Securities and Exchange Commission
PHILIPPINES

SEC MEMORANDUM CIRCULAR NO. 9
Series of 2017

RULES AND REGULATIONS ON THE IMPLEMENTATION OF THE SECURITIES AND EXCHANGE COMMISSION (SEC) OVERSIGHT ASSURANCE REVIEW INSPECTION PROGRAM

In line with the declared State policy under the Securities Regulation Code (SRC) to protect investors and ensure full and fair disclosures about securities and in adherence to International Organization of Securities Commissions' principles on securities regulation, the SEC, pursuant to the powers and functions vested in it under Section 5 of the SRC and its authority to make, amend, and rescind such accounting rules and regulations as may be necessary to carry out the provisions of the SRC as provided for under Section 68 thereof, hereby issues these Rules and Regulations on the implementation of the SEC Oversight Assurance Review (SOAR) Inspection Program.

Section 1. The SOAR Inspection Program

1.1 The SOAR Inspection Program is the initiative of the SEC to do an on-site review of the quality control policies and procedures of accredited firms auditing companies with equity or debt securities listed in an Exchange and a review of portions of the audit work on selected audit engagements of these firms from time to time. The SOAR Inspection Program is intended to improve confidence in the audited financial statements (AFS) of listed companies by promoting high-quality and more transparent financial reporting to protect the interests of investors and other users of AFS. It is also designed to promote compliance with the requirements of the SEC and professional and ethical standards.

The SOAR Inspection Program is conducted by the SEC's Office of the General Accountant (OGA).

1.2 The OGA will follow a risk-based approach in the selection of engagements and firms to be subjected to SOAR inspection.

Section 2. The SOAR Organization

2.1 SOAR Inspection Team

a. The inspections under the SOAR Inspection Program shall be done by an Inspection Team, composed of an Inspection Team Leader and Reviewers. The OGA may create additional Inspection Teams as the need arises subject to Commission *en banc*'s approval and law on appropriations.

b. The Inspection Team shall be under the supervision of the General Accountant and shall undertake its tasks based on policies and procedures set by the Commission *en banc* to ensure the effective implementation of the SOAR Inspection Program.

2.2 Commission *en banc*

a. The OGA's Final Inspection Report (FIR) based on the results of the SOAR inspection require the clearance of the Commission en banc before the same is released to the firm inspected.

b. Sanctions imposed by the OGA on the firms and/or auditors may be appealed to the Commission *en banc* in accordance with the existing Rules of Procedures of the SEC.

Section 3. Rules of Conduct and Independence

3.1 The SOAR Inspection Team members shall be guided by the principles set out in the "Rules of Conduct for Commissioners, Officers and Employees as provided under SRC Rule 6.2, as well as in the "Independence Policy Applicable to the SOAR Inspection Program" approved by the Commission *en banc*.

3.2 The SOAR Inspection Team members shall keep the information obtained during the inspection confidential and shall not use the same for any other purpose.

Section 4. Consultation with Resource Persons

4.1 To provide expert advice to help resolve issues raised by the Inspection Team that are contested by the firm/professional subjected to quality review/inspection, or in circumstances in which the Commission finds it necessary and appropriate, the OGA may consult with appropriate resource persons as needed on a pro bono basis.

4.2 The final decision shall be made by the OGA and Commission *en banc*.

Section 5. Scope, Coverage and Frequency of Inspection

5.1 Only accredited auditing firms engaged by companies with equity or debt securities listed in an Exchange and portions of these firms' audit work for the listed companies, shall be reviewed and covered under the SOAR Inspection Program.

5.2 The SOAR Inspection Program shall cover auditing firms and audit engagement partners. Both Office Level Review and Engagement Level Review shall be conducted by the Inspection Team.

a. The Office Level Review covers the appropriateness of the policies and procedures and the degree of compliance with each of the six (6) elements of quality control as prescribed under Philippine Standards on Quality Control (PSQC) 1 (Redrafted) - "Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements" and the sufficiency of documentation.

b. The Engagement Level Review covers an assessment of the engagement team's compliance with professional standards, relevant regulatory requirements and firm policies, and procedures in connection with its performance of audits, issuance of audit reports and related matters involving publicly listed companies.

