Securities and Exchange Commission

SEC MEMORANDUM CIRCULAR NO. 12
Series of 2021

REVISED RULES AND REGULATIONS ON THE IMPLEMENTATION OF THE SEC OVERSIGHT ASSURANCE REVIEW (SOAR) 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; in adherence to International Organization of Securities Commissions' principles on securities regulation; and in commitment to International Forum of Independent Audit Regulators' mission and principles on audit 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 the Revised SRC Rule 68 and pursuant to the powers vested in it to impose penalties under Sections 162 and 163 of the Revised Corporation Code, hereby issues the Revised Rules and Regulation on the implementation of the SEC Oversight Assurance (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 to review 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 publicly-listed companies by promoting high-quality and more transparent financial reporting to protect the public interest, including the investors and other users of the 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 follows a risk-based approach in selecting engagements and firms subject to SOAR inspection. In certain situations, the Commission may select more than one (1) of the firm's audit engagements for review. The selection of audits for review does not constitute a representative sample of the firm's total population of audit engagements.

Published:
Manila Bulletin, 24 December 2021
Business Mirror, 24 December 2021

Filed with UP Law Center: 22 December 2021

Section 2. The SOAR Organization

2.1 SOAR Inspection Team

a. The inspections under the SOAR program shall be done by the SOAR Inspection Team ("Inspection Team"), composed of an Inspection Team Leader, Deputy Inspection Team Leaders, and reviewers.

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 SOAR Inspection Report and Evaluation Report of Firm's Remediation, which are based on the results of the SOAR inspection and firm's remediation, shall be approved by the Commission *en banc* before said reports are released to the inspected firm.

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 Inspection Team members are 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 Inspection Team members are required to keep the information obtained during the inspections confidential and shall not use the same for any other purpose.

Section 4. Scope, Coverage and Frequency of Inspection

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

4.2 The SOAR Inspection Program shall include both the firm-level and engagement-level reviews for firms and audit engagement partners covered by the inspection.

a. The firm-level review covers the appropriateness of the firm's policies and procedures; the degree of compliance with the elements of a system of quality control; and the sufficiency of the firm's documentation, as prescribed under the Philippine Standards on Quality Control (PSQC) 1 (Redrafted), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and other Assurance Related Services Engagements,* or any of its subsequent amendments.

b. The engagement-level review covers an assessment of the audit 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.

4.3 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 and Philippine Standards on Auditing (PSA) 220 (Redrafted), *Quality Control for an Audit of Financial Statements*, or any subsequent amendments.

b. PSQC 1 (Redrafted), or any of its subsequent amendments, 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, or any of its subsequent amendments, deals with the specific responsibilities of the auditors regarding quality control procedures at the engagement level to obtain reasonable assurance that quality has been achieved. The nature and extent of the policies and procedures developed by an individual firm to comply with PSQC 1, or any of its subsequent amendments, normally depends on various factors such as the size and operating characteristics of the firm and whether it is part of a network firm.

In view of the new and revised standards on systems of quality management, the following shall be the applicable standards upon implementation:

- International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*;
- ISQM 2, *Engagement Quality Reviews*; and
- International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements*.

Accordingly, any references in this Memorandum Circular to "system of quality control" and "quality control" will be replaced with "system of quality management" and "quality management," respectively.

4.4 The approach in the selection of the accredited firms and audit engagements for review is risk-based. Inspections will not involve a random or representative sample of publicly-listed companies. Audits that may pose difficult or complex issues will be identified considering risk factors such as the company's nature, industry, market capitalization, and audit issues likely to be encountered. The Commission, however, is not precluded from prioritizing in the inspection, other firms or audits of publicly-listed companies, as the circumstances would warrant.

4.5 Frequency of Inspection

For all covered firms, the frequency of inspection shall be based on the relative size of the audited publicly-listed companies, in terms of market capitalization as of every 31st of March. The frequency shall be determined by the Inspection Team and shall be updated on a regular basis based on these guidelines:

- Once every two (2) years

  Firms with a client portfolio that collectively comprise 10% or more of the total market capitalization of publicly-listed companies; and

- Once every three (3) years

  Firms with a client portfolio that collectively comprise less than 10% of the total market capitalization of publicly-listed companies.

