SEC Memorandum Circular No. 5

Series of 2002

RE : ACCREDITATION AND REPORTORIAL REQUIREMENTS OF EXTERNAL AUDITORS OF PUBLIC COMPANIES

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, the Commission hereby adopts a policy on the accreditation of external auditors and their reporting requirements. High qualification standard and strict reporting obligations for external auditors of public companies shall be maintained and monitored through a system that will encourage quality control and disciplined financial environment.

SEC. 2. Coverage

This Circular shall be enforceable upon all public companies and their external auditors, including the auditing firms, which such auditors are co-owners/partners or employees.

SEC. 3. Definition of Terms Under this Circular

3.1. External Auditor �means a 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. Misapplication of accounting policies.

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.

iii. Misapplication of accounting policies.

3.4. A public company means any of the following issuer of securities:

i. An issuer which has sold a class of its securities pursuant to a registration under Section 12 of the Securities Regulation Code (Code). However, its status as a public company shall be suspended when it notifies the Commission at the beginning of the fiscal year that it has less than one hundred (100) holders of such class of securities.

ii. An issuer with a class of securities listed for trading In an Exchange; and

iii. An issuer with assets of at least Fifty million pesos (P50,000,000.00) or such other amount as the Commission shall prescribe, and having one hundred (100) or more holders each holding at least One hundred (100) shares of a class of its equity securities. In any event, the issuer shall no longer be considered as a public company once it notifies the Commission at the beginning of the fiscal year that the number of its holders holding at least one hundred (100) shares is reduced to less than One hundred (100).

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 regular audit.

4.2. The accreditation of an auditing firm shall not cover its signing partners and auditors under its employment. The auditor/signing partner responsible for the engagement must be separately accredited by the Commission.

4.3. The accreditation of an external auditor does not exonerate the reporting public 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.

4.4. 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.

4.5. The accreditation of an external auditor and/or auditing firm shall expire or it shall be automatically delisted after a period of three (3) years unless renewed before said date.

SEC. 5. General Qualification Requirements

5.1. Individual External Auditors

i. He shall be in good standing 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;

iv. At the time of application, the external auditor (i.e. individual practitioners or signing partner in an auditing firm) shall have at least five (5) years experience in external audits, of which no less than two (2) years thereof must be in auditing a public company.

v. The audit experience in item (iv) above refers to experience acquired as an in-charge, manager or partner or their equivalent.

vi. At the time of application, he must have/had been engaged as external auditor by at least five (5) active corporate clients with assets of at least P50 million each.

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 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 general qualification requirements under Section 5.1 (i) to (vi) 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.

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

i. Copy of updated PRC license and a Certification that the Certificate of Registration as a public practitioner issued by BOA/PRC is still existing and effective;

ii. Notarized certification of the external auditor that he is in compliance with the general qualification requirements under Section 5.1 (i) to (iii) 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.

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 Privilege Tax Receipt (PTR);

ii. Certification that the Certificate of Registration as a public practitioner issued by BOA/PRC to the firm is still existing and effective;

iii. 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;

iv. Summary of contracts/agreements with companies 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 (i) to (ii).

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. Certification that the Certificate of Registration with BOA/PRC is still existing and effective;

ii. Notarized certification that the firm is in compliance with the general qualification requirements under Section 5.2 (i).

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).

SEC. 8. Reportorial Requirements

8.1. The client-company shall disclose to the Commission on SEC Form 17-C within five (5) days from receipt of the findings from its external auditors, the matters indicated under Section 8.3 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.

8.2. Every contract of engagement shall include an arrangement that in case the client-company fails to comply with the reportorial requirement in Section 8.1, 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. In the event however that the external auditor, within the 30-day period, has become aware that the client-company will not submit the relevant SEC Form 17-C to the Commission, or entertains any doubt as to submission of said disclosure, the external auditor shall furnish the Commission a copy of his final adjusting entry not later than the 35th business day from the submission of his findings to the client-company.

8.3. 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.

8.4 The external auditor shall submit its findings to the client-company�s management/audit committee. The adverse findings in 8.3 (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.

8.5. 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 8.2.

8.6. 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. 9. Grounds for Suspension or Delisting of Accreditation

9.1. An external auditor�s accreditation shall be suspended or delisted, after due notice and hearing by the Commission, under any of the following circumstances:

a. Failure to submit the report required under Section 8.2 of this Circular in case of non-disclosure under SEC Form 17-C by the client-company;

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

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

i. Application for accreditation;

ii. Report required under Section 8.2 of this Circular;

iii. 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;

iv. Notarized certification of the external auditor that he is in compliance with the general qualification requirements under Section 5.1 (i) to (vi) 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.

d. 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;

e. 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.

f. 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.

9.2. 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.

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

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

b. 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;

c. 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:

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

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

d. 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.

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

SEC. 10. Sanctions

10.1. Failure to comply with the foregoing requirements shall subject the auditing firm and the responsible external auditor, after due notice and hearing, to the following scale of fines:

	Auditing Firm	External Auditor
First Offense	P 50,000.00	P 25,000.00
Second Offense	100,000.00	50,000.00
Third Offense	150,000.00	100,000.00

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

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

10.4 Any company covered by this Circular that knowingly engages the services an external auditor who is not accredited by the Commission shall be subject to a penalty of P100,000.00 without prejudice to other administrative sanctions provided under Section 54 of the Securities Regulation Code and its implementing rules and regulations.

SEC. 11. Gender Neutral

It is understood that for purposes of this Circular, the pronoun �he� shall be gender neutral and shall refer to both male and female where applicable.

SEC. 12. Effectivity Clause

This Circular shall take effect beginning January 01, 2003 and will cover audited financial statements for the fiscal year ended June 30, 2003 and thereafter.

Signed on behalf of the Commission on June ____, 2002, Mandaluyong City, Philippines.

(Original Signed)

LILIA R. BAUTISTA
Chairperson