



OFFICE OF THE GENERAL ACCOUNTANT

NOTICE

TO : PUBLICLY-LISTED COMPANIES (COVERED ENTITIES), AUDIT FIRMS, AND OTHER CONCERNED PARTIES

SUBJECT : REQUEST FOR COMMENTS ON THE EXPOSURE DRAFT OF THE PROPOSED REVISED RULES AND REGULATIONS OF THE SEC OVERSIGHT ASSURANCE REVIEW (SOAR) INSPECTION PROGRAM

The Commission hereby requests comments and/or inputs on the attached draft of the Proposed Revised Rules and Regulations of the SEC Oversight Assurance Review (SOAR) Inspection Program.

The written comments on the exposure draft must be submitted to the Office of the General Accountant (OGA) via electronic mail at secoga@sec.gov.ph on or before **27 May 2024 (Monday)**.

Issued on 10 May 2024.



SEC MEMORANDUM CIRCULAR NO. _____
Series of 2024

TO : PUBLICLY-LISTED COMPANIES (COVERED ENTITIES), AUDIT FIRMS, AND OTHER CONCERNED PARTIES

SUBJECT : REVISED RULES AND REGULATIONS OF THE SEC OVERSIGHT ASSURANCE REVIEW (SOAR) INSPECTION PROGRAM

DATE : _____

WHEREAS, the Securities and Exchange Commission (“SEC” or “Commission”) issued Memorandum Circular 12, Series of 2021 - Revised Rules and Regulations on the Implementation of the SEC Oversight Assurance Review (SOAR) Inspection Program (MC 12-21), to implement the declared State policies under the Securities Regulation Code (SRC), adopting for this purpose the applicable principles and best practices in other jurisdictions;

WHEREAS, the Commission is mandated under the SRC to promote the development of the capital market, protect investors, ensure full and fair disclosures about securities, and minimize, if not totally eliminate, fraudulent or manipulative devices and practices that create distortions in the free market¹;

WHEREAS, Section 179(d) of the Revised Corporation Code (RCC)² specifically authorizes the Commission to promote corporate governance and to protect minority investors, through the issuance of rules and regulations consistent with international best practices, including but not limited to the Principles of Corporate Governance adopted by the Organization for Economic Cooperation and Development (OECD), the Principles on Securities Regulation of the International Organization of Securities Commission (IOSCO)³; and the Charter and Core Principles of the International Forum of Independent Audit Regulators (IFIAR)⁴;

WHEREAS, the Commission is a member of the IOSCO, recognized as a global standard-setter for the securities sector, which implements IOSCO Principles 19, 20, and 21 (Securities Regulation) prescribing that auditors should be subject to adequate levels of oversight, independent of the issuing entity that is subject of the audit, and that the quality of the audit standards should be high and internationally acceptable;

WHEREAS, the Commission is an active member of the IFIAR, an international organization of independent audit regulators from fifty-four (54) jurisdictions, which recognizes under its Charter, the qualification and independence of the Commission to conduct an independent audit oversight program that will serve the public interest, promote and enhance investor protection by improving audit quality;

¹ Section 2 of the SRC.

² Republic Act No. 11232.

³ Under IOSCO’s Principles 19, 20, and 21 on securities regulation, auditors should be subject to adequate levels of oversight, independent of the issuing entity they audit, and audit standards should be of high and internationally acceptable quality.

