

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) The Philippines

ACCOUNTING AND AUDITING

Prepared by a staff team from the World Bank¹ on the basis of information provided by the Philippine authorities

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Executive Summary

Historically, accounting and auditing in the Philippines has been heavily influenced by practices of the United States. More recently, efforts have been made to adapt International Accounting Standards and International Standards on Auditing to national circumstances. However, there are gaps between the current international standards and the applicable Philippine standards, and in compliance of Philippine standards.

Established in 1929, the Philippine Institute of Certified Public Accountants (PICPA) is one of the oldest professional accountancy bodies in Asia. The passage of the Accountancy Act 1923 led to the creation of the Board of Accountancy, with authority to issue certificates for certified public accountants. The PICPA presently lacks effective mechanisms either for monitoring members' professional activities or for taking appropriate actions against errant members. There are gaps in the capacity of the SEC and the Central Bank to monitor and enforce rules and regulations with reference to accounting, auditing, and financial reporting by the enterprises under their regulatory authority. The Board of Accountancy, under the Professional Regulation Commission, has the authority and responsibility to regulate the accounting profession, but is handicapped by lack of resources.

Policy recommendations to improve accounting and auditing practices in the Philippines were discussed and agreed by a group of national stakeholders at the conclusion of the accounting and auditing review exercise conducted in May - June 2001, under the joint World Bank-IMF Reports on the Observance of Standards and Codes (ROSC) initiative.

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I. INTRODUCTION

1. Accounting and auditing practices in the Philippines were assessed as part of a World Bank-IMF joint initiative on Reports on the Observance of Standards and Codes (ROSC). The assessment focused on the institutional arrangements that underpin the quality of accounting and auditing practices. In addition, a cross section of country stakeholders, under the leadership of the Board of Accountancy (BOA), took part in a self-assessment exercise in May and June 2001 to review local accounting and auditing standards against the benchmarks of the International Accounting Standards (IASs) and the International Standards on Auditing (ISAs). The exercise used a diagnostic template developed by the Bank to review requirements and actual practices. Bank staff used the data from the self-assessment in preparing this report. The assessment was carried out simultaneously with the ROSC assessment of corporate governance.²

2. A financial reporting institutional framework that includes many formal rules and regulations exists in the Philippines; however, it does not function properly. Poor governance has contributed to weak enforcement of the legal and regulatory framework. Various studies reveal pervasive and deep-rooted corruption in the public and private sectors in the Philippines. President Gloria Macapagal Arroyo has expressed—in her inaugural speech on January 20, 2001, and in the State of the Nation speech on July 23, 2001—the determination of the Government of the Philippines to combat corruption and overcome poor governance.

II. INSTITUTIONAL FRAMEWORK

A. Statutory Framework

3. **The Board of Accountancy under the Professional Regulation Commission (PRC) is charged with licensing and regulation.** State regulation of the accounting profession is provided by the 1975 Revised Accountancy Law and the PRC Modernization Act of 2000. The BOA comprises a chairman and six members appointed by the President of the Philippines, on the recommendation of the PRC based on nominations by the Philippine Institute of Certified Public Accountants (PICPA). The BOA chairman and members work on a part-time basis. They are required to be registered certified public accountants (CPAs). Some of them are full-time professionals of accounting firms that are subject to regulation by BOA. The PRC recognized the PICPA in 1973 as the accredited professional organization for CPAs.

4. **Approximately 250,000 enterprises need to prepare annual audited financial statements to meet the requirements of the Corporation Code.** Any corporation with paid-up capital of P50,000 (Philippine pesos, equivalent to approximately US\$1,000) or more is required to engage a CPA to conduct a statutory audit of the annual financial statements. These financial statements are required to be filed with the Securities and Exchange Commission (SEC). The SEC is required to monitor whether annual financial

² The Corporate Governance ROSC for the Philippines is available at <http://www.worldbank.org/ifa/Philippinesrosc.pdf>.

statements conform with the established rules, regulations, and standards. The degree of compliance with this reporting requirement is uncertain as the SEC is unable to review more than a small proportion of the submitted financial statements. In addition, the National Internal Revenue Code requires corporations, partnerships, and persons with gross quarterly earnings of more than P150,000 to include audited financial statements with their tax returns. The banks are required by Central Bank regulations to publish in newspapers annual balance sheets and income statements without notes. There is no such requirement for other enterprises.