If there is a change or breach in the threshold during the year, such change shall be considered in the following year's assessment of the frequency of inspection of covered audit firms, as determined by the Inspection Team.

The Commission, however, is not precluded from subjecting firms to a more frequent inspection as circumstances would warrant.

4.6 Duration of Inspections

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

4.7 Alternative Mode of Inspection

The manner of inspection shall be done on-site. However, for instances of extraordinary events which necessitate the flexibility on the manner of inspection, such as but not limited to pandemics, natural disasters or civil unrest, which cause travel restrictions or disruptions of business operations or render on-site inspection impracticable, the Inspection Team, upon coordination with the firm, may perform a remote or virtual inspection for a period of at least three (3) weeks. The remote or virtual inspection shall consider the policies and guidelines of the firm on confidentiality, data privacy, cybersecurity and matters related to the acceptable use of technology.

Section 5. SOAR Inspection Process

5.1 The Commission *en banc* approves the selection of the firms and the audit engagements subject to inspection.

The OGA shall notify the firm at least 60 calendar days before the start of the inspection detailing the inspection's plan, purpose, timing and requirements.

The OGA shall then notify the firm of the selected audit engagement at least 30 calendar days before the start of the inspection. The audit team is requested to prepare the following documents that shall be submitted to the Inspection Team within two (2) weeks from the receipt of the engagement notification letter:

a. Completed Engagement Information Form;

b. Key information about the firm as to the number of branches and satellite offices, audit partners, principals/partners in total, professional staff (excluding support/administrative staff) and publicly-listed audited entities as of the last fiscal year-end of the firm, immediately preceding the receipt of notice from the OGA; and

c. Proof of archiving and certification from engagement partner that the files provided to the Inspection Team are the original versions of the archived engagement working papers (both electronic and hard copies, as applicable).

5.2 Once a firm is selected for inspection, the Inspection Team may hold a pre-inspection meeting to discuss planned focus areas with the firm.

The audit team may also request a pre-inspection meeting for any clarifications on the requirements for the planned inspection.

5.3 The SOAR inspection process does not necessarily cover the entire engagement, and rather it concentrates on areas that present significant risks. It does not aim to fully review every single audit engagement in its attempt to evaluate the firm's quality environment 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, procedures and practices and independence policies, or that the financial statements audited by the firm are free of deficiencies, apart from the deficiencies noted in the inspection.

The SOAR inspection process involves the following key steps:

a. planning;
b. execution;
c. reporting; and
d. remediation.

Section 6. Reporting

6.1 Classification of Inspection Findings

Inspection findings are classified into two (2) categories:

a. Opportunities for improvements or enhancements

The identified opportunities for improvements or enhancements are summarized in a Letter of Recommendations and are not carried forward to the SOAR Inspection Report. Recommendations usually relate to, but are not limited to the following:

- Failure to perform audit procedures that are required by the firm's policies and audit methodologies but are not material or significant violations of the requirements under PSAs;

- Minor inconsistencies in audit documentation or minor non-compliance with the documentation requirements of the PSAs that do not significantly affect the appropriateness and sufficiency of the procedures performed and/or the audit evidence obtained; or

- Other instances or cases that the Inspection Team evaluates as opportunities for improvements or enhancements.

b. Significant deficiencies

Firm-Level

For the firm-level review, quality control findings include departures from and/or non-compliance with the requirements of applicable standards on systems of quality control or ethics and independence that may have an effect on audit quality, either due to the significance or systemic nature of the departure and/or non-compliance.

Quality control findings do not relate to specific audit engagements but instead relate to the policies and procedures in place at the firm to provide for the overall system of quality control. Quality control findings are more systemic in nature; they are relevant in general to the firm's audit practice, and therefore there is an interaction between engagement-level and quality control findings. While quality control findings are attributed to a firm in general, findings on quality control systems are considered significant if such deficiencies may impact or impact the firm's environment for individual audit engagements or internal monitoring and oversight of audit engagements. Consequently, a deficient system of quality control would likely be manifested in engagement-level findings. Further, findings noted at the engagement-level review which are determined to be systemic (i.e., not engagement-specific or similar engagement findings that appear consistently in multiple engagements) in nature may be considered deficiencies in the effectiveness of the firm's system of quality control.

