Republic of the Philippines
Department of Finance
Securities and Exchange Commission
COMMISSION EN BANC

GRACIA SEVERA A. BANARIA-ESPIRITU,
Appellant,

-versus-

SEC En Banc Case No. 10-19-464
For: *Denial of Application for Group C Accreditation*

Office of the General Accountant, represented by Atty. EMMANUEL Y. ARTIZA, CPA, in his capacity as the General Accountant of the Securities and Exchange Commission,
Appellee.

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DECISION

This resolves the Notice of Appeal and the Appeal Memorandum both dated 4 October 2019 filed by Appellant, GRACIA SEVERA A. BANARIA-ESPIRITU, on 8 October 2019 assailing the Letter-Order issued by the Office of the General Accountant (OGA) denying her application for accreditation under Group C on the ground that the same is allegedly without merit and basis.

PARTIES

Appellant, GRACIA SEVERA A. BANARIA-ESPIRITU ("Banaria-Espiritu" for brevity), is the Managing Partner of Banaria Banaria and Company CPAs (the "Company"), a general professional partnership organized and existing under and by virtue of the laws of the Philippines, with office address at No. 10 Scout Bayoran Street Barangay South Triangle, Quezon City.

Appellee, the Office of the General Accountant, is a special office of the Commission that implements Section 68 of the Securities Regulation Code and its IRR which covers, among others, financial reporting and auditing standards and practices, accreditation of auditing firms and/or external auditors, appraisal companies or professional service organizations, credit rating agencies and other independent professionals or experts engaged by corporations regulated by the Commission. The OGA is represented by Atty. EMMANUEL Y. ARTIZA, CPA, the Commission's General Accountant.

RELEVANT FACTS

On 4 February 2019, the Commission granted Appellant, Banaria-Espiritu and the Company, a Conditional Accreditation[1] to be effective until 4 June 2019, which provided for a condition, among others, that applicant submits copies of the AFS of its top two (2) clients, and "*the final approval of the accreditation, which shall be effective for three (3) years, shall not be granted unless the said AFS are complaint with the effective accounting standards and SRC Rule 68"*.

On 6 May 2019, Appellant Banaria-Espiritu and the Company applied for the renewal of its Group C Accreditation and submitted the AFS of its top two (2) clients i.e. Halifax Capital Resources and C.M. Pancho Construction, Inc. in compliance with the conditions in the Conditional Accreditation.

The OGA evaluated the 2018 AFS of Appellant Banaria-Espiritu and the Company's top two (2) clients and found material disclosure deficiencies summarized as follows:

Client Companies	Remaining findings
C.M. Pancho Construction, Inc. (CMPCI)	3 Material disclosure deficiencies 1 Minor disclosure deficiency 3 Minor misstatements
Halifax Capital Resources, Inc.	1 Material disclosure deficiency

In a letter dated 20 May 2019, the OGA issued its initial findings of material disclosure deficiencies and directed Appellant Banaria-Espiritu to provide her response thereto.

On 10 June, 2019, Appellant Banaria-Espiritu submitted her comments/responses to the initial findings of the OGA.

The OGA subsequently issued a Letter-Order dated 31 July 2019 (OGA Letter-Order)[2] denying Appellant Banaria-Espiritu's application for a 3-year Group C Accreditation and imposed a penalty of PhP4,000.00 for failure to comply with the terms of the accreditation and for violation of Rule 68 of the Securities Regulation Code (SRC)[3]. Appellant Banaria-Espiritu paid the penalty imposed by the OGA.

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[1] Due to numerous noted findings on the AFS of Headland Road Capital, Inc., the applications were denied on 14 January 2019 with the option to apply for conditional accreditation. On 14 January 2019, the appellant manifested to avail instead a conditional accreditation and paid the total assessed penalty of Php4,000.00.
[2] Received by the appellant dated 13 August 2019.
[3] Republic Act No. 8799.

On 17 August 2019, Appellant Banaria-Espiritu sent a letter[4] to the OGA requesting for reconsideration of the latter's decision denying the application for renewal of Group C Accreditation. Considering that the letter-request of Appellant Banaria-Espiritu was already in the nature of an appeal, the OGA endorsed the matter to the Office of the General Counsel (OGC) for appropriate action.

On 12 September 2019, the OGC issued a Letter-Order directing Appellant Banaria-Espiritu to file an appeal memorandum within fifteen (15) days from receipt thereof, with a caveat that failure to comply with the same will result in Letter-Order of the OGA becoming final and executory. The same was received by the Appellant Banaria-Espiritu on 20 September 2019.