⁴ Under the IFIAR’s Charter to conduct an independent audit oversight program primarily to serve the public interest and enhance investor protection through improving audit quality

WHEREAS, the Commission is an active member of the ASEAN Audit Regulators Group (AARG), a regional organization of independent audit regulators in the Southeast Asia that aims to foster collaboration amongst audit regulators, for the purpose of promoting audit quality in the ASEAN region, an effort that effectively complements IFIAR's initiatives to uphold the standards of audit quality globally;

WHEREAS, the Commission adheres to, and adopts the Principles of Corporate Governance on Disclosure and Transparency of the OECD, which states that "*the designation of an audit regulator, independent from the profession, and who, at a minimum, conducts recurring inspections of auditors undertaking audits of public interest entities, contributes to ensuring high quality audits that serve the public interest consistent with the Core Principles of IFIAR*". Further, the Principles of Corporate Governance on Disclosure and Transparency of the OECD states that "*an annual external audit should be conducted by an independent, competent and qualified auditor in accordance with internationally recognized auditing, ethical and independence standards in order to provide reasonable assurance to the board and shareholders on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.*" As such, the Code of Corporate Governance prescribed by the Commission for all public companies and registered issuers provides for Principle 9, which recommends that the company should establish standards for the appropriate selection of an external auditor and exercise effective oversight of the same to strengthen the external auditor's independence and enhance audit quality;

WHEREAS, the World Bank (WB) and the International Monetary Fund (IMF) have, in their 2017 Report on the Observance of Standards and Codes in Accounting and Auditing (ROSC)⁵, recommended the establishment of an independent, comprehensive system of audit quality assurance with risk-based inspection in the Philippines. The Commission adheres to the recommendation of WB and IMF, which aims, among others, to enhance investors' confidence and boost capital market performance, to encourage more investment and lending, thereby contributing to increased private sector growth and development, and to strengthen the international financial architecture and greater financial stability of the Philippines;

WHEREAS, the Commission adheres to the recommendations of the Asian Development Bank (ADB) embodied in its Diagnostic Studies of Accounting and Auditing for the Philippines, which aims to meet international accounting standards and best practices by strengthening financial management and monitoring for sustained economic development;

WHEREAS, to ensure the effective implementation of its mandate, Section 5 of the SRC provides for the general grant of authority to the Commission, among others, to formulate policies on issues concerning the securities markets; to prepare, approve, amend or repeal rules, and regulations covering all aspects of the securities market; and to regulate, investigate or supervise the activities of the covered entities to ensure compliance⁶; while Section 68 of the SRC provides for the specific authority to make, amend, and rescind accounting rules and regulations to carry out the provisions thereof;

WHEREAS, Section 177 of the RCC requires covered corporations to submit, among others, annual financial statements audited by an independent certified public accountant; while Section 162 of the RCC punishes any person who willfully certifies a report required under the Code, knowing that the same contains incomplete, inaccurate, false, or misleading information or statements; further, Section 163 of the RCC punishes an independent auditor who, in collusion with the corporation's directors or representatives, certifies the corporation's financial

⁵ 2017 Report on the Observance of Standards and Codes in Accounting and Auditing (ROSC); Source: <https://cfr.worldbank.org/publications/philippines-accounting-and-auditing-report-observance-standards-and-codes>

⁶ Secs. 5(a) and (d) of the SRC.

statements despite its incompleteness or inaccuracy, its failure to give a fair and accurate presentation of the corporation's condition, or despite containing false or misleading statements.

WHEREAS, Section 178 of the RCC further expanded the powers and authority of the Commission over corporations, partnerships and associations, with the grant of visitorial powers over the latter, which include the examination and inspection of records, the regulation and supervision of activities, enforcement of compliance, and the imposition of appropriate sanctions;

WHEREAS, in the performance of its function as an integrated regulator and independent gatekeeper, the Commission is duty-bound to oversee all persons that perform an act that affects the entirety of the financial reporting ecosystem, which includes the preparers of the financial statements, the financial reporting oversight bodies, i.e., board of directors, independent directors, or audit committees, external auditors, asset valuers or appraisers, and credit rating agencies, consistent with international best practices and IOSCO's principles;

WHEREAS, the applicable principles, internationally accepted best practices, and the recent developments in international securities regulation, which will promote the effective implementation of the SOAR Inspection Program and ensure the attainment of its objectives, necessitate the amendment of MC 12-21. For this purpose, it is equally necessary to amend the name of the program from SEC Oversight Assurance Review (SOAR) Inspection Program to **SEC Audit Inspection (SEC AI)**;

NOW THEREFORE, pursuant to the authorities and powers vested upon the Commission under the RCC and SRC, and consistent with the principles of good corporate governance, all covered entities with their respective audit firms shall strictly comply with the provisions herein.

