of audit procedures have different purposes, the auditor must design and evaluate each purpose of the tests separately. Auditors were sometimes utilized the dual purpose tests without an appropriate design and the separate evaluations for each purpose of the test, potentially impairing the effectiveness of these tests.

Findings from specific industries

- In audits of leasing businesses, the auditor occasionally performed tests of controls on credit approvals to end customers without examining appropriate supporting documents such as a copy of identification card, corporate registration, leasing contract, delivery note, and payment documents.

- The auditors of a leasing company did not perform the tests of controls on credit approvals to car dealers when they had planned to rely on such controls.

Audits related to fraud risks

Although both those charged with governance of an entity and management are primarily responsible for the prevention and detection of fraud, an auditor is responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. Yet, our audit inspections have uncovered the following deficiencies:

Assessing the risks of material misstatement due to fraud

- In some engagements, the auditors did not obtain sufficient appropriate audit evidence to demonstrate that they had performed necessary audit procedures so as to identify and assess the risks of material misstatement due to fraud, while in others, they might have identified and assessed such risks but then failed to performed further audit procedures whose nature, timing, and extent are responsive to those assessed risks.

- According to TSA 240 The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements, risks relating management override of controls are risks of material misstatement due to fraud and thus a significant risk. Nevertheless, the SEC has encountered instances where the risks of management overriding controls were not identified as a significant risk and therefore, certain required audit procedures, such as testing of journal entries, reviewing of accounting estimates for biases, and evaluating of significant transactions that are outside the normal course of business for the entity, were not performed to ensure that they were responsive to the risks of management overriding controls.

Testing of journal entries and other adjustments

- Before identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the related documents, it is necessary for the auditor to consider matters such as obtaining proper understanding of the financial reporting process and its controls, testing the operating effectiveness of these controls, and examining the completeness of the journal entries chosen for testing before sample selection. However, the audit evidence of such procedures was not found in some audit engagements selected for our inspections.

- In an audit procedure of reviewing general journal entries, there were cases where the auditor did not focus on identifying inappropriate or unauthorized journal entries and other adjustments that possibly resulted from fraudulent activities or management override of controls.

Testing of significant but unusual transactions

- In one audit engagement, a parent company billed its subsidiary for consultant services provided but requested that the whole amount be remitted to another related company. In spite of how unusual this transaction seemed, the auditor still failed to evaluate the reasonableness of this transaction in terms of the services performed, the amount involved, and the fact that the recipient of fees paid was not the entity performing the services.

- The auditor failed to evaluate the business rationale of monthly payment transactions for which the company engaged an individual to bring in customers but this individual had yet to introduce any customers to the company. The auditor merely examined the contract and supporting documents without questioning why the payments were made for unperformed services.

Audits of accounting estimates

As prescribed in TSA 540 Auditing Accounting Estimates, including Fair Value Accounting Estimates, and Related Disclosures, auditors ought to obtain sufficient appropriate audit evidence regarding whether accounting estimates, including fair value accounting estimates, recognized or disclosed, are reasonable and whether related disclosures in the financial statements are adequate. The inspections uncovered the following deficiencies on the tests of accounting estimates:

- The auditor did not evaluate the reasonableness of the assumptions and the methods used for making significant accounting estimates such as allowance for doubtful accounts, provisions for impairments, and fair value estimation related to measurement of goodwill.
- The auditor did not test the accuracy and appropriateness of the data on which the fair value measurements were based.
- The auditor did not review the judgments and decisions made by managements in the making of accounting estimates to identify whether there were indicators of possible management bias, which could have affected the auditor's conclusion as to whether the auditor's risk assessment and related responses remain appropriate.

Group audits

As global economy evolves and expands, companies are compelled to increase their investments both locally and internationally. These trends have created situations where the auditor of the group financial statements ("group engagement partner") might not be the auditor of the subsidiaries or the associates ("component auditor"), requiring the group engagement partner to ensure the competence and capabilities of those performing the group audit engagement, including the component auditors, to clearly communicate with component auditors about the scope and timing of their work and findings, and to obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process in such a way that would not be necessary had there be no component auditors. The following findings identify areas where performance of the group audits could be improved.

Materiality for the group financial statements

- Materiality for the group financial statements as a whole was not communicated to the component auditors to be incorporated into the audit planning of the component financial statements.
- The group engagement partners did not consider whether the aggregate of uncorrected misstatements of the components exceeded the materiality for the group financial statements as a whole when forming the group audit opinion.

Sufficiency and appropriateness of audit evidence obtained

The SEC has encountered instances where the audit evidence for the group audit was inadequate as the group engagement team merely requested the component auditors to respond to the audit questionnaires and to communicate whether they complied with the ethical requirements relevant to the group audit without evaluating whether the work of the component auditors was sufficient for the group engagement partner to draw reasonable conclusions on which to base the auditor's opinion. Specific examples of insufficient audit evidence for the group audits include:

- Failing to communicate necessary audit procedures that should be performed by the component auditors;
- Neglecting to obtain an understanding of the audit risk assessment and the audit planning of the components; and
- Disregarding the necessary reviews of audit working papers of the significant components.

Audits of inventories

Considering the significance of inventories to the financial statements, especially for those of merchandising and manufacturing companies, this account normally remains the key focus of the SEC's audit inspections, from which the following deficiencies were noted:

Inadequate and inappropriate audit sampling

- Inappropriate population from which the sample was drawn;
- No documentation of the sampling methods;
- Failures to use a sample size that was sufficient to reduce sampling risk to an acceptably low level;

Assessment of management's estimates and assumptions

- Failures to assess the appropriateness of the change of the accounting policy for inventory, of the assumptions used to estimate the provisions for slow-moving inventories, and of the return policies used to estimate the liability associated with future returns;

Inadequacy of the audit procedures

- Inappropriate test of the net realizable value ("NRV") of inventories such as the use of outdated price lists and the incorrect comparison of inventory costs against its corresponding selling prices;
- Insufficient and/or inappropriate physical observation of the inventory counts, which included lack of audit planning for this procedure, improper audit scope and audit

sampling, failure to test inventory cut-offs, insufficient audit evidence to ensure existence and accuracy of the inventories for which the auditor was unable to perform the physical count, inadequate work to test the reconciliation of the differences identified during the physical count; no roll-forward procedures performed when the physical count date did not coincide with the date of the financial statements, and the no comparison of the quantities in the inventory stock cards against those in the accounting records for the sampled items;

- Failure to test unit costs of the inventories included in the ending balance; and
- Inadequate tests for the obsolete or slow-moving inventories.

Reviews of audit work

Engagement teams are usually consisted of team members with varying degree of experiences such that supervision and reviews by an engagement partner and EQCR are both necessary and required to ensure compliance with professional standards and applicable legal requirements and the appropriateness of the audit report. However, from the engagements inspected, the SEC noted the following deficiencies:

- In several engagements, the engagement partners and EQCRs signed off their reviews without noticing the discrepancies between the documented audit evidence of various misstatements and the conclusions reached by the team members that the corresponding account balances were fairly stated without performing any additional procedures or revising the current ones.
- In other cases, the auditors issued audit reports prior to obtaining sufficient appropriate evidence to support the conclusions reached. For instance, without receiving the bank confirmations and with no other procedures performed, the auditors opined that the financial statements presented fairly, in all material respects, in accordance with the generally accepted accounting standards.

Audit evidence

Given that auditors ought to form their opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained, it is crucial that the planning, performing, documenting and reviewing of the audit work be carried out in such a way that would ensure the attainment of the sufficient appropriate audit evidence. Instances where the sufficiency and appropriateness of the audit evidence were in doubt are discussed below.

Audit evidence for the audits of accounts receivable

- The auditor readily used the confirmations received via e-mails or facsimile as the audit evidence to support the existence and accuracy of the accounts receivable without performing any additional procedures.

- When evaluating the adequacy of the allowance for uncollectible accounts, the auditor failed to verify the accuracy of the client's aging reports before using them and did not test for cash receipts in subsequent periods to ensure that the accounts receivable was stated at the realizable value.