Engagement-level

For engagement-level review, significant audit deficiencies include the following:

- Insufficient and/or inappropriate audit procedures or audit evidence to respond to the assessed significant or high risk of material misstatement at the assertion level or the financial statement level to support the audit opinion;
- Failure to identify or address a material error in the application of the applicable financial reporting framework;
- Failure to identify or to appropriately address a material misstatement in the financial statements either due to fraud or error, including failure to comply with material disclosure requirements;
- Failure to issue an appropriate audit opinion; and/or material misrepresentation in the auditor's report;
- Failure to include in the auditor's report the material information required by the relevant PSAs or regulatory requirements;
- Failure to satisfy other material requirements of the relevant PSAs; or
- Other instances or cases that the Inspection Team deems appropriate to be included as significant audit deficiencies.

The Inspection Team considers whether audit documentation or any other evidence that a firm might provide to the Inspection Team during the inspection supports the firm's claims that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of other persuasive evidence, even if the firm claimed to have performed the procedure.

The fact that one or more deficiencies in an audit reach this level of significance does not necessarily indicate that the financial statements are materially misstated. An inspection finding related to an audit engagement does not necessarily indicate that the financial statements are misstated; therefore, the audited entity's accounting and disclosure may be appropriate, whether or not the audit procedures satisfy the requirements of auditing standards. It is often not possible for the Inspection Team, based only on the information available from the audit team, to reach a conclusion on those points because the Inspection Team usually only has access to the information that the audit team retained and the issuer's public disclosures.

6.2 Timeline upon Completion of the On-Site Inspection

The following are the timelines to be followed upon completion of the on-site inspection:

Process	Period
1 Status meeting/dialogue to discuss preliminary results and findings and the firm's preliminary responses	On the last day of fieldwork
2 Issuance of Letter of Recommendations and Letter of Findings (LOF) to the firm	Within 45 calendar days after the status meeting
3 Submission of the firm's reply to the LOF	Within 30 calendar days after the issuance of the LOF
4 Issuance of SOAR Inspection Report to the firm	Within 45 calendar days after receipt of the firm's reply to the LOF
5 Submission of the firm's remediation plan, as applicable	Within 60 calendar days after the issuance of the SOAR Inspection Report
6 Remediation process	Within 12 months after the issuance of the SOAR Inspection Report
7 Issuance of Evaluation Report of Firm's Remediation	Within 30 calendar days after the end of the remediation period
8 Submission of firm's request for reconsideration, if any	Within 15 calendar days after the issuance of the Evaluation Report of Firm's Remediation

	Process	Period
9	Publication on SEC website of the unremediated inspection findings and/or contested findings that has attained finality in favor of the Inspection Team's position and which the firm refuses to remediate	30 calendar days after the issuance of Evaluation Report of Firm's Remediation

Firms may request another discussion with the Inspection Team, after the status meeting but before the issuance of the LOF, to further clarify matters raised during the status meeting.

Significant audit deficiencies at engagement level and quality control findings at firm-level identified under Section 6.1 (b) of this Memorandum are summarized in a LOF to confirm the facts of the findings, in writing, and seek responses from the audit firm for each of the inspection finding identified. The LOF serves as a basis in preparing the SOAR Inspection Report. Inclusion in the SOAR Inspection Report does not mean that the deficiency remains unremediated after the Inspection Team brought it to the firm's attention.

The SOAR Inspection Report is the final formal report issued by the Inspection Team to the firm after the Commission *en banc*'s approval. This report is prepared based on the Inspection Team's evaluation of the firm's reply to the LOF. The Inspection Team includes all identified significant audit deficiencies and defects of the firm's internal controls systems in the SOAR Inspection Report for release to the firm (non-public), even if the firm has immediately remediated the findings after the inspection.

The Evaluation Report of Firm's Remediation is the report issued by the Inspection Team to the firm that discusses the inspection findings, the firm's remediation, and the Inspection Team's assessment and evaluation of the firm's remediation, whether satisfactory or not.

Under special circumstances, the firm may request an extension of time to reply to the LOF or SOAR Inspection Report for a number of days not exceeding 15 calendar days.

