Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Bldg. EDSA, Greenhills, Mandaluyong City

SEC Memorandum Circular No. 13
Series of 2006

AMENDED GUIDELINES ON ACCREDITATION AND REPORTORIAL REQUIREMENTS OF EXTERNAL AUDITORS

SEC. 1. Policy Statement

In order to strengthen the enforcement capacity of the Commission as a regulatory body and increase reliance on the opinion of external auditors **and pursuant to its powers under Sections 5 and 68 of the Securities Regulation Code and Sections 141 and 143 of the Corporation Code**, the Commission adopts a policy on the accreditation of external auditors and their reporting requirements. High qualification standards and strict reporting obligations for external auditors of companies covered by this Circular shall be maintained and monitored through a system that will encourage quality control and disciplined financial environment.

SEC. 2. Coverage

2.1 This Circular shall apply to the following companies, **as grouped below**, and their external auditors:

Group A

i. Issuers of registered securities which have sold a class of securities pursuant to a registration under Section 12 of the Securities Regulation Code (SRC) **except those issuers of registered timeshares, proprietary and non-proprietary membership certificates which are covered in Group B;**

ii. Issuers with a class of securities listed for trading in an Exchange;

iii. Public companies or those which have total assets of at least Fifty million pesos (P50,000,000.00) or such other amount as the Commission shall prescribe, and having two hundred (200) or more holders each holding at least One hundred (100) shares of a class of its equity securities.

Group B

i. Pre-need Companies;
ii. Issuers of registered timeshares, proprietary and non-proprietary membership certificates;
iii. Investment Houses;
iv. Brokers and Dealers of securities;
v. Investment companies;
vi. Government Securities Eligible Dealers (GSEDs);
vii. Universal Banks Registered as Underwriters of Securities;
viii. Investment Company Advisers;
ix. Clearing Agency and Clearing Agency as Depository;
x. Stock and Securities Exchange/s;
xi. Special Purpose Vehicles registered under the Special Purpose Vehicle Act of 2002 and its implementing rules;
xii. Special Purpose Corporations registered under the Securitization Act of 2004 and its implementing rules;
xiii. Such other corporations which may be required by law to be supervised by the Commission.

Group C

i. Financing Companies;
ii. Transfer Agents.

Group D

Registered corporations which are mandated by other regulatory agencies to have an external auditor accredited by the Commission, provided however that the Commission has been consulted on such requirement by the said agency and that it has agreed on the terms thereof through a Memorandum of Agreement duly executed between the Commission and the regulatory agency.

This grouping will already cover external auditors of corporate bank borrowers with at least P15 Million in total assets pursuant to BSP Circular No. 439.

2.2. **For Group D above, the applicability of this Circular shall be limited to the qualification and documentary requirements for the accreditation of the external auditors. The monitoring of compliance with reportorial obligations and post accreditation requirements of such external auditors are understood to be the primary and concurrent responsibility of the regulatory agency imposing the SEC accreditation requirement.**

SEC. 3. Definition of Terms

3.1. **External Auditor** – means a single practitioner or a signing partner in an auditing firm.

3.2 **Fraud** means an intentional act by one or more individuals among management, employees, or third parties that results in a misrepresentation of financial statements, which will reduce the consolidated total assets of the company by five percent (5%). It may involve:

i. Manipulation, falsification or alteration of records or documents;
ii. Misappropriation of assets;
iii. Suppression or omission of the effects of transactions from records or documents;
iv. Recording of transactions without substance;
v. Intentional misapplication of accounting policies; or
vi. Omission of material information.

3.3 **Error** means an unintentional mistake in financial statements, which will reduce the consolidated total assets of the company by five percent (5%). It may involve:

i. Mathematical or clerical mistakes in the underlying records and accounting data;
ii. Oversight or misinterpretation of facts; or
iii. Unintentional misapplication of accounting policies.

3.4 **Gross negligence** means wanton or reckless disregard of the duty of due care in complying with generally accepted auditing standards.

3.5 **Material information** means information whose omission or misstatement could influence the economic decisions of users.

