

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) Republic of the Philippines

ACCOUNTING AND AUDITING UPDATE

March 15, 2006

Contents

Executive Summary

I. Introduction

II. Institutional Framework

III. Accounting Standards as Designed and as Practiced

IV. Auditing Standards as Designed and as Practiced

V. Perception of the Quality of Financial Reporting

VI. Policy Recommendations

Appendix

Glossary of Terms

EXECUTIVE SUMMARY

The first Report on the Observance of Standards and Codes (ROSC) for Accounting and Auditing for private sector entities conducted in the Philippines in 2001 contained some far-reaching recommendations for improving accounting and auditing practices. A group of national stakeholders formed an oversight committee to plan and implement the recommendations. During the next years up to 2005, most of the recommendations were addressed by the regulators and members of the accounting profession.

The international accounting and auditing standards were fully adopted in the Philippines by 2005. The International Federation of Accountants Code of Professional Ethics was fully adopted. Revisions of the Accountancy Law in 2004 mandated an acceptable level of continuing professional education and quality control review before a certified public accountant (CPA) could renew his or her accreditation with the Board of Accountancy. Before auditors or audit firms were allowed to audit companies that fell under the rules of various regulatory bodies, these bodies—the Securities and Exchange Commission, Bangko Sentral ng Pilipinas, and Office of the Insurance Commissioner—required accreditation of CPAs under their rules. The Philippine Institute of Certified Public Accountants (PICPA) was designated the authorized professional organization, and all CPAs were legally required to become members of PICPA. The Securities and Exchange Commission took initial steps to review financial statements for compliance with accounting and regulatory rules.

The follow-up recommendations of this ROSC update are meant to build on the improvements already made. A significant step forward is recognizing the shortages of resources faced by the regulators and the profession. An oversight body should be created to coordinate all the quality control activities mandated of the regulators and PICPA to avoid duplication of effort and to add transparency to the control process. PICPA should build up its technical strength by taking on full-time professionals capable of handling the institute's technical responsibilities, particularly for continuing professional education and quality control. PICPA should move away from the practices of having all technical work done by unpaid volunteers. In an effort to recover its costs, PICPA should determine who the beneficiaries are of their work and how costs might be recovered from these beneficiaries.

Prepared by a team from the World Bank, this report is based on findings from a diagnostic review carried out in the Philippines between October and December 2005. The review was conducted through a participatory process involving various stakeholders led by the country authorities. The World Bank team members were M. Zubaidur Rahman (OPCFM), Ernesto T. Diaz (EAPCO).

I. INTRODUCTION

1. This report is an update assessment of accounting and auditing practices in the Philippines as a continuation of the joint initiative of the World Bank and the International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC).¹ The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting for private sector entities. It involves a review of both mandatory requirements and actual practices. It uses International Financial Reporting Standards (IFRS)² and International Standards on Auditing (ISA) as benchmarks, and draws on international experience and good practices in the field of accounting and audit regulation.³

2. The Philippines population is 85.2 million. Economic growth in the Philippines has been rising since 2001, however averaging 4.5 percent in 2002-03 and accelerating to its fastest pace in 15 years of 6.0 percent in 2004.⁴ A growing sector of the Philippine labor force—overseas Filipino workers—through its remittances back into the country for the consumption needs of their dependents is contributing significantly to national output. Over the past several years, remittances have totaled over US\$6 billion annually. In 2004, this level reached US\$8 billion, contributing about 10 percent of domestic economic production.⁵

3. The Philippine Stock Exchange had 235 listed companies by end-2004. Total capitalization reached Philippine Peso (P) 4,766 billion (approximately US\$93.09 billion)⁶, which was almost at par with the country's 2004 GDP.⁷ The efforts in 2004 by the Central Bank, Bangko Sentral ng Pilipinas (BSP), to further strengthen the banking system by encouraging consolidation, as well as closing weak banks, reduced the number of banking institutions from 899 to 893 (comprised of 42 commercial banks, 87 thrift banks, and 764 rural banks). The BSP continues to encourage banks to clean up their balance sheets of non-performing assets through the sale of these assets to private Special Purpose Vehicles. With the availability of incentives under the Special Purpose Vehicles Act of 2002, the BSP had issued 121 certificates of eligibility totaling P26.2 billion (approximately US\$512 million) worth of non-performing assets by end-2004, which was an increase from P713.3 million (approximately US\$12.9 million) at end-2003. At the end of 2004, there were 137 insurance companies with total combined assets of P311 billion (US\$6.07 billion).⁸

4. Ample liquidity in the financial system brought about by currently weak credit demand and selective risk-averse attitude of banks dominated trading in the debt securities market as it fueled the market's appetite for government securities. The market is still dominated by

¹ This assessment is an update of the Philippine A&A ROSC report dated December 17, 2001, accessible at www.worldbank.org/ifa/Philippinesrosc12_01.pdf.

² In this report, IFRS refer to both International Financial Report Standards issued by the International Accounting Standards Board and the standards issued by the Board of the International Accounting Standards Committee, and each applicable Interpretation of the International Financial Reporting Interpretations Committee.

³ ISAs are issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants..

⁴ Country Assistance Strategy for the Republic of the Philippines, The World Bank, April 19, 2005.

⁵ From the statement of Secretary Romulo L. Neri on the release of the FY 2004 National Accounts and the speech of Mr. Rene J. Buenaventura during the BusinessWorld Outlook Forum, January 2005.

⁶ Exchange rate used for conversion purposes: \$1 = P 51.20.

⁷ Philippine Stock Exchange Monthly Report, December 2004.

⁸ Insurance Commission, Statistics Office.

government issuances comprising 94.1 percent of total outstanding domestic debt securities. Short-term debt securities account for 29.1 percent of the total debt securities.⁹

5. In 2001, about 99.6 percent of over 811,000 enterprises in the Philippines were micro enterprises and small to medium enterprises (SMEs), compared to 0.4 percent or 2,958 large enterprises. The SMEs accounted for 70 percent of employed labor; but the SMEs accounted for only 32 percent of the output or gross value added, compared 46 percent in South Korea, 60 percent in China, and 63 percent in Indonesia. To improve on the low productivity of Philippine SMEs, the current government initiated the SME Agenda led by the Department of Trade and Industry. The Medium-Term Philippine Development Plan 2004–2010 includes programs to enhance marketing, production, and financing opportunities for SMEs.¹⁰

6. Although the Philippine economy is driven primarily by the private sector, there are over 70 government-owned and -controlled corporations (GOCC) operating in economic sectors, such as agriculture, housing, and infrastructure. Some government-owned and -controlled corporations, like the National Power Corporation (Napocor) and National Food Authority, have been operating inefficiently and incurring huge losses. In 2003, the large GOCC deficits pushed the government's consolidated public sector deficit to 5.2 percent of GDP and the public debt to 118.2 (revised) percent of GDP. The government has since formulated programs to privatize the government-owned and -controlled corporations to help improve the consolidated public sector deficit and the public debt.

7. This ROSC accounting and auditing report was planned and undertaken based on the characteristics discussed above. Therefore, it sketches policy recommendations to enhance the quality of corporate financial reporting and seeks to foster a financial reporting platform conducive to increased tax collection, private sector growth, foreign direct investment and reduced financial system instability. This ROSC does not include in its scope accounting and auditing matters affecting public sector entities. Under the Philippine Constitution, it is the Commission on Audit, the Philippines' Supreme State Audit Institution, that has the exclusive authority to promulgate accounting and auditing rules applicable to public sector entities, including government-owned and controlled corporations.

II. INSTITUTIONAL FRAMEWORK

A. Statutory Framework

8. **The Philippines' legal system blends both common and statutory law principles.** In case of a conflict between common law principles and statutory (written) law, the latter prevails based on Philippine jurisprudence. The hierarchy of compliance puts priority on written laws. The requirements for accounting, reporting, and auditing are written or codified. These laws have existed for many years and were amended through the years as necessary are described below, except for the revised Accountancy Law of 2004 which is described in paras 20 to 21. **Only the revised Accountancy Law is of recent vintage.** It replaced the previous Accountancy Act and contains the following salient changes:

⁹ Bangko Sentral ng Pilipinas Annual Report 2004.

¹⁰ Source: <http://www.neda.gov.ph/ads/mtpdp/MTPDP2004-2010/PDF/MTPDP2004-2010.html>

- Recognizes Philippine Institute of CPAs (PICPA) as the national professional organization and requires all CPAs to be members of PICPA. This target should be accomplished within three years (see para 22)
- Legally constituted accounting and audit standards setting bodies (para 42 and para 60)
- Requires Continuing Professional Education (CPE) and creates a CPE Council (see para 38)
- Requires accreditation of individual CPAs and firms engaged in public accountancy (see para 53)
- Requires a quality review of those auditors seeking accreditation (see para 54).

9. **The Corporation Code of the Philippines, enacted in 1980, regulates the activities of private stock and nonstock corporations.** The Corporation Code grants to the Securities and Exchange Commission (SEC) responsibility for the registration, licensing, regulation, and supervision of all private corporations. Companies that have paid-up capital of P50,000 (approximately US\$977) and above and that are registered with the SEC are required to file annually with the SEC their most recent financial statements certified by an independent certified public accountant (CPA).

