SEC Oversight Assurance Review

Public Inspection Report
June 2026

Disclaimer and Term of Use

This report is an attestation to the commitment of the Securities and Exchange Commission (SEC) Philippines to free and open exchange of information by virtue of Executive Order No. 2, series of 2016, "Operationalizing in the Executive Branch the People's Constitutional Right to Information and the State Policies to Full Public Disclosure and Transparency in the Public Service and Providing Guidelines Therefor."

This report is not intended to constitute accounting, auditing, legal or any other type of professional advice or service of any kind.

Recommended citation: SEC Philippines, SEC Oversight Assurance Review: Public Inspection Report, June 2026

This page is intentionally left blank.

Table of Contents

Message from the SEC Chairperson

As the Philippine capital market continues to grow and modernize, the Securities and Exchange Commission (SEC) recognizes one basic truth: markets are built on trust. That trust rests on financial information that is accurate and reliable, assured by auditors whose independence, competence, integrity, and professional judgment are beyond question.

This is why audit oversight matters. Beyond technical review, it is a public duty that protects investors, strengthens market confidence, and reinforces the credibility of our financial system. Through the SEC Oversight Assurance Review (SOAR) Inspection Program, led by the Office of the General Accountant (OGA), the Commission continues to advance a more proactive approach to audit oversight, one that is anchored on our broader mandate under the SEC Transformation Roadmap for Enterprises and Market (STREAM 2030) and our investor-first approach to regulation.

For the Philippines to become Southeast Asia's premier investment destination, our regulatory framework must align with the highest global standards and best practices. Financial transparency must be viewed not merely as a compliance requirement, but as a competitive advantage that strengthens market discipline, attracts investment, lowers the cost of capital, and builds economic resilience.

SOAR is central to this work. By advancing audit quality, we safeguard investors and strengthen the Philippines' competitiveness, sending a clear message to domestic and international investors that financial transparency is non-negotiable and accountability will be enforced where standards are not met.

This report is both an assessment and a call to action. It lays bare the progress we have made, the weaknesses we must confront, and the standards audit firms must meet with greater consistency and discipline.

Looking beyond 2026, the SEC, as an active member of the International Forum of Independent Audit Regulators, will continue to strengthen its audit oversight in line with international benchmarks. We remain committed to build a world-class SEC, one that protects not only investments, but the trust and confidence on which our markets depend.

Thank you for your continued trust as we build a Philippine capital market that is transparent, globally comparable, credible, and resilient.

Francisco Ed. Lim
SEC Chairperson

Message from the Supervising Commissioner

The integrity of our capital market depends on the proactive leadership of corporate Boards and the diligence of their Audit Committees. As Supervising Commissioner of the OGA, my focus is to ensure our regulatory oversight translates into actionable governance across the financial reporting ecosystem. Far from being a simple regulatory assessment, this report is intended to serve as a valuable resource that supports corporate leadership in upholding the highest standards of audit quality and financial reporting.

I must emphasize that maintaining audit quality is a shared responsibility, not the sole duty of the external auditors. When a strong "tone at the top" within audit firms is matched by effective oversight from corporate Boards and Audit Committees, the result is financial reporting that is credible, accurate, and consistent with the highest global standards.

The SEC does not view audit oversight as a one-sided enforcement mechanism. Rather, it is an important component of a broader governance framework in which the SEC, corporate Boards, Audit Committees, and external auditors work together to uphold transparency, accountability and investor confidence. Under SEC Memorandum Circular (MC) No. 19, Series of 2016, *Code of Corporate Governance for Publicly Listed Companies*, Audit Committees are entrusted with oversight responsibilities to strengthen external auditors' independence and improve audit quality. To further support Boards and Audit Committees in carrying out these responsibilities, SEC MC No. 12, Series of 2021, allows Audit Committees to request from external auditors information on SEC inspection findings and the remedial actions undertaken by the firm. This enables Audit Committees to make more informed assessments of the performance and quality of external auditors.

Through this report, the SEC shares key observations and findings from the second cycle of the SOAR Inspection Program. These insights are not only to identify areas for improvement but also to provide meaningful input that can enhance boardroom discussions and support the strategic oversight functions of corporate Boards and Audit Committees. The report also highlights the recent regulatory developments relating to the adoption of the International Sustainability Standards Board framework for sustainability reporting, ensuring a globally consistent and decision-useful disclosures.

The SEC stands alongside with corporate Boards and Audit Committees as we navigate these evolving regulatory landscapes to collectively protect investors and promote long-term economic resilience of the Philippines.

Rogelio V. Quevedo
OGA Supervising Commissioner

Message from the Office of the General Accountant

The SEC remains steadfast in its commitment to upholding the highest standards of integrity, transparency, and accountability in the Philippine capital market. As part of our regulatory mandate, we conduct audit inspections to assess the quality and effectiveness of audit practices. This commitment is reinforced by the Supreme Court's ruling, which reaffirms the SEC's authority over the accredited external auditors. Audit oversight is a critical regulatory function to build public trust and confidence in the audited financial statements, and ensuring financial reports are fairly stated and in accordance with applicable laws and professional standards.

The first cycle of the SOAR Inspection, conducted from 2018 to 2021, marked a significant milestone in strengthening audit quality oversight. In line with our commitment to transparency, the SEC published the inaugural Public Inspection Report in 2022 to share common findings, root causes, and best practices identified during the cycle.

Now, we are proud to present the 2026 edition of the Public Inspection Report, covering the latest review cycle. This report builds on our earlier efforts by highlighting common findings, underlying causes, and commendable practices. By sharing these insights, we aim to raise awareness of recurring issues, encourage the enhancement of firm's systems of quality management, and support ongoing improvements across the profession.

The report highlights our dedication to fostering a culture of continuous improvement in the financial reporting ecosystem. It is a valuable resource for corporate management, Boards of Directors, Audit Committees, external auditors, regulators, standard-setters, investors, and other stakeholders who rely on high-quality financial information for sound decision-making.

Transparency in our oversight processes plays a vital role in enhancing audit quality and strengthening the resilience of our financial markets. The insights provided are intended not only for auditors, but also for all stakeholders in the financial reporting ecosystem. This report also provides a glimpse into the development of sustainability reporting in the Philippines, including roadmaps, and key milestones in its implementation.

The SEC extends its sincere appreciation to the participating firms for their cooperation throughout the inspection process. As we move forward, we call on all stakeholders to join us in our shared commitment to excellence in audit oversight, professional conduct, and investor protection.

Emmanuel Y. Artiza
SEC General Accountant

Emmanuel Y. Artiza
SEC General Accountant

Guada May S. Preciados
SOAR Inspection Head

Executive Summary

The **SOAR Public Inspection Report, June 2026** provides a comprehensive overview of the Securities and Exchange Commission's (SEC) findings and observations on audit inspections conducted from 2022 to 2025.

During this period, the SEC inspected **all six of the largest audit firms in the Philippines.** Collectively, these firms audit 87% of publicly-listed companies (PLCs) and account for approximately 99% of total market capitalization in the Philippine Stock Exchange.

The inspections evaluated audit quality across two main areas: (a) the firm's system of quality management ("firm level"), and (b) the quality of performance in individual audit engagements ("engagement level").

This report shares comparative information from the six largest audit firms inspected in the previous audit inspection cycle from 2018 to 2021.

At the firm level, there was a notable **increase in findings regarding systems of quality management for relevant ethical requirements.** Increases in findings were also observed in areas aligned with the newer requirements of the Philippine Standard on Quality Management 1, such as monitoring and remediation, information and communication, governance and leadership, and risk assessment.

Conversely, findings related to policies on **engagement performance declined**, following enhancements implemented by most firms since the prior inspection cycle.

At the engagement level, **accounting estimates remain the most common finding, with 81% of inspected audits exhibiting at least one issue.** These were driven primarily by deficiencies in the audit of expected credit losses and goodwill, where significant assumptions were not sufficiently tested.

There were also significant increases in findings related to **audit sampling**, which, for affected engagements, showed instances of inconsistent application, including inadequately designed selection criteria and incomplete testing of items. Similarly, **group audit** findings reveal weaknesses in planning, coordination, and execution, particularly in evaluating component auditors' work, determining materiality, and developing effective group audit strategies.

The latest inspection cycle shows a notable increase in findings compared to the previous cycle, driven in part by post-pandemic disruptions, including remote work arrangements, reduced in-person training, and project management challenges arising from increased workloads and staffing constraints.

This report also highlights the importance of conducting robust root cause analyses for each identified inspection finding, as well as the role of automated audit tools and techniques in enhancing audit quality. Some firms have recurring findings in the latest inspection cycle, raising concerns about the effectiveness of remediation in prior inspections.

Lastly, the last section of this report provides a summary of the recent developments on sustainability reporting in the Philippines, with a particular focus on assurance. Emerging local trends indicate that more non-accountant assurance practitioners are engaged by companies to provide opinions on their sustainability reports compared with previous years. Mandatory sustainability assurance for the largest PLCs is expected to commence in 2028.

Acronyms

AARG	ASEAN Audit Regulators Group
AI	Artificial Intelligence
ASEAN	The Association of Southeast Asian Nations
ATT	Automated Tools and Techniques
CPA	Certified Public Accountant
ECL	Expected Credit Losses
EP	Engagement Partner
EQR	Engagement Quality Reviewer
ESG	Environmental, Social, and Governance
GHG	Greenhouse Gases
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
ISSA	International Standard on Sustainability Assurance
JE	Journal Entry
LNL	Large Non-listed Entities
LOF	Letter of Findings
MC	Memorandum Circular
MOC	Management Override of Controls
PCAOB	Public Company Accounting Oversight Board
PDEx	Philippine Dealing & Exchange Corp.
PFRS	Philippine Financial Reporting Standards
PLC	Publicly-listed Company
PSA	Philippine Standards on Auditing
PSE	Philippine Stock Exchange
PSQC	Philippine Standard on Quality Control
PSQM	Philippine Standard on Quality Management
RCA	Root Cause Analysis
RoMM	Risk of Material Misstatement
SEC	Securities and Exchange Commission (Philippines)
SOAR	SEC Oversight Assurance Review
SoQM	System of Quality Management
SRC	Securities Regulation Code
TCWG	Those Charged with Governance

Definition of Terms

Accounting Standards	Set of principles and guidelines used by preparers of financial statements when applying accounting policies. These are adopted in the Philippines by the Philippine Financial and Sustainability Reporting Standards Council, as approved by the Professional Regulation Commission – Board of Accountancy, and adopted by the SEC Philippines as part of financial reporting rules. These standards are based on the International Financial Reporting Standards, which are promulgated and issued by the International Accounting Standards Board.
Audit Firm/ Firm	A partnership registered and accredited with the SEC and engaged to conduct an audit of the financial statements.
Audit Sampling	The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population (PSA 530 par. 5a)
Audit Standards	Set of principles and guidelines used by auditors when conducting an audit of financial statements. These are adopted in the Philippines by the Philippine Auditing and Assurance Standards Council, as approved by the Professional Regulation Commission – Board of Accountancy, and adopted by the SEC Philippines as part of financial reporting rules. These standards are based on the International Standards on Auditing, promulgated and issued by the International Auditing and Assurance Standards Board.
Auditor	Person or persons conducting an independent audit, composed of the engagement partner and other members of the audit team.
Exchange	An organized marketplace or facility that brings together buyers and sellers and executes trades of securities and/or commodities.
Other Audit Firms/ Individuals	Audit firms or individual auditors who perform audits of financial statements of a company other than a publicly-listed company (PLC).
Professional Skepticism	An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence (PSA 200 par. 13l).
Publicly-listed Company	Entities with equity or debt securities listed in an Exchange.
Six Largest Audit Firms	Top six SEC-accredited audit firms with client portfolio that collectively comprise the highest market capitalization of all PLCs and with the most employed audit professionals in the Philippines.
Small and Medium-sized Audit Firms	SEC-accredited audit firms engaged in the audits of PLCs, other than those categorized as six largest firms.
Those Charged with Governance	The person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process (PSA 260 par. 10a).

1

INTRODUCTION

Building trust in the Capital Market: The Role of the SOAR Inspection Program

Why it Matters

In today's fast-paced economy, trust and transparency in financial reporting are more important than ever. Primary stakeholders such as investors, businesses, and the public all rely on accurate financial information to make informed decisions. To ensure this, the Securities and Exchange Commission (SEC), in line with its mandate under Section 5 of the Securities Regulation Code (SRC) and its overarching policy of investor protection, issued SEC Memorandum Circular (MC) No. 12, series of 2021, *Revised Rules and Regulations on the Implementation of the SEC Oversight Assurance Review (SOAR) Inspection Program* (see **Figure 1.1**).

Figure 1.1:
Legal Basis of the SOAR Inspection Program

SRC Section 5
Powers and functions to protect investors and ensure full and fair disclosures about securities

Revised Corporation Code Sections 162 and 163
Power to impose monetary penalties to auditors for willful certification of incomplete, inaccurate, false or misleading statements or report

Revised SRC Rule 68
Authority to make, amend, and rescind accounting rules and regulations as may be necessary to carry out the provisions of the SRC

SEC MC No. 12, series of 2021
Sets out the revised rules and regulations on the implementation of the SOAR Inspection Program

The SOAR Inspection Program is a regulatory initiative aimed at improving audit-quality to increase the level of confidence and trust in the audited financial statements of publicly-listed companies (PLCs) in the Philippines. High audit quality ensures reliable financial reporting and ultimately, protect the investors and other users of the financial statements.

The key benefits of the SOAR Inspection Program are shown in **Figure 1.2.**

Figure 1.2:
Benefits of the SOAR Inspection Program

To the Regulators and Public Interest:

- Strengthens financial stability by enhancing oversight of audit quality and financial reporting
- Promotes market integrity and investor protection by improving the reliability and transparency of financial information

To the Investors and Other Users of Financial Statements:

- Greater confidence that financial information is fairly presented and supported by high-quality assurance
- Reduces information risk in investment and economic decision-making

To the Audit Firms and Practitioners:

- Serves as a tool to continually improve the quality of audit services of the certified public accountants (CPAs) in public practice
- Enhances technical competence through inspection findings and good-practice benchmarks

The SOAR Inspection Program demonstrates the SEC's commitment to improving audit quality and strengthening public confidence in the financial market. By delivering targeted benefits to regulators, market participants, and professionals, the program plays a transformative role in shaping a more transparent, accountable, and resilient financial ecosystem.

Independence in Audit Oversight

Strengthening Audit Integrity Through Global Collaboration

Public confidence in capital markets depends on credible financial reporting, ensured by effective audit oversight. In the Philippines, the SEC reinforces financial reporting integrity through active engagement with international organizations, such as the International Forum of Independent Audit Regulators (IFIAR) and the ASEAN Audit Regulators Group (AARG).

Founded in 2006, IFIAR brings together 56 independent audit regulators from different jurisdictions around the world to enhance audit quality through collaboration, knowledge exchange, and the promotion of best practices. As the Philippines' independent audit oversight authority, the SEC is a proud member of IFIAR, a position that grants it access to global benchmarks, emerging trends, and insights that help elevate audit regulation at home.

Membership in IFIAR affirms the SEC's identity as an independent regulator, free from undue influence by the audit profession or the entities it oversees. Independence is essential to ensuring objective evaluations, impartial enforcement, and above all, the protection of the investing public.

The SEC also actively participates in the AARG, a regional alliance of audit regulators from Southeast Asia, including members from Indonesia, Malaysia, the Philippines, Singapore, and Thailand. AARG promotes collaboration through annual plenary meetings, technical workshops, and one-on-one dialogues with audit firms to address emerging issues, share best practices, and align oversight strategies. By engaging in these initiatives, the SEC enhances its regulatory capacity while staying aligned with regional goals and developments in audit oversight.

MEMBERSHIP WITH INTERNATIONAL ORGANIZATION

November 2018	SEC's admission to the International Forum of Independent Audit Regulators
April 2019	SEC became a member of the ASEAN Audit Regulators Group

IFIAR's Core Principles

IFIAR's Core Principles for Independent Audit Regulators[1] seek to further outline and promote effective independent audit oversight globally. Among these, Principle 2 and Principle 5 highlight the importance of independence in audit oversight:

Principle 2: Audit regulators should be independent

Independence in regulation means making and enforcing decisions free from external influence, ensuring governance is not controlled by persons or institutions who are not independent from the audit profession or other stakeholders in the financial reporting ecosystem.

If non-independent individuals are involved, they should be a minority, and regulatory decisions must remain impartial.

Non-independent experts or consultants should only participate in exceptional cases.

The audit regulator must be free from political or commercial interference and have stable, unbiased funding to fulfill its responsibilities effectively.

Principle 5: Audit regulators should have sufficient resources and staff with relevant competence and expertise who are independent of the profession

Audit regulators must ensure staff are independent from the profession, meaning they are not employed by or affiliated with audit firms or accountancy bodies.

Regulators need sufficient, well-trained personnel with expertise across various industries to effectively oversee audits. Their effectiveness depends on adequate resources for inspections and regulatory reviews.

Consultation and discussion among oversight teams should be maintained, and new staff must undergo proper supervision and rigorous training.

[1] IFIAR.org, "Core Principles for Independent Audit Regulators," April 27, 2022.

The Value of Membership with International Organization

By participating in IFIAR and AARG, the SEC is able to connect with peers from different jurisdictions to share experiences, best practices, and insights on improving audit quality. The following are some other benefits of being a member of international organizations:

Figure 1.3:
Benefits of Being a Member of International Organizations

Access to International Best Practices
Keeping pace with global risks, technologies, and standards ensures Philippine audit oversight remains relevant and robust.

Professional Growth and Technical Expertise
Learning opportunities through knowledge-sharing sessions, inspection findings survey, workshops, and training programs, improve regulatory effectiveness and elevate staff competence.

Networking Opportunities
Regulators can connect with peers from different jurisdictions, fostering international cooperation. Members can participate in inter-judicial consultations, peer advisory sessions, and collaborative knowledge forum.