Section 7. Consultation with Resource Person/s

7.1 To provide expert advice to help resolve findings raised by the Inspection Team that are contested by the firm and/or audit team subjected to inspection, or in other circumstances, and in which the Commission finds it necessary and appropriate; the OGA may consult with appropriate resource person/s, in a blind consultation and on a pro bono basis.

7.2 OGA is responsible for selecting the appropriate resource person/s and ensuring that the resources person/s are independent and objective and have the necessary competence and capabilities. Similarly, the Commission shall ensure safeguards are in place to preserve the confidentiality of all information that the Inspection Team will share with the resource person/s.

7.3 The Inspection Team shall prepare a consultation memorandum containing details of the facts, findings and basis for the conclusion reached. The consultation memorandum shall be signed by the Inspection Team Leader.

7.4 Prior to the consultation, the Inspection Team will inform the firm and/or the audit team of the particular inspection finding that will be referred for consultation to the resource person/s and that a redacted copy of the firm and/or the audit team's response to the LOF shall be attached to the consultation memorandum.

The Inspection Team shall ensure that any references, or any other identifying information, in the LOF as to the name of the firm, engagement partner, and the publicly-listed company are appropriately blocked out.

Within 30 calendar days from the submission of the consultation memorandum to the resource person/s, the Inspection Team shall arrange a meeting with the resource person/s to discuss the position of both the Inspection Team and the firm or audit team. The Inspection Team shall prepare minutes of meetings for circulation to the attendees of the meeting. If no adverse comments are received, the minutes of the meeting are considered final on the 2nd day of circulation.

7.5 The General Accountant, through the Supervising Commissioner, shall present the results of the consultation with the resource person/s to the Commission *en banc*. The Commission *en banc* shall make the final decision on the contested findings.

Section 8. Remediation

8.1 Remediation Process

After issuing the LOF to the firm and even before releasing the SOAR Inspection Report, the firm must plan how to address the significant audit deficiencies and any findings on quality control systems. The firm must identify the root causes of all findings and place effective remedial measures to address these root causes.

After the issuance of the SOAR Inspection Report, a 12-month remediation period shall be provided to the firm and the audit team. The OGA may allow an extension of time for remedial actions in special circumstances, as requested by the firm, subject to approval by the Commission *en banc*.

The firm must prepare and submit to the Inspection Team, within 60 calendar days after the issuance of the SOAR Inspection Report, a written remediation plan on how to address the significant audit deficiencies and findings on systems of quality control. If the firm has already communicated its remediation plan through its reply to the LOF, it does not need to prepare and submit the said plan separately.

The firm may provide interim written updates on the progress of its remediation or submit and present its documentation on the results of remediation procedures for the Inspection Team's evaluation. All inspected firms are encouraged to have a continual dialogue with the Inspection Team within the remediation period.

The Inspection Team generally avoids prescribing specific remediation approaches or action steps. The Inspection Team's assessment of whether the firm's efforts to remediate a particular finding are satisfactory depends upon the Inspections Team's evaluation of whether the firm has identified steps suited to the particular quality control objective and the evaluation of the nature and extent of the firm's efforts to implement those steps. For noted significant audit deficiencies, the Inspection Team's evaluation depends on whether the audit team performed the necessary and appropriate audit procedures to address these deficiencies.

8.2 Evaluation of Remedial Actions

The Commission, through the OGA, shall issue an Evaluation Report of Firm's Remediation within 30 calendar days after the end of the remediation period. This report summarizes the Inspection Team's thorough evaluation and assessment of the firm's remedial actions for each of the noted findings on quality control systems and significant audit deficiencies.

a. Consequence when OGA is not satisfied with the firm's remedial actions

Where the firm does not resolve quality control findings and significant audit deficiencies or remedial actions are not satisfactory after the end of the remediation period, the Commission shall publish the inspection findings and the firm's response or remediation plan on the SEC website. Such publication is subject to the Commission *en banc's* approval.