5. **The Securities Regulation Code (SRC) empowers the SEC to prescribe generally accepted accounting principles (GAAP) applicable to certain categories of corporations.** These include issuers having at least 100 holders of a class of securities, issuers with a class of securities listed for trading on an exchange, and issuers with assets of at least P50 million and having 200 or more holders each with at least 100 shares of a class of equity securities. According to the SRC, when no SEC pronouncement covers a particular accounting area, accountants have available standards issued by the Accounting Standards Council (with BOA approval), standards issued by the International Accounting Standards Board, and accounting principles and practices for which there is a long history of acceptance and usage. In order to meet recommendations of the International Organization of Securities Commissions (IOSCO), the SEC, following discussion with BOA, has decided in principle to mandate the use of IASs by listed companies.

B. The Profession

6. **While the accounting profession in the Philippines is fairly well developed, weak governance in the profession has adversely affected the financial reporting regime in the country.** There have been many reported cases of poor financial reporting by large companies, and that many small- and medium-size business enterprises do not prepare quality financial statements. Public concern has also been expressed on the quality of audits and on auditor's independence in respect of a number of large enterprises. There have been no known cases of penalties imposed on auditors for failure to comply fully with the established requirements on accounting and auditing. Neither the professional body nor the statutory regulators appear to have effective means of disciplining errant members of the audit profession. The SEC and the BSP, in the recent past, have started the process of auditor accreditation in order to ensure quality of those auditors who represent before these bodies; however, the results are yet to be seen. It seems that the ability of these regulatory bodies to take disciplinary actions against errant auditors is constrained by the lack of appropriate resources.

7. **The statutory regulator of the accountancy profession suffers from capacity problems.** The limited resources at the secretariat of the Professional Regulation Commission (PRC) are shared by 41 professional regulatory boards, including the BOA. The lack of full-time dedicated staff constrains the BOA in carrying out such mandated functions as administering licensing examinations; promulgating rules and regulations, including the Code of Professional Ethics (subject to PRC approval); and enforcing legal

and regulatory requirements. At present, efforts are underway to complete restructuring of the PRC and strengthen its secretariat within the next year.

8. **The BOA has registered about 100,000 CPAs over the past 40 years.** There are no official statistics on the number of registered CPAs currently in public practice. The BOA has started a campaign to register all practicing auditors and audit firms with the PRC. It is estimated that more than 80 percent of the country's active CPAs work in government, commerce and industry, and educational institutions. The average number of CPAs admitted annually between 1991 and 1997 was about 1,200, which increased to about 2,500 during the period 1998 to 2000. On average, about 14,000 candidates take the CPA licensure examination each year, and the success rate for certification varies between 14 and 20 percent.

9. **The Philippine Institute of Certified Public Accountants (PICPA) does not have adequate resources to bolster the quality of auditing in the country.** Established in 1929, the PICPA is one of the oldest organizations of public accountants in Asia, with a current membership of over 20,000. It has been actively involved in regional and international professional groups, taking a leading role in the creation of Confederation of Asian and Pacific Accountants in 1957 and the ASEAN Federation of Accountants in 1977. A leader of PICPA served as the president of the International Federation of Accountants (IFAC) from 1982 to 1985. Although the PICPA is recognized by the government as the sole accredited professional organization for CPAs in the Philippines, membership is not a legal requirement for practicing CPAs. The leadership of the profession acknowledges that the PICPA does not have a structure that allows it to fulfill the objectives of a professional accountancy body as provided in IFAC guidelines.