3.6 **Pre-need company or issuer** means any corporation registered with the Commission and authorized/licensed to issue pre-need plans.

SEC. 4. Scope and Limitations of Accreditation

4.1 Only an external auditor and his auditing firm if applicable, who is accredited by the Commission shall be engaged by corporations covered by this Circular for statutory audits.

4.2 **The external auditors and auditing firms (if applicable) of companies under Groups A and B must be both accredited by the Commission in accordance with this Circular.**

4.3 **In the case of companies under Group C, accreditation of the auditing firm is sufficient. However, an individual practitioner must be accredited by the Commission as such.**

4.4 The accreditation of external auditors does not exonerate the reporting company or said auditors from their responsibilities. Financial statements filed with the Commission are still primarily the responsibility of the management of the reporting company and accordingly, the fairness of the representations made therein is an implicit and integral part of the issuer's responsibility. The independent certified public accountant's responsibility for the financial

statements required to be filed with the Commission is confined to the expression of his opinion, or lack thereof, on such statements which he has examined.

4.5 The Commission shall not be liable for any liability or loss that may arise from the selection of said accredited external auditor and/or auditing firm to be engaged by a corporation for regular audit.

4.6 The accreditation of an external auditor and/or auditing firm shall expire or **external auditor and/or auditing firm** shall be automatically delisted after a period of three (3) years from date of approval of his accreditation unless renewed before expiry date;

4.7 **Accreditation under Group A shall be considered as a general accreditation which shall allow the external auditors to also audit companies under Groups B through D. For external auditors with Group B accreditation, they can likewise audit Groups C and D. Accordingly, Group C accredited external auditors are allowed to audit Group D companies.**

SEC. 5. Qualification Requirements

5.1 Individual External Auditors

A. General requirements applicable to all applications for accreditation

i. He shall be in good standing as a professional registered with the Professional Regulation Commission (PRC) and the Board of Accountancy (BOA), and entitled to practice as such under the laws governing the practice of public accounting in the Philippines;

ii. He shall possess the independence as defined in the Code of Professional Ethics for Certified Public Accountants as promulgated by the Board of Accountancy and approved by the Professional Regulation Commission;

iii. He shall adhere to the highest standards of professional conduct, including integrity and objectivity.

B. Specific Requirements

i. At the time of application, the external auditor shall have at least five (5) years experience in external audits. In exceptional cases, the Commission may consider the participation, **which should be at least thirty (30) hours for one year,** in industry-specific accounting/auditing seminars conducted by any professional organization or association duly recognized by the Commission or by the BOA/PRC through a Continuing Professional Education (CPE) Council;

ii. The audit experience above refers to experience acquired as an in-charge, manager or partner or their equivalent.

iii. At the time of application, the applicant must have the following track record:

1. For Group A applicant, he/she must have had at least five (5) corporate clients with total assets of at least ₱50 million each;

2. For Group B, the applicant must have had at least three (3) corporate clients with total assets of at least ₱20 million each;

3. For Group C, the applicant must have had at least three (3) corporate clients with total assets of ₱5 million each;

4. **For Group D, the applicant must have had at least one (1) corporate client with total assets of at least Five Million Pesos (P5,000,000.00), or at least five (5) clients regardless of amount of total assets.**

5.2 Auditing Firms

i. The auditing firm must be in good standing and entitled to conduct auditing services under all applicable laws, rules and regulations;

ii. At the time of application, it must have at least one (1) signing practitioner or partner who is already accredited, or who is already qualified and is applying for accreditation by the Commission.