Improved Audit Quality
Heightened oversight, open feedback loops, and consistent enforcement create an environment that fosters integrity and excellence in audit performance.

Audit oversight upholds public trust through independence. Through active participation in IFIAR and AARG, the SEC reaffirms its role as a vigilant, impartial, and globally connected regulator. These organizations do not only provide access to global standards and best practices, but also play a crucial role in promoting independence, fostering collaboration, and strengthening regulatory capacity. By being part of these networks, Philippine audit regulators are better equipped to effectively provide oversight on auditors and help ensure the resilience and integrity of financial systems at both the regional and global levels.

The SOAR Inspection Process is carried out through four phases – Planning, Execution, Reporting, and Remediation – to ensure a systematic review of audit firms and engagements, timely communication of findings, and effective implementation of remedial actions. The process involves the following activities and timelines:

Figure 1.4: Inspection Process

Planning

- Selection of the audit firms and the audit engagement subject to inspection
- Issuance of Audit Firm Notification Letters - 60 calendar days before the start of onsite inspection
- Issuance of Engagement Notification Letters - 30 calendar days before the start of onsite inspection

Execution

- Inspection fieldwork of at least two weeks
- Closing/status meeting with key members of management of the firm at the last day of onsite inspection

Reporting

- Issuance of the Letter of Recommendations and Letter of Findings (LOF) not earlier than 45 calendar days after closing meeting
- Audit firm's reply to LOF within 30 calendar days upon receipt of LOF
- Issuance of Inspection Report within 45 calendar days from receipt of audit firm's reply to LOF

Remediation

- Submission of remediation plan and root cause analysis (RCA) within 60 calendar days after the issuance of the Inspection Report
- Remediation process within 12 months after the issuance of the Inspection Report
- Issuance of Evaluation Report of audit firm’s remediation - within 30 calendar days after the end of the remediation period

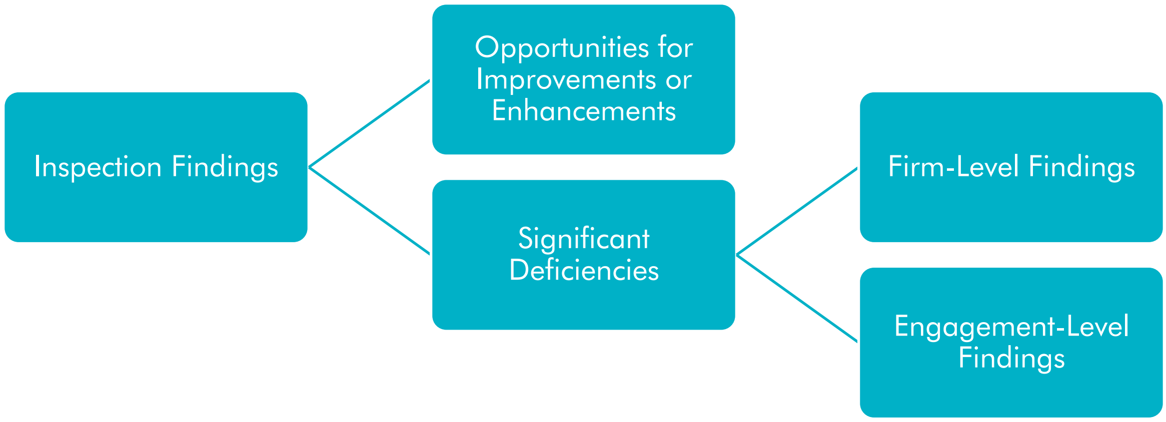
Inspection Findings

What are Inspection Findings?

The SOAR Inspection Team conducts a closing/status meeting with the key members of the Engagement Team and the Firm's management summarizing the results of the onsite inspection. During this meeting, **significant inspection deficiencies** noted are discussed.

Inspection findings are classified into two categories:

Figure 1.5:
Classification of Inspection Findings



Opportunities for Improvements or Enhancements

Inspection findings under this classification are considered minor and are not included in the formal SOAR Inspection Report. Instead, they are summarized in a **Letter of Recommendations** provided to the firm. Although not deemed significant violations of auditing standards, these findings highlight areas where audit practices could be enhanced and refined.

Common examples include:

- Omission of audit procedures required by audit firm policies and audit methodologies but is not significant non-compliance with the Philippine Standards on Auditing (PSA).
- Minor inconsistencies or administrative lapses in audit documentation that do not significantly affect the appropriateness and sufficiency of the procedures performed and/or the audit evidence obtained.
- Other instances evaluated by the inspection team as opportunities for improvement or enhancements.

Significant Deficiencies

These findings indicate more serious issues and are included in the **SOAR Inspection Report**. They are divided into two main subcategories:

a. Firm-Level Findings

These relate to non-compliance with the Philippine Standards on Quality Management (PSQM) 1 and 2. Firm-level deficiencies pertain to systemic weaknesses in a firm's system of quality management (SoQM) and firm's engagement quality reviews. Such deficiencies indicate that the firm's SoQM does not provide reasonable assurance that the firm and its personnel fulfill their responsibilities, and that the engagement reports issued by the firm or engagement partners (EPs) are appropriate.

Significant firm-level findings include:

- Inadequate monitoring of audit engagements
- Weaknesses in leadership or governance
- Insufficient engagement performance reviews by EP and Engagement Quality Reviewer (EQR)

b. Engagement-Level Findings

These findings involve significant non-compliance with the PSAs or firm policies during the performance of specific audit engagements.

Significant engagement-level findings include:

- Insufficient audit procedures to address identified risks at assertion level
- Inadequate audit evidence to support the conclusion and opinion
- Failure to detect or appropriately respond to material misstatements in the financial statements

DID YOU KNOW?

"A significant deficiency does not automatically mean audit failure or financial statements were misstated."

It indicates that certain parts of the audit did not meet the relevant professional standards.

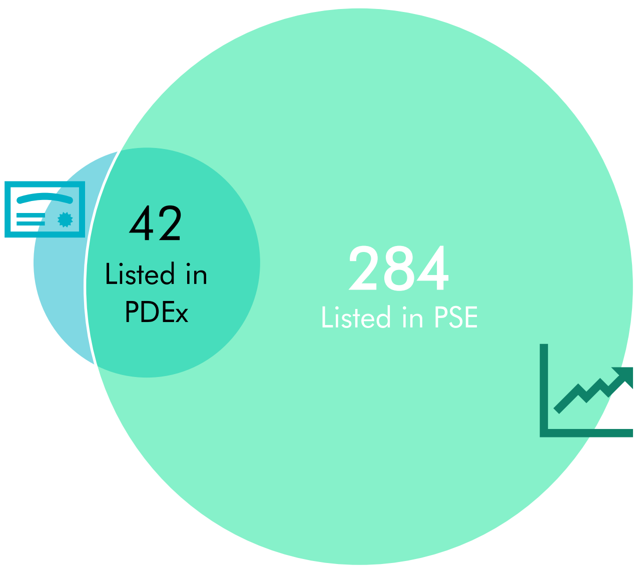
2

SCOPE OF INSPECTION

Publicly-Listed Companies in the Philippines

As of December 31, 2025, a total of 292 companies are listed on exchanges in the Philippines across its trading platforms. Of these, 284 companies are listed on the Philippine Stock Exchange (PSE), which represents the broader equity market, while 42 companies are listed on the Philippine Dealing & Exchange Corp. (PDEx), which primarily caters to the fixed-income and debt securities market. A total of 34 companies are listed on both the PSE and PDEx, reflecting issuers that participate in both equity and debt markets. This distribution is illustrated in **Figure 2.1** below.

Figure 2.1:
Number of PLCs in the Philippines



Total of
292
Listed in an Exchange
250 Solely listed in PSE
8 Solely listed in PDEx
34 Listed in both PSE and PDEx

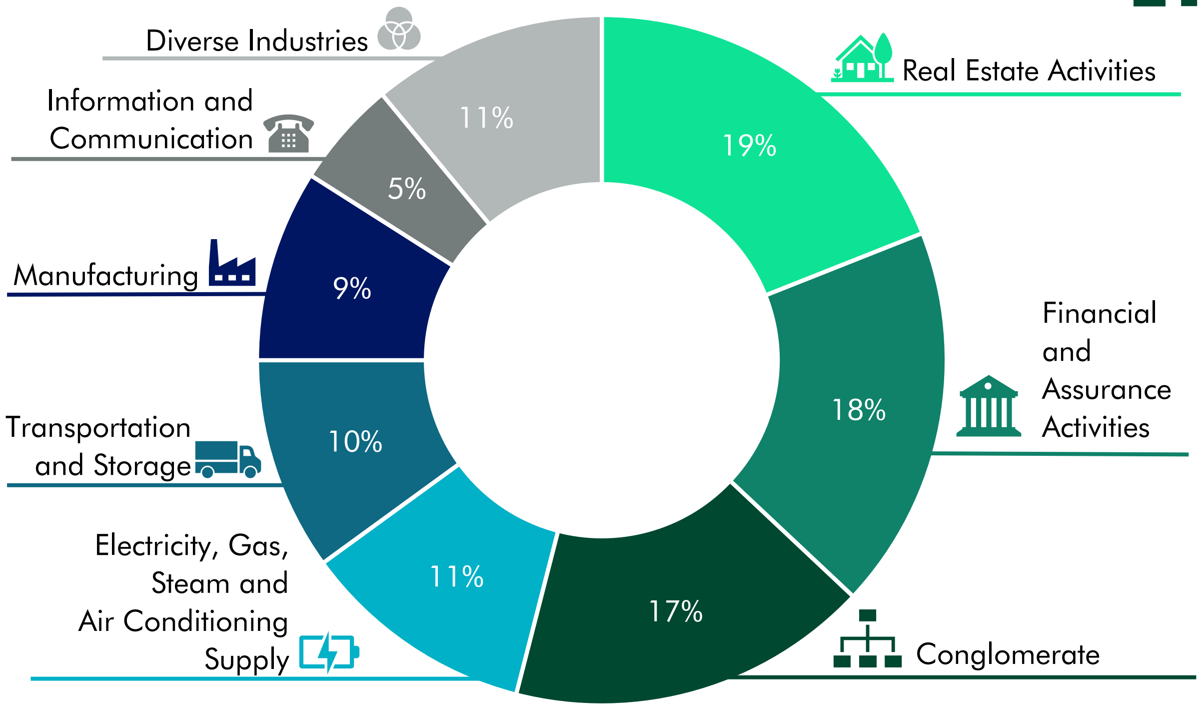
143
PLCs belong to the top 1,000 corporations in the Philippines[2]

Audited by
16 Local audit firms,
2 Foreign audit firms, and
by the Commission on Audit

[2] Based on Revenue per the SEC Database.

The real estate activities held the top spot among PLCs in the Philippines, in terms of market capitalization. As illustrated in **Figure 2.2**, the PLCs from this industry contribute the highest share to the market capitalization, holding 19% as of December 31, 2025. Growth is driven by rapid urbanization, infrastructure development, rising demand for residential and commercial properties, and supportive government programs. Urban population increases and an expanding middle class are key factors propelling demand for housing, mixed-use projects, and sustainable developments, while technological adoption and improved connectivity further enhance market opportunities.

Figure 2.2:
Market Capitalization of PLCs per Industry



The financial and insurance activities industry holds a significant share of the Philippine economy, around 18%, reflecting its essential role in maintaining financial stability and directing investment flows. Recent reports highlight that the local insurance sector has crossed a major milestone, breaching the half-trillion-peso mark in total premiums by 2025. This achievement points to broader access to insurance products and a growing demand for financial protection, even in the face of ongoing economic challenges[3].

Ranking third is the conglomerate sector, made up of diverse businesses, often spanning unrelated industries, under the umbrella of a single parent company. Philippine conglomerates showcase this model, with portfolios that stretch across retail, real estate, banking, energy, infrastructure, and food and beverage. Their diversified structure allows them to spread risk while maintaining strategic control, positioning them as key drivers of resilience and long-term growth in the national economy.

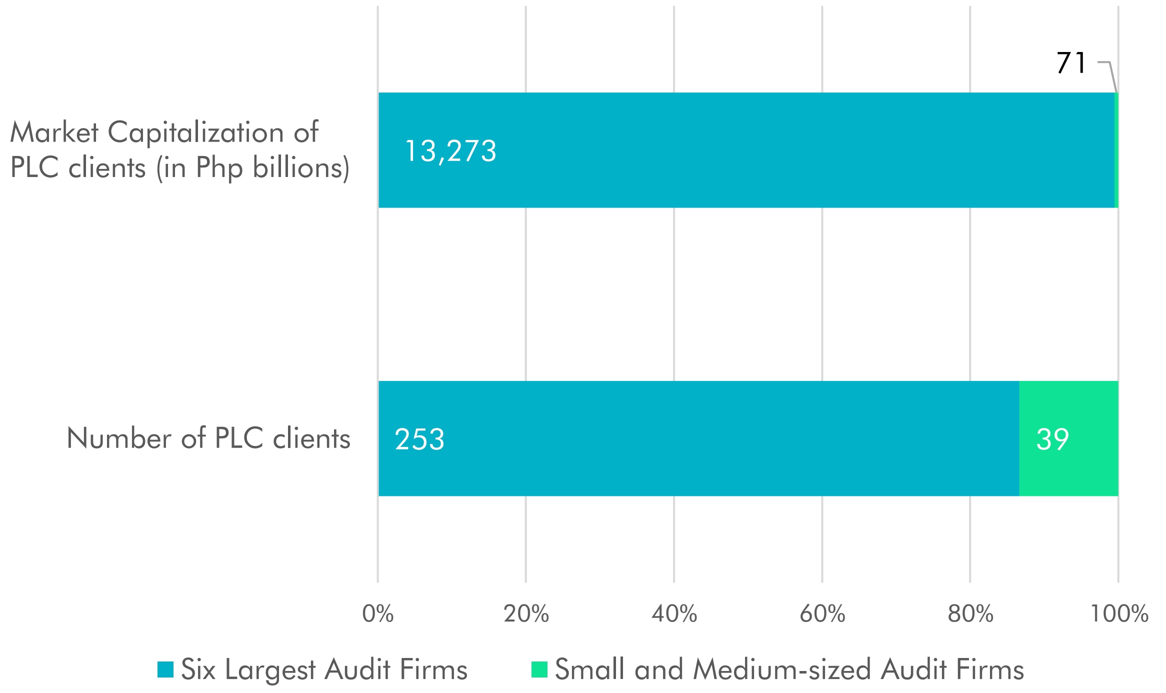
[3] Business Inquirer, "Philippine Insurance Industry Hits P500B Total Premiums in 2025," February 12, 2026.

Audit Firms of Publicly-Listed Companies in the Philippines

As of December 31, 2025, 288 of the 292 PLCs were audited by 16 local audit firms. The other four PLCs were audited by foreign audit firms and the Philippine Commission on Audit. By regulation, only the 16 local audit firms are within the scope of the SOAR Inspection Program.

This report classifies the 16 audit firms into two categories: (a) the **Six Largest Audit Firms**, defined as those that handle the largest portfolios of PLC clients, collectively representing the highest market capitalization of all PLCs (i.e., Php 13,273 billion out of Php 13,344 billion) and employing the greatest number of audit professionals; and (b) **Small and Medium-sized Audit Firms**, comprising the remainder of the population. **Figure 2.3** presents the PLC client portfolio of these audit firms, including the number and relative market capitalization of listed-company engagements.

Figure 2.3:
PLC Client Portfolio of Local Audit Firms in 2025

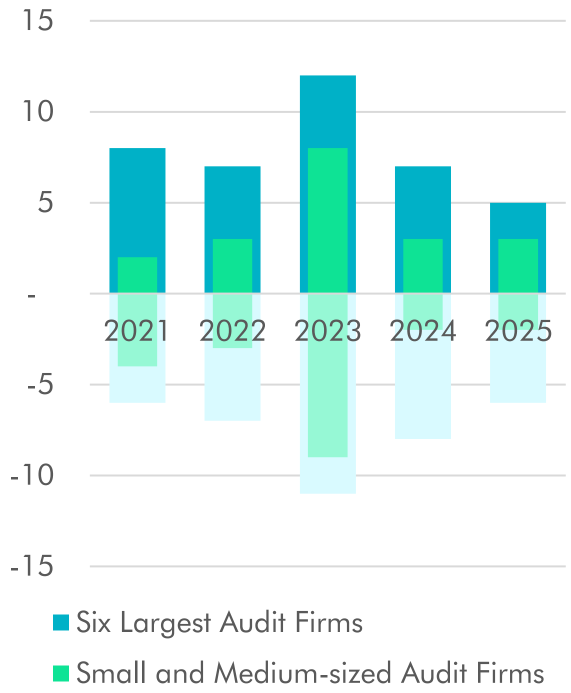


The SEC notes that excessive rotation or "last-minute" changes may disrupt the audit process and lead to audit quality declines, particularly in the transition period when the outgoing auditor exits and the incoming firm is still gaining familiarity. This disruption can lead to auditing inefficiencies, higher audit costs, and potential delays in reporting.

Annual PLC-auditor movements fluctuate within a range of 8 to 20 engagements from 2021 to 2025. As shown in **Figure 2.4**, the largest change occurred in 2023, totaling 20 engagements – comprising 12 PLCs that engaged the six largest audit firms and 8 that engaged small and medium-sized audit firms. Across the period from 2021 to 2025, the six largest audit firms account for the majority of the changes in PLC engagements.

Despite the movement shown in **Figure 2.4**, there is no significant switching of auditors across firm categories. From 2021 to 2025, there were only minimal shifts between the six largest audit firms and small and medium-sized audit firms, indicating limited movement of PLCs from one category to the other.