10. **Auditing in the Philippines is dominated by one professional services firm.** This firm is a member of one of the big-5 international networks of accounting firms and conducts statutory audits for more than 70 percent of listed companies in the country. According to a study published locally in *Business World*, it audited the 1999 financial statements of 48 percent of the top 1,000 corporations in the Philippines. The balance of the 1999 audits were estimated to have been handled by the other four local members of the big-5 networks (23 percent); local audit firms (26 percent); the supreme audit institution, Commission on Audit (1 percent); and unidentified auditors (1 percent). Many individual practitioners and small partnerships provide audit services to many small- and medium-size enterprises, including close corporations. The quality of these audits is perceived to be uneven.

11. **There is no mechanism to ensure compliance with the Code of Professional Ethics for CPAs.** The Code of Professional Ethics was promulgated by the BOA and approved by the PRC in 1978. The Code is divided into five parts: (a) rules applicable to all CPAs; (b) rules applicable to CPAs in public accounting; (c) rules applicable to CPAs in private industry; (d) rules applicable to CPAs in the government service; and (e) rules applicable to CPAs in educational institutions. Compliance with this Code is mandatory for all Philippine CPAs, and the BOA has legal authority to initiate proceedings against any CPA for violations. The PICPA has included the Code in its by-laws and is

committed to take disciplinary actions against members who do not comply with the Code. There is a perception among many of those interviewed for this review—from the SEC, Central Bank, Stock Exchange, Foreign Chamber of Commerce, academia and a number of audit firms—that compliance by many practicing auditors is poor. Neither BOA nor PICPA has an established mechanism to monitor infractions. Filing a complaint with BOA against a CPA leads to an investigation, but there are long delays in reporting serious violations, and some are still pending after more than five years. The BOA has recently decided to revise the Philippine Code of Ethics in line with the IFAC Code of Ethics for Professional Accountants. However, an effective enforcement mechanism has yet to be established.

C. Professional Education and Training

12. The quality of academic education for pre-qualification needs to be improved.

The minimum educational requirement for admission to the CPA licensure examination is a Bachelor of Science in Accountancy (BSAcc). The undergraduate programs offered by the 367 higher education institutions in the Philippines vary significantly in quality. Few institutions have the capacity to maintain quality programs. Around half of the schools offering accountancy programs did not produce candidates who passed the CPA examinations held in May 2000 and October 2000. These schools are under the surveillance of the Commission on Higher Education (CHED) and BOA/PRC. CHED's responsibility includes setting the minimum course contents of programs, including BSAcc programs. To address this problem, the CHED closed BSAcc programs in several non-performing schools. The CHED has now approved a new curriculum for the BSAcc program submitted by BOA that takes into consideration suggestions of the PICPA education sector, and representatives of the users of financial statements and other stakeholders. The new curriculum is based on IFAC guidelines and the recommendations of the United Nations Conference on Trade and Development concerning the education of professional accountants. Implementation of the new accounting curriculum will require significant efforts for retraining the educators and developing instructional materials covering the practical application of international accounting and auditing standards, international dimensions of financial accounting and reporting, and professional ethics.

13. The revised curriculum does not include professional ethics as a separate subject. The IFAC Education Committee recommends that professional ethics should initially be taught separately in the prequalifying education of future accounting professionals.³

14. The examination system for CPA qualification needs to be rationalized in line with international best practice. Currently, CPA candidates' competence is tested through a multiple-choice examination in seven subjects. BOA members prepare the questions and the corresponding answer choices for this exam, and the grading is computerized. Concern exists on the current process of setting examination questions, and some practitioners have noted that as a result of the examination system, many new

³ See IFAC Educational Guideline No. 10, *Professional Ethics for Accountants: The Educational Challenge and Practical Application*

CPAs enter the profession with inadequate knowledge of the theory and practice of accounting and auditing, and with poor critical thinking ability and analytical skills.

15. **There is no practical training requirement for obtaining a license to provide audit services.** Novice CPAs without any practical experience can be authorized under the Accountancy Law to issue an audit opinion. IFAC Educational Guidelines highlight the need for prospective professional accountants to receive practical training as a component of the prequalification program.⁴ The guideline requires that practical training should extend for a period of not less than three years, to develop knowledge, skills, and values sufficient for performing audits with professional competence. The BOA recently decided to introduce a three-year practical experience requirement for a CPA to qualify for signing audit opinion, but this requirement has yet to be effectively implemented. In order to make practical experience mandatory, it will be necessary to amend the Accountancy Law.