SEC. 6. Application by Individual External Auditors

6.1 For initial accreditation, a duly accomplished and notarized application form (SEC Form ExA-001) shall be submitted by the applicant-external auditor to the Commission, together with the following documents:

i. A copy of the Statement of Representation as required under paragraph 3(c)(v) of SRC Rule 68 which may be submitted only once;

ii. Copy of updated PRC license and Certificate of Registration as a public practitioner issued by the Board of Accountancy (BOA)/Professional Regulation Commission (PRC);

iii. Notarized certification of the external auditor that he is in compliance with the qualification requirements under Section 5.1 of this Circular and that he has not been convicted by a competent court for a crime involving moral turpitude or fraud (as defined in the Revised Penal Code), or declared liable by the Commission or by any competent court for violation of the Corporation Code or the Securities Regulation Code;

iv. If the applicant is a sole practitioner, Quality Assurance Manual containing a written general description of the following:

a. quality assurance process, such as, but not limited to client acceptance and retention policies, concurring partner review, consultation process, etc.;

b. **procedure for monitoring professional ethics and independence from clients;**

c. **Other quality assurance policies or procedures provided in Philippine Standard on Auditing No. 220, Philippine Standards on Quality Control 1, and their amendments, or as may be required by the Commission.**

For Groups A or B, high quality assurance (QA) procedures within the audit firm is expected so matters like proper consultation policies, concurring reviews and independence monitoring should be in place. Single practitioners are therefore not likely to be recommended for Group A or B since such QA procedures would not be in place.

v. **Copy of the audited financial statements (AFS) of the applicant's two (2) largest clients in terms of total assets. In evaluating the quality of audit work of the applicant which shall be one of the considerations for either denying or approving his/her application for accreditation, the Commission shall be guided by Annex "A" of this Circular;**

vi. **Copy of certificates of participation/attendance in relevant trainings and seminars;**

vii. **Proof of membership in any accounting professional organization;**

viii. **If the applicant is a sole practitioner, undertaking to preserve working papers for a period of seven (7) years and making them available to the Commission's authorized representative/s when required to do so;**

ix. **Copy of Privilege Tax Receipt (PTR) issued by BIR;**

x. **If sole practitioner, copy of Pro-Forma Audit Engagement Letter with prospective clients prepared in accordance with Annex "B" of this Circular and/or existing engagement contracts with clients;**

xi. In case of an application for Group A accreditation, notarized certification that the applicant has fundamental knowledge of the regulatory requirements on each of the other secondary licensees of the Commission;

xii. **Summary of contracts/agreements with audit clients involving services other than statutory audit of financial statements.**

6.2 The accreditation may be renewed by filing a duly accomplished renewal application form (SEC Form ExA-001-R) and attaching the following documents:

i. Copy of updated PRC license and of the Certificate of Registration as a public practitioner issued by BOA/PRC which should be current and effective;

ii. Notarized certification of the external auditor that he **still possesses all qualification required** under Section 5.1 of this Circular and that he has not

been convicted by a competent court for a crime involving moral turpitude, fraud (as defined in the Revised Penal Code), or declared liable by the Commission or by any competent court for violation of the Corporation Code of the Philippines or the SRC;

iii. **List of corporate clients the audited financial statements (AFS) of which were subjected to evaluation by the Commission. Such list shall likewise indicate the findings noted by the Commission and other regulatory agencies on said AFS including the action thereon by the external auditor. If there is none, such fact should be stated;**

iv. Written proof that the auditor has attended or participated in relevant accounting and auditing training for at least **thirty (30)** hours yearly. Such training shall be in subjects like international financial reporting standards, international standards of auditing, corporate governance, taxation, code of ethics, regulatory requirements of SEC, BIR and BSP or other government agencies, and other topics relevant to his practice, conducted by any professional organization or association duly recognized/accredited by the Commission or by the BOA/PRC through a CPE Council which they may set up.

For those external auditors who have been accredited by the Commission prior to the effectivity of this revised circular, they shall present proof of participation or attendance of at least twenty four (24) hours on relevant accounting and auditing training for the period January 1, 2003 to December 31, 2004, and thirty (30) hours yearly from January 1, 2005 onwards.

v. **In case there is change in any document submitted during the initial application for accreditation, the amended/updated document should be submitted.**

6.3 The application for initial or renewal accreditation of an external auditor shall be accompanied by a fee of Two Thousand Pesos (P2,000.00).