Figure 2.4:
Gross Changes in PLC-Auditor Engagements (2021 - 2025)



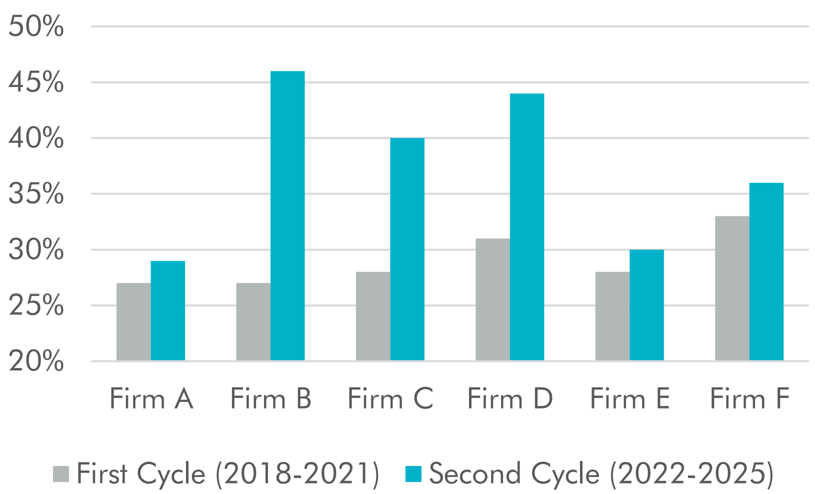
Staffing Trends

All the six largest audit firms experienced an increase in attrition rates from Cycle 1 to Cycle 2 (see **Figure 2.5**). The increase ranged from 3% to 19%, indicating varying degrees of turnover pressures across firms.

This trend is not confined to the Philippines but extends across the ASEAN region, where firms are facing growing challenges in attracting and retaining talent. Key factors contributing to increased attrition include concerns around compensation and benefits, along with perceived limitations in career growth opportunities.

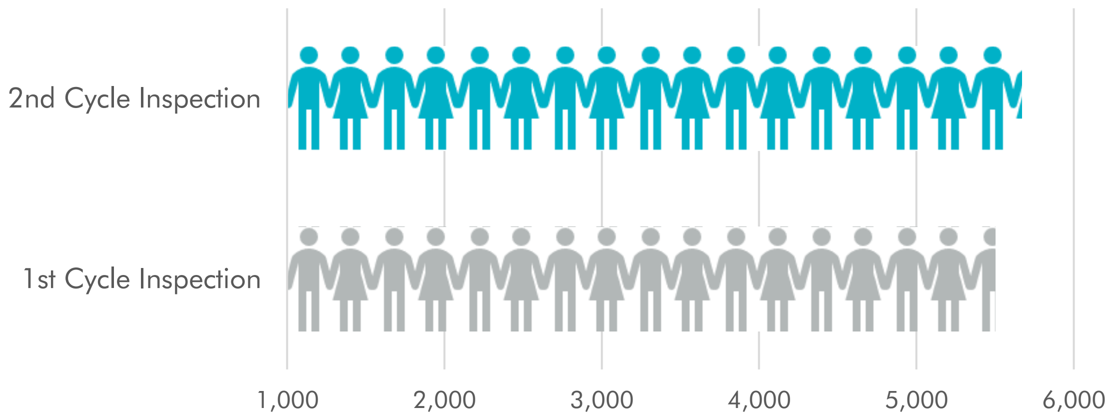
Additionally, emerging workforce trends (e.g., permanent hybrid/remote work setups, four-day workweek, asynchronous work and flextime, and activity-based or outcome-oriented metrics) are further constraining the talent pool for accounting and auditing firms, with concerns about work-life balance, workplace culture, and flexibility playing a crucial role in retention struggles.

Figure 2.5:
Comparison of Attrition Rates of Six Largest Audit Firms



Despite rising attrition rates (see **Figure 2.5**) and a persistent shortage of accountants, driven by declining enrollment in accounting programs and lower CPA board examination passing rates, the total number of audit professionals employed by the six largest audit firms has remained broadly stable (see **Figure 2.6**), with a slight increase observed in the second cycle. This indicates that new hires in the latest cycle have at least offset, and in some cases exceeded, departures from these firms. The relatively steady headcount suggests that the largest firms have been able to manage workforce turnover effectively, sustaining their capacity to meet audit demand notwithstanding the labor market challenges.

Figure 2.6:
Number of Audit Professionals in Six Largest Firms



Coverage of Second Cycle of Inspection (2022 to 2025*)

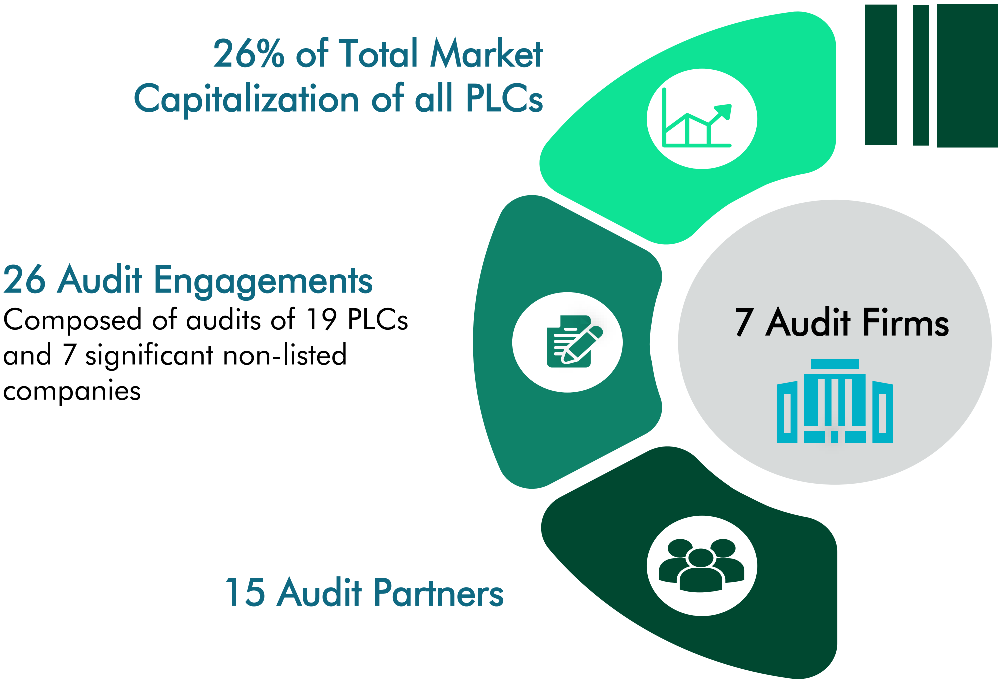
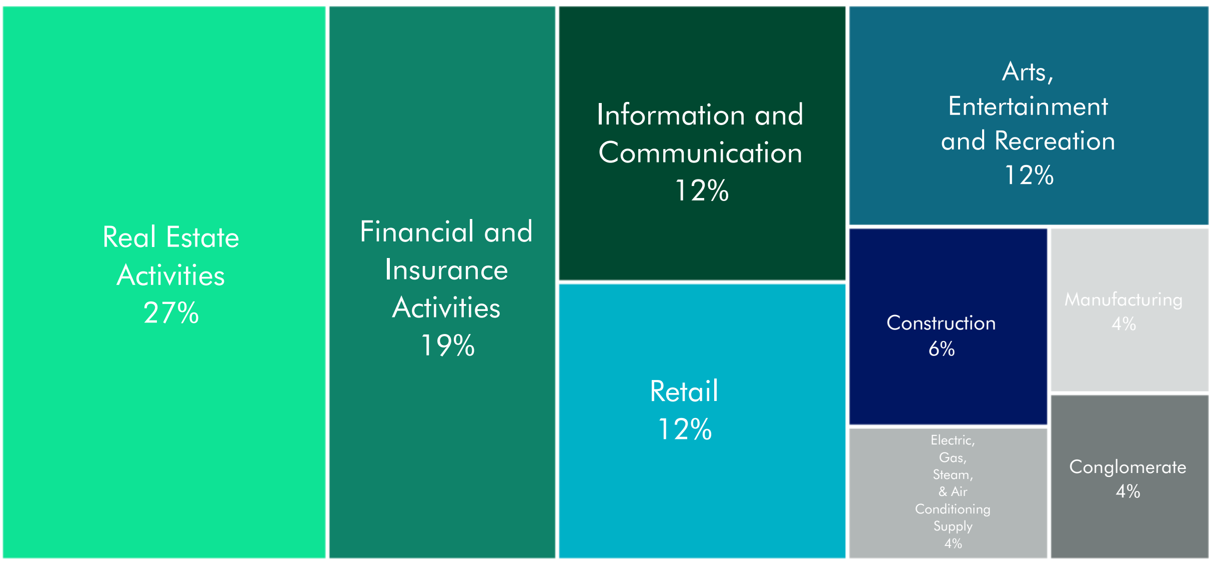


Figure 2.7
Industry Coverage by Number of Publicly-Listed Companies



**Following the Supreme Court's (SC) 2023 decision nullifying CPA accreditation, the SEC took the initiative to pause the SOAR Inspection Program in 2024 to review and revise the inspection guidelines following the SC ruling. The SC subsequently reversed its ruling in January 2025 reaffirming the SEC's authority over the accredited external auditors.*

3

FIRM-LEVEL OBSERVATIONS

Common Inspection Findings

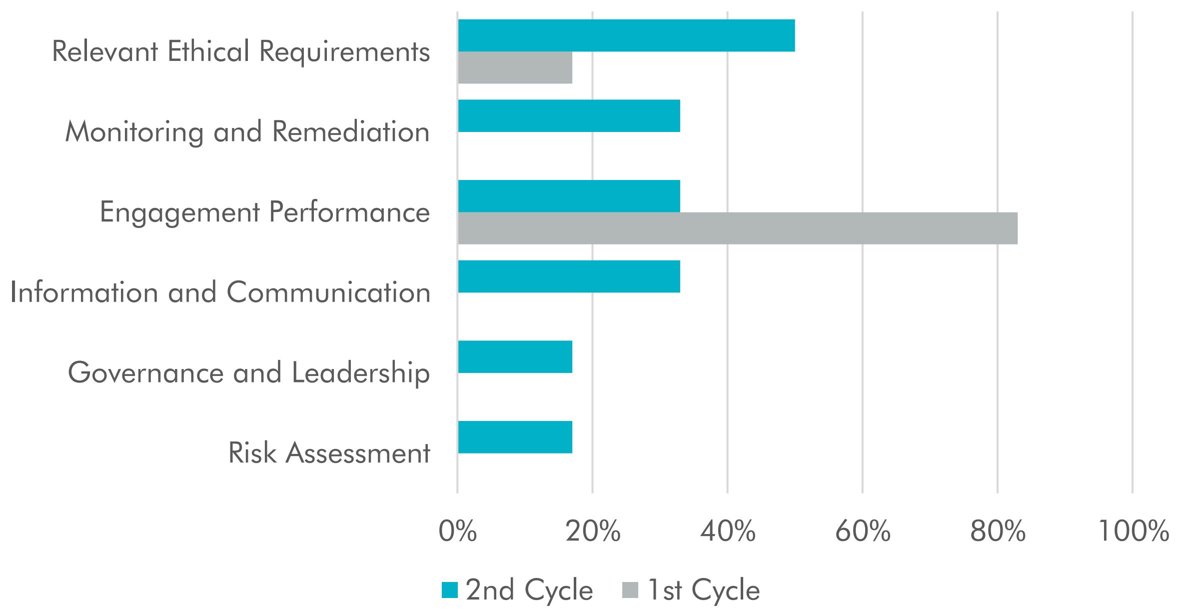
PSQM 1 replaced Philippine Standard on Quality Control 1 (PSQC 1) and introduced a more robust risk-based approach to quality management. PSQM 1 requires audit firms to design an SoQM to manage the quality of engagements performed by the audit firm.

PSQM 1 consists of eight components that are integrated and does not operate in a linear manner. Among these, two new components were introduced by the standard; the audit firm's risk assessment process and information and communication.

At firm level, the SOAR Inspection Team evaluated the audit firm's compliance with the requirements of PSQM 1. For purposes of presenting firm-level inspection findings in this report, only findings from the six largest audit firms for the first and second inspection cycles are included, unless otherwise stated. As shown in **Figure 3.1,** a sudden increase of deficiencies was noted during the 2nd cycle which was mainly attributable to the audit firms' transition to PSQM 1 from PSQC 1. There were notable increases in findings related to relevant ethical requirements, particularly concerning the communications required under the ethical standards.

In addition, new findings emerged in the areas of (a) monitoring and remediation, (b) information and communication, (c) governance and leadership, and (d) the risk assessment process, largely attributable to the new requirements of PSQM 1, with some audit firms still at the initial stage of implementation.

Figure 3.1:
Percentage of Six Largest Audit Firms with Quality Management System Findings



On the other hand, the engagement performance component showed significant improvement in the second cycle, driven by enhancements in firm processes and methodologies, particularly in consultations, engagement reviews, and the assembly of final audit files.

Relevant Ethical Requirements

Clear communication with those charged with governance (TCWG) is a foundation of audit integrity. Under PSA 260, auditors must disclose their compliance with ethical requirements, including independence, to help strengthen confidence in the audit process. When TCWG, such as board members or audit committees, are assured of the auditor's ethical compliance, they can trust that the financial statements are examined without bias or external influence. This transparency helps prevent concerns about conflicts of interest or undue pressure that might compromise the quality of audit.

In this inspection cycle, however, notable gaps in the firm's adherence to independence and ethics policies and procedures were revealed. Data gathered shows that 50% of the six largest audit firms have at least one inspection finding related to the relevant ethical requirements (see **Figure 3.1**).

The specific independence and ethics findings noted by the SOAR Inspection Team are presented below:

Relevant Ethical Requirements Findings	
Inadequate communication 	**3 out of 6 largest audit firms** Failing to communicate independence matters such as: a. Audit and non-audit fees including related safeguards applied to address potential threats to independence b. Ethical requirements (limited to merely confirming the independence of the firm, its partners, and staff)
Business relationship 	**1 out of 6 largest audit firms** Entering into business relationship with audit clients, which may compromise independence.

As response to the identified issue, the audit firms **issued supplemental internal guidance** to strengthen its policies on communicating ethical and independent matters to TCWG, **reiterated its policy in assessing independence** in relation to business relationships, and **enhanced its consultation forms** to include more comprehensive information on business relationships.

The Ethical Role of Auditors: Challenges and Maintaining Integrity

Auditors play a vital role in safeguarding financial transparency. Yet, the pressures of client relationships, deadlines, and ethical dilemmas continue to test their professional independence.

Auditors serve as independent gatekeepers, ensuring financial integrity, regulatory compliance, and investor confidence. Their independent assessments help detect misrepresentation, protect investors from misleading information, and reinforce corporate governance.

However, auditors face significant ethical challenges that can compromise their ability to remain independent and objective in performing an audit engagement. These challenges primarily arise from client pressure, prolonged client relationship, and conflicts of interest. Addressing these issues is highly essential in maintaining public trust and audit integrity.

Client Pressure: Protecting Objectivity

Key Issue: Pressure from the client to issue favorable reports. Since audit client pays for the audit fee, auditors may feel obligated to meet their expectations, even at the risk of compromising their objectivity and independence.

This risk increases when auditors provide additional non-audit services, such as consulting or tax advisory, which creates financial ties that threaten impartiality when assessing financial statements.

To mitigate these risks and enhance transparency over fee-related arrangements, the SEC issued disclosure guidelines on fee requirements applicable to public interest entities.[4] Nevertheless, managing and safeguarding threats to auditor independence arising from client pressure, client dominance over auditors, or other forms of undue influence remains a persistent challenge that must be evaluated and addressed carefully. Client dominance over auditors creates imbalance of power that compromises the integrity and credibility of the financial reports.

How to Address this Challenge

Adopt a Firm Stance	Maintain Comprehensive Documentation	Seek Guidance
Question client's judgments and estimates affecting the bottom figure of the financial statements, key ratios and disclosures; must stand firm and not waiver in exercising professional judgment throughout the conduct of audit.	Strengthen auditor's position supported with strong audit evidence in case of disputes and disagreements with client.	If undue pressure arises, auditor must consult with the audit committee, SEC or other relevant regulatory bodies to reinforce independence and maintain the credibility of audit works.

[4] SEC MC No. 18 series of 2024: Guidelines on the Disclosure of Fee-Related Information of External Auditors.

Prolonged Client Relationship: Upholding Unbiased Judgment and Skepticism

Key Issue: Auditors may struggle to maintain unbiased judgment and professional skepticism when extended tenure, close interactions, or reliance on prior conclusions create familiarity threats, leading to reduced challenge of management's representations.

This may reduce the level of professional skepticism applied in areas involving significant judgments and estimates. Without effective safeguards, it may impair objectivity and compliance with the requirements of applicable auditing and ethical standards.

The Revised SRC Rule 68 reinforces ethical requirements on long association of personnel, including mandatory partner rotation, to mitigate familiarity threats, preserve auditor independence, and ensure the consistent application of professional skepticism throughout the audit.

How to Manage Being Too Familiar with Audit Client

Periodic Engagement Personnel Rotation	Engagement Quality Review	Targeted Training for Skepticism
Ensure fresh perspectives and reduce the risk of long-term familiarity affecting judgment.	Independent review and consultation strengthen the position on significant judgments, estimates, and contentious matters.	Enhance questioning mindset and critical thinking corroborated with sufficient and appropriate audit evidence.

Conflicts of Interest: Maintaining Independence in Fact and Appearance

Key Issue: Close financial or personal relationships with clients create conflicts of interest.

These relationships can compromise auditors' objectivity, making it difficult for auditors to challenge client judgments and estimates that may lead to financial misstatements and disclosure deficiencies. A lack of independence, both in fact and appearance, weakens public confidence in financial reporting and may lead to unethical decision-making.

How to Prevent Conflict of Interest

Mandatory Independence Check	Transparent Disclosures	Strict Internal Control
Strong independence monitoring, including safeguards against receiving favors and gifts, helps identify and address independence threat before they affect audit quality.	Communicate openly potential conflicts of interest and its safeguard to the audit committee.	Avoid situations where impartiality might be questioned.