Within 15 calendar days after the issuance of the Evaluation Report of Firm's Remediation, the firm may seek reconsideration of the Commission's decision to publish the report by requesting the Commission *en banc* to review the decision again.

b. Contested Findings

Where a firm refuses to remediate the contested findings, even after proper consultations by the Inspection Team with the appropriate resource person/s, and where the Commission *en banc* affirms the finality of the decision in favor of the position taken by the Inspection Team, the contested findings shall be published on the SEC website together with the Inspection Team's position and the firm's reply to the specific inspection finding.

Section 9. Publications

9.1 Publication of Inspection Findings on the SEC Website

As discussed under Section 8.2 of this Memorandum, the portion of the SOAR Inspection Report that discusses the following shall be published on the SEC website, 30 calendar days after the issuance of the Evaluation Report of Firm's Remediation, as approved by the Commission *en banc*:

a. Inspection findings that are unresolved within the allowed period of remediation;

b. Inspection findings where the firm's remedial actions are deemed not satisfactory, as determined by the Inspection Team; and/or

c. Contested finding that has attained finality in favor of the Inspection Team's position and where the firm refuses to remediate.

For items (a) and (b) above, the firm's remediation plans and procedures in response to the inspection findings shall also be published. For item (c) above, both the Inspection Team's position and the firm's reply to the specific finding shall be published.

While the publication of inspection findings on the SEC website includes the firm's name, the name of the publicly-listed companies covered in the particular audit engagements shall remain as non-public information.

9.2 SOAR Annual Inspection Report

The Commission shall issue and publish an Annual Inspection Report which aims to provide the public with insights on observations noted during SOAR inspections. This report shall include common findings on firm-wide systems of quality control, common significant audit deficiencies, and good internal controls and audit practices of the inspected firms.

The name of firms and the audit engagements inspected will not be disclosed in the Annual Inspection Report.

Both the firms and the Audit Committees are encouraged to use the report to facilitate audit quality matter discussions.

9.3 Audit Quality Indicators

The Commission will release audit quality indicators (AQIs) guidelines after the Inspection Team has consulted with the relevant stakeholders (i.e., Audit Committees and/or management of publicly-listed companies and external auditors).

AQIs are a set of quantitative measures that provide insights into factors contributing to audit quality. The disclosure of AQIs aims to improve the dialogue between the firms and Audit Committees, which ultimately aids the Audit Committees in selecting and appointing external auditors.

Section 10. Other Matters

10.1 Responsibility of the Firm to Cooperate with the Inspection Team

Accredited 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:

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

b. Provide information through interviews and/or written responses.

At least 60 calendar days before the planned inspection, the Inspection Team shall send a list of firm-level and logistical requirements to allow the firm to prepare the necessary documents and arrangements.

At least 30 calendar days before the planned inspection, the Inspection Team shall request information relevant to the selected audit engagement, as discussed in Section 5.1. During this period, the engagement partner and the firm may also inform the audited entity regarding the scheduled SOAR Inspection.

10.2 Communication with Audit Committees of Publicly-Listed Companies

Upon request from the Audit Committee of the covered publicly-listed company, the inspected firm shall communicate the identified inspection findings and the actions taken by the firm to address such findings, in addition to the requirements under the applicable auditing standards on matters to be communicated with those charged with governance.

10.3 Procedures and Sanctions for Violations Identified During Inspection

If the Inspection Team determines that the information obtained from the firm during the inspection indicates that the inspected firm, any member of the audit team or any firm personnel may have engaged in any act or omission that may violate regulatory requirements, ethical, quality control and auditing standards or any applicable professional standards, the Inspection Team shall:

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

b. 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 firms and/or auditors covered by the inspection:

a. Censure;

b. Require additional professional education and training;

c. 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;

d. Monetary fines;

e. Downgrading of the SEC accreditation level;

f. For egregious or repeat violations, suspension or revocation of the SEC accreditation; and/or

g. Other sanctions that will be subsequently determined and issued by the Commission.

Section 11. Repealing Clause

All other rules and regulations, circulars, memoranda, or any part thereof, in conflict with or contrary to this Memorandum Circular or any portion hereof, are hereby repealed or modified accordingly.

Section 12. Effectivity and Transition

The Revised Rules and Regulations on the Implementation of the SOAR Inspection Program shall become effective starting January 1, 2022.

December 9, 2021.

Pasay City.

For the Commission *en banc:*

EMILIO B. AQUINO
Chairperson