SEC. 7. Application for Accreditation by Auditing Firms

7.1 For initial accreditation, a duly accomplished and notarized application form (SEC Form AuF-002) shall be signed by the managing partner of the auditing firm and shall be submitted to the Commission together with the following documents:

i. Copy of the Certificate of Registration as a public practitioner issued by BOA/PRC to the firm which is current and effective;

ii. Copy of the firm's Pro-Forma Audit Engagement Letter with prospective clients prepared in accordance with Annex "A" of this Circular and/or existing engagement contracts with clients;

iii. Summary of contracts/agreements with its audit clients covered by this Circular involving services other than statutory audit of financial statements;

v. Notarized certification that the firm is in compliance with the general qualification requirements under Section 5.2 of this Circular;

vi. Quality Assurance Manual containing a written general description of the following:

a. quality assurance process, such as, but not limited to client acceptance and retention policies, concurring partner review, consultation process, etc.;

b. procedure for monitoring professional ethics and independence from clients;

c. Other quality assurance policies or procedures provided in Philippine Standard on Auditing No. 220, **Philippine Standards on Quality Control 1, and their amendments**, or as may be required by the Commission.

vii. Copy of firm's audited financial statements for the immediately preceding two (2) years;

viii. Undertaking under oath by the managing partner that the firm shall fully cooperate with the regulator by preserving his working papers for a period of seven (7) years and making them available to the Commission's representatives when required or directed to do so;

ix. **List of corporate clients the audited financial statements (AFS) of which were subjected to evaluation by the Commission. Such list shall likewise indicate the findings noted by the Commission and other regulatory agencies on said AFS including the action thereon by the external auditor. If there is none, such fact should be stated.**

x. A description of the organizational structure of the firm and profile of the staff including their qualifications and training.

7.2 The accreditation may be renewed by filing a duly accomplished renewal application form (SEC Form AuF-002-R) with the following documents:

i. A certified true copy of the Certificate of Registration with BOA/PRC which is valid and effective;

ii. Copy of Quality Assurance Manual. If there are amendments on such Manual, the firm shall attach a written explanation on each revision;

iii. Notarized certification that the firm is in compliance with the general qualification requirements under Section 5.2 ;

iv. Summary of newly executed contracts/agreements with clients involving services other than statutory audit;

v. **In case there is change in any document submitted during the initial application for accreditation, the amended/updated document should be submitted.**

7.3 The application for initial or renewal accreditation of an auditing firm shall be accompanied by a fee of Five Thousand Pesos (P5,000.00).

SEC. 8. Operational Requirements

8.1 The accredited auditing firm or external auditor shall not engage in the following non-audit services for his statutory audit clients, unless the safeguards under the Code of Ethics for CPA's are undertaken by the firm or auditor to reduce the threat to independence:

i. bookkeeping or other services related to the accounting records or financial statements of the audit client;

ii. financial information systems design and implementation;

iii. appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

iv. actuarial services;

v. internal audit outsourcing services;

vi. management functions or human resources;

vii. broker or dealer, investment adviser, or investment banking services;

viii. legal services and expert services unrelated to the audit; and

ix. any other services that the Commission may declare as impermissible.

8.2 *The firm and/or the external auditor shall comply with the following:*

i. Terms of its engagement letter and its undertakings, in accordance with the submitted documents pursuant to Section 7 of this Circular;

ii. Generally accepted auditing standards in the Philippines;

iii. Code of Professional Ethics which include independence rules;

iv. Applicable provisions of SRC Rule 68 and 68.1, and other relevant pronouncements of the Commission; and

v. *Other pertinent laws, rules and regulations.*

8.3 The written procedure for quality assurance and monitoring of professional ethics and independence from clients which is submitted with the application for

accreditation shall be complied with. Any change or amendment thereto shall be reported to the Commission not less than ten (10) days prior to its effectivity. If the Commission does not comment or object to the said changes within ninety (90) days from date of submission, the same shall deemed duly noted and shall form part of the records of such accredited firm on file with the Commission.