Section 1. Objective

- 1.1 These Revised Rules and Regulations are intended to provide guidance for the implementation of the SEC Audit Inspection, which is primarily designed to protect the public interest and enhance investor protection by improving the quality of the audits of financial statements of the covered entities conducted by audit firms and external auditors. The SEC Audit Inspection aims to promote high-quality audits for more transparent, accurate and credible financial reporting to maintain and enhance investors' trust and confidence in the capital market. It primarily supports and enhances the credibility and reliability of the financial statements of the covered entities and the audit opinions issued by the audit firms/external auditors that are relied upon by investors, lenders and other stakeholders in making economic decisions. It is also designed to promote compliance with the Commission's other regulatory financial reporting requirements.

Section 2. Definition of Terms

- a) **Audit** refers to a systematic and independent examination of financial statements performed by an independent auditor, with the objective of obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Independent audit is legally required to enhance the degree of confidence of the intended users in the financial statements. This is also referred to as "statutory audit" under this Circular.
- b) **Independent Auditor/External Auditor** refers to a person, who performs an independent audit, usually the engagement partner or other members of the engagement team who are employed by the audit firms.

- c) **Audit Firm/Firm** refers to a form of partnership of professional accountants registered with the Commission for the purpose of engaging primarily in the general practice of public accounting (e.g., statutory audits of financial statements of the covered entities).
- d) **Auditing Standards** refers to a set of standards known as the Philippine Standards on Auditing or PSA used by auditors when conducting an audit of a company's financial statements. PSA is promulgated by the Philippine Auditing and Assurance Standards Council and approved by the Board of Accountancy (BOA) Professional Regulation Commission. The SEC adopts these standards for implementation by audit firms and independent auditors in conducting statutory audits of the company's financial statements.
- e) **Covered Entities** refer to issuers⁷ of classes of securities registered with the Commission and listed for trading in Exchanges.
- f) **Engagement Team** refers to all partners and staff performing the engagement and any other individuals who perform procedures on the engagement, excluding an external expert and internal auditors who provide direct assistance on an engagement⁸.
- g) **Philippine Standards on Quality Management (PSQM) 1 & 2** refer to the standards that deal with the firm's responsibilities for its systems of quality management for audits and reviews of financial statements and other assurance and related services engagements, including the firm's responsibilities relating to the performance and documentation of an engagement quality review (EQR). PSQM 1 & 2 are promulgated by the AASC and approved by the Board of Accountancy (BOA) Professional Regulation Commission. The SEC adopts these standards for implementation by the audit firms and external auditors. This is referred to as "quality management standards" under this Circular.
- h) **The Philippine Code of Ethics for Professional Accountants** refers to the standard that sets out fundamental principles of ethics for professional accountants, reflecting the profession's recognition of its public interest responsibility. The said Code is promulgated by the PICPA Ethics Committee and approved by the Board of Accountancy (BOA) Professional Regulation Commission. The SEC adopted this standard for implementation by audit firms and independent auditors in relation to the conduct of financial statement audits. This is referred to as "ethical standards" under this Circular.
- i) **Reasonableness Assurance** refers to a high, but not absolute, level of assurance in the context of an audit of financial statements⁹.
- j) **Those Charged with Governance** refers to the person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.