10. **The Securities Regulation Code (SRC) prescribes the powers and functions of the SEC and provides regulations for companies which have issued securities.** The SRC, which became effective in 2000, supplements related provisions of the Corporation Code. Section 68 of the Securities Regulation Code on Special Accounting Rules gives the SEC the authority to make, amend, and rescind accounting rules and regulations as may be necessary to carry out the provisions of the Securities Regulation Code. To implement the law, the SEC issued SRC Rules 68 and 68.1 setting forth the accounting and auditing requirements for financial statements to be submitted to the SEC:

- **SRC Rule 68, Rules and Regulations Covering Form and Content of Financial Statements**, is applicable in general to all corporations registered with the SEC. It requires that financial statements filed with the SEC be prepared in accordance with generally accepted accounting principles (GAAP) in the Philippines, which by 2005 must be compliant with International Financial Reporting standards (IFRS). Refer to paras 43-45 which describe the process of adoption of IFRS as Philippine GAAP. Some relief from this rule is granted to small and medium enterprises (see para 46).
- **SRC Rule 68.1** is applicable to for *publicly-held companies* (listed companies and companies that have sold securities pursuant to a registration with the SEC) and *public companies* (companies with assets in excess of P50 million (approximately US\$976,563) and having 200 or more shareholders (each holding at least 100 equity shares)). SRC Rule 68.1 requires covered corporations to include in their financial statements certain disclosures in addition to those required under Philippine GAAP. SRC Rule 68.1 also requires a three-year comparative period and mandatory unqualified opinion by the external auditor. It also requires compliance with the interim financial reporting rules.

11. **The SRC Rules categorically state that the financial statements are primarily the responsibility of the management of the reporting company.** Accordingly, the fairness of the representations made in financial statements is an implicit and integral part of the management's responsibility. The company's board of directors, in discharging its responsibilities, is required to review and approve the financial statements before these are submitted to the stockholders. For this purpose, the financial statements filed with the SEC are accompanied by a Statement of Management's Responsibility signed under oath by the board chairman, chief executive officer, and chief finance officer.

12. **Consolidated financial statements are required to be filed in accordance with existing GAAP.** Consolidated financial statements should be prepared using uniform accounting policies as for any other transactions and events in similar circumstances. It should be noted that every corporation should file a separate income tax return, even if preparing a consolidated financial statements, since existing tax regulations do not permit filing of a consolidated tax returns (see para 15).

13. **The SEC provides rules for appointing or terminating an auditor.** Public interest companies are mandated under the Code on Corporate Governance (SEC Memorandum Circular No. 2 issued on April 4, 2002) to have an audit committee to select and appoint the external auditor, who is ineligible to serve as internal auditor to the same client. Any other non-audit work between this appointed auditor and client should not be in conflict with the functions of the external auditor. The auditor is required to be rotated every five years or earlier. In case the auditor is an auditing firm, its signing partner shall be rotated. Publicly-held companies, and public companies (see para 10) and secondary licensees¹¹ of the SEC are required to have an external auditor accredited by the SEC (see para 26). The rules require the auditor to have at least five years of audit experience with corporate clients that have P50 million (approximately US\$ 976,563) assets each. The termination of a statutory auditor engagement should be reported to the SEC and the Philippine Stock Exchange for listed companies within five days from said termination.

14. **Violation of any SRC provision or the rules and regulations or misrepresentation in the registration statement is subject to a fine or imprisonment.** If the offender is a legal entity, the penalty may be imposed upon the entity and upon the officer or officers of such entity. The penalty may be a fine or imprisonment (of not less than seven years nor more than twenty-one years), or both at the discretion of the court. The auditor who attested to the financial statements prepared in violation shall, after due notice and hearing, be suspended or barred from practicing before the SEC for such period of time as it may deem adequate. It could also be a ground for the revocation of auditor's license by the Board of Accountancy.

15. **Section 232 of the National Internal Revenue Code requires companies with gross quarterly sales exceeding P150, 000 (approximately US\$2,930) to have their financial statements audited and filed together with their income tax returns.** What constitutes taxable net income is determined by the Tax Code and Regulations, but the tax return must show reconciliation between net income as shown in the financial statements with the taxable income shown in the tax return. Audited financial statements filed with Bureau of Internal Revenue must be the same as those filed with the SEC (see para 10)

¹¹ Secondary licensees include companies such as financing companies, investment houses, brokers and dealers of securities, investment companies, etc.

16. **Financial institutions follow requirements of the General Banking Law of 2000 with regard to preparing financial statements.** As a general rule, financial institutions shall comply with the provisions of Philippine GAAP, in preparing their audited general purpose financial statements (see paras 43-45 on the process of adoption of IFRS as Philippine GAAP). The same audited general purpose financial statements are filed with the Bangko Sentral ng Pilipinas and the SEC (see para 10). For prudential reporting, financial institutions shall follow Philippine GAAP adjusted for the following BSP-prescribed rules:

- In preparing consolidated financial statements, only financial sector subsidiaries except subsidiary insurance companies, shall be consolidated on a line-by-line basis; insurance and non-financial subsidiaries shall be accounted for using the equity method. Further, for purposes of separate financial statements, investments in financial/non-financial, subsidiaries and associates, including insurance subsidiaries and associates, shall be accounted for using the equity method.
- In setting the allowance for probable losses on loans, the BSP-prescribed minimum valuation reserves rules shall be complied with.

Only the general purpose financial statements of financial institutions are required to be audited by external auditors.

The BSP regulations also require banks to publish in newspapers their annual balance sheets and income statements without notes.

17. **The Insurance Code requires each insurance company to file its financial statements with the Insurance Commission in such form and details as prescribed by the Insurance Commissioner.** As corporations registered with the SEC, insurance corporations also prepare general purpose financial statements prepared in conformity with Philippine GAAP which are submitted to the SEC (see para 10), as well as the Insurance Commission and SEC.

Within 30 days after receipt of the annual statement approved by the Commissioner, every insurance company should publish in two newspapers a synopsis of its annual financial statement in English and Filipino.

18. **Other laws also set forth the financial reporting requirements of certain companies.** The Financing Company Act of 1998 requires every financing company to file their audited financial statements with the SEC within 120 days after the end of the fiscal year. The Omnibus Rules and Regulations, issued by the SEC in 2002, require investment houses and universal banks registered as underwriters of securities to file annual audited financial statements with the SEC. In accordance with SEC Rules, the annual financial statements of these companies must be in conformity with Philippine GAAP (see para 10).

19. Table 1 gives a summary of the applicable accounting standards for preparing financial statements filed by various entities. (See paras 46-47 which describe the process of adoption of IFRS as Philippine GAAP.)

Table 1. Applicable Accounting Standards for Filing Financial Statements

<i>Entities required to file financial statements</i>	<i>Legal entity financial statements</i>	<i>Consolidated financial statements</i>
Listed companies and public interest	• Philippine GAAP	• Philippine GAAP

<i>Entities required to file financial statements</i>	<i>Legal entity financial statements</i>	<i>Consolidated financial statements</i>
companies (para 10)	<ul style="list-style-type: none"> • SEC Rule 68.1 	<ul style="list-style-type: none"> • SEC Rule 68.1
Other corporations (paras 10 and 18)	<ul style="list-style-type: none"> • Philippine GAAP 	<ul style="list-style-type: none"> • Philippine GAAP
Small and medium sized entities (para 46)	<ul style="list-style-type: none"> • Philippine GAAP, with some relief on new standards 	<ul style="list-style-type: none"> • Philippine GAAP, with some relief on new standards
Banks and non-bank financial institutions under BSP supervision (para 16)	<ul style="list-style-type: none"> • Philippine GAAP and SEC Rule 68.1, if applicable, for general purpose financial statements submitted to the BSP and SEC • Philippine GAAP with BSP prescribed exemptions for prudential reporting 	<ul style="list-style-type: none"> • Philippine GAAP and SEC Rule 68.1, if applicable, for general purpose financial statements submitted to the BSP and SEC • Philippine GAAP with BSP prescribed exemptions for prudential reporting
Insurance companies (para 17)	<ul style="list-style-type: none"> • Philippine GAAP for general purpose financial statements submitted to the Insurance Commission and SEC • Insurance Commission prescribed rules for prudential reporting 	<ul style="list-style-type: none"> • Philippine GAAP for general purpose financial statements submitted to the Insurance Commission and SEC • Insurance Commission prescribed rules for prudential reporting

B. The Profession

20. **The Republic Act (RA) 9298, *Philippine Accountancy Act*, revised and enacted in 2004, provides for regulation of the accounting profession.** RA 9298 provides for the standardization and regulation of accounting education (section 3), licensure of CPAs (section 5), and the supervision and regulation of the accountancy practice in the Philippines (section 9). The practice of accountancy includes work in public accountancy, commerce and industry, education/academe and government. The Professional Regulatory Board of Accountancy (BOA), which continues to be under the supervision and administrative control of the Professional Regulation Commission (PRC), carries out the provisions of the Republic Act.

21. **The revised Accountancy Act embodies regulatory measures and programs intended to strengthen the accounting profession.** Changes brought about by the act include continuing professional education (CPE) and quality control review of registered CPAs and audit firms as a requirement for accreditation to engage in the practice of public accountancy. The Professional Regulatory Board of Accountancy has created a CPE Council for Accountancy to implement the continuing education requirements under RA 9298. The Board of Accountancy has also created a Quality Review Committee (QRC) for oversight on the quality control of audits of financial statements through a review of the quality control measures instituted by individual CPAs and audit firms.

22. **There are about 18,450 members in good standing in the Philippine Institute of CPAs (PICPA).**¹² The Professional Regulatory Board of Accountancy registered an

¹² As of October 2005 (www.picpa.com.ph).

estimated 118,000 CPAs in more than 40 years. Each year 2,500 new CPAs pass the CPA board examination on average. PICPA members practice in the public sector, commerce and industry, education, and government. PICPA is the recognized national professional organization and the accredited professional organization for CPAs. Under RA 9298, registered CPAs are required to be members of PICPA. To keep its status as an accredited professional organization, PICPA is mandated to have a credible three-year plan to enlist into active membership at least a majority of CPAs in the country. It is worth mentioning that until the introduction of RA 9298, there was no legally backed arrangement in the country for requiring the CPAs to maintain membership of any professional accounting body. At present majority of the CPAs do not have membership of PICPA or any other professional accounting body, and as a result many practicing accountants do not have any link with any organized initiative on professional development.