Audit evidence for the audits of fixed assets

- Fixed assets are normally audited differently from other types of assets due to factors such as the fewer current-period acquisitions, the significant amount associated with those acquisitions, and their long-term uses. Given these differences, the emphases in auditing the fixed assets usually rest upon the verifications of the current-period additions and the depreciation accounts. Findings from our inspections indicated circumstances where the auditors failed to verify the existence and accuracy of significant additions and where they failed to examine the appropriateness of the allocation basis from depreciation expenses to product costs.

Audit evidence for the audits of cash and cash equivalents

- For every audit, the direct receipt of confirmation from every bank or other financial institution with which the client does business is necessary and if the bank does not respond to the first confirmation request, the auditor must send a second request. Additionally, the importance of bank confirmations in the audit extends beyond the verification of the cash balance as they are used to confirm both loan information and bank balances on the same form. Our inspections revealed that in some engagements, the auditor disregarded the inactive bank accounts and did not send any confirmation requests to the banks, failing to ensure the completeness of liabilities and other outstanding obligations through the use of bank confirmations. In other engagements, the auditor did not send the second confirmation request after the first one failed to elicit the bank's response and did not perform any alternative audit procedures, yet it was concluded that the balance of cash and cash equivalents was fairly stated.

Audit evidence for the audits of opening balances

- In accordance with TSA 510 Initial Audit Engagements-Opening Balances, the auditor must obtain sufficient appropriate audit evidence about whether opening balances contain any material misstatements and whether appropriate accounting policies reflected in the opening balances have been consistently applied in the current-period financial statements or any changes are properly accounted for. Nonetheless, the SEC's inspections encountered cases where necessary audit procedures were disregarded and thus, the auditor failed to obtain the sufficient appropriate audit evidence upon which the conclusions about the accuracy of the opening balances were based. These critical, yet unperformed, procedures include reviewing the predecessor auditor's working papers, evaluating the prior-period risk assessment of material misstatements, and assessing the appropriateness of the nature, timing, and extent of the audit procedures performed by the previous auditor.

Audits of related party transactions

While related party transactions could be normal business transactions, they do affect the auditor's assessment of risks of material misstatement because related party relationships present a greater opportunity for collusion, concealment or manipulation by management and inherently, management is under constant pressure to improve, or at least maintain, its financial results. Considering the risks involved and the potential for undisclosed related party relationships and transactions, it is especially important for the auditor to plan and perform the audit with professional skepticism. The SEC, however, has observed the opposite for circumstances with insufficient audit evidence. For example, the auditor had merely inquired of management with no other audit procedures performed before concluding that the related party transactions were properly accounted for and were in the normal course of business with regular terms and conditions.

Using the work of a management's expert

As the auditor designs and performs audit procedures for the purpose of obtaining sufficient appropriate audit evidence, the auditor must consider the relevance and reliability of the information to be used as the audit evidence. In the circumstances where such information has been prepared using the work of a management's expert in fields such as actuarial calculations, valuations, or engineering data, the auditor then ought to evaluate the competence, capabilities and objectivity of that expert, obtain an understanding of the work of that expert, and evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. Observed circumstances where audit evidence might be insufficient or in accordance with the above requirements include the followings:

- No audit procedures performed to evaluate whether assumptions used by actuaries in their estimates of loss reserves were in compliance with the regulations of the Office of Insurance Commission; and
- Lacking of audit evidence on the evaluation of the actuaries' competence and of the appropriateness of factors used in the calculation of employee benefits.

Audits of going concern assumption

Financial statements are generally prepared on a going concern basis unless management either intends to liquidate the entity or incapable of continuing its operations. When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and settle its liabilities in the normal course of business. While the management is in charge of assessing the entity's ability to continue as a going concern, the auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statements, as well as to conclude whether a material uncertainty exists. Deficiencies found generally involve the areas of audit planning and procedures; they are discussed in details below:

Inadequacy of audit planning

- Although the conditions that cast significant doubt on the entity's ability to continue as a going concern exist, the auditor still assessed the risk associated with the going concern issue as being moderate and therefore did not perform the necessary audit procedures, such as evaluating management's plans for future actions, whether the outcome of these plans is likely to improve the situation and whether they are feasible in the circumstances, to obtain the audit evidence that would substantiate the conclusion of whether the management's use of the going concern assumption was appropriate and whether a material uncertainty exists.

Inappropriate audit procedures performed on disclosures of the going concern

- Given that the management's use of the going concern assumption is appropriate but a material uncertainty exists, the auditor then must determine whether the financial statements adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and the management's plans to deal with these events or conditions. The auditor must also ensure that the relevant information on the going concern issue is clearly disclosed in the financial statements before issuing an unmodified audit opinion with an Emphasis of Matter paragraph. However, the SEC noted circumstances where auditors expressed the unmodified opinion with an Emphasis of Matter paragraph even though they did not verify whether the principal events, the management's plans, and other relevant information regarding the entity's going concern were clearly and appropriately disclosed in the financial statements.
- In another case, although the company disclosed in the notes to financial statements that its parent company had assured that it would provide the necessary financial supports and would settle any outstanding intra-group obligations for the company, the auditor did not obtain any written confirmation

or proof of such promise and no other audit procedures were performed. Yet, the auditor still concluded that the management's use of the going concern assumption was appropriate.

Professional skepticism

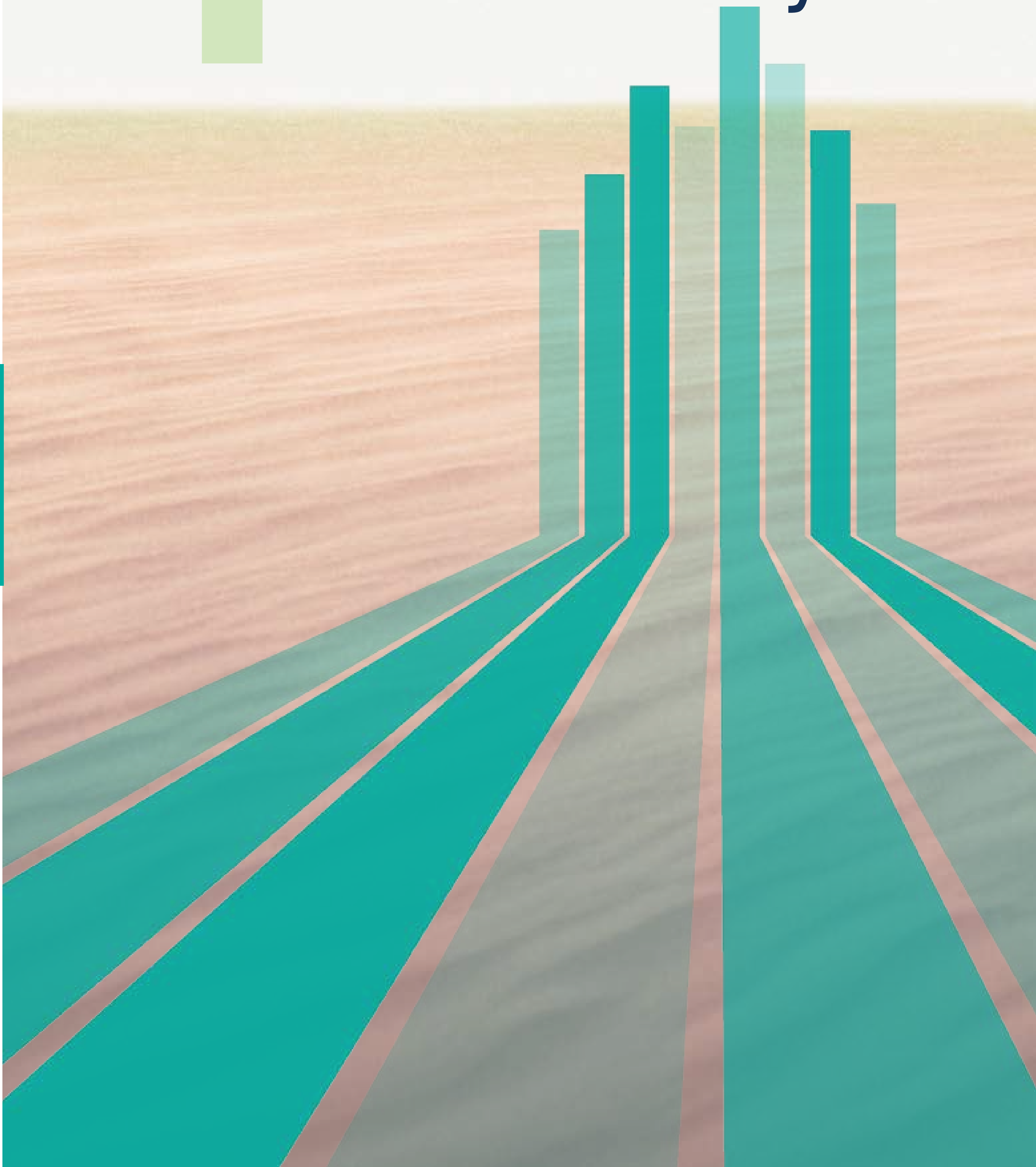
Auditing standards require auditors to plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated. In other words, the auditor should perform the audit work with a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. However, the inspections still uncovered instances where the auditor failed to exercise sufficient professional skepticism. Specific examples are discussed below.