16. **There is no requirement for continuing professional education (CPE).** It is recommended practice internationally for professional accountants, specifically those involved in public practice, to pursue continuing education. The regulatory requirements in the Philippines do not presently include this practice. In 1995, the PICPA introduced a CPE requirement. Subsequently, the PRC attempted to implement a rule that CPAs must comply with CPE requirements as a condition of license renewal. Since the PRC rule encompassed all the regulated professions, there were legal challenges arguing that mandatory CPE infringed on constitutional rights. The PRC Modernization law eliminated this requirement and, as a result, professional accountants currently do not need to fulfill any CPE requirements. BOA/PRC intend to propose this requirement in a future accounting law which is now being drafted.

D. Setting Accounting and Auditing Standards

17. **Accounting and auditing standards are set by the Accounting Standards Council (ASC) and Auditing Standards and Practices Council (ASPC), respectively.** The ASC and ASPC were created by the PICPA. Their standards become mandatory after receiving approval from the BOA. The ASC comprises eight members—four from PICPA, and one each from SEC, Bangko Sentral ng Pilipinas (BSP), BOA, and the Financial Executives Institute of the Philippines. The ASPC comprises 17 members—one each from seven independent auditing firms in the country, five from PICPA, two from the Association of CPAs in Public Practice, and one each from BOA, SEC, and the Commission on Audit. Both the ASC and the ASPC lack the necessary resources to independently research and develop standards. They generally adapt U.S. standards (GAAP and GAAS) or international standards (IASs and ISAs) to suit Philippine conditions.

18. **Resource constraints hinder timely issuance of new standards and revision of old standards.** The standard setting process involves issuance of an exposure draft for

⁴ See IFAC Educational Guideline No. 9, *Professional Ethics for Accountants: The Educational Challenge and Practical Application*.

public comment following which the final standard is approved by majority vote of the members of the council—ASC in the case of accounting standards, and ASPC in the case of auditing standards. The last auditing standard was issued by the ASPC in 1994. Although ASC issued the last accounting standard as recently as January 2001, new developments with regard to accounting for financial instruments have not yet been addressed. Many accounting standards issued in the 1980s and 1990s need to be revised to reflect changes in internationally accepted accounting practices, including IASs.

E. Compliance with Accounting and Auditing Standards

19. **The SEC lacks capacity to enforce compliance with the established accounting standards, rules and regulations.** Specifically, it lacks sufficient resources to employ the specialists needed to review the financial statements of publicly traded companies. While staff of Corporate Finance Department at the SEC scrutinize the prospectus and accompanying documents for listed companies, including the financial statements of companies at the stage of initial public offering of securities, regular monitoring of compliance with accounting requirements receives low priority. The SEC is particularly handicapped by a lack of expertise for detecting accounting manipulations that may distort information in financial statements. In the recent past, the SEC has embarked on a retraining of the staff on new standards in order to ensure effective monitoring of compliance with standards of accounting and financial reporting. The Philippine Stock Exchange does not have an effective mechanism for monitoring the quality of financial reporting by listed companies. Consequently, large corporations face little threat of punishment for noncompliance with accounting and reporting requirements. The SEC has conducted investigations in some recent well-publicized cases of infractions in financial statements. There are no reported cases of the SEC taking effective disciplinary actions against issuers or auditors for significant violations of established standards and rules. However, the SEC has recently taken important steps to impose appropriate penalties on the non-compliant companies as per Section 54 of the SRC and Memo Circular No. 001, dated March 28, 2001.

20. **The SEC Office of the General Accountant has been vacant since its creation at the end of year 2000.** The responsibility of the Office of the General Accountant includes leading the establishment of international accounting standards to support transparency in the Philippine capital market. It is not clear whether its mandate is confined to simply introducing IASs, or taking steps to monitor and enforce compliance. The latter would suggest a need to work with the accounting standard-setter and the professional accountancy body to ensure full adoption of IASs and development of a functional SEC enforcement mechanism. To date, the SEC has been unable to fill the Office of the General Accountant. However, effective June 1, 2001, the SEC has appointed a consultant in accounting and auditing who is acting as a “De facto General Accountant.”