23. PICPA is an implementing arm of the Board of Accountancy. Since the Board of Accountancy lacks the necessary human and financial resources, it has teamed up with PICPA as the accredited professional organization in implementing some of the new requirements of the revised Accountancy Act. PICPA established a CPE Council as the counterpart organization to that of the Professional Regulation Commission's CPE Council for Accountancy (see para 40). The PICPA CPE Council is serving as the implementing arm of the PRC CPE Council, including the acceptance and processing of applications for accreditation of CPE providers.

24. PICPA needs strengthening in order to run professional activities. PICPA needs to strengthen its organization and increase its resources to run the CPE program and other activities that may be delegated to it by the Board of Accountancy.¹³ PICPA also needs to have a continuing quality assurance review program, which is a requirement for membership in the International Federation of Accountants (IFAC). PICPA created a Quality Control Board; however, this effort by volunteer members has not evolved into any concrete actions.

25. Individual practitioners and firms or partnerships in public accountancy, including their partners and staff, are required to be accredited by the Professional Regulation Commission and the Board of Accountancy every three years.¹⁴ Accreditation by the Board of Accountancy requires three years of meaningful experience in the practice of accountancy in public practice, commerce and industry, academe and government; CPE credits of the individual, and partners and staff of audit firms and partnerships; and internal quality assurance procedures within the firm¹⁵ The Board of Accountancy has accredited 210 partnerships and 1,762 individual professionals to practice public accountancy.

26. Only individual external auditors and auditing firms that are accredited by the SEC can perform statutory audits of financial statements of SEC-registered entities. Only individual external auditors and auditing firms, including the signing partners who are accredited by the SEC, can perform statutory audits of financial statements of public companies (with total assets of at least P50 million (approximately US\$976,563) and 200 or more stockholders each holding at least 100 shares) and secondary licensees (issuers with securities listed in an exchange, issuers of registered securities, pre-need companies¹⁶,

¹³ Annual PICPA membership fee is currently P1,000 (approximately US\$20).

¹⁴ RA 9298, Sections 28, 31.

¹⁵ Rules and Regulations Implementing RA 9298, Annex B.

¹⁶ "Pre-need" companies is a term used in the Philippines for companies that issue plans that provide future benefits related to education, pension, interment and death related services.

financing companies, and investment houses).¹⁷ This accreditation must be renewed every three years. Accreditation requirements include prior accreditation by the Board of Accountancy, prescribed and relevant audit experience requirements, CPE credits for individual practitioners, and some prescribed quality control procedures for audit firms.¹⁸ To date, the SEC has not carried out any in-depth assessment of quality assurance arrangements of the accredited auditors and audit firms.

27. Banks must appoint an external auditor from the pool of BSP-selected external auditors. The external auditor shall be changed or the lead and concurring partner shall be rotated every five years or earlier, provided that the rotation of the lead and concurring partner shall have an interval of at least two years. Only external auditors included in the list of BSP-selected external auditors shall be engaged by banks for regular audit or special engagements. The BSP criteria for the selection of external auditors of banks include, among others, compliance with independence requirements and relevant audit experience. For example, the external auditor for a universal bank or commercial bank must have at least twenty (20) existing corporate clients each with resources of at least P50 million ([approximately US\\$976,563](#)) and at least one existing commercial bank in the regular audit. The BSP however does not have any mechanism for carrying out in-depth assessment of quality assurance arrangements of the auditors and audit firms for their inclusion in or exclusion from the pool of selected external auditors.

28. Starting in 2005, the Insurance Commission imposed an accreditation rule for auditors. Only external auditors included on the list of auditors as selected by the Insurance Commission shall be engaged by insurance companies for audits. To qualify for accreditation, the Insurance Commission require the auditor, among others, to have at least five years experience in regular audits, two years of which must be on audits of insurance companies. The list however is not based on any in-depth review of auditor's capacity to perform high quality audit.

29. PICPA has adopted the IFAC Code of Ethics for Professional Accountants as the Code of Ethics for Professional Accountants in the Philippines. Adopted by PICPA in 2004, the Code of Ethics was approved by the Board of Accountancy and Professional Regulatory Commission. The IFAC Code of Ethics for Professional Accountants was adopted with only minor modifications made to take into consideration Philippine circumstances.

30. Measures to protect the independence of the accounting profession. The SEC proscribes the performance of non-audit services by the accredited external auditor of public companies and secondary licensees, unless safeguards under the Code of Ethics are undertaken. Such proscribed non-audit services include bookkeeping services, financial information systems design and implementation, appraisal or valuation services, actuarial services, internal audit outsourcing services, management functions, investment banking services, or legal services.¹⁹ The BSP prohibits the external auditor of a bank or other financial institution under its regulatory supervision from engaging in internal audit functions,

¹⁷ SEC Memorandum Circular No. 13, Series of 2003, dated October 23, 2003, *Accreditation and Reportorial Requirements of External Auditors of Public Companies and Secondary Licensees of the Commission*.

¹⁸ A list of accredited auditing firms and individual external auditors is posted on the Philippine SEC website (www.sec.gov.ph).

¹⁹ SEC Memorandum Circular No. 13, Series of 2003, dated October 23, 2003, *Accreditation and Reportorial Requirements of External Auditors of Public Companies and Secondary Licensees of the Commission*.

information systems design, implementation and assessment and other services which could affect their independence.²⁰

31. **The size of audit firms is a factor in the quality of audits.** Audits of financial statements are undertaken by local audit firms, which include local affiliates of international accounting firm networks and individual practitioners. The five largest accounting firms audit about 70 percent of the top 1,000 corporations in the Philippines in 2004.²¹ The auditors of larger companies face more complex transactions and regulatory requirements and, therefore, need to have a higher level of technical proficiency and capability than those auditors just doing audits of smaller companies.

C. Academic and Professional Education and Training

32. **The undergraduate degree program of accredited Philippine colleges and universities is based on a curriculum recommended by the Board of Accountancy in 2001.** The curriculum was implemented at the start of school year 2001-2002 through the Commission on Higher Education Memorandum Order No. 27. This revised curriculum was based on the UNCTAD Guideline in National Requirements for the Qualification of Professional Accountants (1999) and the IFAC International Education Guidelines No. 9, *Education, Assessment of Professional Competence and Experience Requirements of Professional Accountants* (1997). Further revision of the curriculum is underway.

33. **The prescribed curriculum and the CPA Licensure Examinations incorporate international accounting and auditing standards.** IFRS adopted as Philippine GAAP were phased into the bachelor's curriculum starting 2003 through 2005. The adopted IFRS (see paras 43-44), International Standards on Auditing (see para 52), IFAC Code of Ethics for Professional Accountants (see para 29), New Government Accounting System, and Philippine Accountancy Act of 2004 (see paras 20-21) were covered in the CPA Licensure Examinations starting October 2005.

34. **The prescribed undergraduate curriculum includes teaching professional ethics in schools.** This was drawn from IFAC's International Education Guidelines 9 and 11 that identified the core competencies of knowledge, skills, and values. Values-focused education concentrates on professional ethics and moral values.

35. **The dearth of textbooks on international accounting and auditing standards is a serious problem.** The scarcity of locally developed instructional materials, practice manuals, student textbooks and other learning materials to facilitate teaching and learning practical applications of IASs/IFRSs and ISAs is the main stumbling block to teaching current developments in accounting and auditing practices. Actual experience in applying International Accounting Standards may be acquired through employment in an audit firm associated with an international network. However, this type of experience is not available to academe. This means that while the accounting standards that prescribe general principles are available to educators, their actual applications to real situations are not.

36. **In order to practice accountancy in the Philippines, an individual must obtain a license by passing a professional examination.** The Board of Accountancy administers the

²⁰ BSP Circular No. 210, Series of 2003, dated October 29, 2003.

²¹ *Business World*, Top 1000 Corporations of the Philippines, <http://bworldonline.com/Downloads/top1000.php>.

professional examinations with support from the Professional Regulation Commission. Examinations are conducted in locations and on dates specified by the Professional Regulation Commission. Eligibility to take the examination requires that the applicant is a Filipino citizen of good moral character, holds a Bachelor of Science degree in accountancy, and has not been convicted of any criminal offense. The CPA examinations emphasize technical knowledge on theory of accounts, business law and taxation, management services, auditing theory and problems, and practical accounting problems.

37. The Board of Accountancy will issue practicing certificate after three years of meaningful experience. Practical experience is not required prior to taking the CPA examinations. After passing the examination, a new CPA must attain at least three years of meaningful experience before being accredited by the Board of Accountancy to be in the public practice. However, this is a provision in the revised Accountancy Act that is still in its initial implementation. Adoption of international good practices with regard to monitoring quality of practical training and capability of practical training provider is yet to be established.. Meaningful experience, to be certified under oath by the employer, can be earned in the following areas:

- Commerce and industry with significant involvement in general accounting, budgeting, tax administration, internal auditing, liaison with external auditors, representing one's employer before government agencies on tax matters related to accounting or any other field functions;
- Academe/education with teaching for at least three trimesters or two semesters in either financial accounting, business law and tax, auditing problems, auditing theory, financial management and management services;
- Government with significant involvement in general accounting, budgeting tax administration, internal auditing, liaison with the Commission on Audit or any other related functions; and
- Public practice with at least one year as audit assistant and at least two years as auditor in charge of an audit engagement covering full audit functions of significant clients.

38. Section 32 of the revised Accountancy Act, Implementing Rules and Regulations, requires continuing professional education (CPE) for CPAs. Continuing professional education will be offered by accredited organizations or education institutions in coordination with PICPA. A CPA needs to present to the Professional Regulation Commission a certification of CPE credit units earned before licensing can be renewed. Accounting professionals must earn 60 CPE units within three years. This requirement is still in its beginning stage as a requirement in the revised Accountancy Act.

