



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



**NOTICE**

In its meeting on April 3, 2008, the Commission En Banc resolved to approve the amendment of Annex "A" of SEC Memorandum Circular No. 13, Series of 2006 ("Circular").

The *Amended Guidelines on the Evaluation of Audit Work of Applicants for Accreditation as External Auditors* shall therefore read as follows:

**I. GROUP A or B APPLICATIONS**

- a. The latest audited financial statements (AFS) of the top two (2) clients of the applicant, based on total assets, shall be reviewed. However, if any of these clients is a bank, insurance company or cooperative, the AFS of the next largest client which is not engaged in the business of any of the said corporations shall become the subject of evaluation.
- b. For Group A applications, the audit work of the applicant shall be acceptable only if the number of minor disclosure deficiencies found in the AFS of the applicant's clients do not exceed two (2). For Group B applications, the acceptable number of minor disclosure deficiencies shall not exceed five (5).

*Please see paragraph III (a), (b and (c) for the variations of deficiencies.*

- c. The application shall be denied or downgraded if the number of minor disclosure deficiencies exceeds the limits earlier mentioned, or there is a material deficiency or misstatement in the financial statements of the top two (2) clients. The applicant may request a reconsideration of the denial or downgrading on condition that he/she submits for review by the Commission the AFS of his/her next two largest clients that are grantees of secondary licenses from the Commission. In case material disclosure deficiencies are found in the said AFS, the request for reconsideration shall be denied and the application shall be downgraded. If the findings in the said AFS are only minor disclosure deficiencies, the applicant may be granted probationary accreditation subject to the following provisions:

- (i) For renewal applications where the findings on the clients' AFS include a material deficiency or misstatement, the applicant-external auditor shall be assessed the penalty provided for in Section 11 of the Circular on violation of the Statement of Representation covering the audit of financial statements that the Commission has found to contain material deficiency/ies or misstatement/s.
  - (ii) The probationary accreditation shall be effective only for a period of four (4) months from the date it is granted;
  - (iii) A copy of the AFS of the top two (2) clients signed by the external auditor during the probationary period shall be submitted to the Commission at least fifteen (15) business days before the end of the probationary period;
  - (iv) The final approval of the accreditation, which shall be effective for three (3) years, shall not be granted unless the subject AFS and other clients' latest financial statements that the Commission may review are fully compliant with the effective accounting standards and SRC Rule 68.
- d. The findings on the clients' AFS resulting from the foregoing procedures shall be referred to the operating department of the Commission that monitors the activities of the said company-clients for the imposition of the appropriate penalties.

## **II. GROUP C or D APPLICATIONS**

- a. The latest AFS of the top two (2) clients of the applicant, based on total assets, shall be reviewed. If any of these clients is a bank, insurance company or cooperative, the AFS of the next largest client which is not engaged in the business of any of the said corporations shall become the subject of evaluation.
- b. An application for Group C or D accreditation shall be denied if, after evaluation, the AFS of the top (2) clients show any of the following material deficiencies or misstatements:
  - (i) The material deficiency pertains to an item under paragraph III (a)(1) to (4) below;
  - (ii) Substantially incomplete notes to financial statements arising from the absence of the summary of significant accounting policies and/or lack of explanatory notes on material accounts; or

- (iii) More than three (3) accounting policies on significant accounts, as defined under paragraph III (b) below, are not in accordance with PFRS or GAAP.
- c. If the application is denied due to any of the foregoing deficiencies, the applicant may, after proper request, be granted probationary accreditation subject to the following conditions:
- (i) For renewal applications where the findings on the clients' AFS include a material deficiency or misstatement, the applicant-external auditor shall be assessed the penalty provided for in Section 11 of the Circular on violation of the Statement of Representation covering the audit of financial statements that the Commission has found to contain material deficiency/ies or misstatement/s..
  - (ii) The probationary accreditation shall be effective only for a period of four (4) months from the date it is granted;
  - (iii) A copy of the AFS of the largest clients signed by the external auditor during the probationary period shall be submitted to the Commission at least fifteen (15) business days before the end of the probationary period;
  - (iv) The final approval of the accreditation, which shall be effective for three (3) years, shall not be granted unless the subject AFS and other clients' latest financial statements that the Commission may review are fully compliant with the effective accounting standards and SRC Rule 68.
  - (v) An applicant-external auditor shall be allowed a probationary accreditation only once.
- d. The findings on the clients' AFS resulting from the foregoing procedures shall be referred to the operating department of the Commission that monitors the activities of the said company-clients for the imposition of the appropriate penalties.