Ethical Breach: Answer Sharing Misconduct

In 2024, a local member firm of a global network was sanctioned by the U.S. Public Company Accounting Oversight Board (PCAOB) due to widespread improper sharing of answers on mandatory internal training exams. This misconduct violated the U.S. PCAOB rules and quality control standards over several years in connection with the firm's internal training program.

Recognizing the seriousness of the violation, the SEC likewise issued a public advisory about the incident and monitored the firm's implementation of remedial actions to address the quality control deficiencies.

Since then, the audit firm has implemented remedial and corrective measures aimed at successfully ending improper answer sharing, including changes to its quality control policies and procedures to promote professional integrity and ensure that personnel obtain the required technical training and proficiency.

Ethical compliance is not just a regulatory obligation, it is the foundation of public trust in financial reporting. By adhering to ethical guidelines, maintaining independence, and fostering a culture of integrity, auditors can uphold high ethical standards and contribute to financial transparency and accountability.

Monitoring and Remediation

Monitoring and remediation form a vital component of the quality management process in audit firms, as outlined in PSQM 1. This component ensures that audit firms maintain consistent quality in their engagements and remain compliant with regulatory expectations.

	Monitoring refers to the regular and systematic assessment of an audit firm's quality management system. Its aim is to identify deficiencies or areas of improvement by examining completed or on-going audits, and overall operations.
	Remediation involves addressing the deficiencies identified during monitoring, evaluating root causes, implementing corrective actions and preventing their recurrence.

The specific monitoring and remediation findings noted by the inspection team are summarized below:

Monitoring and Remediation Findings	
Design and implementation of monitoring activities	**2 out of 6 largest audit firms** Failure to design and perform monitoring activities to provide basis for the identification of deficiencies.
Evaluation of firm's SoQM	**1 out of 6 largest audit firms** Failure to establish policies and procedures to evaluate the firm's SoQM.
Evaluation of identified deficiencies	**1 out of 6 largest audit firms** Failure to evaluate the severity and pervasiveness of identified deficiencies.
Evaluation of remedial actions	**1 out of 6 largest audit firms** Failure to set policies to evaluate whether remedial actions effectively addressed the identified deficiencies and the related root causes, and to ensure that they are implemented.
Communication and monitoring and remediation	**1 out of 6 largest audit firms** Failure to establish policies and procedures that ensure timely communication of monitoring and remediation to individuals with ultimate and operational SoQM responsibilities.

To ensure effective monitoring, audit firms shall implement the following key measures to ensure that the objectives of PSQM 1 are achieved:

1. Verify whether the individual or team responsible for monitoring and remediation activities meet the qualifications set by the firm.
2. Ensure that the monitoring and remediation team has specialized training in risk-assessment, problem-solving, RCA, quality management system and other relevant topics.
3. Conduct a performance evaluation of the individuals assigned operational responsibility for the SoQM, particularly the monitoring and remediation process, focusing on their effectiveness in monitoring and remediation activities.
4. Check annually on the completion of the performance evaluation of staff, managers, partners, and reviewers
5. Check the indicators set to measure if enough reviews and supervision were provided to the engagement teams.
6. Check the indicators set to ensure that auditor's workload was prioritized.
7. Conduct inspection of completed engagements.
8. Periodic review of an on-going engagements, particularly high-risk accounts, is encouraged.
9. Evaluate whether schedules are being met and objectives are being achieved.
10. Evaluate feedback received from engagement team and process owners.
11. Evaluate sufficiency and adequacy of documentation.

IMPORTANT NOTE!

"Findings are only as valuable as the actions they inspire."

Inspection findings highlight gaps and risks, but their true purpose is realized when we take timely and thoughtful remediation and monitoring improvements. PSQM reminds us that quality management is ongoing. Fixing issue once is not enough; understanding causes and tracking progress ensures lasting improvement.

Engagement Performance

Engagement performance is a component of PSQM 1 ensuring that engagements are properly planned, executed, supervised, reviewed, and reported, including timely completion and archiving of engagement documentation and resolution of differences in opinion, in accordance with professional standards and applicable legal and regulatory requirements.

In the inspections conducted, two out of the six largest audit firms were identified to have at least one finding regarding engagement performance. The specific engagement performance findings noted by the SOAR Inspection Team are summarized below:

Engagement Performance Findings	
Archiving of final audit file	**2 out of 6 largest audit firms** Failure to complete the assembly of the final engagement file within the prescribed 60-day time limit after the date of the engagement report. Majority of the inspected files were archived within an average of 26 days following the audit report date (ranging from 1 day to 59 days).
Differences of opinion	**1 out of 6 largest audit firms** Failure to design and implement responses to address the quality risks identified related to the resolution of differences of opinion within the engagement team, EQR, or individuals performing activities within the firm's SoQM.
Sufficient and timely engagement review and supervision	**1 out of 6 largest audit firms** Failure to observe the firm's policies on required minimum level of involvement of EP and EQR. Majority of the working papers of the selected engagements were signed off by the EP and EQR after the audit report date.

Information and Communication

Information and communication component requires effective communication of reliable information within the firm and with external parties to support the effective operation of the audit firm's SoQM.

Two out of the six largest audit firms have at least one finding regarding information and communication. The specific finding related to information and communication noted by the inspection team is summarized below:

Information and Communication Findings	
Design and implementation to address required communication 	**2 out of 6 largest audit firms** Lacking policies and procedures to fully identify relevant risks and responses related to communication with external parties, such as the required communication to TCWG and those required by law or regulations.

The Revised SRC Rule 68 Part I. par 3. viii (c) **mandates the auditor to file a report to SEC** containing the following findings on the entity, in case the audit committee fails to submit the required report:

(1) Any finding of: (i) violation of SRC Rule 68; (ii) offering of securities without prior registration with the Commission under the SRC; or (iii) engaging in the business of financing or lending without a secondary license;

(2) Any material finding involving fraud or error;

(3) Losses or potential losses the aggregate of which amounts to at least ten per cent (10%) of the consolidated total assets of the company;

(4) Any finding to the effect that the consolidated assets of the company, on a going concern basis, are no longer adequate to cover the total claims of creditors; and

(5) Material weaknesses in internal control which may lead to financial reporting problems.

Governance and Leadership

Governance and leadership component ensures that firm leadership promotes a culture of quality, ethical behavior, and compliance with professional standards and regulatory requirements.

The specific finding related to governance and leadership noted by the SOAR Inspection Team is summarized below:

Governance and Leadership Finding	
Assignment of responsibility 	**1 out of 6 largest audit firms** Failure to assign ultimate responsibility and accountability for the SoQM to the firm's chief executive officer or the firm's managing partner (or equivalent). The firm assigned the ultimate responsibility of the firm's SoQM to its Assurance Head. This weakens governance because ultimate accountability should rest with the firm's highest leadership (Chief Executive Officer/ Managing Partner) to ensure compliance with standards, firm-wide accountability, and a culture of quality across all services, not just assurance.

The clear assignment of responsibilities is critical to the effective operation of the firm's SoQM, as it ensures that individuals not only have the necessary competence but also the appropriate authority and influence to carry out their roles effectively. Properly designated authority and influence enable responsible individuals to enforce quality policies, make decisions regarding remediation of deficiencies, and ensure that the firm's quality objectives are met consistently.

TONE AT THE TOP

"A firm's SoQM can fail before it even starts simply because no one is clearly accountable for it."

When ultimate responsibility isn't assigned to the CEO, managing partner, or governing board, the SoQM loses the leadership oversight it needs to operate effectively.

Risk Assessment Process

The risk assessment process of PSQM 1 is an approach that identifies and evaluates threats to quality, enabling the firm to design and implement appropriate responses to achieve consistent compliance with professional standards and regulatory requirements.

One of the six largest audit firms was identified as having at least one finding regarding information and communication. The specific finding related to the risk assessment process noted by the SOAR Inspection Team is summarized below:

Risk Assessment Process Finding	
Identification and assessment of quality risks related to the quality objectives 	**1 out of 6 largest audit firms** Failure to consider how, and the degree to which, the conditions, events, circumstances, actions, or inactions may adversely affect the achievement of the quality objectives. The firm's risk assessment process is limited to identifying quality risks associated with each objective, without evaluating the likelihood or the extent of their potential impact.

The risk assessment process is fundamental to the effective operation of the firm's SoQM, as it ensures that conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of quality objectives are appropriately identified and evaluated. A robust and structured assessment of the nature, severity, and likelihood of such risks enables the firm to design and implement effective responses, thereby supporting consistent compliance with professional standards and regulatory requirements and the ongoing achievement of the firm's quality objectives.

Figure 3.2:
Input-Activities-Output Model for Quality Risk Assessment Process

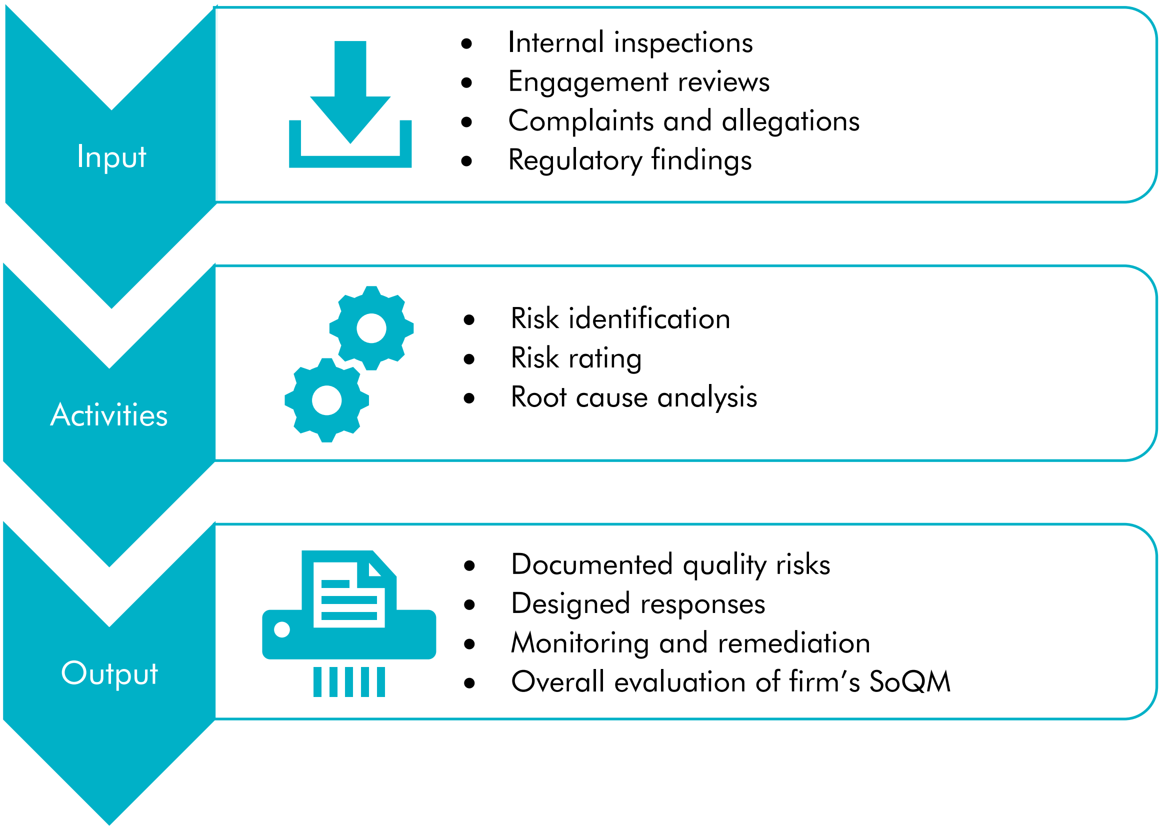


Figure 3.2 illustrates the Input-Activities-Output model applied to some firm's quality risk assessment process. The model demonstrates how relevant inputs are analyzed through structured activities to produce clear outputs that support the effective operation of the SoQM.

ADDRESSING INSPECTION FINDINGS

All audit firms performed the required RCAs to identify the underlying causes of the inspection findings and developed corresponding remediation plans to address the identified deficiencies.

The inspection findings were subsequently addressed by the audit firms through the implementation of corrective actions and enhancements to their respective SoQM. These remediation efforts formed part of the firms' implementation of PSQM 1.

4

ENGAGEMENT-LEVEL OBSERVATIONS

Common Inspection Findings

This section presents a summary of the engagement-level findings, highlighting the areas with the highest frequency of findings for PLC audits. Inspections of individual audit engagements evaluate the audit firm's application of auditing standards on selected audits and, as such, the presence of a finding does not necessarily indicate a misstatement in the related financial statements.

Figure 4.1:
Percentage of Inspected Audits of PLCs with at Least One Inspection Finding

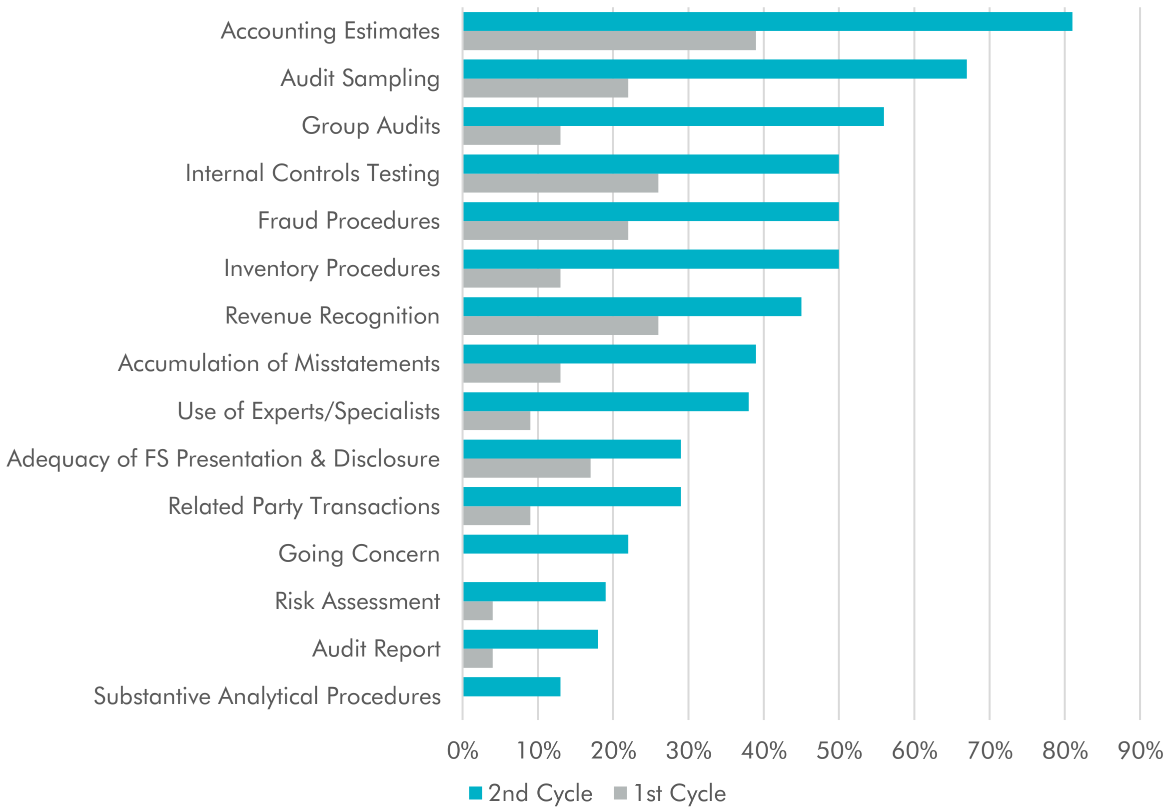


Figure 4.1 summarizes the rate of PLCs audited by the six largest audit firms, with at least one finding in the latest inspection cycle, with comparative data from the previous cycle. The findings presented here are the top 15 most frequent engagement-level findings. As shown in **Figure 4.1**, the second inspection cycle recorded a notable increase in findings, driven in part by factors such as disruptions from remote work and limited in-person training during the pandemic, which affected auditor supervision and professional development. Project management challenges were also observed, as many firms face increased workloads and staffing constraints. For more information on the possible root causes of these findings, please refer to **Chapter 5** of this Report. Additionally, two emerging findings were identified in the second cycle: going concern and substantive analytical procedures.

Accounting Estimates: including Fair Value Measurement

Accounting estimates, including fair value measurements remained the most common inspection finding at the engagement level. Eighty-one percent (81%) of the inspected audits by six largest audit firms of PLCs had at least one finding related to estimates, a significant increase from 39% in the previous cycle.

Figure 4.2:
Audit Areas with Findings Related to Accounting Estimates

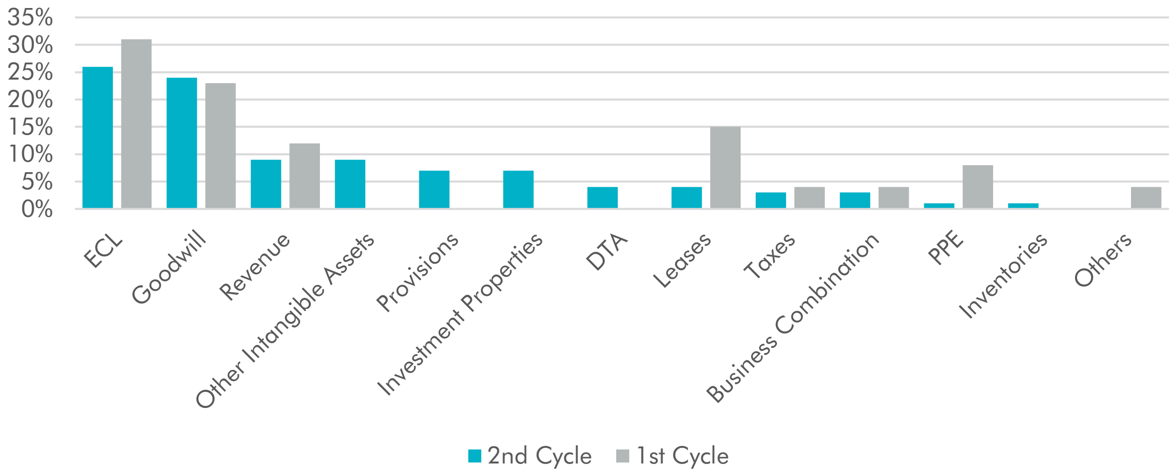


Figure 4.2 shows that the **expected credit losses (ECL)** and **goodwill** remain the top two audit areas with findings related to accounting estimates. This is primarily due to: (1) **their inherent complexity**, where auditors lack in-depth understanding of management's method and fail to adequately test the key assumptions used in developing these accounting estimates; and (2) **insufficient involvement of experts** in the review and evaluation of complex assumptions and estimates.