8.4 The Commission may exercise visitorial power over the accredited firms and external auditors, as it deems necessary.

8.5. The external auditor shall adopt and implement the following communication process as part of the operational requirements:

i. Critical Accounting Policies and Practices

The external auditor shall communicate to the audit committee **or its equivalent or those charged with governance,** all critical accounting policies and practices. Critical accounting policies are those that are both most important to the portrayal of the company's financial condition and performance, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Prior to finalizing and filing annual reports, audit committees should review the selection, application and disclosure of critical accounting policies. Consistent with auditing standards, audit committees shall be apprised of the evaluative criteria used by management in their selection of the accounting principles and methods. Proactive discussions between the audit committee and the company's senior management and auditor about critical accounting policies are deemed necessary.

ii. Alternative Accounting Treatments

a) External auditors shall provide audit committees with information on material accounting alternatives. This will minimize the risk that audit committee members will be distracted from material accounting policy matters by the numerous discussions between the auditors and management on the application of accounting principles to relatively small transaction or events. The external auditor shall communicate, either orally or in writing, to the audit committee all alternative treatments within generally accepted accounting principles (GAAP) for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures and the treatment preferred by the accounting firm. This rule is intended to cover recognition, measurement, and disclosure considerations related to the accounting for specific transactions as well as general accounting policies.

b) Communications regarding specific transactions shall identify, at a minimum, the underlying facts, financial statement accounts impacted, and applicability of existing corporate accounting policies to the transaction. In addition, if the accounting treatment proposed does not comply with existing corporate accounting policies, or if an existing corporate accounting policy is not applicable, then an explanation of why

the existing policy was not appropriate or applicable and the basis for the selection of the alternative policy should be discussed. Regardless of whether the accounting policy selected preexists or is new, the entire range of alternatives available under GAAP that were discussed by management and the auditor shall be communicated along with the reasons for not selecting those alternatives. If the accounting treatment selected is not, in the auditor's view, the preferred method, the reasons why the auditor's preferred method was not selected by management and the possible impact of such method on the auditor's report.

c) Communications regarding general accounting policies shall focus on the initial selection of and changes in significant accounting policies, as required by generally accepted auditing standards (GAAS), and should include the impact of management's judgments and accounting estimates, as well as the auditor's judgments about the quality of the entity's accounting principles. The discussion of general accounting policies should include the range of alternatives available under GAAP that were discussed by management and the auditor along with the reasons for selecting the chosen policy. If an existing accounting policy is being modified, then the reasons for the change also should be communicated. If the accounting policy selected is not the auditor's preferred policy, then we expect the discussions to include the reasons why the auditor considered one policy to be preferred but that policy was not selected by management.

d) The separate discussion of critical accounting policies and practices is not considered a substitute for communications regarding general accounting policies, since the discussion about critical accounting policies and practices might not encompass any new or changed general accounting policies and practices. Likewise, this discussion of general accounting policies and practices is not intended to dilute the communications related to critical accounting policies and practices, since the issues affecting critical accounting policies and practices, such as sensitivities of assumptions and others, may be tailored specifically to events in the current year, and the selection of general accounting policies and practices should consider a broad range of transactions over time.

iii. Other Material Written Communications

Written communications between auditors and management shall range from formal documents, such as engagement letters, to informal correspondence, such as administrative items, which shall include but not limited to, the following:

- Reports on observations and recommendations on internal controls;
- Schedule of unadjusted audit differences, and a listing of adjustments and reclassifications not recorded, if any;
- Engagement letter; and
- Independence letter.

The management of the registrant shall furnish the audit committee with a copy of the management representation letter addressed to the external auditor.

iv. Timing of Communications

The communications between the auditor and the audit committee shall occur prior to the filing of the audit report with the Commission pursuant to applicable securities laws. As a result, these discussions will occur, at a minimum, during the annual audit, but could occur as frequently as quarterly or more often on a real-time basis.