39. Even before CPE was mandated by law in 2004, PICPA and the larger accounting firms embarked on a program to spread knowledge about IAS. In 2001, PICPA was the beneficiary of a grant from the Asian Development Bank consisting of IAS teaching materials. These teaching materials were periodically updated for new standards and revisions to existing standards. PICPA conducted several courses on *Training the Trainers*. Over the last three years, some 200 trainers went through this program. A program called *CPE on the Road* was then undertaken whereby these trainers helped familiarize others on the use of IAS. The larger

accounting firms likewise held their own IAS training programs. These training programs contributed to the increase in awareness of IAS adopted in the Philippines.

D. Setting Accounting and Auditing Standards

1. Accounting Standards

40. **Most accounting requirements on the preparation and presentation of general purpose financial statements are contained in accounting pronouncements issued by the Accounting Standards Council.** The Accounting Standards Council was created in 1981 to establish accounting standards that would be generally accepted in the Philippines.²² It receives funding from PICPA.²³ The Accounting Standards Council is composed of eight representatives from the profession, regulators, and preparers: four representatives from PICPA; and one representative from the SEC, the Bango Sentral ng Pilipinas, the Board of Accountancy, and the Financial Executives Institute of the Philippines (FINEX). The Accounting Standards Council formed an Interpretations Committee whose main purpose is to identify, discuss, and resolve on a timely basis emerging issues affecting financial reporting. Its members consist of representatives from auditing firms, the SEC, and the Board of Accountancy.

41. **The authority of ASC pronouncements comes from the approval and recognition of the standards by the regulators.** Exposure drafts of proposed accounting standards are issued for comment, to members of PICPA, members of the Financial Executives Institute of the Philippines (FINEX), and interested persons and organizations in the business community, and the comments are considered in the finalization of the standard. Accounting standards approved by the Accounting Standards Council are submitted to the Board of Accountancy for approval. ASC-approved accounting standards, when approved by the Board of Accountancy and the Professional Regulation Commission, become part of Philippine GAAP. The SEC has also adopted ASC-approved standards in its SRC Rule 68 and Rule 68.1.

42. **Under the rules and regulations implementing RA 9298, a new accounting standard setting body, the Financial Reporting Standards Council (FRSC), shall be created (Section 9[A]).** The creation of the Financial Reporting Standards Council merely gave legal recognition to the accounting standards-setting function of the predecessor Accounting Standards Council. The FRSC is accountable to the Professional Regulatory Commission Board of Accountancy. The Financial Reporting Standards Council, like the Accounting Standards Council, shall include representatives from the profession, regulators, and preparers. It shall have 15 members. The Chairman shall be a senior accounting practitioner in any area of accounting practice; the other fourteen representatives come from the following:

- (a) One representative each from--
- Board of Accountancy
 - Securities and Exchange Commission
 - Bangko Sentral ng Pilipinas (Central Bank)

²² Preface to Statements of Financial Accounting Standards of the Accounting Standards Council, 1982.

²³ The ASC annual subsidy from the PICPA Foundation of P50,000 (approximately US\$977) covers meals during meetings and other incidentals. The ASC members serve without any remuneration.

- Bureau of Internal Revenue
- A major organization composed of preparers and users of financial statements
- Commission on Audit²⁴;

(b) Two representatives from each discipline in PICPA, as the accredited national professional organization of CPAs--

- Public practice
- Commerce and industry
- Academe/education
- Government.

The Accounting Standards Council has been folded into the Financial Reporting Standards Council (FRSC).

43. **The adoption of International Accounting Standards as Philippine generally accepted accounting principles was undertaken over a number of years.** The Accounting Standards Council started to adopt International Accounting Standards as early as 1996. Prior to this, Philippine generally accepted accounting principles were based mainly on US-based accounting standards. In 1997, the Accounting Standards Council decided to move to IAS. Under its IAS project, the Accounting Standards Council replaced US-based standards, adopted IAS with no local equivalent, and updated previously issued IAS-based standards. The adoption of IAS followed the exposure process for accounting standards issued by the Accounting Standards Council (see para 41). The official language of Philippine accounting standards is English; hence, translation of adopted IAS was not a factor to consider.

44. In 2005, the Accounting Standards Council completed adoption of the IFRSs issued by the International Accounting Standards Board (IASB) and the revised versions of previously adopted IASs. At this time, the Accounting Standards Council also changed the designation of accounting standards it issues to Philippine Accounting Standard (PAS) and Philippine Financial Reporting Standard (PFRS) to correspond to the adopted IASs and IFRSs, respectively. Previously issued accounting standards that were based on pre-2005 versions of the IASs were updated and reissued as PAS. New IFRSs and amendments to IFRSs will be adopted by the Accounting Standards Council, as they are finalized and issued by the IASB. Table 2 lists accounting standards issued as of October 2005, showing which standards were adopted in 2005 and which were adopted in previous years.

45. **IAS and IFRS were adopted with minimal changes, such as effective dates.** The Accounting Standards Council adopts IAS and IFRS with a Preface that sets forth the effective date of the standard in the Philippines and explanatory guidance, when necessary, relating to the application of the standards for Philippine purposes. The transition provisions of each IAS and IFRS were also adopted. In the case of IAS 19, *Employee Benefits*, the transition provisions included as an alternative the deferred and amortization of a transition liability for a defined benefit pension plan. Had the standard been applied in 1999, the date of issuance of IAS 19, any deferred transition liability would have been fully amortized by 2005. Since, the standard was adopted only in 2005 in the Philippines, the deferral and amortization of a

²⁴ The Commission on Audit is the Philippines' Supreme State Audit Institution, that has the exclusive authority to promulgate accounting and auditing rules applicable to public sector entities, including government-owned and controlled corporations.

transition liability for a defined benefit plan was allowed starting in 2005 for Philippine financial reporting purposes.

46. Small and medium enterprises were given some relief by the Accounting Standards Council from new financial reporting standards. There are a significant number of small and medium entities in the Philippines. When initially issued, the new international accounting standards that became effective in 2005 were intended to be applicable to all reporting entities required to file financial statements in accordance with Philippine GAAP. In 2005, the IASB undertook a project to develop accounting standards suitable for entities that do not have public accountability, referred to as non-publicly accountable entities (NPAEs). When preparing their 2005 financial statements, NPAEs are given the option not to apply the new international accounting standards that became effective in 2005 but to apply instead the accounting standards that were effective in 2004.²⁵ Philippine GAAP effective in 2004 do not include IAS on the effects of foreign exchange, employee benefits, and financial instruments; and the new IFRS. The relief is provided to non-publicly accountable entities and would *not* apply to following classifications which define entities with public accountability:

- An entity required to file financial statements under SRC Rule 68.1 (see para 10);
- An entity in the process of filing its financial statements for the purpose of issuing any class of instruments in a public market;
- An entity that holds assets in a fiduciary capacity for a broad group of outsiders (e.g., a bank, an investment house, a finance company, an insurance company, a securities broker/dealer, a mutual fund and a pre-need company);

²⁵ Accounting Standards Applicable to Qualifying Entities under PAS 101

Table 2. Accounting Standards Council,
Outstanding Accounting Standards, As of October 2005

<i>Philippines Accounting Standards/ Philippine Financial Reporting Standards</i>	<i>IFRS Adopted</i>	
	<i>2004 & prior years^a</i>	<i>2005a</i>
Preface to Philippine Financial Reporting Standards		X
Framework for the Preparation and Presentation of Financial Statements	X	
PAS 1. <i>Presentation of Financial Statements</i>	X	
PAS 2. <i>Inventories</i>	X	
PAS 7. <i>Cash Flow Statements</i>	X	
PAS 8. <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	X	
PAS 10. <i>Events after the Balance Sheet Date</i>	X	
PAS 11. <i>Construction Contracts</i>	X	
PAS 12. <i>Income Taxes</i>	X	
PAS 14. <i>Segment Reporting</i>	X	
PAS 16. <i>Property, Plant and Equipment</i>	X	
PAS 17. <i>Leases</i>	X	
PAS 18. <i>Revenue</i>	X	
PAS 19. <i>Employee Benefits</i>		X
Amendments to PAS 19: <i>Actuarial Gains and Losses, Group Plans and Disclosures^b</i>		X
PAS 20. <i>Accounting for Government Grants and Disclosure of Government Assistance</i>	X	
PAS 21. <i>The Effects of Changes in Foreign Exchange Rates</i>		X
PAS 23. <i>Borrowing Costs</i>	X	
PAS 24. <i>Related Party Disclosures</i>	X	
PAS 26. <i>Accounting and Reporting by Retirement Benefit Plans</i>	X	
PAS 27. <i>Consolidated and Separate Financial Statements</i>	X	
PAS 28. <i>Investments in Associates</i>	X	
PAS 29. <i>Financial Reporting in Hyperinflationary Economies</i>		X
PAS 30. <i>Disclosures in the Financial Statements of Banks and Similar Financial Institutions</i>		X
PAS 31. <i>Interests in Joint Ventures</i>	X	
PAS 32. <i>Financial Instruments: Disclosures and Presentation</i>		X
PAS 33. <i>Earnings per Share</i>	X	
PAS 34. <i>Interim Financial Reporting</i>	X	
PAS 36. <i>Impairment of Assets</i>	X	
PAS 37. <i>Provisions, Contingent Liabilities and Contingent Assets</i>	X	
PAS 38. <i>Intangible Assets</i>	X	
PAS 39. <i>Financial Instruments: Recognition and Measurement</i>		X
Amendments to PAS 39: <i>Transition and Initial Recognition of Financial Assets and Financial Liabilities^b</i>		X
PAS 40. <i>Investment Property</i>		X
PAS 41. <i>Agriculture</i>		X
PFRS 1. <i>First-time Adoption of Philippine Financial Reporting Standards</i>		X
PFRS 2. <i>Share Based Payment</i>		X
PFRS 3. <i>Business Combinations</i>	X	
PFRS 4. <i>Insurance Contracts</i>		X
PFRS 5. <i>Non-current Assets Held for Sale and Discontinued Operations</i>		X
PFRS 6. <i>Exploration for and Evaluation of Mineral Resources^b</i> (effective in 2006)		X

Notes:

a. IAS adopted and effective in 2004 and earlier years were based on the pre-2005 versions of the IAS. These were updated and issued in 2005 as Philippine Accounting Standards. IAS and IFRS effective in 2005 are based on the IFRS 2004 Bound Volume, containing all IFRS as of 3/31/04

b. Amendments to PAS 19 and PAS 39 and PFRS 6 were adopted as these were finalized and issued by the IASB in 2005.