- The auditor should have been aware that the company had not recognized any provisions for inventory obsolescence although its net realizable value was lower than cost.

- Due to risks associated with related party transactions, the auditor's questioning mind and alertness are especially important. However, the SEC noted that the auditors were not sufficiently skeptic of the findings resulted from their tests of controls that should have affected their assessments of the risks of material misstatement and thus influencing the necessary audit procedures to be performed. For example, when testing whether the entity's procurement policy of soliciting at least three proposals from three separate suppliers for each purchase requisition was effective for related party transactions, the auditor had noted some exceptions with no proposals submitted and some with the required three proposals that all came from the same group.The auditor then failed to include these findings in the risk assessment of the material misstatements.

- In the audit relating to going concern assumption, the auditor failed to consider the fact that the company incurred significant losses because its major supplier had ceased operations, resulting in the company's inability to fulfill its customers' orders. This situation should have triggered the auditor's attention to incorporate this indicator in his/her assessment of the appropriateness of management's use of the going concern assumption.

4 Root cause analysis

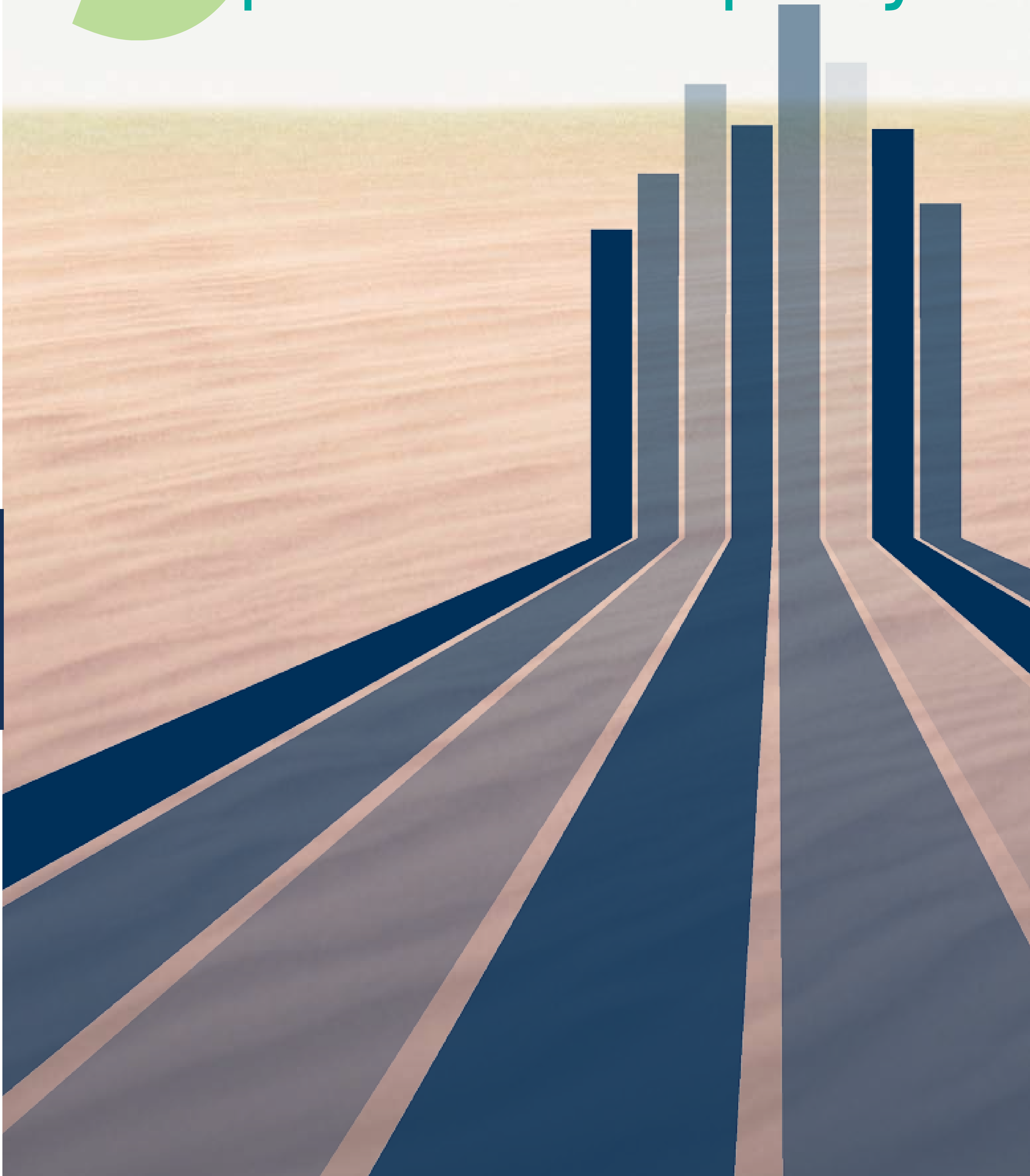


As the reliability of financial statements is of such import to the investors' and other stakeholders' confidence in Thai capital markets, the SEC has put tremendous efforts into enhancing audit quality both in firm level and engagement level to ensure comparability of Thai audit practice to the international standards. Despite the improvements made by firms in their efforts to move towards higher audit quality during the past year, the observed deficiencies could be further addressed in a more effective and timely manner if the root causes are to be suitably identified and the action plans effectively implemented. The SEC has therefore identified some of these root causes as follows:

- Insufficient understanding of the entity's business, coupled with financial statements preparers' inadequate understanding of the relevant accounting standards;
- Lack of leadership from firm leaders to set an example and persuade others on the importance of audit quality;
- Shortage and high turnover of audit staff, together with the inability of new additions of young professionals to keep up with the increasing demands;
- Inadequate and ineffective audit tools such as out-of-date or poorly designed audit manuals and audit programs, along with inadequate training provided for audit staff, to ensure that the audit work was performed in accordance with the applicable accounting and auditing standards;
- Inappropriate audit planning, resulting in the audit work on complex areas being assigned to inexperienced team members, combining with inadequate supervision by senior staff and engagement partners;
- Low level of professional skepticism exercised during planning and performing of audit work;
- Insufficient technical supports on complex and judgmental issues;
- Inexperienced reviewers and/or low involvement of the EQCRs, resulting in low quality of EQCRs, which was insufficient to ensure timely and effective audit review system, the situation especially evident in smaller firms;

- Low professional fees, resulting in insufficient resources allocated to audit engagements and professional developments, creating unnecessary pressures for cost controls that could potentially compromise the audit quality;
- Inadequate oversight provided by audit committee whose important roles include overseeing of the implementation and operation of effective governance and internal control systems, as well as high quality financial reporting processes;
- Inadequate understanding and support from other stakeholders on the importance of audit quality, leading to both low motivation for the auditors to achieve high audit quality and low collaboration among all the stakeholders to ensure the continuation of necessary professional developments; and
- Inadequate guidance from relevant professional bodies on the complex and difficult areas of the accounting and auditing standards that would ensure accurate understanding of those standards by the financial statement preparers and auditors.