5.3 Standards on Quality Control and Auditing

a. SOAR Inspections are intended to enhance the quality of audits of the financial statements of publicly listed companies. The system of quality controls to achieve this objective is set out in PSQC 1 (Redrafted) - "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements" and Philippine Standards on Auditing (PSA) 220 (Redrafted)- "Quality Control for an Audit of Financial Statements."

b. PSQC 1 (Redrafted) deals with a firm's responsibilities for its system of quality control for audits and reviews of financial statements and other assurance and related services engagements. PSA 220 deals with the specific responsibilities of the auditors regarding quality control procedures to be followed for an audit of the financial statements.

The nature and extent of the policies and procedures developed by an individual firm to comply with PSQC 1 normally depends on various factors such as the size and operating characteristics of the firm and whether it is part of a network.

The standards require the firms to address the following elements of quality control:

1. Leadership Responsibilities for Quality within the Firm

2. Relevant Ethical Requirements

3. Acceptance and Continuance of Client Relationships and Specific Engagements

4. Human Resources/Assignments of Engagement Teams

5. Engagement Performance and Engagement Quality Review

6. Monitoring.

5.4 The approach in the selection of the accredited firms and engagement partners for review is risk-based. The selection will be made by the General Accountant. Inspections will not involve a random or representative sample of listed entities. Audits that may pose difficult or complex issues will be identified considering risk factors such as nature of the company, including its industry and market capitalization and audit issues likely to be encountered. However, the OGA is not precluded from prioritizing other firms or selected engagements for review as the circumstances would warrant.

5.5 Frequency of Inspections

Upon full implementation of the SOAR Inspection Program, the frequency of the inspection shall be as follows:

a. For all covered firms, it shall be once every three (3) years. All audit firms of listed companies will be covered within the three-year period. The Commission, however, is not precluded from subjecting firms to an annual inspection, if circumstances would warrant the conduct thereof;

b. During the triennial review of an audit firm, at least one engagement will be selected.

5.6 Duration of Inspections

The duration of the on-site inspection shall be at least two (2) weeks.

Section 6. SOAR Inspection Process

6.1 The SOAR inspection process does not necessarily cover the entire engagement, rather it concentrates on areas that appear to the Inspection Team to present significant risks. The Commission shall inform the firm at least 60 days in advance regarding its plan of conducting the inspection of the engagement selected. The firm shall be requested to provide the SOAR inspectors with information regarding concerned areas.

The audit inspection process involves the following key steps:

a. planning;

b. execution;

c. reporting; and

d. remedial actions.

6.2 Once a firm to be inspected is selected, the SOAR Inspection Team will hold a pre-inspection meeting with the selected audit firm to seek inputs on and discuss planned areas of focus with the selected audit team.

6.3 The Inspection Program does not aim at reviewing every single audit engagement in its attempt to evaluate the quality environment in a firm and the overall quality of the audit engagements that a firm undertakes. Accordingly, the SOAR inspection outcome does not provide assurance that the inspection of the firm's quality control policies and procedures and practices and independence policies, or the financial statements audited by the firm, are free of deficiencies, apart from the deficiencies noted in the inspection.

Section 7. Reporting

7.1 The following are the steps to be followed after the fieldwork:

Step		Period
I	Closing meeting / dialogue to discuss preliminary results and findings and the firm's responses	On the last day of fieldwork
II	Provide Letter of Findings to the firm	Within 30 days after the closing meeting
III	Submission of the firm's reply to the Letter of Findings	Within 15 days after receipt of the Letter of Findings
IV	Provide Preliminary Inspection Report (PIR) to the firm	Within 45 days after receipt of the firm's reply to the Letter of Findings
V	Submission of the firm's reply to the PIR	Within 30 days from receipt of the PIR
VI	Provide the Final Inspection Report (FIR) to the firm	Within 45 days after receipt of the firm's reply to the PIR

The Letter of Findings confirms the facts of the findings at hand as the Inspection Team understands them. This document will be the basis of the Inspection Team in preparing the PIR.