- An entity that is a public utility or similar entity that provides an essential public service;
- An entity that is economically significant (i.e., with total assets of more than P250 million (approximately US\$4.9 million) or total liabilities of more than P150 million (approximately US\$2.9 million));
- An entity that is considered by its primary regulator to have public accountability.

47. In addition to Philippine GAAP requirements set forth in accounting standards issued by the ASC, accounting guidance is also issued by regulatory authorities such as the Bangko Sentral ng Pilipinas (para 16) and Insurance Commission (para 17), mainly for prudential reporting purposes.

2. Auditing Standards

48. **Most auditing requirements in the Philippines are contained in auditing pronouncements issued by the Auditing Standards and Practices Council (ASPC).** The Auditing Standards and Practices Council was created in 1985 to formalize the auditing standard setting function.²⁶ The Auditing Standards and Practices Council has 17 members composed of 7 (including the chairman) from independent auditing firms; 5 from PICPA; 2 from the Association of CPAs in Public Practice; and 1 each from Board of Accountancy, SEC, and the Commission on Audit. The Auditing Standards and Practices Council receives an annual subsidy from the PICPA Foundation.²⁷

49. **The authority of ASPC auditing pronouncements comes from the approval and recognition of the standards by the regulators.** Exposure drafts of proposed standards are issued for comments which are considered in the finalization of the standard. Auditing standards approved by the Auditing Standards and Practices Council are submitted to the Board of Accountancy for approval. ASPC standards approved by the Board of Accountancy and Professional Regulation Commission constitute generally accepted auditing standards in the Philippines.

50. **New audit standard setting body.** Under the rules and regulations implementing RA No. 9298, the Auditing and Assurance Standards Council (AASC) shall be created (section 9[A]). The Auditing and Assurance Standards Council, which is yet to be established, is accountable to the Professional Regulatory Board of Accountancy. The AASC chairman shall be a senior practitioner in public accountancy; the other 14 AASC representatives shall comprise of 1 each from Board of Accountancy, the SEC, the BSP, the Commission on Audit, and an association or organization of CPAs in active public practice of accountancy; 6 from an accredited national professional organization of CPAs in public practice, in addition to 1 each from commerce and industry, academe/education, and government. The Auditing Standards and Practices Council continues its audit standard setting function until the new AASC takes over. It is expected that the new AASC will have the same function as the predecessor Auditing Standards and Practices Council.)

²⁶ Preface to Statements of Auditing Standards of the Philippines, 1993.

²⁷ The ASPC receives an annual subsidy of P50,000 (approximately US\$977). The subsidy is supplemented by contributions from accounting firms. The ASPC members serve without any remuneration.

51. **Adoption of International Auditing Standards in the Philippines was undertaken over a number of years.** The Auditing Standards and Practices Council started adopting in 2001 the International Standards on Auditing (ISA) and International Auditing Practice Statements (IAPS) issued by the International Auditing Practices Committee (now the International Auditing and Assurance Standards Board) of the International Federation of Accountants. By 2005, all ISA were adopted as Philippine Standards on Auditing (PSA) and all IAPS were adopted as Philippine Auditing Practice Statements (PAPS). Any changes made in the convergence generally relate to inclusion, when appropriate, to relevant requirements/policies of regulatory agencies, for example under the SEC and BSP (reference to the Code of Professional Ethics in the Philippines, instead of the IFAC Code of Ethics for Professional Accountants; use of the phrase “present fairly, in all material respects” in the auditor’s report, instead of “give a true and fair view”; and making certain general ISA requirements/provisions Philippine-specific). Table 3 lists current status of the few remaining standards to be adopted from ISA and IAPS

Table 3.
Pending Status of Adoption of Philippine Standards of Auditing (as of November 2005)

<i>Pending Approval by the BOA/PRC</i>
Philippine Framework for Assurance Engagements
PSAE 3000 (rev.), <i>Assurance Engagements Other Than Audits or Reviews of Historical Financial Statements</i>
<i>Pending Submission to the BOA/PRC*</i>
PSA 240 (rev.), <i>The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements</i>
PSA 700 (rev.), <i>The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements</i> (with conforming amendments to PSA 200, PSA 210, PSA 560, PSA 701 and PSA 800)
PAPS 1014, <i>Reporting by Auditors on Compliance with International Financial Reporting Standards</i>
PSQC 1, <i>Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements</i>
PSA 220 (rev.), <i>Quality Control for Audits of Historical Financial Information</i>
Notes: *These standards have been approved by the ASPC and prepared for submission to the BOA/PRC. PSAE refers to Philippine Standard on Assurance Engagements and PSQC to Philippine Standard on Quality Control.

E. Enforcing Accounting and Auditing Standards

52. Since the previous ROSC conducted in the Philippines in 2001, initial legal steps have been taken to ensure compliance with accounting and auditing standards.

53. **Auditors must be accredited.** Auditors (and audit firms) are required to be accredited with the Board of Accountancy, SEC, BSP, and Insurance Commission (see paras 25–28) enabling them to audit companies under their jurisdictions. As of March 2006, the Board of Accountancy accredited 210 partnerships and 1,762 individual professionals.

54. **The revised Accountancy Act of 2004 and its implementing rules and regulations require that the accreditation process include a quality review of those seeking accreditation.** A Quality Review Committee (QRC) was created consisting of a chairman who should be a senior practitioner in public accounting and 6 other members: 1 from the Board of Accountancy, and 5 PICPA-accredited members who represent its

sectors, 2 from public practice; and 1 each from education, commerce and industry, and government. The Quality Review Committee will conduct quality review on applicants for accreditation. It will also be tasked with recommending to the Board of Accountancy the revocation of any CPA certificate if the applicant does not meet the standards of quality prescribed for the practice of public accountancy. There have been serious problems with the effectiveness of this quality review program, namely the inability to find full-time members who are willing to perform this function without remuneration; and a general lack of resources all around.

55. **The SEC conducted in 2004 a review of financial statements of listed companies and companies with secondary licenses for compliance with SEC rules of financial reporting.**²⁸ Under the supervision and instructions of the Office of the General Accountant, the SEC engaged the services of professors from the College of Business Administration of the University of the Philippine to review the 2003 audited financial statements of listed and/or public companies, and those which acquired secondary licenses, and some 2004 audited financial statements of some ordinary corporations. The review sought compliance and validity with SRC Rules 68 and 68.1, as amended; and Philippines Accounting Standards/Philippines Financial Reporting Standards in effect during the period under review. The Corporate Finance Department and the Office of the General Accountant of the SEC have assembled a joint team to carry out the review of financial statements in 2005 and beyond. This arrangement does not appear to be effective and efficient.

56. **The SEC finds difficulty in the compliance reviews.** The SEC indicated that it encountered difficulties in conducting the compliance reviews due to lack of sufficient human resources and training on the new and revised accounting and auditing standards. The SEC Office of the General Accountant must likewise be strengthened to further improve its present capability to monitor compliance with the accounting and auditing regulations.

57. **There has been an attempt to pass a bill in Congress patterned after the Sarbanes-Oxley legislation in the United States.** The bill proposed the establishment of a Public Company Accounting Oversight Board consisting of five full-time members appointed from among prominent individuals who would oversee the audit of public companies. The Oversight Board's function includes inspection of public accounting firms under rules to be promulgated by the SEC. The Oversight Board would not to be considered an agency of the government. However, not considered a priority by Congress, this bill is not expected to be passed in the immediate future. It has also received criticisms from various sources and would probably require major modifications before it could be passed.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

58. The ROSC team's assessment in this section is based on the review work done by the SEC, and inputs from knowledgeable specialists in user groups and preparers of financial statements.

²⁸ As a result of the SEC compliance monitoring activities in 2004, monetary and non-monetary sanctions were imposed on 98 listed/registered issuers of securities, 10 mutual funds, 9 public companies, 26 financing companies, 8 investment houses, 13 brokers/dealers, 2 salespersons, and 1 transfer agent. The most recent one involved a company which failed to recognize and present in its financial statements the collected deposits for subscriptions. The SEC imposed a penalty of PHP1.4 million on the company and its external auditor was required to explain why the transactions were not covered by the audit.

59. **The SEC review findings show lack of complete or adequate disclosures required under SEC Rule 68 and 68.1 (see para 10) in the financial statements of some entities reviewed.** SEC's review of financial statements mainly aimed at determining the possible misstatement or misrepresentation, going-concern issues, probable liquidity problem, possibility of errors, and other warning signals which may guide the SEC in resolving whether or not to conduct on-site examination of the books of accounts and records of the subject company. Assessments were also made on disclosures made on the audited financial statement. These disclosure requirements should comply with Philippine GAAP and should be consistent with the non-financial information submitted to the SEC (SEC Form 17-A, SEC Form 17-Q). Following are some of the more repeated violations found by the SEC:²⁹

- Inadequate or lack of disclosure of significant accounting policies;
- Incomplete or lack of disclosure of related party transactions;
- Incomplete or lack of disclosure related to trade and other payables and accruals;
- No provision for retirement benefits/inadequate disclosure on retirement benefits;
- Incomplete or lack of disclosure related to segments;
- No or incomplete disclosures required by new standards, such as provisions and leases;
- Failure to present comparative statements; and
- Failure to submit consolidated financial statements.