5 Suggestions on how to improve audit quality



A. Firm level

To effectively improve the audit quality to be conforming with the TSQC 1, audit firms need to analyze root causes of deficiencies and establish action plans that are tailored to fit the firms and equipped with important milestones, performance indicators, and responsible persons. Even though the firms' quality controls would be most effective when they correspond to the environment of a specific firm, the SEC believes that the following suggestions, albeit generic, should be useful for the firms in their endeavor to take an important step towards higher audit quality.

1. Leadership responsibilities

Inconsistent application of quality control policies

- Firm leaders should ensure that the quality control policies and procedures are effectively implemented and consistently applied across engagements.
- Firm leaders should establish policies to ensure that engagement partners and EQCRs sufficiently supervise and oversee audit works.
- Responsible persons are assigned the tasks of developing and updating audit manuals and audit programs that comply with the current auditing standards.
- Monitoring and follow-up procedures for each engagement should be effectively implemented to successfully identify and immediately rectify any important deficiencies.

Inadequate firm policies for auditor independence

- It is crucial that the firm leaders put in place effective policies and procedures to be absolutely certain that there are no concerns or questions regarding the independence on both firm level and staff level. This issue is especially important for an audit firm that belongs to a network of firms, and thus requiring careful consideration from the firm leaders. Any breaches should be rectified immediately with sufficiently severe sanctions.

Improper client acceptance and inadequate human resources

- At all times, the firm leaders must ensure that each engagement is assigned to a suitable audit team, both in terms of workloads and levels of experiences, and available resources should always be considered before accepting any new clients.

2. Ethical requirements

Non-compliance with ethical requirements

- An audit firm must identify all related parties to be certain that there will be no violations of independence requirements of the audit firm.
- An audit firm and its network firms or related parties should assess their independence and identify any possible conflicts of interest within the group before accepting any non-audit services. The firm should establish appropriate client acceptance procedures and adequately document its non-audit service acceptance decisions, making it evident that such decisions are a result of careful deliberations.
- An audit firm should set proper policies and procedures regarding the independence of outsourced staff in order to ensure that those staff will satisfy the independence requirements when performing any audit procedures.

3. Client acceptance and continuance

Insufficient information in the consideration of client acceptance and continuance

- An audit firm must consider all significant information before accepting any audit engagements. It must document the relevant factors and its judgment in accepting each client, especially the information on the integrity of management and its independence issues.
- An audit firm needs to assess whether it has adequately available human resources with sufficient skills, knowledge, and capabilities to deliver high quality audit work.

Insufficient and inappropriate risk assessment procedures

- An audit firm needs to improve criteria used in its risk assessment process to ensure that sufficient consideration has been applied. Before accepting any clients, it is critical to assess the risks involved by taking into account all relevant information and risk factors.
- The audit firm should sufficiently document both the process and the results of its risk assessment so its audit teams could use such information in their planning and performing of the audit work.

4. Human resources

Inappropriate human resources allocation

- Adequately competent audit staff must be assigned to each engagement, as required by the auditing standards.

Improper follow-up procedures for staff trainings

- An audit firm should establish policies and procedures to monitor and follow up on staff who failed to comply with training requirements to ensure that those staff will have adequate knowledge and experiences in fulfilling their responsibilities. For instance, employees must complete all mandatory courses within the proper period of time, either by attending the required training sessions or by self-studying and taking the tests to confirm their adequate understanding of the training materials.

No quality control policies for outsourced staff

- With the presence of outsourced staff, an audit firm should set quality control policies and procedures for those staff by taking into consideration the audit firm's expectations of the outsourced staff regarding the quality of their work and their compliance with the applicable ethical requirements.

Inappropriate criteria used for performance evaluations

- The criteria used for performance evaluations should reflect an audit firm's expectations of the quality of the audit work.

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5. Engagement performance

Insufficient involvement of engagement partners and EQCRs

- Sufficient involvement of engagement partners and EQCRs must be required to ensure the appropriate level of supervision to achieve high audit quality.
- An audit firm should require that the signing partner be as equally responsible for audit quality as the engagement partner.

Insufficient audit procedures performed

- An audit firm should update its audit manuals and audit programs as appropriate to be in line with the applicable auditing and accounting standards and provide any necessary training to its staff in a timely manner.

- An audit firm should set up requirements and procedures for technical consultations as to when and in which situations should it be necessary for the audit teams to seek technical consultations. It is also important to promote internal cultures that encourage such consultations and make available of the appropriate resources.
- It is necessary to improve the monitoring process at the engagement level. This could be done through analyzing the deficiencies found, considering alternative solutions and communicating them to audit teams to ensure that the same deficiencies will not be repeated.

6. Monitoring

Insufficient monitoring

- An audit firm should be certain that its monitoring process and procedures, particularly those relating to engagement performance, are sufficiently detailed to cover all important aspects of the auditing standards so that the audit teams could easily and effectively follow the procedures. Also, monitoring responsibility should only be assigned to the team with adequate knowledge and experiences.

No action plans to follow up on the remediation of the deficiencies found

- An audit firm should follow up on the deficiencies found according to the remediation plan to ensure the proper and timely rectification of those deficiencies.

B. Engagement level

Due to its immense effects on the integrity of financial reports, audit quality at the engagement level should be one of the top priorities for all audit firms and any obstacles or deficiencies should be immediately and properly dealt with to ensure that the quality of the audits is not impaired. From the SEC's inspection findings, areas that appear to require most and immediate attention from the audit firms include audits of revenues, substantive analytical procedures, and professional skepticism. Addressing the deficiencies found might require the combination of one or more of the following recommendations.

Table 1 Recommendations on how to improve the audit quality at engagement level

Area of interest	Recommendations
Audits of revenues	Types of revenues depend on the industry in which a company operates. As a result, different audit procedures may be required. The firms might consider the following suggestions when planning and performing their audit procedures: • For percentage of completion method, the auditors need to assess the appropriateness of both the completion percentage and the budgeted construction costs. • Auditors should evaluate control risks relevant to the sales and cash collection cycle and adjust their substantive procedures accordingly. • It is particularly important that the conclusions reached for the audits of revenues that are identified with material risks of misstatement be supported by sufficient appropriate audit evidence. • When testing for accuracy of revenue recognition, the substance of types of revenues, products sold or services provided should be considered, instead of their forms. • Auditors should sufficiently document all of the work done, including nature, timing and extent of the audit procedures performed to gather sufficient appropriate audit evidence that would assist the engagement partners and EQCRs in their supervisory capacity. • According to the relevant auditing standards, the revenue recognition has presumed risks of fraud. Therefore, auditors should assess fraud risks and establish the procedures to respond to those risks. The auditors must also consider the probability of management's overriding of controls of the sales cycle when assessing the risks of fraud. • Auditors should set audit procedures that would respond to all risks relating to each assertion identified during the audit planning.

