Republic of the Philippines
SECURITIES AND EXCHANGE COMMISSION
SEC Building, EDSA, Greenhills
Mandaluyong City

SEC MEMORANDUM CIRCULAR NO. 15
Series of 2004

AMENDMENTS TO THE ACCREDITATION AND REPORTORIAL REQUIREMENTS OF EXTERNAL AUDITORS OF PUBLIC COMPANIES AND SECONDARY LICENSEES OF THE COMMISSION

(SEC MEMORANDUM CIRCULAR NO. 13, SERIES OF 2003)

The Commission En Banc at its meeting held on October 14, 2004, resolved to revise the subject requirements as follows:

I. **Section 3.7** For purposes of this circular the Secondary licensees of the Commission shall be grouped as follows:

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

B.

i. Pre-need Companies
ii. Investment Houses
iii. Brokers and Dealers of securities
iv. Investment companies
v. Government Securities Eligible Dealers (GSEDs)
vi. Universal Banks Registered as Underwriters of Securities
vii. Investment Company Advisers
viii. Clearing Agency and Clearing Agency as Depository
ix. Issuers of Registered Time Shares, Proprietary and Non-Proprietary Membership Certificates
x. Stock and Securities Exchange/s
xi. Special Purpose Vehicles registered pursuant to RA 9182

C.

i. Financing Companies
ii. Transfer Agents

II. **Section 5.1(B)(i)** of the subject circular shall henceforth read as:

"At the time of application, the external auditor (i.e. single practitioner or signing partner in an auditing firm) shall have at least five (5) years experience in external audits. In exceptional cases, the Commission may consider the participation 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."

Section 5.1(B)(iii) of the subject circular shall henceforth read as:

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

1. The external auditor with general accreditation to audit public companies and all secondary licensees listed in Section 3.7 must have had at least five (5) clients with total assets of at least ₱50 million each

2. The external auditor for the Group B secondary licensees in Section 3.7(B)(i)to(xi) must have had at least three (3) clients with total assets of at least P20 million each; Provided that an external auditor with general accreditation pursuant to item (1) above is automatically qualified to audit these Group B secondary licensees.

3. The external auditor for Group C secondary licensees in Section 3.7(C)(i)to(ii) must have had at least three (3) clients with total assets of ₱5 million each; Provided, that an external auditor with general accreditation pursuant to item (1) above or selected to audit Group B secondary licensees pursuant to item (2) above, is automatically qualified to audit these Group C secondary licensees."

III. **Section 8 (Operational Requirements)** of the Circular shall have an additional paragraph which shall contain the following provisions:

"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 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."

III. Section 6.2 (iii) of the circular shall henceforth read as follows:

Written proof that the auditor has attended or participated in relevant accounting and auditing training for at least thirty (30) hours yearly beginning January 2005. 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.

Section 13.3 shall likewise read as follows:

At the time of renewal of accreditation, external auditors who have been accredited by the Commission prior to the effectivity of this revised circular, 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.

The foregoing amendments on Sections 5 and 8 of Circular No. 13 shall take effect fifteen (15) days from publication in a newspaper of general circulation in the Philippines. The groupings of secondary licensees under Sections 3.7 and 5.1(B)(i) of said circular may however be immediately observed by external auditors who have pending applications with the Commission as of this date.

October 29, 2004. Mandaluyong City, Philippines.

E B. BARIN
Chairperson