21. **The SEC has issued new guidelines for the accreditation of auditors.** The SEC has recently decided to require external auditors of public companies to have at least five years of track record in conducting external audits and at least 10 existing corporate

clients each with assets of at least P50 million. Following the accreditation process, the SEC will circularize to all concerned corporations the list of accredited external auditors during the first quarter of every year. The SEC will also ask external auditors to inform the agency of any fraud and material errors in reporting by listed firms. The external auditor will be required to report to the SEC within 30 days any discrepancy which may be discovered during the course of audit work. Plans are underway for the SEC to put in place an arrangement for conducting investigations or special examinations to substantiate information provided by auditors.

22. **The Central Bank of the Philippines (BSP) has improved monitoring of loan-loss provisioning by banks, but enforcement of compliance with other accounting requirements by banks needs to be strengthened.** As part of banking supervision activities, the BSP monitors and enforces the requirements concerning loan-loss provisioning. Fines are often imposed for violations of rules. In the course of conducting on-site and off-site banking supervision, the inspectors sometimes identify poor accounting practices and non-compliance with established accounting requirements. Efforts are underway at the BSP to introduce more rigorous monitoring and enforcement of accounting and disclosure requirements.

23. **The BSP has recently started accrediting bank auditors.** Auditors of banks are required to inform the BSP banking supervision department of any fraud and violations of rules and regulations in banks' financial statements. An auditor who fails to adhere to the rules and regulations promulgated by the Central Bank may lose accreditation and could be disallowed from conducting future bank audits.

24. **The BOA lacks capacity to enforce accounting and auditing standards, rules, and regulations.** The BOA does not have the resources to monitor and enforce compliance with the accounting law and accounting and auditing standards. Generally, the BOA takes action only when an affected party or third party lodges a complaint. Between 1996 and 2000, 30 complaints against CPAs were filed with the BOA—29 alleged dishonorable professional practice, and one alleged immorality. Of these, five cases were dismissed, two resulted in revocation of the CPA license, two were archived, three are on appeal with PRC, and 18 are still pending hearings before the BOA. A number of cases filed before 1996 have not yet been heard by the BOA. The process of disciplinary action can take between 5 and 10 years, and some cases have been dismissed because the complainant lost interest. There have been suggestions that members of BOA (some of whom work for audit firms) tend to ignore conflicts of interest in dealing with cases against other audit firms.⁵

25. **There is no mechanism for independent review by the PICPA of the quality assurance arrangements of audit firms.** IFAC recommends that the professional body in a country have the responsibility to develop quality control standards and relevant guidance, requiring audit firms to establish the quality control policies and procedures

⁵ See Dyball, Maria Cadiz, and Lina J. Valcarcel, The "Rational" and "Traditional": The Regulation of Accounting in the Philippines, *Accounting, Auditing and Accountability Journal*, Vol. 12(3), 1999, pp. 303-327).

necessary to provide reasonable assurance of conforming to professional standards in performing services. To ensure that audit firms have effective quality control arrangements, a mechanism of independent review must be in place. However, the PICPA has not yet established a mechanism for independent review of the quality assurance arrangements in audit firms.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

26. **Although the Philippine Statements of Financial Accounting Standards (SFASs) are broadly consistent with internationally accepted accounting standards, in many cases there are differences with regard to detailed accounting and disclosure requirements.** As international standards are adapted to national circumstances, full IAS compatibility is often lost. The development of national accounting standards on a timely basis, and subsequent revisions to reflect of changing circumstances, requires commitment of dedicated resources not always available. Once a particular national accounting standard is developed, subsequent revisions in the IAS are often not reflected in the standard. The BOA recognizes that full adoption of IASs would make a positive contribution to high-quality accounting standards in the country and also allow it to devote use of scarce resources to developing manuals and implementation guidelines. It has therefore stepped up efforts to replace the Philippine SFASs with the IASs within three to four years. Moreover, the Philippine SEC has decided in principle to require listed companies to prepare statutory financial statements in accordance with the IASs.