Area of interest	Recommendations
Substantive analytical procedures	Auditors should perform substantive tests by applying the substantive analytical procedures rather than analytical reviews. Additionally, they should set expectations based on reliable source of information and consider both internal and external data when setting the expectations. They should also set tolerance thresholds and the acceptable discrepancies within which further investigation would not be warranted by considering materiality level, required assurance level and the probability of material misstatement. Furthermore, when the discrepancies are material or the gathered information is not in agreement with information from other sources, auditors need to perform other procedures, in addition to inquiries of management.
Tests of controls	• Auditors should understand their clients' internal control system in order to plan and perform appropriate audit procedures to obtain sufficient appropriate audit evidence. • Auditors should employ suitable sampling methods to ensure that the samples selected are appropriate to the audit objectives and are good representation of the population. • Regarding dual-purpose tests, auditors should plan audit procedures to achieve the objectives of both tests of controls and tests of details. To achieve this, the auditors must consider the reliability of sources of data used, the quantity and characteristics of the selected samples. Furthermore, when planning for substantive tests, the auditors must consider the assessed inherent risks and control risks from each account that may result in material misstatement.
Audits related to fraud risks	• Auditors must respond to risk of material misstatement due to fraud. Due to the nature of fraud risks, the audit procedures would need to specifically address these unusual and unexpected traits to obtain reliable audit evidence. The examples are illustrated in Appendix 2 of

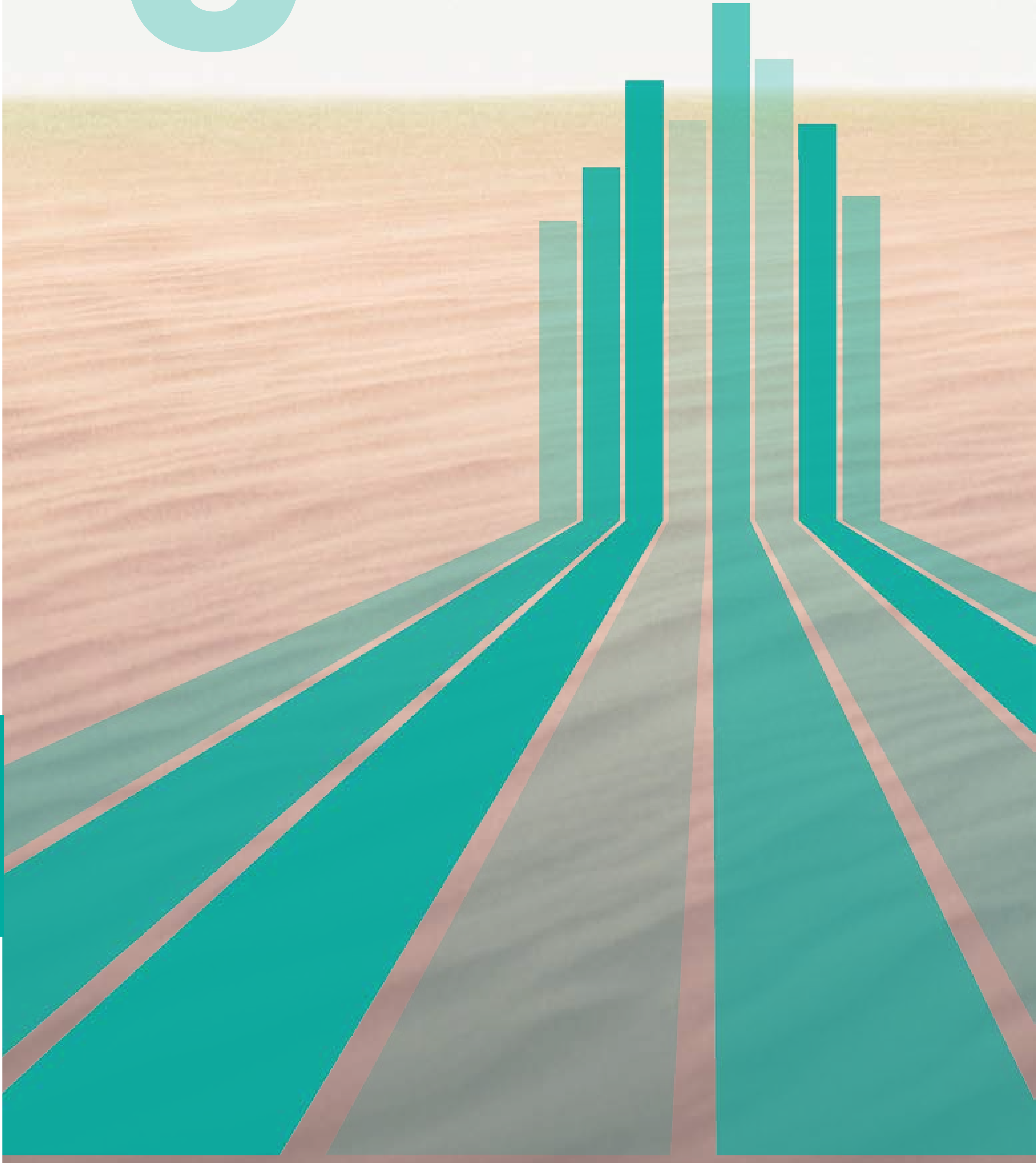
Area of interest	Recommendations
	the TSA 240 Auditor's Responsibility relating to Fraud in an Audit of Financial Statements. • Auditors should obtain adequate understanding of the entity's accounting procedures and internal controls before assessing risks and should examine unusual transactions that might occur throughout the year. Furthermore, they should examine and review journal vouchers issued between the date of the financial statements and the audit report date with special attention on any unusual items. • Auditors should review accounting estimates to determine whether there was any management's bias involved in the estimation that might indicate potential opportunities for fraud. • Auditors should evaluate transactions with unusual business practice and consider whether their purpose is to conceal any asset misappropriation or any fraudulent activities. • If auditors find audit evidence which indicates unusual business transactions, they must perform other procedures that are necessary and suitable to the circumstance at hand to obtain sufficient audit evidence, rather than merely inquiring the management. • Auditors should exercise professional skepticism when performing audit, and should always consider the probability of management's overriding of controls.
Audits of accounting estimates	Auditors must document their understanding and considerations regarding the appropriateness and reasonableness of assumptions used and estimates presented in financial statements.
Group audits	To obtain sufficient appropriate audit evidence to support conclusions reached for the audits of group financial statements, auditors should consider the following procedures:

Area of interest	Recommendations
	• Identify and evaluate risk of material misstatement, understand control environment of the group of companies, set materiality at consolidation level, plan audit procedures for the group and adequately review working papers of the group audits; • Communicate to group audit teams about group audit plans; • Gather and document all evidence concerning communications among the auditors, including component auditors; and • Examine responses on group audit instruction questionnaire from component auditors to ensure that group audit works are completed according to the audit plans.
Audits of inventories	In order to assure the appropriate valuation of inventory, auditors should consider the following procedures: • Evaluate the reasonableness of assumptions that management used in estimating allowance for inventory obsolescence; • Test whether the inventory is recorded at the lower of cost or net realizable value; and • Test unit cost of inventory.
Reviews of audit work	Engagement partners should sufficiently and appropriately review audit works performed by team members. The reviews must be completed before or on the date of the audit report to ensure that the audit opinion is formed based on the sufficient appropriate audit evidence.
Audit evidence	To obtain audit evidence to support conclusions reached and audit opinion formed, auditors might consider the following suggestions for gathering audit evidence and preparing audit working papers:

Area of interest	Recommendations
	• Properly document in working papers their audit planning, audit procedures performed, audit evidence collected and conclusions reached; • Follow up on causes of deficiencies and develop suitable remediation plans; and • Keep all audit evidence in the audit files and ensure that they are complete by the audit report date.
Audits of related party transactions	In order to ensure that related party transactions are properly accounted for and are in the normal course of business, auditors should consider the followings: • Obtain understanding on related party relationships and transactions and consider whether the transactions are arranged under normal business terms and conditions; • Consider whether all relevant information is appropriately disclosed in the notes to the financial statements; and • Plan and perform the audits of related party transactions according to the assessed risks of material misstatement and in accordance with the relevant auditing standards.
Using the work of a management's expert	In an auditor's evaluation of the use of the work of management's experts, the auditor must assess the competence of the experts, evaluate the relevance and reasonableness of any assumptions used, and obtain understanding of the experts' works.
Audits of a going concern assumption	To obtain audit evidence about the appropriateness of management's use of the going concern assumption and the existence of any material uncertainties, the audits should be planned, executed, and documented appropriately and in response to the identified risks. In the course of these audits, auditors should consider the feasibility

Area of interest	Recommendations
	and reliability of the management's future business plans as well as its financing capabilities in relation to the evaluation of whether the management's use of going concern assumption was appropriate and they should also obtain the management representation letter on the probability of such plans. If a material uncertainty is identified, the auditor must consider whether the relevant information is adequately disclosed in the notes to the financial statements. If such is accomplished, the auditor then must add an Emphasis of Matter paragraph to address this issue in the audit report. Otherwise, the auditor must modify the audit opinion accordingly.
Professional skepticism	Auditors must exercise professional skepticism when planning and performing audit procedures by considering the substance of transactions and questioning any circumstances which may lead to fraud or error. Possessing knowledge in other disciplines would also support the auditors well in their exercise of the professional skepticism, and therefore enhancing the overall effectiveness of the audit works.