60. **Discussions with preparers and users of financial statements revealed that they are aware of the new standards and areas that presented implementation problems.** Some problem areas that were identified in the implementation of the standards follow. These are expected to be addressed and resolved as the new standards are adopted in 2005:

- **IAS 19, *Employee Benefits*.** Entities that sponsor defined benefit plans need to obtain actuarial reports that are compliant with the IAS requirements. This entailed more discussion with actuaries on the IAS requirement on the computation of the defined benefit pension liability. Implementation issues also arose on the information required to be provided by the actuary; assumptions used, particularly the discount rate; the complex accounting, such as the "corridor approach" used for actuarial gains and losses; and extended disclosures required.
- **IAS 21, *Effects of Changes in Foreign Exchange Rates*.** Companies are required to determine their functional currency and measure their financial position and results of operations in that currency. The Bureau of Internal Revenue however still requires the computation of tax liabilities based on transactions measured in Philippine pesos, thus raising bookkeeping problems. The prohibition of capitalization of foreign exchange losses will require the write off of capitalized foreign exchange losses resulting in significant decreases in the assets and stockholders' equity of some companies. This would affect debtors with loan covenants related to net assets.

²⁹ Summary of Findings, Review of the 2004 Financial Statements.

- **IAS 27, Consolidated and Separate Financial Statements.** Investments in subsidiaries, associates, and jointly controlled entities are now required to be valued either at cost or at fair value in accordance with IAS 39 in the separate or legal entity financial statements of a parent company. The net income and stockholders' equity in the separate statements could now differ from the amounts shown in the consolidated financial statements. The carrying amount of both investments and total stockholders' equity will be also be reduced by an amount representing the undistributed earning of the subsidiaries, associates, or jointly controlled entities which were previously included in these accounts under the equity method.
- **IAS 32, Financial Instruments, Disclosure and Presentation.** Companies with mandatory redeemable preferred stock, which are issued by some Philippine companies, would now classify these as debt and not equity. This would result in changes in the debt to equity ratio and may pose problems in compliance with debt covenants.
- **IAS 39, Financial Instruments: Recognition and Measurement.** The use of fair value in accounting for financial instruments could result in volatile earnings. Issues are also being raised relating to the complex accounting for derivatives, fair valuation techniques, required systems changes, and extensive disclosures. Banks, for example, now need to use the effective interest rate method in determining the loan loss provisions.
- **IAS 16, Property, Plant, and Equipment.** Companies that opt to follow the revaluation model need to identify items of property, plant, and equipment whose fair values can be reliably measured usually through market-based appraisal by professionally qualified valuers. This entailed more discussion with appraisers or valuers to ensure that their appraisal measurements are in accordance with the fair value measured under IAS 16.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

61. The ROSC team assessment in this section is based on discussions with representatives from about 20 audit firms, both large and small, as to their observance of the international accounting standards. There was a consensus among the group regarding the following issues:

- Switching from US-based auditing standards (which the profession has been accustomed to applying) to the International Standards on Auditing (ISA) would not be difficult as the group felt that there was not much difference in their substance.
- The audit quality among firms of different sizes was uneven.
- Many audit firms find it difficult to charge adequate fees and therefore are not able to give necessary level of effort. As a result proper procedures may not be followed, and this hinders application of some standards, including (a) quality control standards (lack of training and supervision over assistants on the job, and second partner review is almost not present); and (b) documentation standards

(management representations would be relied on particularly for fair values, impairment of assets, related party transactions and contingent liabilities).

- Reliance is placed on the work of other experts, such as property valuers and actuaries, without assessing the adequacy and the expert's competence and objectivity.
- Audit opinions may not be suitably qualified by not applying professional competence and due care.
- The participants all agreed that the review of the quality of the work of audit firms was a natural next step after accreditation by the Board of Accountancy, SEC, BSP and Insurance Commission was already instituted, and the SEC already embarked on reviewing some of the financial statements filed with them. There was a consensus that quality review programs should be tailored to suit those audit firms that audited large companies, and audit firms that did work for only small companies.

V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

62. There was general knowledge among stakeholders that Philippine accounting standards were migrating in a systematic manner to the international standards, and that in year 2005 the international standards would be fully adopted in the country. The regulators were pushing for the adoption of international standards. The standard setters set the program and implemented the migration. During the migration, the auditors geared up for the change to international standards by providing training to their partners and staff. The preparers and many users were being briefed about the change and their effects by their auditors.

63. Stakeholders recognized that there was unevenness in the quality of audits between the large and small auditing firms, but they were quite happy with the feeling that at least the larger firms would be able to cope and help their clients convert to the international standards. The stakeholders were in agreement that strengthening enforcement mechanisms would further improve the quality of corporate financial reporting. The idea of classifying audit firms into two or three tiers and applying different levels or quality control procedures to each tier was an acceptable mechanism to address the existing unevenness in quality among audit firms.

VI. POLICY RECOMMENDATIONS

64. The policy recommendations have emerged after taking note of the improvements in the accounting and auditing scene since the last ROSC A&A assessment made in 2001, and valuable inputs from country stakeholders. These improvements are summarized below and classified as (a) substantially complete and (b) still requiring substantial effort to complete:

Improvements that are substantially complete

- a) The Accountancy Act of 2004 and its implementing regulations, as amended now provide that all CPAs must be members of an accredited professional

organization (see para 22). The Act imposed a three-year experience requirement before a new CPA could practice public accountancy.

- b) The Philippine Institute of Certified Public Accountants (PICPA) continues to be the accredited professional organization. It has taken on board an executive director and is implementing a plan to have at least a majority of CPAs in the country as members (see para 22).
- c) The international standards for both accounting and auditing have all been substantially adopted by 2005 (see paras 44 and 51). This also includes the IFAC-issued requirements on professional ethics which was adopted in 2004 (see para 29).
- d) Regulators have instituted their respective programs to accredit auditors and audit firms that could audit companies under their supervision (see paras 25–28). The SEC has taken on board a General Accountant and also started to review financial statements of companies filing financial statements with them for compliance with the required accounting and disclosure rules.
- e) The accounting and auditing standards-setters have been legally constituted and will take over the functions of the present Accounting Standards Council and Auditing Standards and Practices Council (see paras 42 and 50)

Improvements that still require substantial effort to complete:

- a) The Accountancy Act 2004 required continuing professional education and the creation of a CPE Council. PICPA was designated to create a CPE Council to take charge of the establishment of CPE requirements (see paras 21 and 23).
- b) The Board of Accountancy is mandated by law to supervise the profession and provide oversight on the quality of audits (see para 21). PICPA has likewise created a Quality Control Board (see para 24).

As the recommendations try to improve and build on the efforts that are already being made to improve the corporate accounting regime in the Philippines, the policy recommendations will principally cover those improvements that still require a substantial effort to complete – i.e., (a) monitoring and enforcement mechanism for quality control review and (b) education and training matters.

65. **Monitoring and enforcement mechanism for quality control review.** High-quality financial reporting depends not only on having appropriate accounting and auditing standards, but also on having a proper monitoring and enforcement mechanism. There are three links in the enforcement chain:

- Top management needs to make necessary arrangements for ensuring that corporate financial statements are prepared in compliance with the applicable accounting and financial reporting requirements.

- Auditors need to be independent and competent for ensuring that auditing is conducted in compliance with the applicable auditing standards, and to determine the extent which the preparers of financial statements have complied with the applicable accounting and reporting standards.
- Regulators need to protect public interest through monitoring and enforcement activities aimed at preventing noncompliance with accounting and auditing requirements.

66. Many stakeholders are involved in the enforcement of quality control measures. The SEC, BSP and the Insurance Commission have shown interest by requiring accreditation of auditors. The SEC has also embarked on reviewing financial statement submitted for compliance. The Board of Accountancy is mandated by law to supervise the accounting profession and provide quality control oversight on audits PICPA has created its Quality Control Board to handle a similar function for which it is obligated to perform to meet its IFAC-membership requirements.

67. With resources being scarce, there is a need to coordinate the activities of the stakeholders involved in enforcement of quality reviews to avoid duplication of efforts and costs. Our recommendations on the monitoring and enforcement of quality control are as follows:

- ***Establish an oversight body to coordinate the quality control programs of the various stakeholders (SEC, BSP, Insurance Commission, and BOA) and provide appropriate transparency in carrying out the quality control function.*** The oversight body would establish the objectives and policies such as the companies to be covered by quality control review and the nature and extent of work to be done. In the absence of legislation in the short to mid-term, the public oversight body could be created by means of a Memorandum of Agreement between the parties concerned. After a few years, legislative measures should be taken with the benefit of experience. The composition, functions, and powers of the proposed arrangement need to focus on protecting public interest. In developing such an arrangement, lessons/principles could be drawn from similar arrangements in other countries. Appendix A includes summaries of the United Kingdom's Financial Reporting Council (FRC), Australia's Financial Reporting Council, and the United States' Public Accounting Oversight Board (PCOAB) as examples of evolving regulatory structures.
- ***Set up quality control review teams of full time qualified professionals who report directly to the oversight body.*** The quality control review teams will be part of and perform functions and procedures prescribed by the oversight body. The SEC and PICPA will receive necessary information from the unified quality control arrangement, and will not need to build their own control teams.
- ***The oversight body should be able to recruit qualified personnel with commensurate compensation.*** We recommend that appropriate arrangements should be put in place for insulating the oversight body from interference by the practicing members of accountancy profession as-well-as other vested interest groups. Arrangements will need to be made so that the specialists who will carry out monitoring and enforcement activities on behalf of the oversight body, can be paid compensation according to market rate and commensurate to skills required for quality control work.

Funding for the oversight body would have to be shared by the various stakeholders. This is a matter that requires coordination by the stakeholders.