### **III. BASIS OF MATERIALITY**

Any of the following shall be considered a **material deficiency or misstatement**:

- (a) One or more of the following are not submitted:
  - (1) Balance Sheet;
  - (2) Income Statement;
  - (3) Cash Flow Statement;

- (4) Notes to Financial Statements;
- (5) Statement of Management's Responsibility.
- (6) Auditor's Report.

(b) The following shall likewise render the financial statements materially deficient or misstated:

- (i) If the auditor's opinion is qualified and the reporting company is a listed company, public company, mutual fund company or an issuer of securities to the public;
- (ii) If the auditor's report is not compliant with the wording prescribed under Philippine Standards on Auditing (PSA) No. 700, as revised.

(c) There is no accounting policy provided on a significant account.

For purposes of these Guidelines, a **significant account** means a Balance Sheet or Income Statement item, the amount of which is equivalent to:

*For listed companies, public companies, mutual fund companies, other issuers of securities to the public, and pre-need companies*

- (1) 5% or more of Total Current Assets, if it is one of the current asset items;
- (2) 5% or more of Total Non-Current Assets, if it is one of the non-current asset items;
- (3) 5% or more of Total Current Liabilities, if it is one of the current liabilities items;
- (4) 5% or more of Total Long-Term Liabilities, if it is one of the long-term liabilities items;
- (5) 5% or more of the Total Stockholders' Equity, if it is one of the equity items; or of the Total Assets, if there is a capital deficiency;
- (6) 5% or more of the Net Income, if it is one of the Income Statement items.

*For all other corporations, the threshold amount shall be 10% or more of the items mentioned above.*

- (d) An accounting policy for a significant account is not consistent with PFRS or GAAP, e.g., for non-publicly accountable entities or pre-need companies;
- (e) An accounting policy for a significant account is not consistently applied between periods or to similar transactions and events (consistency in application); or

- (f) The estimate or assumption used on a significant account is unreasonable and has resulted in a material<sup>1</sup> misstatement of the financial statements;
- (g) Any of the required disclosures and presentations under the applicable financial reporting framework and SRC Rule 68/68.1 for a significant account is not provided in the financial statements. However, for disclosures on related party transactions required under PAS 24, any deficiency found shall be considered material whether or not the amount involved in the said transaction is significant;
- (h) There is a material misstatement in the financial statement, i.e., overstatement or understatement of income, asset, liability or equity. The test of materiality of the amount of misstatement shall likewise be based on paragraph (c) above;
- (h) There are more than one (1) minor misstatement and the aggregate amount involved for the misstatements meets the test of materiality;
- (i) The financial statements of a corporation with a subsidiary or subsidiaries are not presented on a consolidated basis in violation of PAS 27;
- (k) Other deficiencies or misstatements that the Commission may consider material.

The following shall be considered **minor disclosure deficiencies**:

- (a) The financial statements are not presented in the prescribed comparative format;
- (b) There is no distinction between the current and non-current portion of assets or liabilities;
- (c) There are no cross-references to the notes to financial statements;
- (d) One of the schedules required under SRC Rule 68.1 is not provided (applicable for listed companies, public companies, mutual fund companies and other issuers of securities to the public);
- (e) One or two disclosure items are not provided for an insignificant account, the non-disclosure of which does not affect the fair presentation of the financial statements;
- (f) The information that is not provided may be derived or computed based on other financial items, such as, earnings per share, net asset value, that are presented in the same financial statements;

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<sup>1</sup> Please use the 5% and 10% threshold in item (b) above.

- (g) There is no breakdown or explanatory note on *accrued expenses, miscellaneous or other accounts*, and the aggregate of which is not significant;
- (h) The Statement of Management's Responsibility is not signed by all of the required signatories or is not notarized, in the case of listed or public companies;
- (i) Other minor disclosure deficiencies or misstatements that the Commission may determine.

#### IV. TRANSITION PERIOD

- (a) Paragraphs I(c)(i) and II(c)(i) shall be implemented for renewal applications for accreditation that are filed starting April 30, 2008.
- (b) No renewal application shall be accepted if the date of expiration of the existing accreditation is more than four months from the date of filing of the renewal application.

Issued this 23rd day of April 2008 at Mandaluyong City, Philippines.

For the Commission:

*Fe B. Barin*  
**FE B. BARIN**  
Chairperson