Section 3. The SEC Audit Inspection

- 3.1 The SEC Audit Inspection, previously known as the SEC Oversight Assurance Review or SOAR Inspection Program, is an initiative of the Commission to conduct a review of financial statement audits of the covered entities by reviewing portions of the audit firm's working papers to ensure compliance with applicable professional standards. The inspection also

⁷ Issuer is any entity authorized by the Commission to offer to sell, sell or promote the sale to the public of its equity, bonds, instruments of indebtedness and other forms of securities. (*Revised Securities Regulation Code, Rule 68*).

⁸ Source: Philippine Standard on Quality Management 1, Quality Management for Firms that Performs Audits or Review of Financial Statements, or other Assurance or Related Service Engagements

⁹ Source: Philippine Standard on Auditing 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Philippines Standards on Auditing.

covers the review of the audit firm's systems of quality management or internal controls, which aims to ensure compliance with applicable systems of quality management standards, including independence and ethical requirements. This ensures that an audit firm has the design, implementation, and operations of an effective quality management system for financial statement audits of the covered entities.

- 3.2 The SEC Audit Inspection is conducted by the Commission's Office of the General Accountant (OGA), through the SEC Audit Inspection Division (SEC AID).
- 3.3 In selecting the financial statement audits for review, the OGA follows both risk-based and random selection methods. Selections are based on internal evaluation of audits with heightened risk of material misstatements to the issuer's financial statements and those with challenging audit areas and other risk-based characteristics. To incorporate an element of unpredictability, a random selection of financial statement audits may be necessary.
- 3.4 In certain situations, the Commission may select more than one (1) of the firm's audit engagements for review. The selection of audits for review does not constitute a representative sample of the firm's total population of audit engagements.

Section 4. Scope and Applicability

These Rules shall apply to all covered entities and their respective audit firms engaged in conducting statutory audits of financial statements. For this purpose, the covered entities shall require their respective audit firms engaged in conducting statutory audits of financial statements to undergo and be subject to the audit inspection under this Circular.

Section 5. The SEC Audit Inspection Organization

- 5.1 The SEC Audit Inspection Team
 - a. The inspections shall be done by the Audit Inspection Team ("Audit Inspection Team"), composed of an Audit Inspection Team Leader, Deputy Audit Inspection Team Leaders, and reviewers.
 - b. The Audit Inspection Team shall be under the supervision of the General Accountant. It shall undertake its tasks based on policies and procedures following international best practices set by the Commission *En Banc* to ensure effective implementation.
- 5.2 Commission *En Banc*
 - a. The OGA's Inspection Reports and Evaluation Report of Firm's Remediation, which are based on the results of the inspection and firm's remediation, shall be approved by the Commission *En Banc* before said reports are released to the inspected firm.
 - b. Sanctions imposed by the OGA on firms and/or auditors may be appealed to the Commission *En Banc* in accordance with the existing Rules of Procedures of the Commission.

Section 6. Rules of Conduct on Independence and Confidentiality

- 6.1 The SEC commissioners, directors and members of the SEC Audit Inspection Team are all independent of the covered entities, audit firms, audit profession, professional accountancy and auditing bodies.

No personnel of the Commission are practicing auditors or employed by or affiliated with an audit firm. Personnel who are former auditors or former employees of the covered entity must have an appropriate cooling off period before they participate in the conduct of inspection they were previously associated with as an employee.

- 6.2 To ensure impartiality and avoid conflict of interest, no related fees shall be charged to the covered entities and audit firms for the conduct of SEC Audit Inspection.
- 6.3 The Commission and Audit Inspection Team members are guided by the principles set out in the "Rules of Conduct for Commissioners, Officers and Employees" as provided for under SRC Rule 6.2, as well as in the "Independence Policy Applicable to the Audit Inspection" approved by the Commission *En Banc*.
- 6.4 The Audit Inspection Team members shall keep the information obtained during the inspections confidential and shall not use the same for any other purpose as provided for under SRC Rule 66.5 and RA 6713, Code of Conduct and Ethical Standards for Public Officials and Employees.