- ***Design quality control procedures appropriate to audit firms to be reviewed.*** No one would dispute that the extent of quality control work on an audit of a listed company should not be as extensive as for the audit of a small or medium size company. The quality control oversight body would need to classify audit firms into types or divisions taking into account such factors as the size or public interest accountability of their clients. The quality control oversight body would also decide on the nature and extent of quality control procedures that would be applied for each division or classification of audit firms.

68. **Education and training matters.** Our recommendations on education and training matters are addressed to various stakeholders as follows:

- ***Preparers.*** Directors of public interest entities should be made aware of their responsibilities with regard to financial reporting; and corporate accountants should get training in preparing IFRS/IAS-based financial statements.
- ***Regulators.*** Staffs of various regulatory agencies could better enforce accounting standards by receiving IFRS/IAS theoretical and practical training.
- ***Tax officials.*** As IFRS/IAS net income is the starting point of the accounting and tax reconciliation, tax personnel should have a sound understanding of IFRS/IAS. Tax assessors at the Board of Revenue need to build their capacity in order to properly handle corporate tax payers who prepare and present financial statements in accordance with the modern financial reporting requirements.
- ***Auditors.*** Auditors of all public interest entities need to receive practical training to help them to audit the IFRS/IAS-based financial statements, and to comply with ISA.
- ***Academe.*** Global developments in accounting and auditing must be reflected in the CPA training and examination arrangements on a timely basis.
- ***BOA examiners.*** The professional qualification examinations should test candidates' knowledge about the practical aspects of professional ethics.
- ***Trainee accountants.*** Practical experience leading to qualification as a professional accountant should be conducted under the direction of a mentor who is an experienced CPA. The mentor should have sufficient knowledge and experience with practical aspects of all the applicable standards and codes. The practical experience environment also needs to be assessed and approved (reviewing the nature and scope of practical experience and training arrangements of employers to ensure trainees are receiving practical exposure to core areas and proper direction and supervision). The Board of Accountancy should make necessary arrangements for monitoring and approving authorized practical training providers. In addition, the Board of Accountancy should provide detailed written guidance to employers, mentors, and trainees regarding the program of practical experience. It is worth mentioning that license to conduct statutory audit should not be issued to anyone without practical audit training under supervision of a qualified audit training provider.

- **PICPA.** PICPA, as a CPE provider (see para 39) and as the body designated to create a CPE Council (see para 23), should build up a core of full time professionals who will handle its CPE activities, rather than rely on volunteer efforts (see para 70).

Other Recommendations

69. **Rationalize audit requirements for small companies.** The present thresholds that require submission of audited financial statements were set many years ago and are no longer realistic. The SEC threshold is paid up capital of P50,000 (approximately US\$977) and the Bureau of Internal Revenue threshold is gross quarterly sales of P150,000 (approximately US\$2,930). As a result of low thresholds, the system by itself encourages below-standard audits. Recent auditing pronouncements now provide guidance on other types of services that may be performed by a CPA, such as compilation services and review services. While it is understandable that regulatory authorities would want to obtain assurance on financial statements reported by companies, lower levels of service, such as compilation and review services, may be adequate for companies close to the present thresholds. The profession should work with the SEC and the Bureau of Internal Revenue to review the reportorial requirements of these agencies, consider recent auditing pronouncements and work for a change in the law or regulations toward increasing the thresholds for filing of financial statements and a change in the nature of CPA services that may be rendered for such small entities.

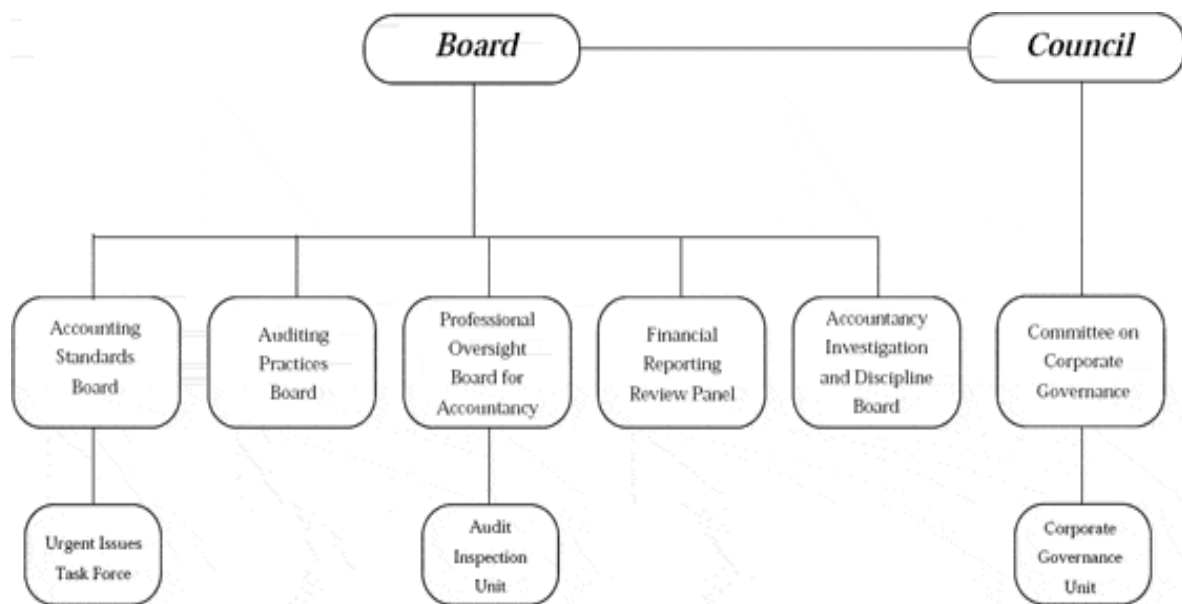
70. **Rationalize PICPA's membership fee structure.** In addition to strengthening its institutional capacity for mandated activities, PICPA should determine the full cost of rendering its mandated services to its members. It should stop relying on volunteer efforts and hire full time personnel and build a core of full time professionals to handle its mandated activities for CPE and quality control instead of relying on part-time volunteers. Since this would result in additional costs, PICPA should increase its present US\$20 annual dues, which seems quite low, and align its fee structure with those of other professional bodies in neighboring countries.

APPENDIX A
INTERNATIONAL DEVELOPMENTS IN REGULATORY FRAMEWORK
OF ACCOUNTING AND AUDITING

This note describes salient features of regulatory structures in three countries, for example. For more details, refer to (a) www.frc.org.uk for the United Kingdom's Financial Reporting Council, (b) www.frc.gov.au for Australia's Financial Reporting Council, and (c) www.pcaobus.org for the United States' Public Company Accounting Oversight Board.

1. UNITED KINGDOM: THE FINANCIAL REPORTING COUNCIL (FRC)

The Financial Reporting Council (FRC) of the UK is a unified, independent regulator which (a) sets, monitors and enforces accounting and auditing standards, (b) oversees the regulatory activities of the professional accountancy bodies, (c) regulates audit; and (d) promotes high standards of corporate governance. It was initially established in 1990 and the mandate was expanded in 2003. It has five subsidiary boards with a Management Board that co-ordinates the key policy and resource issues of the organization. The FRC is the parent of all the subsidiary boards, all of which are established as companies limited by guarantees.



The Council is headed by a chief executive and comprises of a chairman, a deputy chairman (both of whom are directors of FRC limited) and three additional directors (each representing a community of stakeholders, namely Confederation of British Industry (CBI), consultative committee of the Accountancy Bodies (CCAB) and, a representative of the investor community). The Council determines the strategic direction of the organization, oversees the delivery by each subsidiary Board of its functions, reviews and amends the combined code as necessary to secure and maintain observance of high standards of corporate governance; and manage the broad strategic relationship with key players domestically and internationally. The FRC and its subsidiaries are currently

supported and funded jointly³⁰ by the accountancy profession (through the Consultative Committee of the Accountancy Bodies [CCAB]), business (through a levy collected by the FSA) and the Government.

The Accounting Standards Board (ASB)

The role of the Accounting Standards Board (ASB) is to issue accounting standards under the Companies Act 1985, which took over the task of setting accounting standards from the Accounting Standards Committee (ASC) in 1990. The ASB has up to ten Board members, of whom two (the Chairman and the Technical Director) are full-time, and the remainders, who represent a variety of interests, are part-time. Under the ASB's constitution, votes of seven Board members (six when there are fewer than ten members) are required for any decision to adopt, revise or withdraw an accounting standard. Board members are appointed by a Nominations Committee comprising the chairman and fellow directors of the Financial Reporting Council (FRC).

The Auditing Practices Board (APB)

The new Auditing Practices Board (APB) was established in April 2002 which a APB which had been in place since 1991. The APB establishes standards of auditing, meets the developing needs of users of financial information; and ensures public confidence in the auditing process.

The Public Oversight Board for Accountancy (POBA)

The POBA provides (a) independent oversight of the regulation of the auditing profession by the recognized supervisory and qualifying bodies; (b) monitoring of the quality of the auditing function in relation to economically significant entities; and (c) independent oversight of the regulation of the accountancy profession by the professional accountancy bodies.

Audit Inspection Unit. The POBA includes an Audit Inspection Unit (AIU), which in the initial year (2004-05) is focusing on the audits of the FTSE 350 companies and the Big 4 firms of auditors, which audit 97% of those companies. Coverage will be extended over the following two years to other public interest entities, including listed companies with a minimum market capitalization of £100 million, major charities, major pension funds, mutual organizations and other public interest entities over the following two years. A sample of audits will be subject to review in any one year, the selection of audits will, in part be on a risk basis, and to provide coverage across the audit firms. The Professional Bodies own monitoring units will continue to be responsible for monitoring audits not falling within the scope of the AIU. The AIU will be supported by a Panel of very senior individuals with experience of audit who will be available to provide advice on inspections, and particularly on issues involving professional judgment. The AIU will present their reports with recommendations for action to the Audit Registration Committees (ARCs) of the accountancy bodies, who will then exercise their existing functions: taking appropriate regulatory action and/or referring the matter to the bodies' disciplinary procedures for action. The POBA will monitor the response of the Audit Registration Committees to AIU reports to ensure itself that appropriate action is being taken. In addition, the AIU can inform the AIDB if it identifies concerns, which might lead to disciplinary action. The AIU can also inform the FRRP of concerns it has with the

³⁰ The FRC has one-third government funding, one-third funding from the CCAB and the balance from listing companies and the banking and investment sector. Previously, the Accountancy Foundation had been funded solely by the CCAB, which was considered to risk the independence of the organization.

audits of individual companies, so that the FRRP may take appropriate action in relation to the company accounts.