6 Our focus for 2014



As the SEC firmly believes in the value of high audit quality on the integrity of financial reporting, we will continue in our endeavor to enhance the audit quality at both firm level and engagement level, mainly through communications of findings from our inspections and other knowledge-sharing initiatives. In 2014, we will continue to focus on leadership responsibilities for quality within the firm and engagement performance, as was our original plan for the second-cycle inspections. However, due to the common deficiencies encountered during 2013, we have included the testing of independence and conflicts of interests to our plan for the next year, especially on the determination of network firm in relation to the firms' compliance with the applicable ethical requirements.

Likewise, the 2014 focus for engagement-level inspections will remain primarily on substantive analytical procedures, audits of revenues, audits related to fraud risks, and documentation of audit evidence. The SEC expects to see improvements on all aspects but we are particularly interested in the improvements on the documentation of audit evidence due to its pervasive effect on the overall audit quality. Also, as the profession is anticipating changes on the requirements of audit reports, we expect that the auditors plan accordingly and be ready for the changes to come, especially for their audits of going concern assumption seeing that the revised audit report will include a section that specifically addresses the going concern issue, i.e., whether the management's use of the going concern assumption was appropriate and whether there is any material uncertainty identified.

Lastly, although high quality financial reporting depends on the efforts of all stakeholders, the auditors hold an important role of providing assurance on the reliability of financial reports. Combining that with the increased and more intense scrutiny on audit quality and fast-changing business environments, the SEC expects that the auditors continue to put forth their efforts into improving the audit quality and be active in their adaptation to the constant changes of the business worlds.

7 Significant statistical information

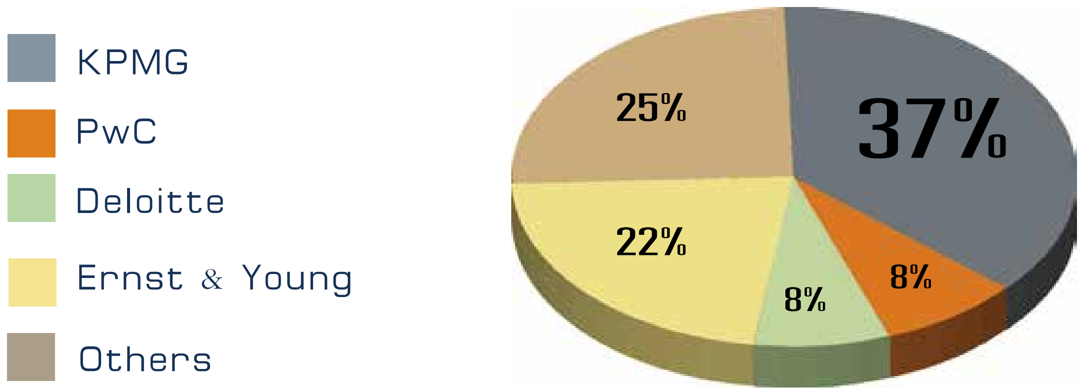
Firm level

- Registration of audit firms and individual auditors as at December 31, 2013

Audit firms	Number of audit firms	Number of auditors approved by the SEC
Big-4 firms	4	82
International firms*	4	10
Local firms	19	56
Total	27	148

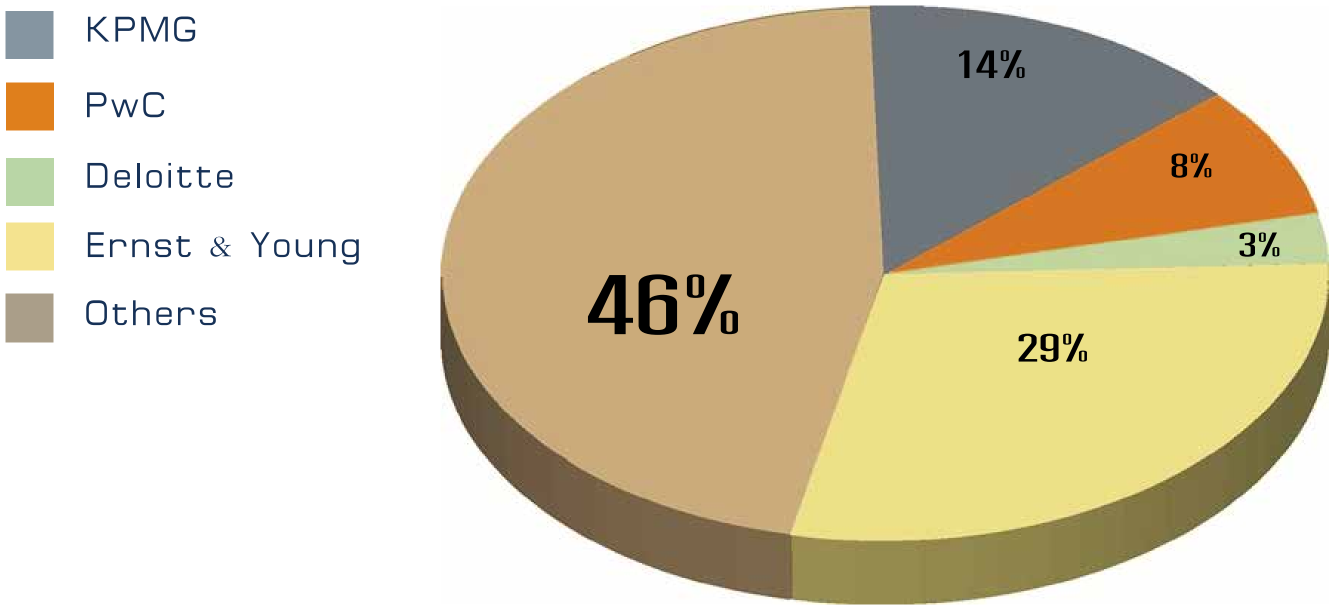
Note:
International firms include non Big-Four audit firms that are full members of international network firms, use their policies and procedures, and are monitored regularly by the network firms.
More information is available on
http://market.sec.or.th/public/orap/AUDITOR01.aspx?lang=en