SEC. 9. Reportorial Requirements

9.1 For companies covered by this Circular, each shall disclose to the Commission in a current report (SEC Form 17-C) in case of companies under Group A, **or in a disclosure letter for companies under Groups B to C**, within five (5) days from receipt of the findings from its external auditors, the matters indicated under Section 9.3 hereof which have been discovered by the latter during the conduct of audit for the company's recently completed fiscal year, and determined in accordance with generally accepted auditing standards. **For companies under Group D, said disclosure shall be submitted to the concerned regulatory agency, copy furnished the Commission's Office of the General Accountant.**

9.2 In case the client-company fails to comply with the reportorial requirement under Section 9.1 above, the external auditor shall, within thirty (30) business days from the submission of his findings to the client-company, file a report (SEC Form Au-Rep) to the Commission.

9.3 The following findings shall be disclosed:

i. Any material findings involving fraud or error, as defined under Section 3.2 and 3.3;

ii. Losses or potential losses the aggregate of which amounts to at least ten percent (10%) of the consolidated total assets of the company;

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

iv. Material internal control weaknesses which may lead to financial reporting problems.

9.4 The external auditor shall submit its findings to the client-company's management/audit committee. The adverse findings in 9.3 (i-iii) shall be discussed by the external auditor with said body in order to preserve the concerns of the supervisory authority and external auditors regarding the confidentiality of the information.

9.5 The external auditor shall document the management's explanation and/or corrective action taken regarding his adverse findings. The same shall be included in the report mentioned under Section 9.2.

9.6 The contract between the company and the external auditor shall contain a provision that the disclosure of information by the external auditor to the Commission shall not be a ground for civil, criminal or disciplinary proceedings against the auditor.

SEC. 10. Grounds for Suspension or Delisting of Accreditation

10.1 An external auditor's accreditation shall be suspended or, **an external auditor shall be** delisted, after due notice and hearing by the Commission, under any of the following circumstances:

i. Failure to submit the report required under Section 9.2 of this Circular in case of non-disclosure under SEC Form 17-C by the client-company, in the case of the companies mentioned under subparagraphs (i) to (iii) of Section 3.5 above, or the required Disclosure reports, in the case of All Other Market Participants;

ii. Continuous conduct of audit despite loss of independence as provided for under the *Code of Professional Ethics*;

iii. Any willful misrepresentation in the following information/ documents:

a. Application for accreditation;
b. Report required under Section 9.2 of this Circular;
c. Statement of Representation, as required under paragraph 3(c)(v) of SRC Rule 68, except as to the representation provided under sub-paragraph (1) thereof;
d. Notarized certification of the external auditor that he is in compliance with the general qualification requirements under Section 5.1 and that he has not been convicted by a competent court for a crime involving moral turpitude, fraud (as defined in the Revised Penal Code), or declared liable by the Commission or by any competent court for violation of the Corporation Code or the Securities Regulation Code.

iv. The Board of Accountancy (BOA) found that, after due notice and hearing, the external auditor committed an act discreditable to the profession as specified in the Code of Professional Ethics for Certified Public Accountants. In this case, the BOA shall inform the Commission of the results thereof;

v. Declaration of conviction by a competent court of a crime involving moral turpitude, fraud (as defined in the Revised Penal Code), or declaration of liability for violation of the Corporation Code or the Securities Regulation Code;

vi. Refusal for no valid reason, upon lawful order of the Commission, to submit requested documents in connection with an ongoing investigation. The external auditor should however been made aware of such investigation.

vii. Gross negligence in the conduct of audits which would result, among others, in non-compliance with generally accepted auditing standards in the Philippines or issuance of an unqualified opinion which is not supported with full compliance by the auditee with generally accepted accounting principles in the Philippines (GAAP). Such negligence shall be determined by the Commission after proper investigation during which the external auditor shall be given due notice and hearing;

viii. Conduct of any of the non-audit services enumerated under Section 8.1 of this Circular for his statutory audit clients, if he has not undertaken the safeguards to reduce the threat to his independence;

ix. Failure to comply with the Philippine Auditing Standards and Philippine Auditing Practice Statements;

x. **For external auditors of companies under Group D, there is a written recommendation by the concerned regulatory agency for his/her suspension or delisting.**

10.2 An external auditor who has been suspended by the Commission shall, after serving the suspension period and prior to his acceptance of any assignment, report the matter to the Commission to update his records with the same.