For ECL, common findings primarily relate to how the auditor test management's estimates, particularly the estimation of probability of default rates, including the macroeconomic factors in developing forward-looking information.

Deficiencies in audit procedures relating to ECL in banks and financial institutions are primarily due to the auditor's superficial understanding and insufficient testing to assess the reasonableness of the bank's method of estimating ECL. This includes limited validation of model inputs, insufficient challenge of management's judgments, and overreliance on internally generated data without appropriate corroboration.

For goodwill, the main cause of findings identified is due to the auditor's failure to sufficiently test the inputs used by management in its forecast. Specifically, some auditors relied on these inputs and assumption without performing further procedures to test their reasonableness.

> ***IMPORTANT NOTE!***
>
> *"Failing to appropriately test even a single significant assumption in an accounting estimate can lead to a material misstatement in the financial statements."*

Audit Sampling

Audit sampling is a tool used by auditors to draw conclusions from a population based only on selected samples. Auditors use different audit approaches, and these differences can lead to variations in sample size, the items selected, and how well the samples represent the entire population. As a result, this affects how confidently auditors can draw conclusions about the whole population and whether they obtain sufficient and appropriate audit evidence. Thus, auditors follow a sampling methodology and guidance for consistency and to support their use of professional judgment in audit sampling.

Figure 4.3:
Common Deficiencies in Audit Sampling Identified

- Insufficient sample size to reduce sampling risk to an acceptable level
- Failure to fully test all the selected samples
- Failure to test the completeness and accuracy of the population used for sample selection
- Lack of proper investigation of exceptions, resulting in potential misstatements being overlooked
- Failure to identify the population from which the samples were drawn
- Failure to provide rationale or basis for sample size and selection

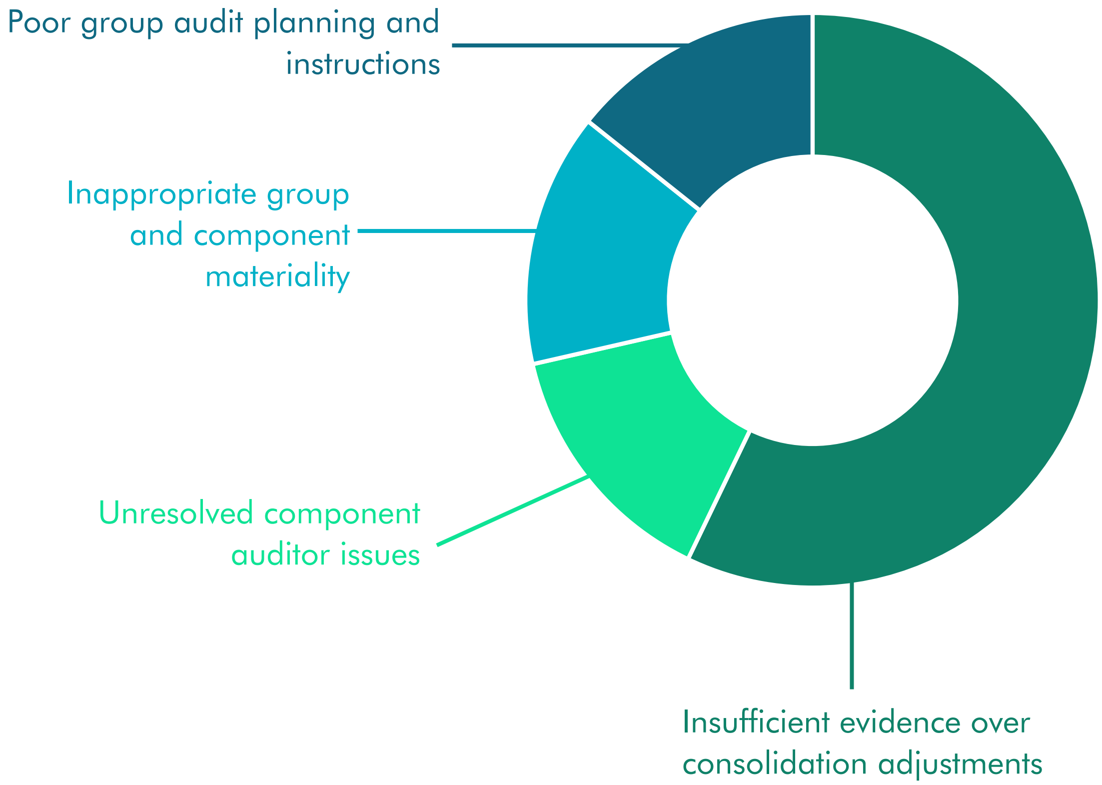
Figure 4.3 shows common deficiencies in audit sampling identified during inspection. These findings suggest that auditors were not applying sampling procedures carefully or consistently. In some cases, the procedures performed were not enough to support reliable conclusions, either because sample approaches are not appropriately designed in response to assessed risks, sample selections are not clearly defined, items selected are not fully tested, or supporting evidence is not obtained or followed up. This creates a risk that potential errors or misstatements may not be identified, thereby reducing the overall quality of the audit.

RCAs conducted by some of the six largest audit firms identified insufficient knowledge and understanding of PSA 530, *Audit Sampling*, as the primary reason for recurring deficiencies in selecting samples for the audit. This highlights the need for ongoing training to ensure audit professionals fully understand the standard, particularly given that audit sampling is a fundamental technique for conducting an effective audit.

Group Audits

Group audits require the evaluation of component auditors' work and the review of consolidation adjustments, which are often extensive and complex. To address these risks, PSA 600 emphasizes the auditor's responsibility for effective coordination, communication, and supervision, including performing additional procedures in conducting group audits. The summary of group audit findings is presented in **Figure 4.4**:

Figure 4.4:
Most Common Findings Related to Group Audit



These matters reflect weaknesses in planning, coordination, and execution of group audits. Gaps were noted in how issues raised by component auditors were evaluated and addressed, as well as in the determination of group and component materiality and the development of a clear group audit strategy, including effective scoping and communication with the component auditor. **Figure 4.4** shows that insufficient evidence over consolidation adjustments emerged as the most frequent finding, as these adjustments are often prepared centrally and late in the reporting process. Auditors may therefore rely heavily on management explanations or summary schedules without fully testing the completeness, or accuracy of the consolidation entries. The complexity and judgment involved in consolidation entries, combined with manual procedures and time pressure further increases the risk that significant group-level matters are not adequately supported by audit evidence or not completely captured at group level.

The key root causes identified by the firms include insufficient review and lack of supervision by senior members of the group engagement team and ineffective project management. Group audits of complex conglomerate entities require robust project management, which includes timely review of component auditor's audit procedures while maintaining close supervision and regular communication to ensure timely submission of deliverables. While the group auditor is responsible for testing the consolidation entries, including eliminating entries, capturing significant accumulated adjusting entries form the component auditors is crucial to ensure completeness of consolidation entries at group level.

To address these findings, auditors had several remediation measures, including implementing training programs on group audit procedures, enhancing documentation of eliminating entries to ensure proper testing of their accuracy, completeness, and appropriateness, and performing real-time or hot reviews of group audits, among others.

PSA 600 revised introduces significant updates to the audit of group financial statements. The revision aligns PSA 600 with internationally revised standards and reflects evolving practice expectations. The key changes are as follows:

a. Introduces a proactive **risk-based approach;**
b. Reinforces that other standards must be applied in group audits, particularly the key foundational standards: **PSA 220 (revised), PSA 230, PSA 300, PSA 315 (revised 2019), and PSA 330;**
c. Strengthen the importance of **two-way communication** between group auditor and component auditor;
d. Enhanced **documentation requirements;**
e. Reinforced importance of **professional skepticism** throughout the group audit procedures; and
f. Standard now is **scalable and adaptable** for various group structures.

Internal Controls

Understanding and evaluating internal controls are essential for auditors to determine the extent to which controls can be relied upon, assess the degree of control risk, and design appropriate audit approach to support an effective and efficient execution of audit, either controls or substantively only.

The **two most prevalent findings** relate to the following:

Insufficient testing of information technology general and application controls; and

Inadequate testing of information produced by entity.

These findings show why strong internal controls are important to a high-quality audit. Internal controls help prevent and detect errors and ensure that financial information is accurate and complete. When controls are not properly understood, tested, or evaluated, and when auditors do not respond appropriately to control issues and weaknesses, the risk of missing errors or misstatement increases. Effective internal controls, supported by thorough audit testing, are necessary to support credible and reliable financial reporting.

The key root cause identified by the firms includes issue on documentation due to insufficient knowledge on PSA 230, *Audit Documentation*. However, this is not the only challenge the auditors face, as there are several other factors that also contribute to difficulties in effectively understanding, evaluating, and documenting internal controls.

Problems Encountered by Auditors in Understanding and Documenting Controls

Time and Resources Constraints

Limited budgets often reduce the time and resources available for understanding and documenting of internal controls, often resulting to high-level documentation rather than detailed analysis. This may also limit the use of specialist, such as IT auditors.

Complexity of Process and System

Complex business operations and advance information system can make it difficult for auditors to fully understand how controls are designed and implemented.

Limited Cooperation from Management

Delays in obtaining information and incomplete explanations can hinder the auditor's ability to accurately understand and document how controls operate in practice.

Inadequate or Outdated Documentation

Many organizations lack formal or updated documentation requiring auditors to rely on inquiries and walkthroughs which may lead to incomplete understanding if information is inconsistent and unclear.

Despite the challenges related to execution and documentation, internal control testing remains an effective audit approach, offering benefits such as:

- Ensuring that controls prevent, detect, and correct errors or fraudulent transactions that may lead to misstatements of the financial statements. Strong internal control serves as the foundation that supports the reliability of financial reporting process – from initiation, implementation, recording up to reporting of financial transactions;
- Increasing efficiency by testing controls over automated process rather than large numbers of individual transactions;
- Reducing the overall volume and scope of substantive testing;
- Allowing for interim testing prior year-end, which distributes audit effort and mitigates peak-season pressure;
- Providing assurance that controls operate effectively, giving auditors confidence that risks are addressed consistently throughout the period rather than just at testing points; and
- Enabling a more strategic focus on higher-risk and judgment areas.

Fraud Procedures

During the second cycle of inspection, fraud-related procedures emerged as the fourth most common inspection finding, with 50% of the inspected audits of PLCs exhibiting at least one deficiency in this area.

Figure 4.5:
Findings Related to Fraud Procedures

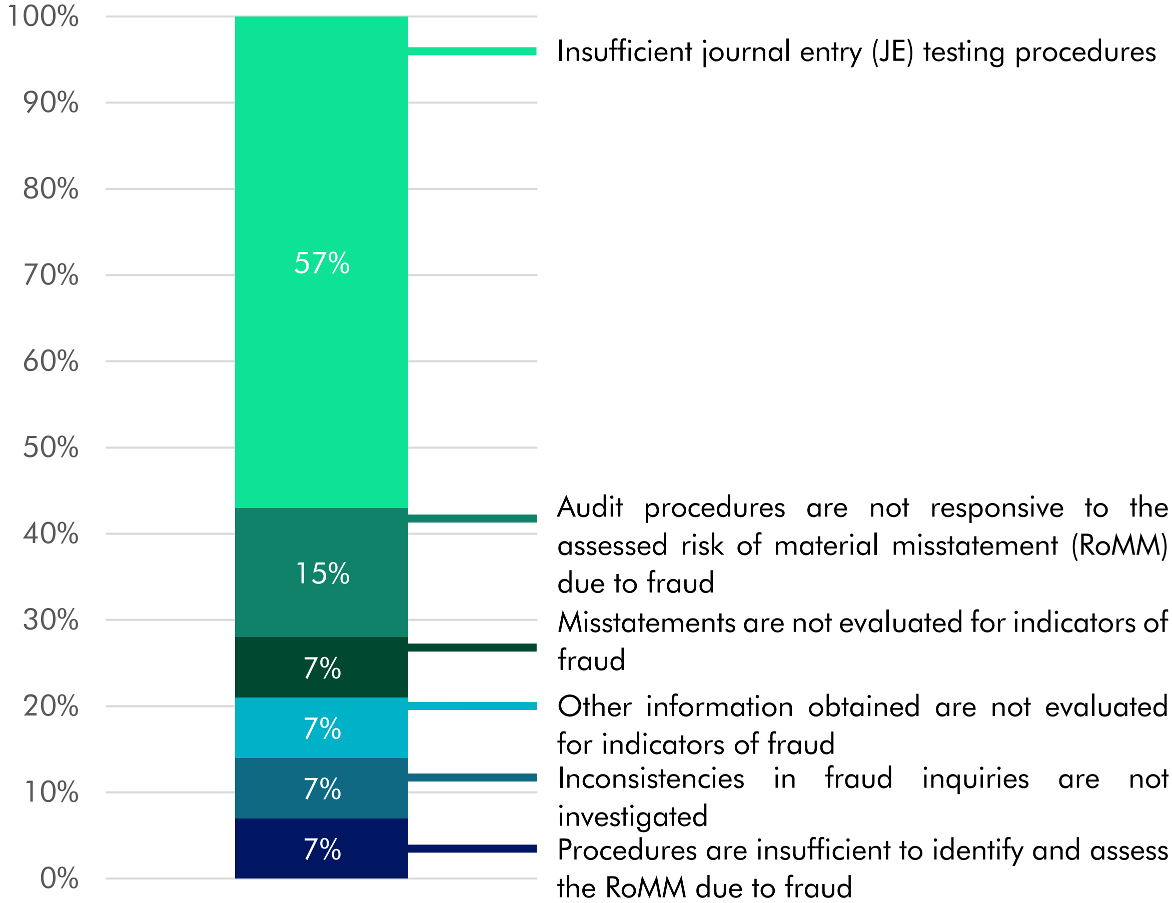
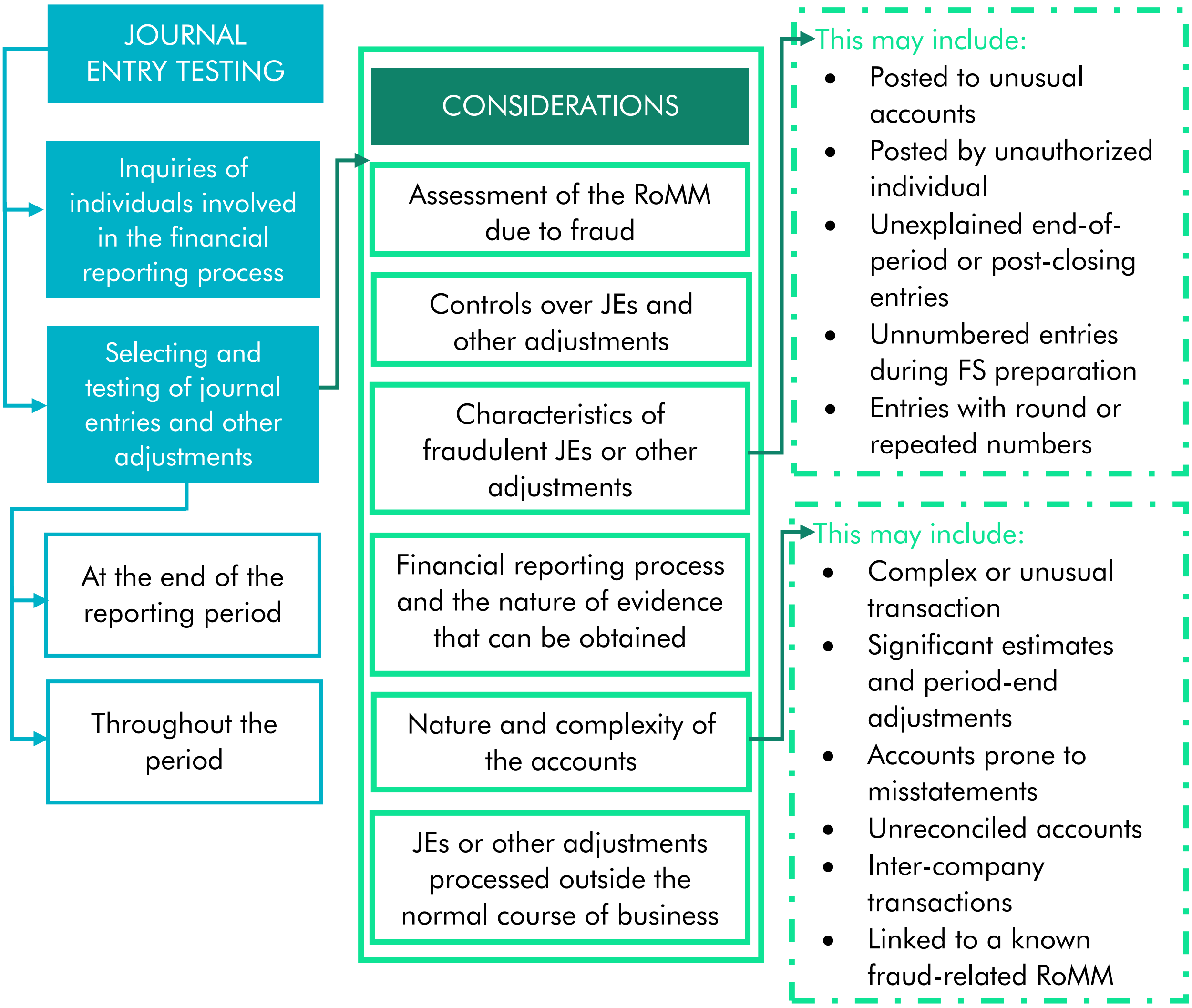


Figure 4.5 shows a significant factor contributing to this finding is the lack or insufficiency of procedures related to JE Testing. PSA 240, *The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements,* states that the auditor is mainly concerned about two types of intentional misstatements, namely: (1) misstatements resulting from fraudulent financial reporting; and (2) misstatements resulting from misappropriation of assets.