The PIR is the initial formal report submitted by the Inspection Team to the firm which is prepared based on the Letter of Findings. The firm is given the opportunity to comment on the PIR. A written response by the firm to the PIR (although not mandatory) is submitted to the Inspection Team for its consideration.

The FIR is the final formal report submitted by the Inspection Team to the firm which is prepared based on the PIR and the firm's reply to the PIR. Approval by the Commission *en banc* is required before the FIR is released to the firm. The firm can request for reconsideration of certain matters in the FIR, if it so decides.

Section 8. Remediation Action

8.1 Remediation Process

After the PIR is received by the firm and sometimes even before the release of the FIR, the inspected firm is expected to plan on how to address the inspection findings, and any findings and concerns on quality control that the Inspection Team noted.

The Firm must prepare and submit to the Inspection Team a written Action Plan on how the review findings will be addressed, within six (6) months from the release of the FIR. The Inspection Team shall provide written comments on the proposed Action Plan within thirty (30) days after the submission of a copy of the Action Plan.

8.2 Audit Quality Matters and Findings

a. Remediation Period - A twelve (12) to eighteen (18)-month remediation period shall be provided from the date of the FIR. The firm may provide interim written updates on the progress of remediation.

   The OGA with prior approval by the Commission *en banc*, upon request by the firm, may allow an extension of time for remediation actions only in special circumstances.

b. Consequence when the OGA is not satisfied with a firm's remediation process - If the firm and/or auditor fails to remedy deficiencies within the prescribed period, the SEC may publish on its website the portion of the FIR that discusses the quality control findings that have not been

remediated. Upon receipt of notice of publication, the firm may seek reconsideration of the decision by the OGA to publish the aforementioned report by requesting the Commission *en banc* to review the decision again. If the findings are contested, both the Inspection Team's findings and the firm's response shall be published.

8.3 Quality Control System Issues

a. A Firm may submit evidence or demonstrate to the SEC through the OGA that it has improved and/or remediated the findings on quality control system no later than twelve (12) to eighteen (18) months after the issuance of the FIR.

b. When the firm has satisfactorily addressed the findings in the quality control system, as determined by the OGA and approved by the Commission *en banc*, it shall be notified in writing that the SEC accepts the remedial measures that the firm has implemented to address the quality control issues noted by the Inspection Team. The firm will likewise be informed in writing if its remedial measures being implemented are not satisfactory to address the concern on quality control raised by the Inspection Team.

Section 9. Other Matters

9.1 Responsibility of the Firm to Cooperate with the Inspection Team

Accredited audit firms and their personnel shall cooperate with the Inspection Team during and until the Inspection is completed. Cooperation shall include but not be limited to, complying with the requests of the Inspection Team to:

1. Provide access to all relevant audit quality policies and procedures, and working papers in the custody of the firm; and

2. Provide information by oral interviews and/or written responses.

At least 60 days before the planned start of the inspection, the Inspection Team shall send a list of data requirements to the audit firm and partner, to enable them to prepare the documentation and obtain necessary clearances from the audit client.

9.2 Procedures and Sanctions for Violations Identified During Inspection

If the Inspection Team determines that information it obtained from the firm and the engagement team during the inspection indicates that the firm subject to such inspection or any member of the engagement team or any firm's personnel may have engaged in any act or omission that may be in violation of professional standards or the firm's own quality control procedures, it shall:

1. Report information concerning such act, practice or omission to the Commission *en banc*; and

2. If deemed necessary, recommend an investigation of such act, practice or omission or a disciplinary proceeding in accordance with the rules of the Commission.

The following administrative sanctions may be imposed on auditing firms/auditors covered by the inspection:

1. Censure

2. Require additional professional education and training

3. Require the firm to engage another consultant to design policies and to improve compliance with professional standards relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto

4. Monetary fines;

5. For egregious or repeat violations, suspension or revocation of the SEC accreditation.

This Circular shall take effect within fifteen (15) days from its publication in two (2) newspapers of general circulation in the Philippines.

Pasay City.

August 18, 2017

For the Commission *en banc:*

TERESITA J. HERBOSA
Chairperson