10.3 An auditing firm's accreditation shall be suspended or delisted, after due notice and hearing, under the following grounds:

i. Any misrepresentation which the Commission may find to be willful, in its application form and pertinent attached certifications;

ii. Dissolution of the auditing firm/partnership, as evidenced by an Affidavit of Dissolution submitted to the Board of Accountancy, or upon findings by the Commission that the firm/partnership is dissolved. The accreditation of such firm/partnership shall however be reinstated by the Commission upon showing that the said dissolution was solely for the purpose of admitting new partner/s and thereafter shall be reorganized and re-registered;

iii. There is a showing that the accreditation of the following number or percentage of external auditors, whichever is lesser, have been suspended or delisted for whatever reason, by the Commission:

a. at least ten (10) signing partners and currently employed accredited external auditors, taken together; or

b. such number of external auditors constituting fifty percent (50%) or more of the total number of the firm's signing partners and currently accredited auditors, taken together.

iv. The firm or any one of its auditors has been involved in a major accounting/auditing scam or scandal. The suspension or delisting of the said firm shall depend on the gravity of the offense or the impact of said scam or scandal on the investing public or the securities market, as may be determined by the Commission;

v. Refusal for no valid reason, upon order of the Commission, to submit requested documents in connection with an ongoing investigation. The firm should however be made aware of such investigation;

vi. **For auditing firms engaged by companies under Group D, there is a written recommendation by the concerned regulatory agency for its suspension or delisting.**

SEC. 11. Sanctions

11.1 Failure to comply with any of the requirements **of this Circular** shall subject the auditing firm or the responsible external auditor **(individual practitioner)** with **Groups A to C accreditation**, after due notice and hearing, to the following scale of fines:

Group A

	Auditing Firm	External Auditor (Individual Practitioner)
First Offense	**P 100,000.00**	**P 50,000.00**
Second Offense	**200,000.00**	**100,000.00**
Third Offense	**400,000.00**	**200,000.00**

Group B

	Auditing Firm	External Auditor (Individual Practitioner)
First Offense	**P 50,000.00**	**P 25,000.00**
Second Offense	**100,000.00**	**50,000.00**
Third Offense	**200,000.00**	**100,000.00**

Group C

	Auditing Firm	External Auditor (Individual Practitioner)
First Offense	**P 25,000.00**	**P 10,000.00**
Second Offense	**50,000.00**	**20,000.00**
Third Offense	**100,000.00**	**50,000.00**

For external auditors and auditing firms engaged by companies under Group D, the concerned regulatory agency may adopt the foregoing scale of fine for Group C and/or may recommend to the Commission the suspension or delisting of accreditation of such auditor or firm.

11.2 The foregoing penalties shall be without prejudice to other administrative or criminal sanctions that may be imposed by the Commission.

11.3 The above penalties may be reduced by the Commission, upon written request of responsible auditor/firm, depending on the presence of mitigating circumstances for the violation.

11.4 The responsible external auditor's accreditation may also be suspended or delisted after due notice and hearing by the Commission.

11.5 Any company covered by this Circular that knowingly engages the services of an external auditor who is not accredited by the Commission, shall be subject to the following penalty without prejudice to other administrative sanctions provided under Section 54 of the Securities Regulation Code and its implementing rules and regulations:

Group A	**P100,000.00**
Group B	**50,000.00**
Group C	**25,000.00**

For Group D companies, the concerned regulatory agency may impose the necessary penalty which may include non-acceptance of audited financial statements that are signed by an unaccredited external auditor.