On 8 October 2019, Appellant Banaria-Espiritu filed a Notice of Appeal and Appeal Memorandum praying that the Letter-Order of the OGA be set aside for alleged lack of legal and factual basis.

In its *Comment* dated 19 December 2019, the OGA reconsidered its findings on Halifax Capital Resources, Inc. but maintained its findings on C.M. Pancho Construction, Inc., and thus prayed for the denial of the Appeal on the ground that Appellant Banaria-Espiritu failed to comply with the terms of the Conditional Accreditation.

ISSUE

Whether or not the OGA committed reversible error in denying the application of Appellant Banaria-Espiritu for Group C Accreditation.

RULING

At the outset, the Commission notes that the Appeal was filed on 8 October 2019 or eighteen (18) days after Appellant Banaria-Espiritu received the OGC Letter-Order.

Section 3-2, Rule III, Part V of the 2016 Rules of Procedure of the Securities and Exchange Commission (the "2016 Rules") provides for the period within which to file an appeal, to wit:

> "**SEC. 3-2**. **Period of Appeal**.- An appeal to the *Commission En Banc* may be taken within fifteen (15) days from the receipt by the party to an action of the adverse decision, final order or resolution of a Director of an Operating Department or the Special Hearing Panel."

[4] Received by the OGA dated 20 August 2019.

Section 2-4, Rule 1, Part IV of the 2016 Rules provides that "*if no appeal or motion for reconsideration is filed within the period fixed in these Rules or the Rules of Court, the decision, final order or resolution of the Commission En Banc, Special Hearing Panel or the Director of the Operating Department, as the case may be, shall become final and executory*." (Emphasis supplied)

On the basis of the afore-quoted provisions of the 2016 Rules, the Appeal having been filed beyond the 15-day period has rendered the OGA Letter-Order final and executory.

While the Commission is mindful of the general rule upholding the importance of adjective law in ensuring the effective enforcement of substantive rights through the orderly and speedy administration of justice, the interest of substantial justice justifies the relaxation of the rules and the resolution of the instant case on the merits.[5]

Coming now on the substantive issue, Appellant Banaria-Espiritu assailed the OGA Letter-Order on the ground that the same was devoid of legal and factual basis.

The OGA Letter-Order denied the application for Group C Accreditation of Appellant Banaria-Espiritu on the basis of a finding of material disclosure deficiencies and minor misstatements in the AFS of C.M. Pancho Construction, Inc., in violation of the terms of the conditional accreditation. The findings of the OGA and the corresponding justifications made by Appellant Banaria-Espiritu are summarized as follows:

Components of Financial Statements	**Finding of Non-Compliance**	**Response of Appellant Banaria-Espiritu**
Cash Flows	Cash flows from financing activities should be reported gross by major class of cash receipts and major class of cash payments and not as increase or decrease in the relevant accounts. (PAS 7, par. 21)	The "proceeds from loans, net of payments" under the cash flows from financing activities reflected the amount in gross. There was no proceeds from loans but payments only. Proceeds of bank loans and payments fall under

[5] It is settled that liberal construction of the rules may be invoked in situations where there may be some excusable formal deficiency or error in a pleading, provided that the same does not subvert the essence of the proceeding and connotes at least a reasonable attempt at compliance with the rules. After all, rules of procedure are not to be applied in a very rigid, technical sense; they are used only to help secure substantial justice. (Bank of the Philippine Islands v. Court of Appeals, G.R. No. 168313, [October 6, 2010])

		exception No. 3 (PAS 7.22-24) i.e. deposits by financial institutions, which allows net basis reporting.
		Note 14 mentioned that the maturity is beyond one year, hence, it should be presented under the financing activities. In a construction business, collection of billings usually takes more than a year to collect particularly receivables from Government Agencies. Management decided to classify this account as non-current activity.
Cash Flows	Considering that the "Other non-current liabilities" represents obligation from customers and are deductible from succeeding contract billing, the cash flows arising from additional non-current liabilities should have been recognized under the operating activities. (PAS 7)	Note 14 mentioned that the maturity is beyond one year, hence, it should be presented under the financing activities. In a construction business, collection of billings usually takes more than a year to collect particularly receivables from Government Agencies. Management decided to classify this account as non-current activity.
Liabilities	The accounting policy on "Trade and Other Payables" is not in accordance with the standards. PFRS 9 requires that this type of financial liabilities should be measured initially and subsequently on fair value.	Trade and other payables is comprised of Payable to Suppliers and Sub-Contractors. It also consists of statutory obligations such as payment of taxes. These obligations are short term and not discounted, hence initially recorded at its normal cost or face value.