Section 7. Coverage, Frequency and Duration

- 7.1 The Inspection shall include both the firm-level and engagement-level reviews conducted by the Audit Inspection Team:
- a. The firm-level review refers to the evaluation of the design, implementation and effectiveness of the firm's quality management systems in accordance with the prevailing quality management and ethical standards and relevant regulatory requirements; and
 - b. The engagement-level review refers to the evaluation of the audit firm's compliance with auditing standards, ethical standards, relevant regulatory requirements, and firm policies and procedures in connection with its performance of statutory financial statements audits and issuance of audit reports.
- 7.2 Standards on Quality Management and Auditing
- a. Audit inspection is intended to enhance the quality of audits of the financial statements of covered entities. The systems of quality management to achieve this objective are set out in PSQM 1 and 2 and Philippine Standards on Auditing (PSA) 220 (Revised) or any of its subsequent amendments.
 - b. The nature and extent of the policies and procedures developed by the audit firm to comply with PSQM 1 and 2, or any of its subsequent amendments, normally depends on various factors such as the size and operating characteristics of the firm and whether it is part of a network firm.
- 7.3 Frequency of Inspection

For the respective audit firms of the covered entities, the frequency of inspection shall be once every three (3) years, except for the following:

- a. Audit firms with audited entities whose securities are publicly traded that collectively comprise 10% or more of the total market capitalization as of every 15th of April shall be inspected once every two (2) years; and

- b. If circumstances warrant, firms of covered entities may be inspected more frequently following a risk-based approach to be determined by the Commission.

The Audit Inspection Team shall determine the frequency and shall be updated on a regular basis. If there is a change in the 10% threshold during the year, such change shall be considered in the following year's assessment.

7.4 Duration of Inspections

The on-site inspection shall be conducted for a period of at least two (2) weeks. The duration of the inspection may be extended if deemed necessary.

7.5 Alternative Mode of Inspection

The manner of inspection shall be done on-site. However, for instances of extraordinary events that necessitate flexibility in the manner of inspection, such as but not limited to pandemics, natural disasters, or civil unrest, which cause travel restrictions or disruptions of business operations or render on-site inspection impracticable, the Audit Inspection Team, upon coordination with the firm, may perform a remote or virtual inspection for a period of at least three (3) weeks, subject to extensions if deemed necessary. The remote or virtual inspection shall consider the firm's policies and guidelines on confidentiality, data privacy, cybersecurity, and matters related to the acceptable use of technology.

Section 8. SEC Audit Inspection Process

- 8.1 For inspection purposes, the Commission follows a risk-based approach in selecting the audits of covered entities and the respective audit firms. Audits that may pose difficult or complex issues will be assessed considering risk factors such as the covered entity's nature, industry, market capitalization, and other potential audit concerns that may materially impact the financial statements. The Commission, however, is not precluded from prioritizing audits of certain covered entities, as the circumstances would warrant.
- 8.2 The Commission *En Banc* approves the selection of the audits of covered entities and the respective audit firms engaged in conducting the statutory audits of financial statements.
- 8.3 The Audit Inspection Team shall formally notify those charged with governance of the covered entity regarding the scheduled inspection at least sixty (60) calendar days prior to the actual date thereof. The Audit Inspection Team shall discuss the purpose, benefits, coverage, timing, and requirements of the inspection. After notifying the covered entity, the covered entity shall immediately notify its audit firm about the inspection within two (2) working days.

The audit firm shall prepare relevant information and documents as required and should be available on the first (1st) day of the scheduled inspection of the audit firm. The audit firm shall prepare the following documents to be submitted to the Audit Inspection Team within two (2) weeks from the receipt of the notification:

- a. Completed Engagement Information Form;
- b. Certification from the engagement partner that the files to be provided to the Audit Inspection Team are the original versions of the archived engagement working papers (both electronic and hard copies, as applicable).

The external auditor may also request a pre-inspection meeting for any clarifications on the requirements for the planned inspection.