27. **An analysis prepared for this review of the accounting requirements under applicable Philippine SFASs in 2001 showed difference from veals various incompatibilities from IAS requirements.**⁶ Some examples are presented below. For example:

- Deferral of foreign exchange gains or losses on long-term monetary items until settlement, and capitalization of foreign exchange losses related to assets without meeting the conditions prescribed in IAS21 and relevant interpretations.
- No specific criteria, as prescribed in IAS38, for recognition of development expenditure and its capitalization—the treatment of research and development costs is not subject to any standardized rules.
- No standard on accounting for leases consistent with the requirements of IAS17.
- A number of IAS disclosure requirements on related-party transactions are absent in Philippine SFAS.
- Generally accepted accounting principles for financial instruments largely differ from the IAS requirements.
- Inconsistencies between Philippine SFAS on business combinations and IAS22.
- In contrast with the requirements of IAS16, revalued fixed assets do not need to be continually kept up to date, and detailed disclosures on fixed assets are not required.

⁶ A comparison of Philippine Statements of Financial Accounting Standards to IASs prepared by seven leading international accounting firms is also available at www.ifad.net in a report entitled GAAP 2001 dated December 10, 2001.

- No IAS-comparable requirements regarding recognition of impairment losses and regular performance of impairment tests for tangible and intangible assets.
- The absence of an IAS-comparable fair valuation concept in accounting for investment property.

28. **The review also noted divergence between applicable standards and actual accounting and reporting practices.** A review of the financial statements published in 2000 by 25 companies listed on the Philippines Stock Exchange suggests that companies are inclined to disclose minimum information. There is evidence of noncompliance with various Philippine accounting standards. A few examples of noncompliance are discussed below:

- ***Earnings per Share.*** SFAS29 requires that an enterprise should disclose (a) the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net income or loss for the period; and (b) the weighted average number of common shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other. There is a perception that many listed companies in the country overstate reported earnings per share, with the area most often cited being the determination of the denominator upon declaration of stock dividend.
- ***Consolidated Financial Statements.*** Many companies that meet the conditions necessary for presenting consolidated financial statements do not comply with the requirements of SFAS21. Many of those that present consolidated financial statements exclude from consolidation subsidiaries that have high levels of liabilities, with some large entities showing unusually low borrowing figures in the consolidated balance sheet. The requirement for separate disclosure of long-term debts of subsidiaries is commonly ignored, as are other required disclosures relating to subsidiaries. Market sources observe that in some cases “realized gains on inter-company sales” are not eliminated in the process of preparing consolidated financial statements. None of the sample companies—many of which are involved in a variety of businesses—complied with the requirement on disclosure of disaggregated information for subsidiaries or groups of subsidiaries whose activities are dissimilar from those of the other companies in the group.
- ***Related-Party Transactions.*** The financial statements of the sample companies did not provide adequate information to determine the magnitude of related-party transactions. I, Some provide no information on related party transactions when an examination of the operational activities and other relevant information indicates that most have related parties.
- ***Equity Method of Accounting for Investments in Common Stock.*** Most of the sample companies that reported stock investments under the equity method failed to disclose all information required by SFAS11.

- **Short-Term Investments in Securities.** According to SFAS10, short-term investments in marketable securities should be reported at the lower of cost or market price. Most companies with these investments report them at cost.
- **Intangible Assets.** None of the companies that reported intangible assets in the balance sheet complied with the SFAS9 requirement to disclose the method and period of amortization of such assets.
- **Borrowing Costs.** Most of the sample companies failed to disclose their accounting policy for borrowing costs, as per SFAS25. The companies that capitalized borrowing costs during a construction period did not disclose relevant information required by the standard.
- **Accounting Policy for Revenue Recognition.** Many of the financial statements failed to disclose accounting policies for various important treatments, including revenue recognition.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