Of these, fraudulent financial reporting often involves management override of controls (MoC), whereby management circumvents established internal controls to manipulate financial results. Recognizing the inherent risk posed by MoC, PSA 240 requires that auditors design and perform procedures to address this risk, regardless of their initial risk assessment. One of the core procedures in this regard is JE Testing, which is designed to detect unusual or inappropriate journal entries that may signal fraudulent activity.

The diagram below outlines the minimum requirements for JE Testing as prescribed by PSA 240:



Beyond these minimum requirements, PSA 240 emphasizes the necessity for auditors to exercise professional judgment and apply additional procedures when specific fraud risks are identified, especially those that may not be addressed by standard procedures.

More importantly, the auditor's professional skepticism plays a crucial role in assessing whether a RoMM due to fraud exists given the audit evidence obtained throughout the audit. This mindset ensures that auditors remain alert to conditions that may indicate possible misstatement due to fraud.

PSA 240 requires auditors to exercise professional skepticism by maintaining a questioning mind and remaining alert to conditions that may indicate possible misstatements due to fraud. However, professional skepticism alone is not sufficient. Auditors must also demonstrate professional courage which is the willingness to raise concerns, challenge unsupported explanations, pursue unresolved issues, and openly communicate significant matters to TCWG, or to relevant authorities when necessary. Such courage enables auditors to act objectively despite pressure, resistance, or conflicts, thereby upholding auditor independence, protecting the public interest, and enhancing quality.

Revenue Recognition

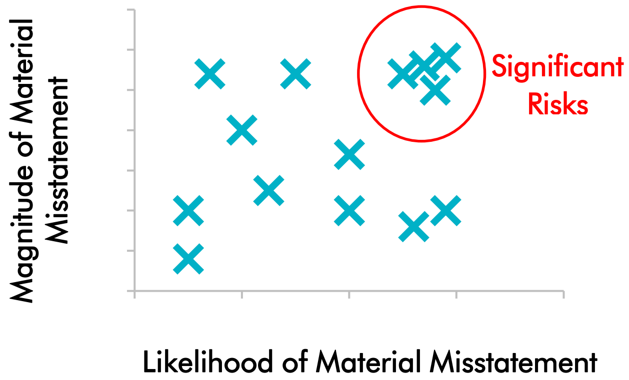
As noted by the Inspection Team during the second inspection cycle, the deficiencies identified in relation to revenue recognition were primarily attributable to the auditor's deficient assessment of the risks of material misstatement relative to this account. In a significant number of audit engagements reviewed, auditors designated certain risks associated with revenue recognition as "significant" without sufficient justification. These risk assessments were often based on generic assumptions, standard audit checklists, or the rebuttable presumption of fraud on revenue, rather than a robust, entity-specific evaluation of the underlying facts and circumstances surrounding the entity's operations.

While revenue recognition is often presumed to carry a higher or significant risk due to its inherent susceptibility to manipulation, the auditors in these cases did not substantiate the classification with a thorough understanding of the entity's revenue streams, industry-specific risk factors, or control environment. Consequently, risks that were deemed significant were, in fact, not significant based on the surrounding controls and current conditions.

More concerning, however, was the consistent failure by auditors to properly identify and respond appropriately to the actual significant risks that were present. These risks, often embedded in complex contractual arrangements, manual journal entries, or aggressive revenue targets, were either overlooked or not recognized as a threat of material misstatement. As a result, critical audit procedures necessary to address these significant risks were either not performed or were inadequately executed.

This misalignment in risk assessment had a direct impact on audit quality. By misjudging which risks were truly significant at the assertion level, auditors failed to design and implement responsive audit procedures that would provide sufficient and appropriate audit evidence. In several cases, this led to insufficient professional skepticism, inadequate documentation, and ultimately, a failure to meet the requirements of auditing standards related to risk assessment and revenue recognition.

The Inspection Team's observations suggest a need for improved auditor training and enhanced supervisory review over the risk assessment process and tailoring audit responses to the assessed risks at the assertion level, particularly in areas with judgments and estimates are required.



Firms should also consider reinforcing guidance on how to evaluate the significance of identified risks in a manner that is tailored to the unique aspects of each engagement, rather than relying on boilerplate assumptions.

Accumulated Misstatements

The SOAR Inspection Team identified two main causes for auditors' failure to accumulate misstatements during audits:

1

First, some auditors failed to consider and carry forward uncorrected misstatements from prior years to the current year's audit. This oversight can lead to a cumulative effect of misstatements that could be material over multiple reporting periods, potentially distorting the financial statements. When prior-year misstatements are not properly evaluated and carried forward, there is a risk that material misstatements may go undetected, ultimately impacting the reliability of the financial reports.

2

Second, some auditors failed to project misstatements identified in audit samples to the entire population, resulting to the non-accumulation of projected misstatements. When misstatements are detected in samples tested from the population, auditors are required to project their impact on the total population.

PSA 450 requires the auditor to accumulate all misstatements identified during the audit, except those that are clearly trivial, and consider the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. This accumulation is essential for evaluating whether the aggregate misstatements, both individually and in combination, have a material impact on the financial statements.

IMPORTANT NOTE!

"Ignoring past errors and overlooking sample patterns turns minor mistakes into a mountain of hidden risks."

Use of Experts / Specialists

Thirty-eight percent (38%) of the audits of the PLCs inspected in the second cycle were found to be deficient in the following areas:

1. Lack of procedures to evaluate the competence and capabilities of the expert; and
2. Failure to evaluate whether the expert's work is adequate or appropriate.

This is mainly attributable to the rise in audit engagements where either management or the auditor engaged experts to prepare or review accounting estimates, driven by the increasing complexity of accounting standards.

However, even though management of several PLCs took the initiative to involve an expert in order to obtain more supportable information about their assumptions, it is a common finding that the auditor's procedures were insufficient with respect to evaluating the competence and capabilities of management's expert along with its work.

Figure 4.6:
Auditor's Responsibilities in Using the Work of an Expert

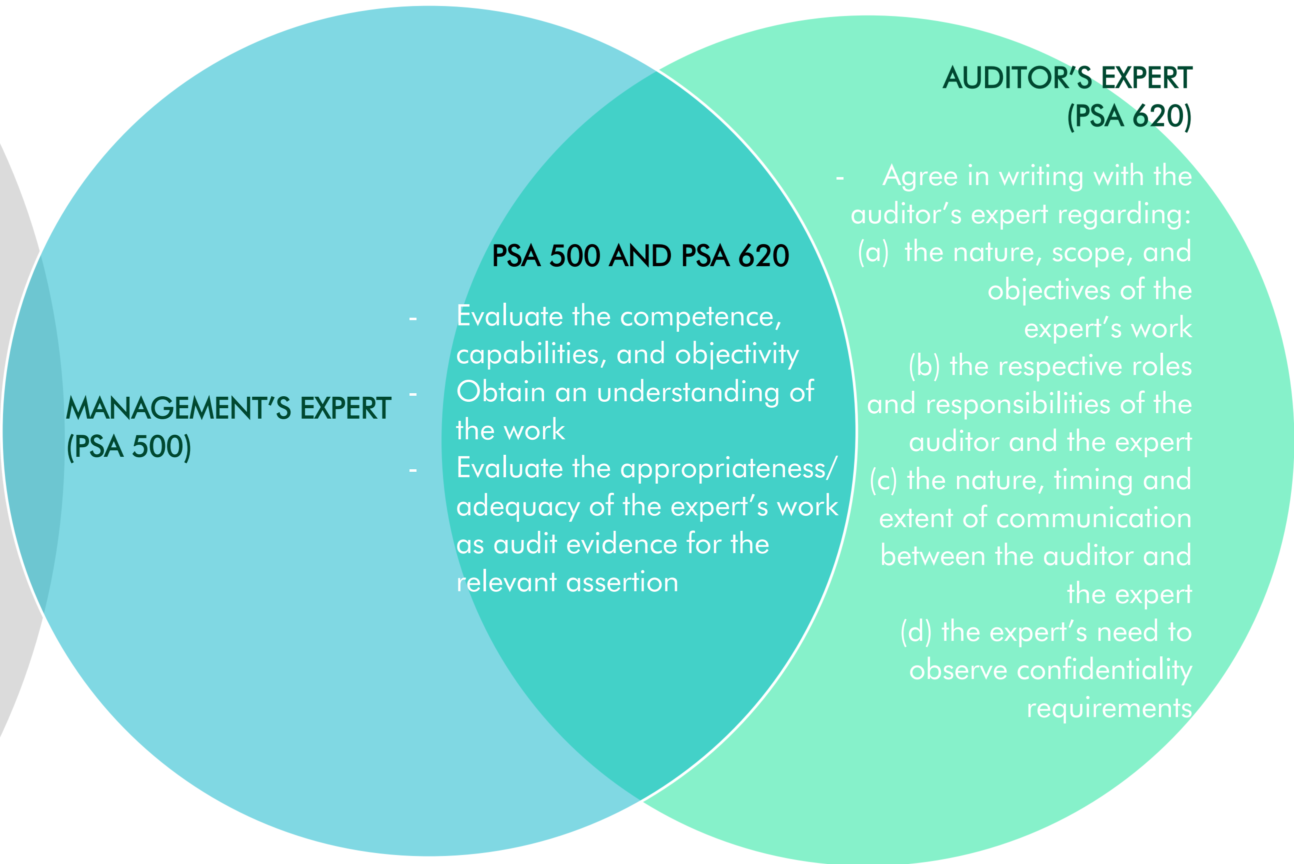


Figure 4.6 shows the procedures required by either PSA 500 or 620 when using the work of an expert.

On the other hand, in audits where no expert was engaged by management, the auditor also took its part by involving its own expert to ensure that management's accounting estimates and related disclosures in the financial statements are reasonable. Despite this initiative, a recurring finding in engagements involving an auditor's expert relates to inadequate evaluation of the expert's work and its consistency with the applicable financial reporting framework.

In other engagements, we also noted instances in which the auditor failed to involve an expert despite the engagement team lacking the necessary expertise in a field other than accounting or auditing.

An expert, whether management or auditor's expert, needs to:

- Meet applicable ethical and independence standards
- Have relevant skills and experience aligned with the identified audit risks
- Apply professional skepticism

An expert's role is to inform, not to own the outcome. Experts contribute specialized knowledge and experience that may sit outside the auditor's skill set; however, they do not bear the broader context and consequences of the audit. There is danger in hiding behind experts. Statement such as "the consultant said so" or "the specialist recommended" can become shields against accountability. Thus, once an expert's work is received, it is essential to:

- Confirm the expert's competence and objectivity;
- Understand the scope, limitation and purpose of the expert's work;
- Evaluate the methods, assumptions, and data used;
- Assess whether the conclusions are reasonable in the audit context; and
- Document the evaluation and conclusion.

IMPORTANT NOTE!

"Using an expert isn't about outsourcing accountability."

Regardless of whether the expert is engaged by management or the auditor, the auditor remains solely responsible and accountable for the audit opinion. This responsibility is not diminished by the use of an expert's work.

Going Concern

The going concern basis of accounting assumes that an entity will continue its operations for the foreseeable future and that it has neither the intention nor the necessity to liquidate or cease operations. This assumption is fundamental in the preparation of financial statements, as it affects the valuation of assets and liabilities.

Under PSA 570, auditors are required to obtain sufficient and appropriate audit evidence to assess whether management's use of the going concern basis of accounting is appropriate. The auditor must also determine, based on the audit evidence obtained, whether there is a material uncertainty regarding the entity's ability to continue as a going concern. If such uncertainty exists, it should be properly disclosed in the financial statements.

Deficiencies in Auditors' Assessment of Going Concern Assumptions	
Inadequate evaluation of disclosures	In cases where the auditor identified a material uncertainty about the entity's ability to continue as a going concern, some auditors lack thorough assessment of whether the disclosures in the financial statements were sufficient and appropriate.
Failure to assess management's evaluation	Some auditors did not perform adequate procedures to critically evaluate management's assessment of the entity's going concern status, such as analyzing future cash flows, financial support from third parties, and other mitigating factors.

Such deficiencies cast doubt on the reliability of going concern financial statements. If the auditor does not adequately assess or challenge management's assumptions, the financial statements may fail to reflect the entity's true financial position, potentially misleading stakeholders.

To address these issues, auditors must enhance their evaluation of going concern assumptions, including:

- Evaluating the reasonableness of assumptions used in management's going concern assessment, including conducting a robust review of management's forecasts, liquidity, and financing options. When management's assumptions rely on related and third-party financial support, auditors should obtain written confirmation and evidence of the related and third party's ability to provide that support.
- Ensuring that adequate disclosures are made in the financial statements when material uncertainties exist.
- Applying heightened professional skepticism, especially in industries or economic conditions where financial distress is more prevalent, and may be indicative that a material uncertainty exists relative to the entity's ability to continue as a going concern.

Substantive Analytical Procedures

On certain engagements, some auditors assessed that performing movement analysis, by explaining the increases or decreases from the prior period to the current period, constituted a sufficient and appropriate substantive analytical procedure. However, this approach is not sufficient and does not meet the requirements of PSA 520, *Analytical Procedures*, for substantive testing, as it lacks sufficient precision and appropriate design to detect material misstatements. The auditor should be guided that when designing and performing substantive analytical procedures for purposes of substantive testing, the auditor shall:

- Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
- Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation ;
- Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
- Determine the difference of recorded amounts from expected values that is acceptable without further investigation.

It is essential for auditors to understand relationships and plausible connections among the financial and non-financial data to effectively plan, design, and evaluate the results of substantive analytical procedures. This requires a thorough knowledge of the company's business and the industry in which it operates.

PSA 520 states that the auditor may inquire management as to the availability and reliability of information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.

5

ROOT CAUSE ANALYSIS

What is Root Cause Analysis (RCA)?

The firm-level and engagement-level observations discussed in the previous sections, and communicated through the LOF, can serve as a starting point for a more in-depth analysis of the conditions that gave rise to these findings. Once the LOF has been issued, and even before releasing the SOAR Inspection Report, the firm has an opportunity to reflect on what may be driving these issues, identify their root causes, and begin considering practical steps to address them, particularly where gaps in the quality management systems may exist.

As shown in a diagram in **Figure 5.1**, PSQM 1 follows a cyclical process designed to strengthen audit quality. PSQM 1 requires the audit firms to:

1. **Design and Implement SoQM.** Design and implement SoQM to manage the quality of engagement performed by the audit firm;
2. **Monitor.** Establish monitoring processes to provide relevant, reliable, and timely information on the design, implementation and operation of this SoQM;
3. **Evaluate Findings and Identify Deficiencies.** Evaluate findings from the monitoring to determine whether deficiencies exist;
4. **Root Cause Analysis.** Investigate the root cause of the identified deficiencies to evaluate their severity and pervasiveness; and
5. **Remedial Actions.** Design and implement remedial actions to address identified deficiencies that are responsive to the result of the root cause analysis (RCA).

RCA has long been recognized as an important step for improving audit quality and addressing systemic deficiencies. However, despite its importance, many auditors continue to face challenges in consistently and effectively applying RCA in practice. A thorough understanding and disciplined execution of RCA are essential to identifying underlying causes of audit deficiencies, supporting the implementation of planned remedial actions, and reducing the likelihood of recurrence.

When a deficiency is identified, either from the result of the firm's internal monitoring process, or from external audit inspection, the firm shall evaluate the severity and pervasiveness of the identified deficiency by investigating its root cause, and evaluating its effect. The firm shall then respond to the deficiency by taking actions to correct it, and implement actions to prevent its recurrence.