- Percentage of market capitalization audited by the Big-Four firms

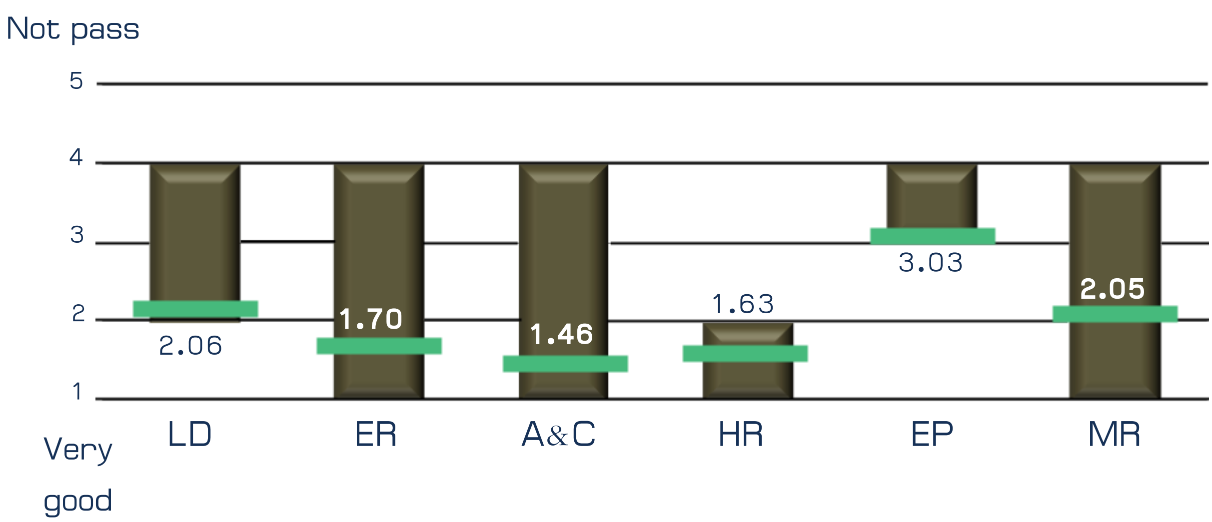


Note: Market capitalization as at December 27th, 2013

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



- Range of scores each audit firm received for each the TSQC 1 element and weighted average scores by total market capitalization



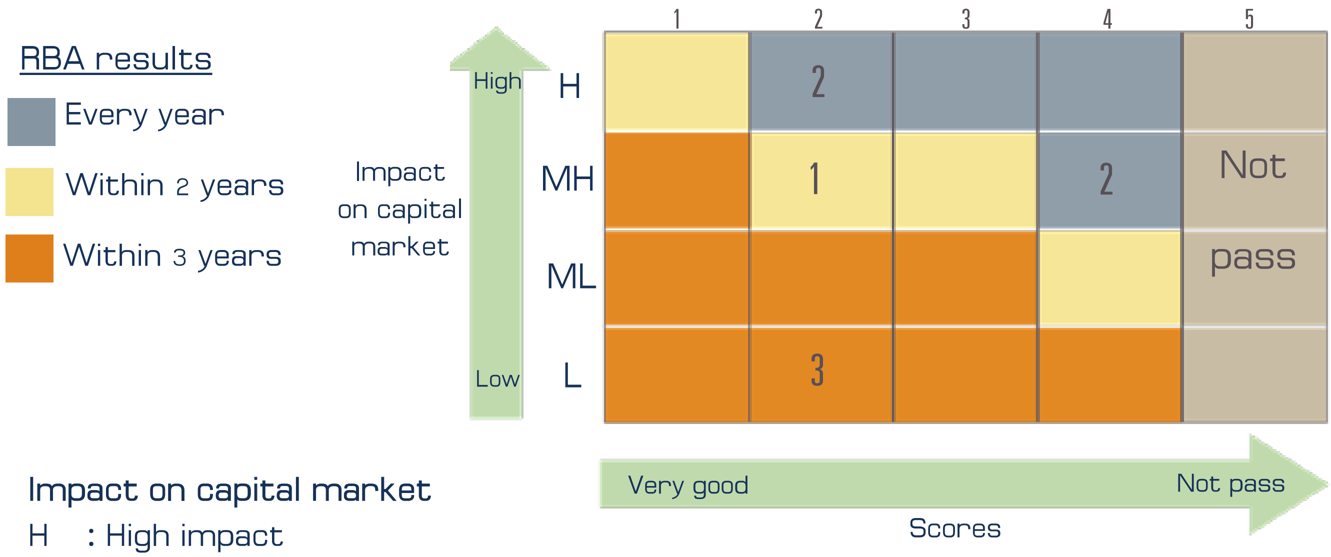
LD : Leadership responsibilities
ER : Ethical requirements
A&C : Client acceptance and continuance
HR : Human resources
EP : Engagement performance
MR : Monitoring

Weighted average scores by market capitalization

Range of scores

As shown in the figure, the range of scores audit firms received varies for each TSQC 1 element. The scores range from "Very good" (level 1) to "Urgent improvement required" (level 4). Although all audit firms passed the inspection, none of the firms received the "Very good" rating for both leadership responsibilities and engagement performance which are the two elements that the SEC currently puts more focus on during the second-cycle audit inspection.

- Firm-level inspection findings using risk-based approach (RBA)



Impact on capital market
H : High impact
MH : Moderate to high impact
ML : Moderate to low impact
L : Low impact

Engagement level

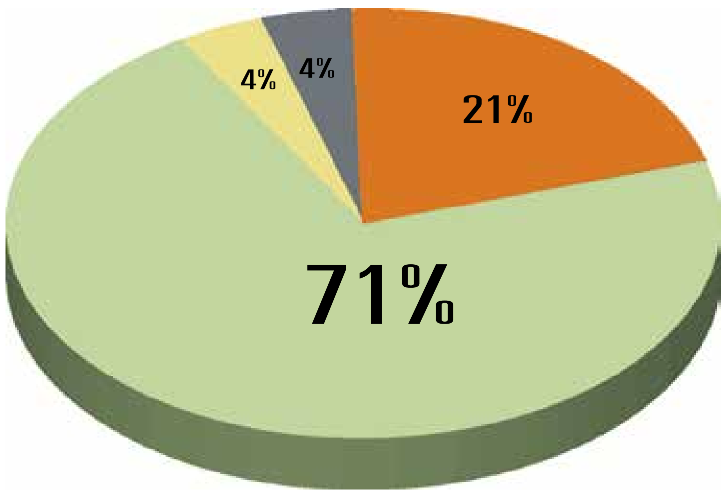
- Engagement level inspection results

Approval given with no deficiencies found

Approval given, but remedial actions required

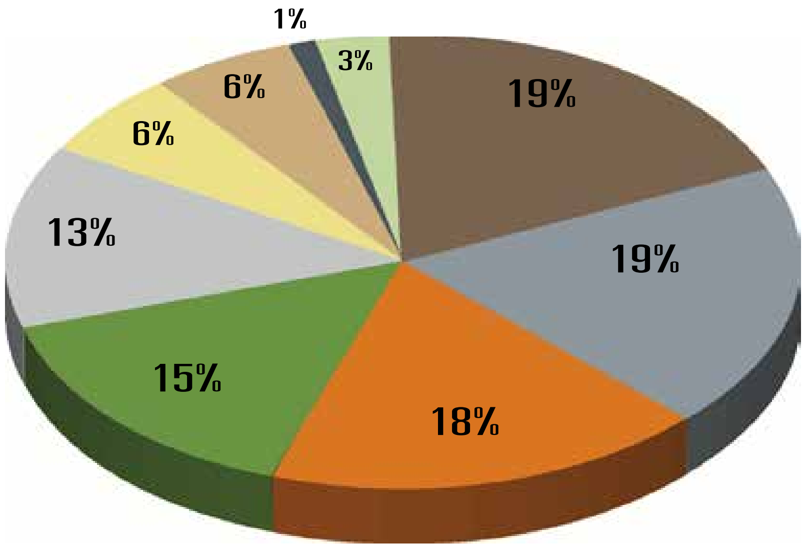
Approval given, but remedial actions and future inspection required