The Financial Reporting Review Panel (FRRP)

The FRRP (commonly referred to as "the Panel") considers whether the annual accounts of public companies and large private companies comply with the requirements of the Companies Act 1985 including applicable accounting standards. The Panel can ask directors to explain apparent departures from the accounting requirements. If the Panel is not satisfied by the directors' explanations it aims to persuade them to adopt a more appropriate accounting treatment. The directors may then voluntarily withdraw their accounts and replace them with revised accounts that correct the matters in error. Depending on the circumstances, the Panel may accept another form of remedial action—for example, correction of the comparative figures in the next set of annual financial statements. Failing voluntary correction, the Panel can exercise its powers to secure the necessary revision of the original accounts through a court order.

The Accountancy Investigation and Discipline Board (AIDB)

The AIDB is the independent investigative and disciplinary body for accountants in the UK. It has up to eight members and is responsible for operating and administering an independent disciplinary scheme ('the scheme') covering members of professional accountancy bodies under its purview. The AIDB deals with cases which raise or appear to raise important issues affecting the public interest in the UK and which need to be investigated to determine whether or not there has been any misconduct by an accountant or accountancy firm. The Scheme and Regulations contain the detailed rules setting out how cases are dealt with by the AIDB. In the first instance, complaints about accountants or accountancy firms would be made to the accountancy body of which the accountant or the firm is a member. Matters which raise serious issues affecting the public interest will be referred to the AIDB by the accountants' professional bodies. The AIDB will then decide whether to investigate the matter, in which case it will be referred to an Executive Counsel. The AIDB may also decide of its own accord to investigate a matter without it having been referred to it by one of the accountants' professional bodies. The Executive Counsel will conduct the investigation and decide whether or not any accountant or accountancy firm should be subject to disciplinary proceedings. If disciplinary proceedings are to be commenced, the Executive Counsel will file a complaint with the AIDB and the AIDB will appoint a Disciplinary Tribunal to hear the case.

2. AUSTRALIA: THE FINANCIAL REPORTING COUNCIL

The Financial Reporting Council (FRC) is a statutory body under the *Australian Securities and Investments Commission Act 2001* (ASIC Act), as amended by the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004. The FRC is responsible for providing broad oversight of the process for setting accounting and auditing standards as well as monitoring the effectiveness of auditor independence requirements in Australia and giving the Minister reports and advice on these matters.

Specific accounting and auditing standard setting functions for which the FRC is responsible include (a) appointing the members of the Australian Accounting Standards Board (AASB) and Australian Auditing Standards Board (AuASB), (b) determining,

approving and monitoring the AASB's and AUASB's priorities & business plans, (c) giving the AASB and AUASB directions, advice or feedback on matters of general policy and on the AASB's and AUASB's procedures, (d) monitoring the development of international accounting and auditing standards and the accounting and auditing standards that apply in major international financial centers, (e) promoting the continued adoption of international best practice accounting and auditing standards in the Australian accounting and auditing standard setting processes, (f) monitoring [(i) the operation of accounting and auditing standards to assess their continued relevance and their effectiveness in achieving their objectives in respect of both the private and public sectors of the Australian economy; (ii) the effectiveness of the consultative arrangements used by the AASB and AUASB; and (iii) seeking contributions towards the costs of the Australian accounting and auditing standard setting processes].

Specific auditor independence functions for which the FRC is responsible include (a) monitoring and assessing the nature and overall adequacy of (i) the systems and processes used by Australian auditors to ensure compliance with auditor independence requirements; (ii) the systems and processes used by professional accounting bodies for planning and performing quality assurance reviews of audit work undertaken by Australian auditors to the extent to which those reviews relate to auditor independence requirements; (iii) the action that Australian auditors who have been subject to such quality assurance reviews have taken in response to the reports prepared as a result of those reviews; (iv) the action taken by professional accounting bodies to ensure that Australian auditors who have been subject to such quality assurance reviews respond appropriately to the reports prepared as a result of those reviews; and (v) the investigation and disciplinary procedures of professional accounting bodies as those procedures apply to Australian auditors, (b) monitoring the overall compliance by companies, registered schemes and disclosing entities with the audit-related disclosure requirements of the Corporations Act and the accounting and auditing standards, (c) giving the Minister and the professional accounting bodies reports and advice on the above matters, (d) monitoring international developments in auditor independence, assessing the adequacy of the Australian auditor independence requirements in the light of those developments and giving the Minister, and professional accounting bodies, reports and advice on any additional measures needed to enhance the independence of Australian auditors; and (e) promoting, and monitoring the adequacy of, the teaching of professional and business ethics by, or on behalf of, professional accounting bodies to the extent to which the teaching of those subjects relates to auditor independence.

The members of the FRC are appointed by the Treasurer and hold office on terms and conditions determined by the Treasurer. The FRC includes members appointed from nominations put forward by key stakeholder groups, as well as members appointed independently of stakeholder interests.

3. UNITED STATES: PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (USPCAOB)

Following are the most important accounting and auditing related requirements of the *Sarbanes-Oxley Act of 2002*. The Act includes provisions concerning various other matters affecting investor protection.

- ***Oversight of Public Company Audit.*** The Act establishes the Public Company Accounting Oversight Board (PCAOB), to be organized as a non-profit corporation, with SEC administration and oversight. The PCAOB's mission is to oversee the audits of public companies and related matters.
- ***Organization of PCAOB.*** The Securities and Exchange Commission appoints the chairman and members of the Public Company Accounting Oversight Board. The Board comprises five members—two can be professionally qualified accountants.
- ***Auditor registration.*** All auditors of public companies must register with the PCAOB, identify public audit clients, identify all accountants associated with those clients, list fees earned for audit and nonaudit services, explain their audit quality control procedures, and identify all criminal, civil, administrative, and disciplinary proceedings against the firm or any of its associated persons in connection with an audit.
- ***Inspection of CPA firms.*** The PCAOB must inspect all CPA firms that audit public companies to assess compliance with the law, SEC regulations, rules established by the PCAOB, and professional standards. Firms that audit more than 100 public companies will be inspected annually. Firms that audit 100 or fewer public companies must be inspected at least once every three years. If violations are found, the PCAOB must take disciplinary action.
- ***Audit committees.*** All audit committee members must be independent (non-executive) directors. Audit firms will be appointed by, and will report directly to, the audit committee. Audit committees must establish procedures to deal with complaints about accounting, auditing, and internal controls.
- ***Audit, quality control, ethics, and independence standards.*** The PCAOB must adopt audit, quality control, ethics, and independence standards. In doing so, the PCAOB may look to standards established by recognized professional organizations such as the AICPA.
- ***Quality control.*** The PCAOB's quality control standards must require that registered firms properly supervise all work, monitor compliance with ethics and independence rules, and establish internal systems for consultation, professional development, and client acceptance and retention.
- ***Restrictions on services to audit clients.*** The Act restricts consulting work auditors can do for their audit clients. Restricted services include (with certain exceptions) bookkeeping, financial systems design, appraisal and valuation, actuarial, internal audit, management functions, human resources, broker-dealer, investment banking, and legal. PCAOB may enumerate additional prohibited services. The registrant's

audit committee must pre-approve engaging the auditor for other nonaudit services, including tax work.

- **Partner rotation.** The Act requires 5-year rotation of the audit partner and second reviewing partner.
- **Accounting standards.** The law permits the SEC to recognize standards established by a private-sector accounting standard-setter provided that the standard-setter is deemed acceptable by the SEC and considers international convergence in developing standards.
- **Disclosures.** The Act requires certain disclosures in financial reports, including information about off-balance sheet transactions, and orders the SEC to develop rules regarding pro forma disclosures.
- **Principles-based standards.** The SEC is required to study the “adoption by the United States financial reporting system of a principles-based accounting system” and, within one year, submit a report to specified committees of the US Senate and House of Representatives.
- **Corporate and criminal fraud.** The Act provides for criminal penalties for corporate fraud and document shredding.
- **Restatements.** The Act specifically prohibits improper influence on audits and requires forfeiture of executive bonuses and equity gains if financial statements must be restated.
- **Compliance with SOX Section 404.** Section 404 of the Sarbanes Oxley Act requires the management of a company registered with the SEC to assess and report on the effectiveness of the company's internal control over financial reporting, and requires auditors to attest to and report on management's assessment.

GLOSSARY OF TERMS

AASC	Auditing and Accounting Standards Council
ASC	Accounting Standards Council
ASPC	Auditing Standards and Practice Council
BOA	Board of Accountancy
BSP	Bangko Sentral ng Pilipinas (Central Bank)
CPA	Certified Public Accountant
CPE	Continuing Professional Education
FRSC	Financial Reporting Standards Council
GAAP	Generally Accepted Accounting Principles
GOCC	Government-owned and –controlled organization
IAS	International Accounting Standard
IAPS	International Auditing Practice Statement
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standard
ISA	International Standard on Auditing
NPAE	None Publicly Accountable Entities
OGA	Office of the General Accountant
PAS	Philippine Accounting Standard
PFRS	Philippine Financial Reporting Standard
PICPA	Philippine Institute of Certified Public Accountants
PRC	Professional Regulation Commission
QRC	Quality Review Committee
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprise
SRC	Securities Regulation Code