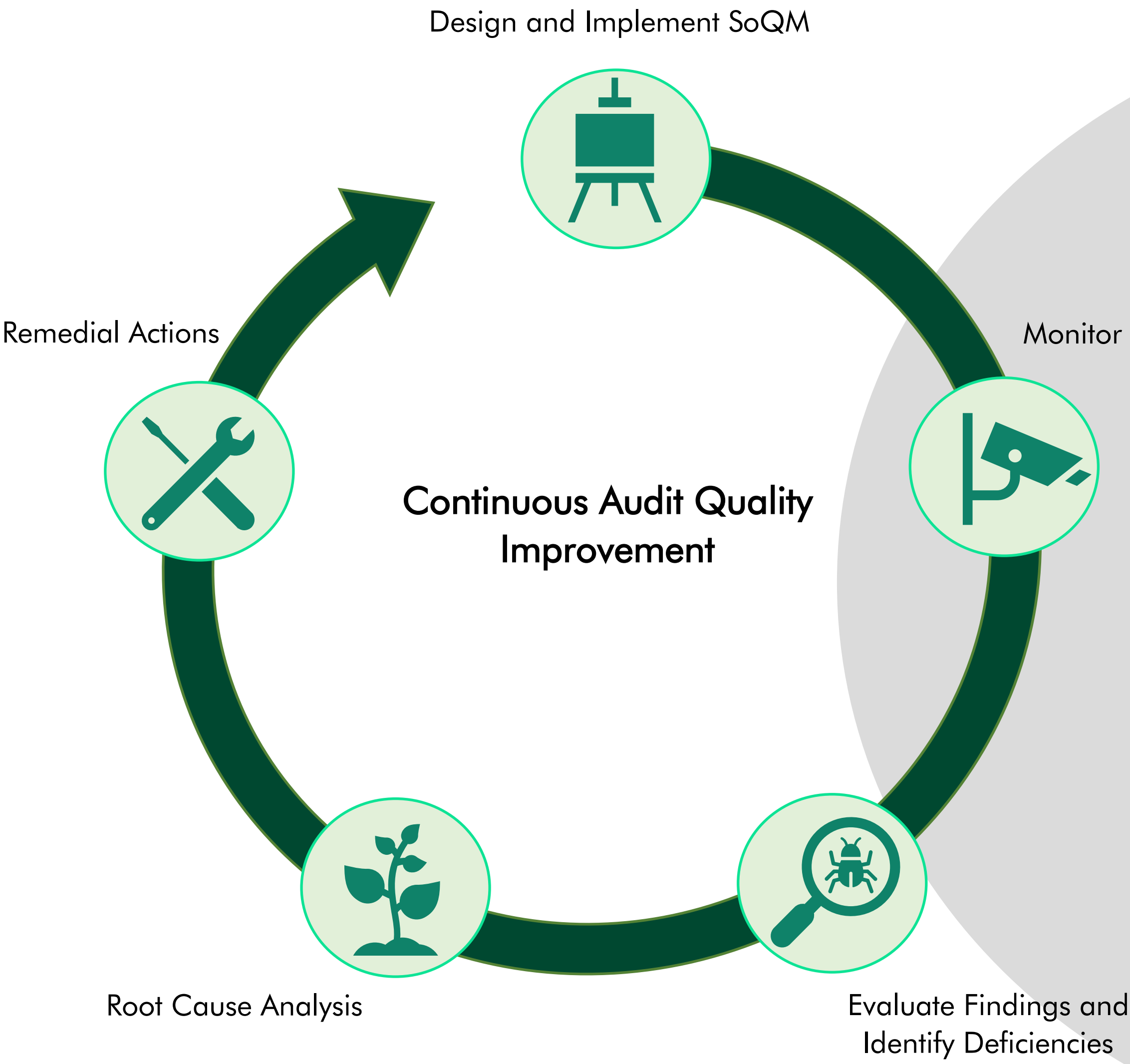
Did you know?

"RCA can also be used to identify and nurture positive outcomes."

RCA isn't just for solving problems, it can be used to spot and strengthen what's already working well. By uncovering reasons behind successful outcomes, RCA helps organization capture good practices and spread positive behavior across the firm.

To address deficiencies effectively, the underlying reasons for the failures must be identified. RCA is a crucial process that enables firms to pinpoint the main sources of problems, whether specific to one audit engagement or firm-wide.

Figure 5.1:
Continuous Audit Quality Improvement

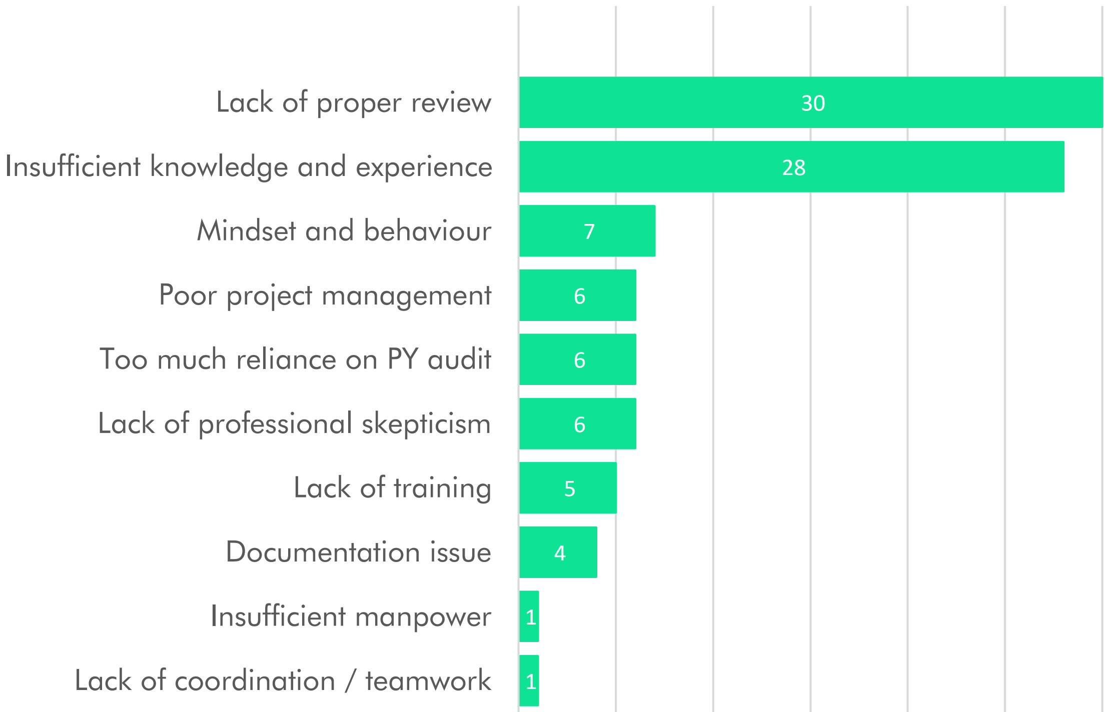


Common Root Causes and Actions Taken in Response to Identified Deficiencies

Remediation is a critical component of the SOAR inspection process, as it ensures that identified deficiencies are not only addressed but also prevented from recurring. In response to the findings issued by the SOAR Inspection Team, the inspected audit firms undertake RCA to identify systemic issues and to design appropriate preventive measures to address these issues.

As illustrated in **Figure 5.1**, most firms attributed the root causes to lack of proper review by executives and insufficient knowledge and experience. These underlying causes formed the basis for the remedial actions to address the specific inspection finding.

Figure 5.1:
Frequency of Identified Root Causes of SOAR Inspection Findings



In line with these findings, firms introduced various measures to strengthen audit quality. **Figure 5.2** highlights the most common actions taken, which include the provision of additional training, enhancements to review procedures, and targeted briefings for engagement teams.

However, despite these measures, the same findings continue to emerge. Comparing the results from both the first and second inspection cycles show recurring issues, suggesting that the underlying root causes may not have been accurately or fully identified.

Figure 5.2:
Frequency of Actions Taken as Responses to SOAR Inspection Findings

Identifying the true root cause

Many firms fail to address the true root causes of deficiencies. For example, recurring issues on failure to perform certain audit procedures are mostly attributed to the following root causes:

1

Lack of proper review

Most of the inspection findings can be avoided with sufficient and timely review and supervision. While the firm reported enhancements to its review procedures, this approach was still ineffective. The firm should perform a comprehensive RCA to identify and address why reviews do not function as intended. Potential true root causes may include the following:

- **Ineffective or unclear review policies and procedures** - Policies that lack clear guidance can lead to inconsistent review practices;
- **Overburdened partners and managers, and resource constraints** - Excessive workload and insufficient staffing pressure reviewers to prioritize completion over depth of review, increasing the risk of overlooking deficiencies;
- **Insufficient time allocated for thorough reviews** - Unrealistic timelines for reviews may result in inappropriate evaluation and judgments;
- **Reviewer complacency** - Reviews that focus on form rather than substance, treating procedures as "checklists" rather than performing a thorough evaluation;
- **Lack of accountability** - Reviewers may not be held responsible for the quality of their oversight or may lack clear consequences for inadequate review outcomes;
- **Deficient training and competency** - Reviewers may lack the technical knowledge, professional skepticism, or practical experience to identify and address complex audit issues; or
- **Organizational environment that discourage challenge** - Work environment that does not encourage open dialogue, questioning, and consultation can weaken the effectiveness of the review process.

Addressing these foundational issues, rather than simply increasing the frequency of reviews, is crucial to strengthening the firm's overall audit quality and preventing repeat deficiencies.

2 Insufficient knowledge and experience

As a preventive measure, firms commonly responded by incorporating the relevant topic into their staff training programs. Notwithstanding these actions, similar deficiencies continued to recur in subsequent inspections, suggesting that the issue may not attributable solely from gaps in technical knowledge or experience. Repeated failures despite targeted training indicate that the problem may stem from behavioral or project management issues rather than educational. The true root causes may therefore include:

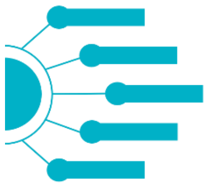
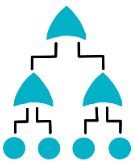
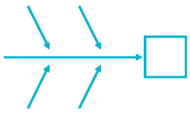
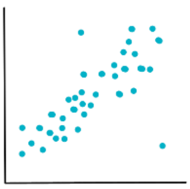
- **Skill mismatch** - There is a misalignment in resource allocation where staff are deployed to engagements outside their core industry expertise. Complex tasks are sometimes assigned to the wrong staff level.
- **Failure to engage a subject matter expert** - Without assessing the need for expert's involvement, auditors rely on standard procedures that fail to address other technical risks. Critical audit procedures are either skipped entirely or done poorly.
- **Complacent or routine-driven behavior among staff** - Complacent behavior resulting in mechanical execution of audit procedures without sufficient understanding or judgment.
- **Overreliance on historical audit approaches** - Prior-year practices are replicated without adequate reassessment of current-year risks and therefore affect performance.
- **Time pressure and deadline-driven execution** - Compressed audit timelines resulting in the omission or superficial performance of audit procedures.

Unless these deeper behavioral and systemic factors are addressed, additional training alone is unlikely to result in the full remediation or prevent the recurrence of similar inspection findings.

Failure to identify the true root causes indicates that there is a need to improve the process of identification and analysis of root causes to effectively address the deficiencies. The firm's continuous improvement practices may consider appropriate **problem-solving methods and tools, the composition of its RCA team**, and the recognition of **common pitfalls encountered during the RCA.**

Method and Tools

There are various problem-solving methods and quality tools which can help to identify the true root causes of deficiencies. These tools are not requirements, but rather important approaches that are widely utilized across many industries to support quality improvement. Many of these methodologies are commonly discussed by quality management experts and leading organizations such as the International Organization for Standardization and American Society for Quality. These tools are presented to offer additional perspective and optional approaches that auditors may find useful in understanding underlying causes and supporting effective responses:

	**5 Whys Technique** Purpose: Determines the root cause of a problem by successively asking the question "Why?" Structure: A step-by-step questioning technique without visual elements Best for: Quickly identifying the root cause of a single issue
	**Fault Tree Analysis** Purpose: Visually maps out the different potential causes of the failures Structure: A hierarchical tree diagram starting with the issue at the top and branching into contributing factors Best for: Failure analysis and risk assessment
	**Fishbone Diagram** Purpose: Identifies and categorizes potential causes of a specific problem Structure: Shaped like a fishbone, with "bones" representing categories Best for: RCA in quality management and troubleshooting
	**Scatter Diagram** Purpose: Display relationship between two variables to identify correlations or trends Structure: A graph with plotted data points to show patterns or lack thereof Best for: Statistical analysis and testing relationship between variables
	**Pareto Chart** Purpose: Highlights the most significant factors contributing to a problem Structure: A combination of bar and line graphs, showing frequency and cumulative impact Best for: Prioritizing issues and focusing on the most critical factors

The RCA Team

It is important to form a dedicated team to conduct RCA. A well-structured team ensures that the RCA goes beyond surface-level analysis and thoroughly addresses the underlying issues and prevent recurrence. It is important that the RCA team is led by a designated lead which streamlines the RCA process, fosters accountability, and improves the likelihood of identifying and addressing issues effectively.

The firm may consider the following factors when forming the team:

Diversity of team.
A mix of junior and senior auditors provides various perspectives. Senior members bring deep experience and knowledge, while junior members offer fresh insights and innovative approaches. A diverse team ensures that decisions are not solely based on traditional methods but also incorporate new ideas and modern techniques. The engagement team might also feel less intimidated when interviewed by junior auditors, allowing them to speak more freely. However, some individuals may be more open and transparent when interviewed by more experienced professionals due to perceived authority.

Skills and experience.
The individual or team performing the RCA must have the necessary technical knowledge to understand the issues and sufficient problem-solving skills.

Size of the team.
Strike a balance; include enough members to cover different process and perspectives but keep the team small enough for efficient collaboration.

Availability and commitment.
Choose members who can dedicate the necessary time to thoroughly investigate and analyze the root cause. Ensure that workloads remain manageable for key personnel with additional responsibilities.

Communication and collaboration.
Members shall have strong communication skills to facilitate discussions and document findings. Foster culture of collaboration and respect within the team to encourage open dialogue.

Accountability and authority.
Ensure that the team has decision-making authority to implement corrective and preventive actions. Members must take responsibility for their roles and findings within the analysis process.

Objectivity and independence.
Ensure that the team includes neutral members who can analyze the issue without bias. Avoid conflict of interest by including individuals not directly involved in the noted findings.

Common Pitfalls

While RCA is a powerful tool for addressing inspection findings, our recent inspection cycle observed several recurring pitfalls that may impair its effectiveness when not properly executed. The following are common issues identified during our inspections:

1. **Jumping to conclusions.** Teams may rush to identify a cause without thorough investigation. The auditor might not be able to gather and analyze data thoroughly which led them to incorrect conclusions and root causes.

2. **Lack of proper data collection.** RCA relies on accurate and comprehensive data. Incomplete or biased data can result to incorrect conclusions.

3. **Focusing on symptoms instead of causes.** Treating surface-level issues rather than digging deeper.

4. **Resistance to change.** Even after identifying the root cause, teams may resist implementing corrective actions. Organizational culture plays a big role in accepting and sustaining changes.

5. **Failure to involve the right people.** Involving the right people ensures accurate problem identification, diverse perspectives, and effective long-term solutions. This leads to a more comprehensive understanding of the root cause, reducing reliance on temporary fixes.

6. **Lack of follow-up.** Identifying the root causes is only half the battle. Without proper implementation and monitoring, the same issues may resurface.

In the end, RCA reveals far more than the source of a problem; it exposes how an organization chooses to see itself. Done superficially, it produces neat explanations but fails to drive meaningful change. Done well, it challenges habits, test assumptions, demand level of honesty that can be uncomfortable but transformative. The difference is not subtle. One approach preserves the status quo, while the other has the power to reshape it. For firms willing to do the harder work, RCA becomes more than a diagnostic tool. It becomes a turning point where recurring issues are finally resolved, and quality stops being an aspiration and starts becoming discipline.

This page is intentionally left blank.

6

AUTOMATED TOOLS AND TECHNIQUES

Automated Tools and Techniques Findings

Audit regulators worldwide have increased focus on how Automated Tools and Techniques (ATTs), are being used in audit engagements. Inspection of these tools and techniques has revealed several issues resulting to a significant impact in the audit process.

The following section details the specific observations related to ATTs identified during audit inspections of the six largest audit firms in the Philippines:

Automated Tools and Techniques Findings	
Journal Entry Testing	**2 out of 6 largest audit firms** There was no evidence that the auditor extracted and uploaded the complete population of journal entries into the ATT for data-driven testing. There were also instances where testing is only limited to revenue transactions, a practice which will not fully comply with the standards. The JE testing performed by the auditor did not incorporate the required parameters initially considered in sample selection which includes closing entries and post-closing entries.
Assembly of Engagement Documentation	**1 out of 6 largest audit firms** The firm's automatic lockdown feature was disabled, resulting in the failure to complete and archive final audit files within the required 60-day period. These happened on several engagements of the firm.
Sampling Methodology	**1 out of 6 largest audit firms** The firm's sampling tool determined the appropriate sample size based on the control frequency; however, the auditor did not enter the correct materiality amount in the sampling tool. As a result, the sample size generated by the tool was lower, affecting the basis of the audit procedures performed. Further, the full sample generated by the tool was not tested by the engagement team.

Transforming the Audit

Traditional audit methods have long been the cornerstone of the auditing profession, ensuring financial accuracy and regulatory compliance. However, with the volume of transactions, advancement of technologies, and evolving stakeholder expectations, auditors must innovate and transform their audit approaches to improve efficiency and remain effective. The adoption of audit ATTs, like data analytics and visualization tools, cloud technology, and artificial intelligence (AI), is reshaping the audit landscape. This shift enhances the efficiency and effectiveness of audits and enables auditors to deliver deeper insights and greater value to their clients and other stakeholders. As the auditing profession continues to evolve, auditors must embrace innovation and adapt to these changes to maintain their relevance and uphold the trust of stakeholders

Enhancing the Effectiveness and Efficiency

ATTs represent the structured methodologies and digital platforms that auditors use to execute audit procedures, analyze large volumes of data, and provide a reliable basis for their conclusions. In large audit firms, proprietary audit platforms are used to centralize audit documentation, integrate global audit methodology, and track engagement progress and workflow.

These firms also leverage advanced data analytics tools for functions such as JE testing, fraud detection, transaction pattern analysis, and data visualization and reporting. AI is increasingly embedded within these ATTs to enhance efficiency allowing auditors to focus on higher-risk areas and more complex judgments.

As large firms continue to invest in advanced audit ecosystems, the effective deployment of ATTs has become fundamental to delivering high-quality, data-driven audit opinions in an increasingly complex reporting environment. Among these tools are:

Visualization and Data Analytics

It plays a crucial role by enabling auditors to analyze large datasets quickly and accurately. These tools help identify patterns, trends, and anomalies that may indicate potential issues or areas of risk. By leveraging data analytics, auditors can concentrate their efforts on high-risk areas, thereby improving the overall quality of the audit.

Cloud Technology

It is a transformative tool that facilitates various audit activities, including planning, documentation, information-sharing, and collaboration. Cloud-based platforms allow auditors to access and analyze data more efficiently, regardless of location, and enable seamless collaboration among clients and auditors. The shift to cloud technology reduces reliance on document-heavy processes, promoting more streamlined and effective digital workflows.

AI

It revolutionizes audits by automating complex tasks and enhancing risk assessment. AI-powered tools analyze voluminous data to detect patterns or transactions that might indicate errors or fraud. Additionally, AI tools streamline record processing and improve the detection of suspicious activities. This allows auditors to move beyond traditional practices analyzing client information more efficiently to enhance audit quality.