		PFRS 9 contains a fair value option, hence, does not require that those type of financial liabilities be initially and subsequently measured at fair value.

After a careful review of the arguments and justifications presented by Appellant, the Commission does not find any compelling reason to disturb the findings of the OGA.

Appellant Banaria-Espiritu failed to report the cash flows from financing activities of CMPCI on a gross basis.

In its review of the AFS of C.M. Pancho Construction, Inc. (CMPCI), the OGA found that Appellant Banaria-Espiritu reported the cash flows from financing activities as increase or decrease in the relevant accounts, and not as gross by major class of cash receipts and major class of cash payments and not as increase or decrease in the relevant accounts required under PAS 7, Par. 21.

In her Appeal, Appellant Banaria-Espiritu alleged that she complied with PAS 7 because she fully disclosed in the Notes to AFS that the amount stated in the Statement of Cash Flows under Financing Activities was stated in gross. Appellant Banaria-Espiritu also alleged that since the relevant account involves cash receipts and payments relating to deposits by financial institutions, the same is considered as an exception[6] to the general rule of reporting gross receipts and payments under PAS 7. Considering that the item covers proceeds of bank loans and payments, Appellant Banaria-Espiritu argued that net basis reporting is allowed.[7]

At the outset, the Commission notes that Appellant Banaria-Espiritu admitted that she reported the cash from bank loans and payments (under financing activities) as net, and justified the same as an exception under PAS 7.22-24.

Paragraphs 22-24 of PAS 7 provides:

> "Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:
>
> a) Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

[6] PAS 7.22-24
[7] Par. 14 (page 4) of the Appeal

b) The placement of deposits with and withdrawal of deposits from other financial institutions; and
c) Cash advances and loans made to customers and the repayment of those advances."

A careful reading of the afore-quoted provision will readily reveal that cash from bank loans is not included in the list of recognized exceptions. In fact, nowhere in Paragraphs 22-24 of PAS 7 can we find, even by implication, that the exceptions extend to or cover cash from bank loans. It bears emphasis that the transaction between the bank and Appellant Banaria-Espiritu's client, CMPCI, was a loan and not a deposit. The OGA was thus correct in finding that Appellant Banaria-Espiritu failed to report the financing activities of CMPCI in gross as required under PAS 7.[8] Considering that the account involved is significant i.e. "Banks and other loans" is 25% of the total non-current liabilities and 12% of the total assets, the OGA correctly considered the same as a material disclosure deficiency.

Appellant Banaria-Espiritu failed to recognize the cash flows arising from "additional non-current liabilities" under "operating activities".

In relation to the finding of the OGA that Appellant Banaria-Espiritu failed to recognize the cash flows arising from additional non-current liabilities under operating activities, the latter argued that the nature of the business of her client i.e. construction has prompted management to classify its collectibles as "non-current activities", and thus present the same in the AFS under "financing activities". Moreover, Appellant Banaria-Espiritu argued that the other non-current liabilities represent advance payments from customers and are thus considered as a liability account until a recoupment is made. This, according to Appellant, is in the nature of a "Non-Current Liability" which is exempted from the gross reporting requirement. [9]

The Commission finds the argument of Appellant Banaria-Espiritu to be misplaced. A careful review of the finding of the OGA will reveal that the material disclosure deficiency relates to the failure of Appellant to classify the cash flows arising from "Other non-current liabilities" under operating activities, and not on the manner of reporting which the exceptions under PAS 7.22-24 cover. Considering that the account involved is significant i.e. "Other non-current liabilities" account for 75% of the total non-current liabilities and 64% of the total liabilities, the OGA correctly considered the same as a material disclosure deficiency.

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[8] PAS 7 (*Statement of Cash Flows*) requires an entity to present a statement of cash flows as an integral part of its primary financial statements. Cash flows are classified and presented into operating activities (either using the 'direct' or 'indirect' method), investing activities or financing activities, with the latter two categories generally presented on a gross basis.
[9] Pars. 17 to 19 (page 4) of the Appeal

Appellant Banaria-Espiritu failed to measure the "Trade Payables" of CMPCI at fair value.

Finally, the OGA found that the accounting policy used by Appellant Banaria-Espiritu on "Trade and Other Payables" was not in accordance with the standards because the latter recorded the same at nominal cost or face value.