29. At present there are 16 Philippine Statements of Auditing Standards and Practices (SASPs) developed between 1987 and 1994 through adaptation of auditing standards issued by the American Institute of Certified Public Accountants (AICPA). Although there have been significant changes in the auditing environment and new developments in auditing standard-setting at the international level, the SASPs have not been revised, nor have new standards been issued. There are differences between local auditing standards and the ISAs promulgated by the International Auditing Practices Committee (IAPC) of IFAC.⁷

30. There is a need for detailed guidelines to amplify the requirements of the auditing standards. Members of the profession suggest that the lack of local auditing standards poses less of a problem than the lack of concrete guidance on the practical application of auditing standards reflecting country conditions. The large- and medium-

⁷ For example, the following ISAs do not have local counterparts in the Philippines: ISA250, *Considerations of Laws and Regulations in an Audit of Financial Statements*; ISA310, *Knowledge of the Business*; ISA320, *Audit Materiality*; ISA400, *Risk Assessments and Internal Control* (risk assessment is not covered by any local standard; only a very few provisions of ISA400 have comparable provisions in SASP6); ISA402, *Audit Considerations Relating to Entities Using Service Organizations*; ISA501, *Audit Evidence—Additional Considerations for Specific Items*; ISA510, *Initial Engagements—Opening Balances*; ISA520, *Analytical Procedures*; ISA540, *Audit of Accounting Estimates*; ISA560, *Subsequent Events*; ISA600, *Using the Work of Another Auditor*; ISA610, *Considering the Work of Internal Auditing*; ISA620, *Using the Work of an Expert*; ISA710, *Comparatives*; ISA720, *Other Information in Documents Containing Audited Financial Statements*; and ISA[new], *Communication of Audit Matters with Those Charged with Governance*. In addition, there are differences between SASPs and the following ISAs: ISA210, *Terms of Audit Engagement*; ISA220, *Quality Control for Audit*; ISA240, *Fraud and Error*; ISA401, *Auditing in a Computer Information Systems Environment*; ISA500, *Audit Evidence*; ISA570, *Going Concern*; and ISA580, *Management Representations*. An exposure draft on Related Parties (ISA550 comparable) has been issued and is awaiting approval.

size audit firms are perceived to comply with the requirements of local auditing standards. Some of these firms try to follow, as far as practicable, internationally accepted auditing practices. Since observance of auditing standards other than the 16 Philippine SASPs is not mandated, practicing auditors are under no obligation to follow ISA requirements. Consequently, auditors may apply different auditing standards in different ways and claim to have complied with the requirements set by ISAs. There is consensus that improvements in the quality of auditing can be achieved by (a) immediately adopting all ISAs; and (b) the development and dissemination of practical guidelines on the implementation of ISAs.

31. **Recent publicized incidents of disclosure deficiencies in published corporate financial statements have suggested possible weaknesses in auditing practices in the country.** These cases have attracted attention of the statutory regulators, including the SEC. There has been no finding of fault by audit firms to date.

V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

32. **The investor community, in general, recognizes the need for improvements in the quality of corporate financial reporting.** In responses to a questionnaire survey, and in interviews conducted for this review, many investors and interested parties expressed the need to adopt international accounting and auditing standards. There is a perception among regulators, practitioners and academic researchers that failure by auditors to comply with the Code of Ethics and independent standards adversely affects the usefulness of much of the information provided in audited financial statements. It is the general view that in the Philippines many capable accountants and auditors can produce corporate financial statements of internationally comparable standards. However, this capacity is not used because of the lack of effective enforcement of internationally comparable rules and regulations.

VI. POLICY RECOMMENDATIONS

33. **A group of national stakeholders met in Manila in early June 2001, discussed the results of the review with Bank staff, and agreed to take appropriate steps for implementation of a number of policy recommendations.** The meeting established an Oversight Committee with responsibility to follow-up, establish specific priorities and responsibilities, set timetables, and monitor progress of the implementation process. The Oversight Committee is headed by the current Chairman of PRC (the then-Chairman of BOA), with members from the Department of Finance, Securities and Exchange Commission, Central Bank of the Philippines, National Economic Development Authority, financial executives of the Philippines, Philippine Institute of Certified Public Accountants, and academic institutions. The policy recommendations are summarized below:

- ***Strengthen capacity of the BOA to regulate the accountancy profession.*** In this regard, amend the 1975 Revised Accountancy Law and the PRC Modernization Act of 2000 to put into effect the following:

- (a) Restructure BOA to provide sectoral representation and a secretariat with permanent full-time staff.
 - (b) Drawing on the experience of other countries, develop a feasible system for conducting CPA examinations including a best-practice method of preparing the questions. Determine appropriate syllabi and subjects for harmonizing the CPA licensure examinations with international best practices.
- ***Strengthen enforcement capacity of the regulatory bodies.***
 - (a) Strengthen the independence of SEC and BSP and their capacity (human resources, training, methodology, and equipment) to monitor and review audited financial statements and other reports submitted to SEC and BSP. Introduce an effective enforcement mechanism at the SEC and BSP for imposing sanctions on violators—preparers and auditors—of accounting and reporting requirements.
 - (b) Amend the Corporation Code to exempt from the statutory audit requirement close corporations whose operations do not affect public interest, and to develop criteria for determining exempted close corporations.
- ***Strengthen coordination*** among BOA/PRC, Commission on Higher Education, Securities and Exchange Commission, Bangko Sentral ng Pilipinas, and the Bureau of Internal Revenue.
- ***Take steps to adopt international standards in accounting and auditing.***
 - (a) Adopt the IASs and ISAs in full, without any modification or adaptation.
 - (b) Change the responsibility of the Accounting Standards Council from standard-setting to developing implementation guidelines and interpretations on application of IASs.
 - (c) Change the responsibility of the Auditing Standards and Practices Council from standard-setting to developing implementation guidelines and interpretations on application of ISAs.
- ***Take measures to improve auditors' performance.***
 - (a) Amend the 1975 Revised Accountancy Law to (i) include a practical experience requirement before issuance of practicing license can be issued to a CPA; and (ii) introduce a continuing professional education (CPE) requirement as a condition for renewing the practicing license, including a monitoring and enforcement mechanism under the overall supervision of BOA
 - (b) The BOA to revise and issue the Code of Ethics in conformity with the latest revision of the IFAC Code of Professional Ethics.
 - (c) Re-train practicing CPAs on IASs, ISAs, Implementation Guidelines, and Interpretations, as well as professional ethical standards.
- ***Provide the environment for conducting high-quality and independent audits.*** Amend the 1975 Revised Accountancy Law to provide for the creation of a quality assurance review mechanism to evaluate the system of quality control of

auditors/audit firms involved in conducting statutory audits of public companies and financial institutions. The results should be furnished to the regulatory agencies for appropriate action.

- ***Create an independent research organization to monitor the quality of information provided in published financial statements.*** This organization will conduct regular reviews of annual published financial statements of public companies, including banks, to determine compliance with established accounting standards, and will share the findings with the various regulatory bodies.
- **Take necessary steps to improve accountancy education:**
 - (a) Include in the accountancy curriculum a component on professional ethics.
 - (b) Prepare practice manuals, instructional manuals, student textbooks and other materials to facilitate teaching and learning practical applications of IASs and ISAs.
 - (c) Undertake a “training-the-trainers” program to sharpen the skills of accountancy faculty on IAS, ISAs, Implementation Guidelines, and Interpretations. Emphasis should be given to the teaching of professional ethics.
- ***Revitalize PICPA to make it an effective professional body that could assist in regulating of CPAs, producing quality financial reporting, and auditing:***
 - (a) Organize a secretariat with full-time technical staff, to enable it to undertake among other functions, evaluation of the system of quality control of auditors/audit firms involved in conducting statutory audits of public companies and financial institutions, and provision of technical support to BOA/PRC.
 - (b) Revive the PICPA Training Division for the purpose of administering and conducting the CPE Program.
 - (c) Establish a Disciplinary Committee to carry out supervisory tasks for monitoring and ensuring that the CPAs perform professional conduct in compliance with the standards, rules and regulations; to investigate allegations of infractions by CPAs; and to recommend sanctions to be imposed in the way decided by the governing council of the PICPA. Take necessary steps so that the information about sanctions against CPAs are made publicly available.