Roadblocks in Adopting Audit Tools and Techniques

Based on insights gathered during inspections and consistent with findings in other jurisdictions, the following roadblocks have been identified that limit the broader adoption and effective use of audit tools in the audit process:

Lack of Training and Infrastructure within the Firm

This is a significant obstacle, particularly for small and medium-sized firms, regarding the adoption of technologies like data analytics, data visualization, and other automated tools.

Explanation: Many firms lack professionals with the necessary skills to use these technologies effectively, including understanding their application in audits and interpreting the results. Existing IT infrastructure might also be insufficient to support these tools, requiring substantial investments. Even large firms need to ensure continuous training and adapt infrastructure as technology evolves.

Impact: This lack of internal capability can make firms hesitant to invest in unfamiliar technologies, leading to slower adoption rates and underutilization of potentially beneficial tools.

Resistance to Change

Failure to recognize new technologies' value and importance indicates resistance.

Explanation: Some auditors resist adopting new technologies and methodologies due to conventional mindsets. They do not fully understand the benefits of advanced audit tools like enhanced efficiency, broader data coverage, and improved risk identification. Existing tools like Excel and Computer Assisted Audit Techniques are often seen as sufficient, indicating a lack of awareness of the capabilities of sophisticated data analytics and AI.

Impact: Resistance to change significantly hinders the adoption and effective implementation of crucial audit tools, leading to slow progress in incorporating data analytics and other advanced audit tools into practices. Ultimately, this resistance limits the firm's ability to address risks, perform thorough testing, and efficiency in the audit process.

Client Data Challenges

Technology-driven audits face significant challenges in extracting and utilizing client data.

Explanation: Some audit firm's clients have accounting systems that make it difficult to extract data in a usable format. Data quality issues, inconsistencies, or a lack of standardization can also hinder the effective use of audit tools. Firms need to invest time and resources in standardizing data ingestion processes and clearly communicate data requirements to clients.

Impact: Data accessibility and quality issues can limit the scope and effectiveness of technology-based audit procedures, potentially requiring firms to revert to more traditional, less efficient methods.

Cost of the Audit Tools

The financial investment required for acquiring and implementing audit tools, especially advanced ones like AI, can be a major deterrent.

Explanation: The initial costs, ongoing fees, maintenance, and training can be substantial, particularly burdensome for small and medium-sized firms with limited budgets. While large firms have more resources, the cost of scaling and integrating new technologies across a large organization can still be significant.

Impact: High costs can put advanced tools out of reach for many firms, preventing them from leveraging the benefits these tools offer for enhancing audit quality and efficiency.

LARGE FIRMS LEADING THE WAY

Large auditing firms have taken the lead in adopting advanced tools and techniques. With substantial resources, they can invest in cutting-edge technology and possess the expertise to implement it effectively. For instance, many top firms utilize sophisticated tools to enhance their audit processes, resulting in higher-quality audits. These firms also employ data analytics and visualization tools to conduct various audit procedures, such as risk assessment, tests of controls, and substantive procedures. These tools enable large firms to deliver audits more efficiently and effectively, providing better insights and value to their clients.

7

SUSTAINABILITY

Sustainability Reporting: Not Just About Checklist Compliance

In today's corporate landscape, profit-oriented organizations are under mounting pressure to incorporate sustainable practices in their businesses. The SEC enforces internationally aligned regulations to enhance the transparency, comparability, and interconnectivity of both financial and sustainability disclosures in the Philippine capital market. In line with this and to promote sustainable economy, the SEC implemented mandatory sustainability reporting using a phased or tiered approach, starting in 2026. However, companies are urged to see sustainability reporting not simply as an exercise of ticking the regulatory boxes. It is a proactive approach to building trust and value; demonstrating accountability; and a deeper commitment to responsible leadership. The benefits of sustainability reporting are discussed in the succeeding sections.

1 Risk Management

Sustainability reporting helps companies identify and assess sustainability-related risks and opportunities that may not be captured through traditional financial reporting alone. Environmental issues such as climate change, resource management, and regulatory transition risks, as well as social factors like labor practices and community relations, can pose significant risks to the company's prospects. Through regular reporting, companies can monitor these risks more effectively, implement mitigation strategies, identify business opportunities, and ensure business resilience in the face of emerging challenges.

By analyzing sustainability-related data, organizations can identify inefficiencies, uncover opportunities for innovation, and align sustainability goals with broader business objectives. This data-driven approach supports more informed decision-making, enabling companies to allocate resources more effectively.

2 Reputation & Brand Value

Demonstrating a genuine commitment to sustainability-related issues can enhance reputation and brand perception. These companies are perceived as responsible and forward-looking organizations which help in building stronger relationships with their stakeholders. Sustainability reporting promotes greater transparency by providing stakeholders with transparent information about a company's sustainability risks and opportunities. This transparency helps to build trust with stakeholders, including investors, customers, regulators, and the public, reinforcing the company's credibility and adherence to ethical business practices.

3 Investment Opportunities

Investors and financial institutions are increasingly integrating sustainability-related information into their decision-making processes. This information is becoming more essential in determining the long-term value, risk management, and resilience of businesses. Companies that publish credible sustainability reports are more likely to attract investments from sustainability-focused funds. Moreover, sustainability performance is becoming a factor in credit ratings, insurance, and loan terms, giving sustainable companies an edge in accessing favorable financing.

4 Long-term value creation

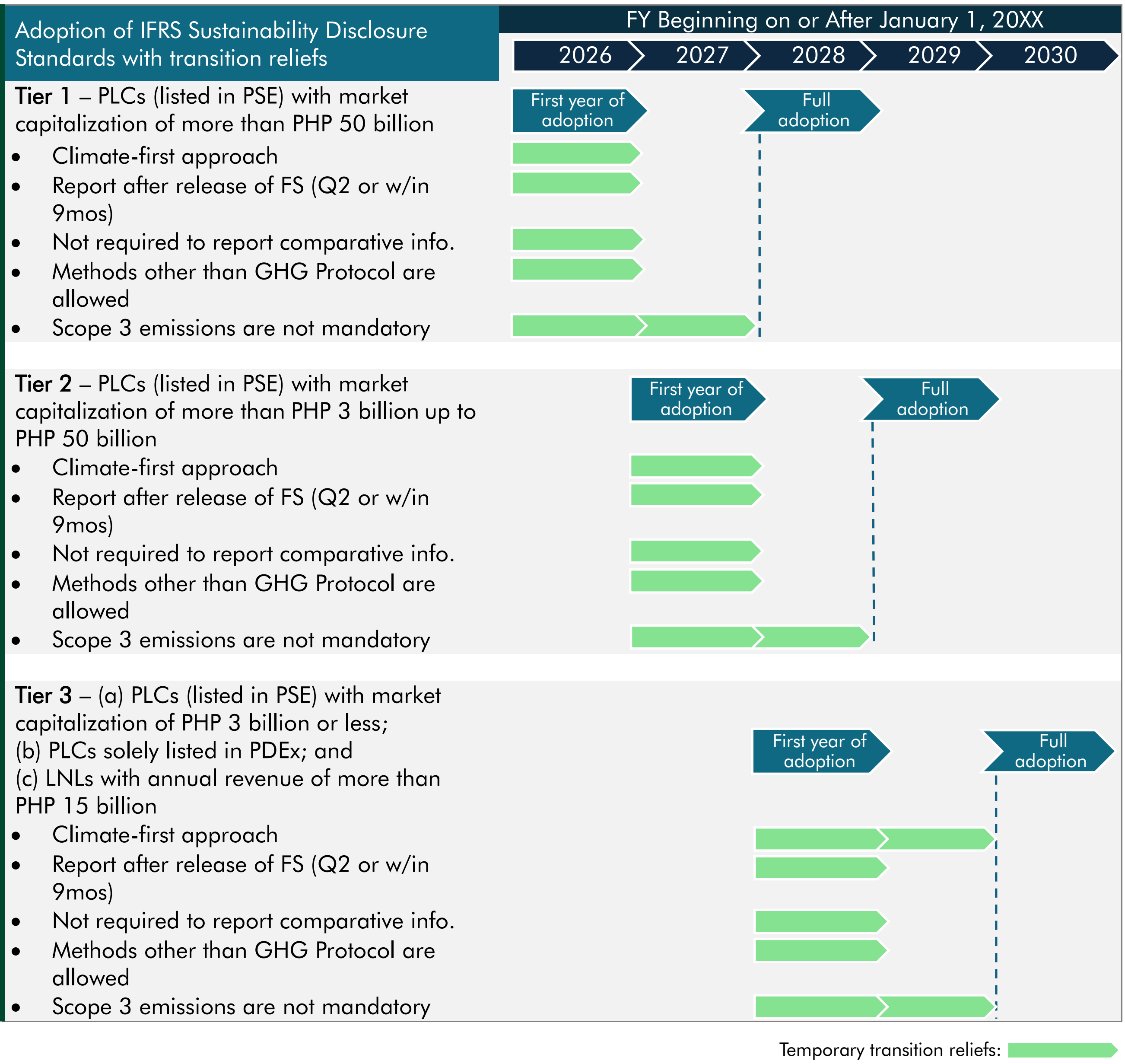
Ultimately, sustainability reporting supports long-term value creation by embedding responsible practices into the core of business strategy. Companies that focus on sustainable growth are better equipped to attract and retain talent and maintain stakeholder support in the long run. By aligning their activities with broader sustainability goals, businesses not only contribute to a more sustainable world but also secure their own long-term viability.

The SEC acknowledges that sustainability reporting is not a simple undertaking—it requires time, resources, and a deep commitment to transparency and continuous improvement. From gathering complex sustainability-related data to aligning with global reporting standards, the process can be demanding. However, the long-term benefits far outweigh the initial challenges. Sustainability reporting enhances stakeholder trust, supports risk management, opens doors to more investments, and strengthens a company's reputation in an increasingly purpose-driven market. Again, it is not just a tool for compliance, but a necessary measure to enhance resilience, innovation, and long-term value creation.

Sustainability Reporting in the Philippines

On December 22, 2025, the SEC issued MC No. 16 series of 2025, adopting the Philippine Financial Reporting Standards (PFRS) on Sustainability Disclosures to promote sustainability reporting for PLCs and large non-listed companies. While larger corporations have begun integrating environmental, social, and governance (ESG) metrics into their disclosures, many small and medium enterprises still face challenges due to limited resources and technical expertise. The summary of the roadmap is presented in **Figure 7.1**.

Figure 7.1:
PFRS S1 and S2 Adoption Roadmap



Sustainability Assurance: Enhancing Sustainability Credibility

In its current state, sustainability reporting allows preparers considerable flexibility in how they present their information. Unfortunately, this often leads to selective disclosure, with companies more likely to highlight positive outcomes while omitting negative ones, resulting in biased reporting and greenwashing. Sustainability assurance plays a critical role in addressing these concerns and improving the transparency and credibility of sustainability disclosures. It involves an independent practitioner evaluating an organization's sustainability information and providing an objective opinion on its accuracy and reliability. This independence from management is crucial for building trust and credibility with users. The assurance process includes gathering evidence and forming a conclusion on whether the report is fairly presented. An assurance service is a three-party relationship between management, the practitioner, and the users of sustainability information, helping ensure that sustainability reporting is credible.

The MC No. 16 series of 2025 issued by the SEC also covers the mandatory external limited assurance requirement on sustainability disclosures. The SEC recognizes the challenges in making these disclosures "assurance-ready," which is why the mandatory assurance will cover Scopes 1 and 2 greenhouse gas (GHG) emissions, starting two (2) years after the initial implementation of PFRS S1 and S2. Mandatory assurance by each preparer tier is summarized in **Figure 7.2**.

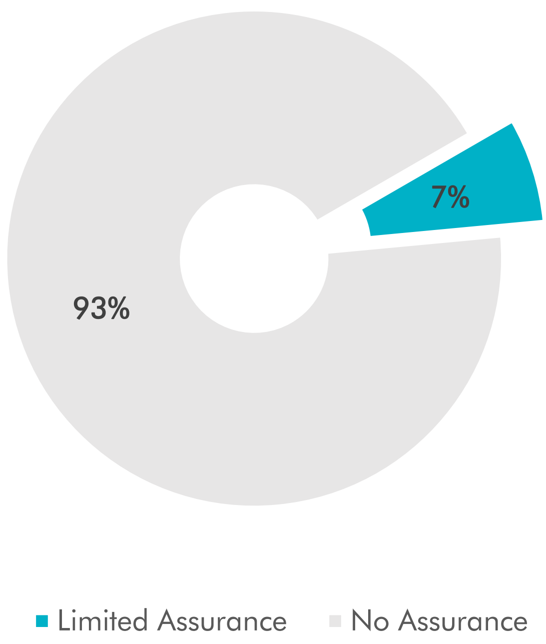
Figure 7.2: Sustainability Assurance Roadmap

Mandatory limited assurance by accountant or non-accountant assurance practitioners	FY Beginning on or After January 1, 20XX				
	2026	2027	2028	2029	2030
Tier 1 PLCs (listed in PSE)			Scopes 1 and 2 only		
Tier 2 PLCs (listed in PSE)				Scopes 1 and 2 only	
Tier 3 PLCs (listed in PSE), PLCs solely listed in PDEx, and LNLs					Scopes 1 and 2 only

The assurance engagement must be performed by an independent assurance practitioner, who may be a CPA or a qualified non-accountant. Over time, the assurance requirement is expected to progress toward reasonable assurance, and companies are encouraged to voluntarily obtain reasonable assurance over their full sustainability reports. All external assurance engagements must be conducted in accordance with the International Standard on Sustainability Assurance (ISSA) 5000, subject to its quality management and ethical requirements, with additional rules and guidelines to be issued by the SEC.

Considering that sustainability reporting is still in its early stages, not just in the Philippines, but also worldwide, sustainability assurance is in an even earlier phase. As shown in **Figure 7.3**, only 7% of PLCs (20 companies) voluntarily engaged assurance practitioners who expressed limited assurance on their sustainability reports in 2024[5].

Figure 7.3:
Percentage of PLCs with Externally Assured Sustainability Reports



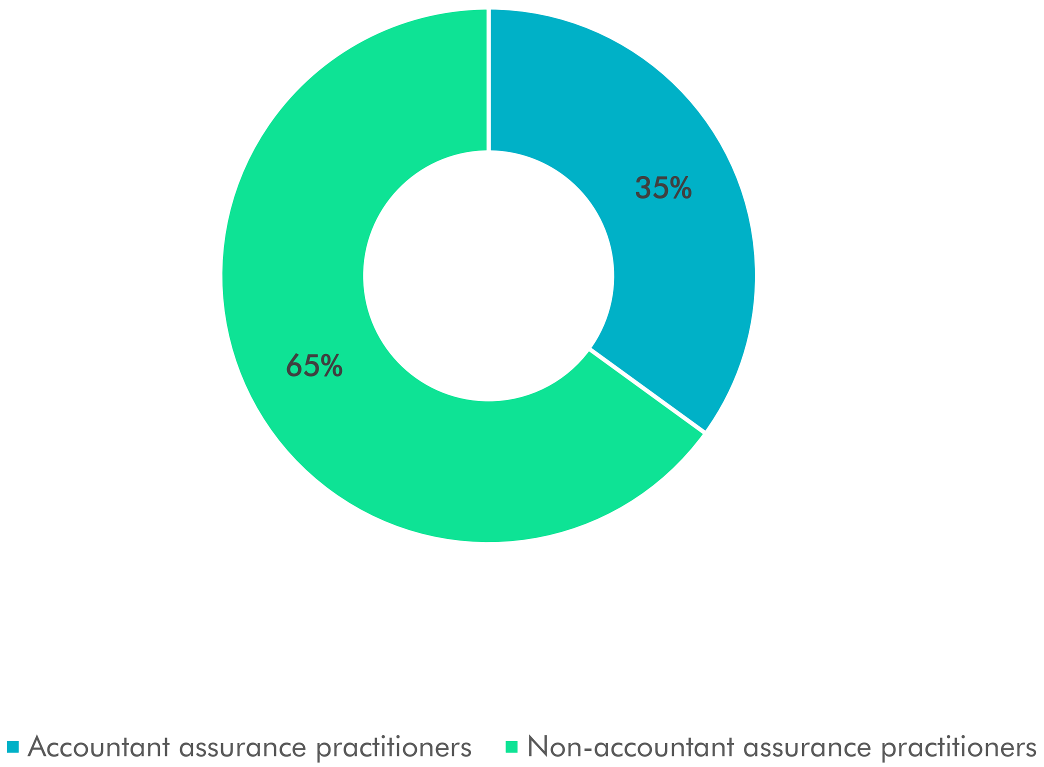
Limited assurance offers a lower level of confidence than that of a reasonable assurance we typically see in financial statements.

The demand for credible assurance over these disclosures amplifies the importance of having a robust assurance standard. The ISSA 5000, *General Requirements for Sustainability Assurance Engagements* is a new global sustainability assurance standard aimed to provide a comprehensive baseline for all types of sustainability assurance engagements. It is profession agnostic, meaning it can be used both by accountant and non-accountant assurance practitioners as long as they comply with quality management standards and ethical principles and requirements.

[5] As of December 31, 2025, the latest sustainability reports publicly available relate to the 2024 reporting period.

In the Philippines, among PLCs that obtained external assurance, 35% (7 PLCs) engaged accounting firms while 65% (13 PLCs) were assured by non-accounting firms (see **Figure 7.4**).

Figure 7.4:
Assurance Practitioners Mix



This represents a notable increase in the engagement of non-accounting firms in 2024 compared to the prior year, when accounting firms comprised the majority of assurance providers. As sustainability reporting continues to evolve, it is increasingly important for companies to prioritize the transparency and credibility of their disclosures. Both preparers and assurance practitioners should align with globally recognized standards not only to meet stakeholder expectations, but also to support long-term strategic decision-making and resilience in a rapidly changing environment.

SEC Headquarters, 7907 Makati Avenue
Salcedo Village, Bel-Air, Makati City
www.sec.gov.ph | secoga@sec.gov.ph