In its Appeal, Appellant Banaria-Espiritu admitted that the "Trade and Other Payables" of CMPCI are current liabilities which in practice, are not discounted anymore because the difference between the face amount and the present value is usually not material and is thus ignored. She likewise admitted that "Trade and Other Payables" of CMPCI are recorded at face value since they are short term obligations, consisting mainly of payables to suppliers, subcontractors, and other statutory obligations, and are thus not discounted.[10]

To justify the foregoing, Appellant Banaria-Espiritu argued that trade and other payables consists of statutory obligations which include payment of taxes, and are short term and not discounted, hence, should be recorded initially at its face value. Appellant Banaria-Espiritu also argued that the final version of PFRS 9 dated 24 July 2014 provides for Fair Value Option which allegedly does not require that trade and other payables be initially and subsequently measured at fair value.

Section 4.2 of PFRS provides that "*an entity shall classify all financial liabilities as subsequently measured at amortized cost, except for:*

a) Financial liabilities at fair value through profit or loss. Such liabilities including derivatives that are liabilities, shall be subsequently measured at fair value.
b) Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies.. Paragraphs 3.2.15 and 3.2.17 apply to the measurement of such financial liabilities.
c) Financial guarantee contracts.. After initial recognition, an issuer if such a contract shall (unless paragraph 4.2.1(a) or (b) applies) subsequently measure it at the higher of:
    i. The amount of the loss allowance determined in accordance with Section 5.5, and

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[10] Par. 84 (page 8) of the Appeal.

ii. The amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principle of IFRS 15.

d) Commitments to provide a loan at a below-market interest rate. An issuer of such commitment shall (unless paragraph 4.2.1(a) applies) measure it at the higher of:

i. The amount of the loss allowance determined in accordance with Section 5.5 and

ii. The amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principle of IFRS 15.

e) Contingent consideration recognized by an acquirer in a business combination to which AFRS 3 applies. Such contingent consideration shall subsequently be measured at fair value which changes recognized in profit or loss.

A cursory reading of the afore-quoted provision will readily reveal that recording of financial liability at its nominal cost or face value is not recognized, contrary to the assertion of Appellant Banaria-Espiritu. Considering that the “Trade and Other Payables” subject of the review accounts for 98% of the current liabilities and 18% of the liabilities, the OGA correctly classified and found the same to be a material disclosure deficiency.

Appellant Banaria-Espiritu failed to comply with the terms and conditions of the Conditional Accreditation.

The Conditional Accreditation provides, among others, a condition that “*the final approval of the accreditation, which shall be effective for three (3) years, shall not be granted unless the said AFS are complaint with the effective accounting standards and SRC Rule 68”,* which was accepted by Appellant Banaria-Espiritu. The OGA denied the application of Appellant Banaria-Espiritu for accreditation under Group C on the ground that she failed to comply with the conditions in the Conditional Accreditation, based on the finding of material disclosure deficiencies in the AFS of CMPCI. The records reveal that the findings of the OGA were admitted by Appellant Banaria-Espiritu in her Appeal. The OGA thus correctly found that Appellant Banaria-Espiritu failed to comply with the terms of the Conditional Accreditation. The Commission do not find any compelling reason presented in the Appeal which would warrant the reversal of the Letter-Order of the OGA.

Moreover, Rule 68 of the SRC specifically requires that the accreditation applicants’ quality of audit work based on the evaluation of the financial statements of clients shall be acceptable in reference to the conditions provided under Annex "68-A".[11]

"Annex "68-A" of Rule 68 provides:

2. Group C or D Applications

B. An application for accreditation under Group C or D shall be denied if upon evaluation, the AFS of top (2) clients show that there are material deficiencies or misstatements therein as follows:

xxx.

(ii) The auditor's report does not substantially comply with the Philippine Standards on Auditing, SRC Rule 68 and other relevant regulations."

The findings of material disclosure deficiencies of the OGA which was admitted by Appellant Banaria-Espiritu in her appeal also warrants the denial of her application for accreditation on the ground that the same violated Rule 68 of the SRC.

WHEREFORE, premises considered, the Memorandum of Appeal filed by appellant Banaria-Espiritu is hereby **DENIED** for lack of merit. The Letter-Order of OGA is hereby **AFFIRMED**.

SO ORDERED.

Pasay City, Philippines, 21 May 2020.

EMILIO B. AQUINO
Chairperson

EPHYRO LUIS B. AMATONG
Commissioner

JAVEY PAUL D. FRANCISCO
Commissioner

KELVIN LESTER K. LEE
Commissioner

KARLO S. BELLO
Commissioner

[11] See Rule 68 No. 3(B)(iv)(ii)(3).