Failed the SEC-approval process



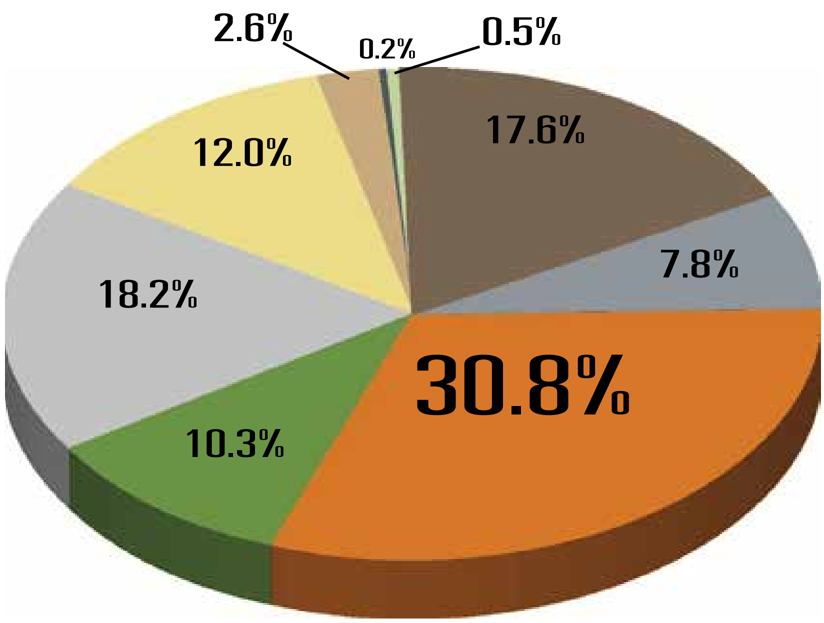
- Percentage of market capitalization of the listed companies in Thailand by industries

Services
Finance & Securities
Resources
Property Development and Construction
Technology
Agriculture & Food Industry
Industrial Products
Consumer Products
Others



Note: Total market capitalization of the listed companies in Thailand as at December 27th, 2013

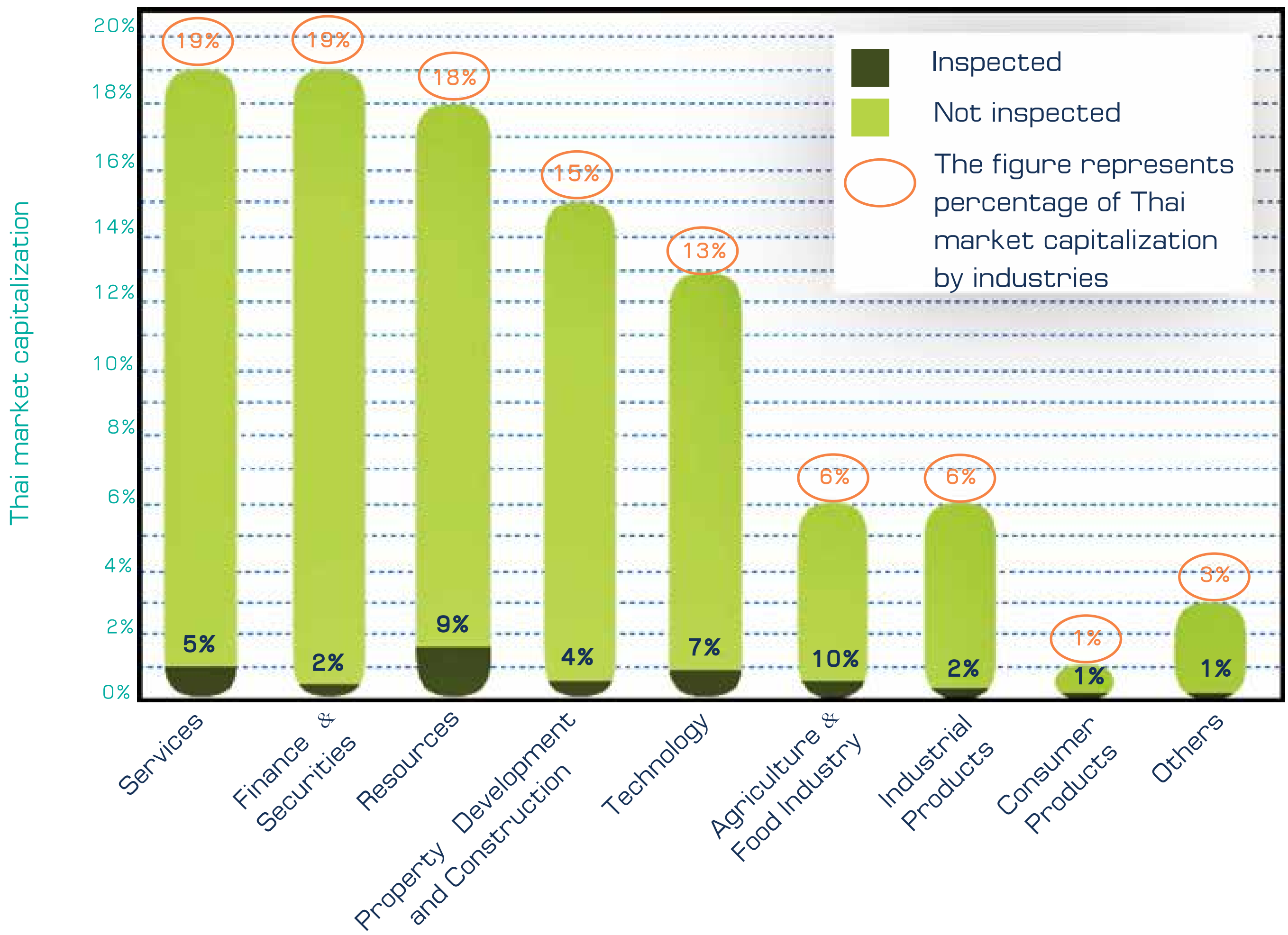
- Percentage of market capitalization of the inspected listed companies in Thailand by industries



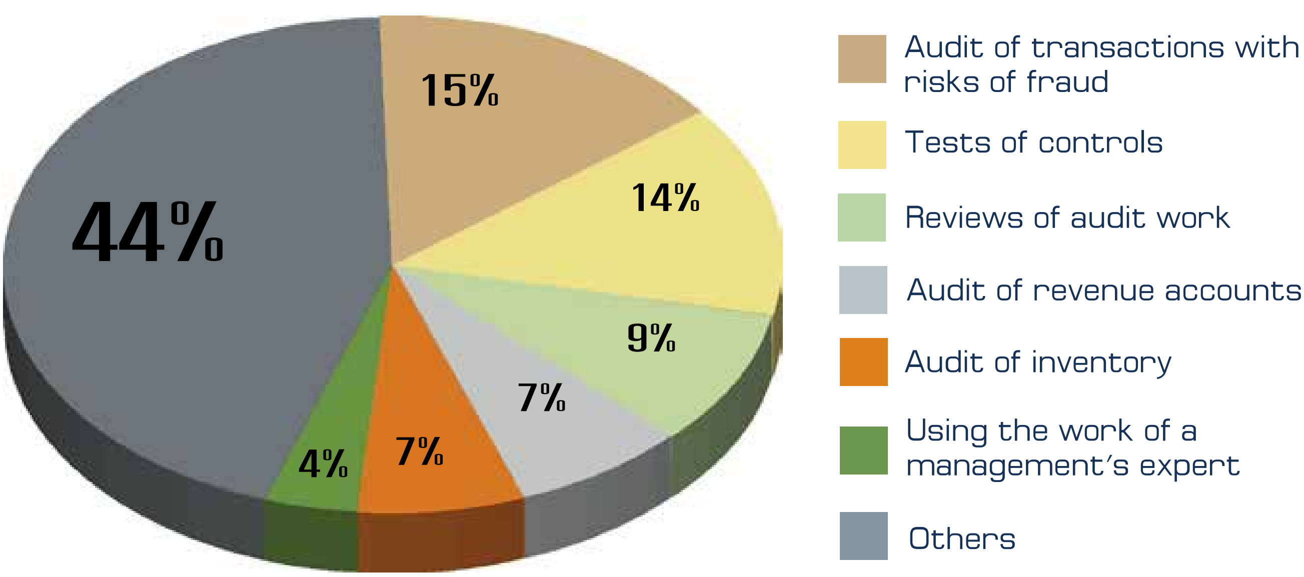
Services
Finance & Securities
Resources
Property Development and Construction
Technology
Agriculture & Food Industry
Industrial Products
Consumer Products
Others

Note: Market capitalization of the inspected listed companies in Thailand as at December 27th, 2013

- Percentage of inspected engagements by industries based on market capitalization



- Percentage of deficiencies found during the 2013 engagement-level inspections by types of audit areas



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