SEC. 12. Repealing Clause

This Circular supersedes SEC Memorandum Circular **Nos. 13, Series of 2003 and 15, Series of 2004.**

SEC. 13. Transitory Provisions

13.1 **The accreditation of all auditing firms and external auditors who have been accredited under the above-rescinded Circulars shall remain effective until the expiration thereof or until the end of three (3) years from grant of said accreditation.**

13.2 **For those external auditors which applied for and accredited under Group C but do not have clients under said group or do not intend to audit such type of companies, the Commission may change their accreditation to Group D upon submission of the following:**

i. **Written request for a downgrade from Group C to D, with a manifestation that he/she does not have clients under Group C or does not intend to audit such type of companies; and**

ii. **List of corporate clients with amount of total assets and an indication whether each of the company is covered by other regulatory agency's requirement on accreditation;**

iii. **Original copy of the certificate of Group C accreditation.**

SEC. 14. Effectivity Clause

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

Signed on behalf of the Commission on November 30, 2006, Mandaluyong City, Philippines.

JE B. BARIN
Chairperson

GUIDELINES ON THE EVALUATION OF AUDIT WORK

a. **The application shall be denied if any of the following findings are noted on the financial statements audited by the applicant-external auditor unless a qualification/modification or adverse/disclaimer opinion in the auditor's report has been provided:**

   1. **No *cash flow statement*;**

   2. **No balance sheet;**

   3. **No Income Statement (unless the company is non-operational);**

   4. **No statement of changes in equity (unless the only change in the equity is the net income or loss for the period);**

   5. **No *notes* or substantially incomplete notes to financial statements; or**

   6. **Major accounting policy is non-GAAP (i.e. cash accounting).**

b. **For Groups A application, it may be favorably considered only if minor disclosure incompleteness (one to two items) are found in AFS of the applicant's clients and sufficient explanation are provided by the applicant. The level of deficiencies acceptable for Group B accreditation *shall also be minor disclosure deficiencies but such* may be up to five items.**

c. **For Groups C and D application, common deficiencies such as the following are considered not material to affect the quality of the submitted AFS and shall not be a ground for denial:**

   1. **Incomplete information on auditor's report;**

   2. **Incomplete *explanatory notes* (but all other basic components of FS should have been presented, i.e., Balance Sheet, Income Statement, Cash Flow Statement, Statement of Changes in Equity, significant notes to FS);**

   3. **The required comparative two-year figures are not presented;**

   4. **One or two accounting policies are not disclosed.**

   The applicant in this case should, however, submit a written explanation on each of the finding, and an undertaking to improve his audit work.

Annex "B"

PRO-FORMA AUDIT ENGAGEMENT LETTER

To the Board of Directors
Company Name
Address

You have requested that we audit the balance sheet of (name of company) as of (fiscal year end) and the related statements of income, cash flows and changes in stockholders' equity for the year then ending. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our Audit will be made with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with Philippine Standards on Auditing. Those Standards require that we plan and perform the audit and to obtain reasonable assurance that the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation.

Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting internal control system, there is an unavoidable risk that even some material misstatements may remain undiscovered.

In addition to our report on the financial statements, we expect to provide you with a separate letter concerning any material weaknesses in accounting and internal control systems which come to our knowledge.

We remind you that the responsibility for the preparation of financial statements including adequate disclosure is that of the management of the company. This includes the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and the safeguarding of assets of the company. As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

However, as part of our responsibility as an accredited external auditor of the Securities and Exchange Commission, we shall report to the Commission any of the following cases which may have been discovered based on generally accepted auditing standards, if the company fails to disclose the same to the Commission:

1. Any material findings involving fraud or error which will reduce the consolidated total assets of the company by five percent (5%);

2. Losses or potential losses the aggregate of which amounts to at least ten percent (10%) of the consolidated total assets of the company;

3. Any findings to the effect that the consolidated assets of the company, on a going concern basis are no longer adequate to cover the total claims of creditors.

We look forward to full cooperation with your staff and we trust that they will make available to us whatever records, documentation and other information are requested in connection with our audit. Our fees, which will be billed as work progresses, are based on the time required by the individuals assigned to the engagement plus out-of-pocket expenses. Individual hourly rates vary according to the degree of responsibility involved and the experience and skill required.

This letter will be effective for _____ years unless it is terminated, amended or superseded.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our audit of your financial statements.

Name of Company
Acknowledge on behalf of
The company by:

Name/Title:

_____
Signature/Date

Name of Auditor/Firm

_____
Signature/Date