- 8.4 The inspection process does not necessarily cover the entire audit engagement; rather, it concentrates on areas that present significant risks. It does not aim to fully review every single audit engagement in its attempt to evaluate the firm's quality management and the overall quality of the audit engagements that a firm undertakes. Accordingly, the inspection outcome does not provide assurance that the inspection of the firm's quality control policies, procedures, practices, and independence policies or that the financial statements audited by the firm are free of deficiencies, apart from the deficiencies noted in the inspection.

The Inspection process involves the following key steps:

- a. planning;
- b. execution;
- c. reporting; and
- d. remediation.

Section 9. Reporting

9.1 Classification of Inspection Findings

Inspection findings are classified into two (2) categories:

a. **Opportunities for improvements or enhancements**

The identified opportunities for improvements or enhancements are summarized in a Letter of Recommendations and are not carried forward to the Inspection Report. Recommendations usually relate to, but are not limited to:

- Failure to perform audit procedures that are required by the firm's policies and audit methodologies but are not material or significant violations of the requirements under PSAs;
- Minor inconsistencies in audit documentation or minor non-compliance with the documentation requirements of the PSAs that do not significantly affect the appropriateness and sufficiency of the procedures performed and/or the audit evidence obtained; or
- Other instances or cases that the Audit Inspection Team evaluates as opportunities for improvements or enhancements.

b. **Significant deficiencies**

Firm-Level

For the firm-level review, quality management findings include departures from and/or non-compliance with the requirements of applicable standards on systems of quality management or ethics and independence that may have an effect on audit quality, either due to the significance or systemic nature of the departure and/or non-compliance.

Quality management findings do not relate to specific audit engagements but instead relate to the policies and procedures in place at the firm to provide for the overall systems of quality management. Quality management findings are more systemic; they are generally relevant to the firm's audit practice, and therefore, there is an interaction between engagement-level and quality management findings. While quality management findings are attributed to a firm in general, findings on quality management systems are considered significant if such deficiencies may impact the firm's environment for individual audit engagements or internal monitoring of audit engagements. Consequently, a deficient quality management system would likely manifest in engagement-level findings. Further, findings noted at the engagement-level review, which is determined to be systemic (i.e., not engagement-specific or similar engagement findings that appear consistently in multiple engagements), may be considered deficiencies in the effectiveness of the firm's quality management system.

Engagement-level

For engagement-level review, significant audit deficiencies include the following:

- Insufficient and/or inappropriate audit procedures or audit evidence to respond to the assessed significant or high risk of material misstatement at the assertion level or the financial statement level to support the audit opinion;
- Failure to identify or address a material error in the application of the applicable financial reporting framework;
- Failure to identify or to appropriately address a material misstatement in the financial statements either due to fraud or error, including failure to comply with material disclosure requirements;
- Failure to issue an appropriate audit opinion; and/or material misrepresentation in the auditor's report;
- Failure to include in the auditor's report the material information required by the relevant PSAs or regulatory requirements;
- Failure to satisfy other material requirements of the relevant PSAs; or
- Other instances or cases that the Audit Inspection Team deems appropriate to be included as significant audit deficiencies.

The Audit Inspection Team considers whether additional audit documentation or any other evidence that a firm might provide to the Audit Inspection Team during the inspection supports the firm's claims that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of other persuasive evidence, even if the firm claimed to have performed the procedure.

The fact that one or more deficiencies in an audit reach this level of significance does not necessarily indicate that the financial statements are materially misstated. An inspection finding related to an audit engagement does not necessarily indicate that the financial statements are misstated; therefore, the audited entity's accounting and disclosure may be appropriate, whether or not the audit procedures satisfy the requirements of auditing standards. It is often not possible for the Audit Inspection Team, based only on the information available from the engagement team, to reach a conclusion on those points because the Audit Inspection Team usually only has access to the information that the engagement team retained and the issuer's public disclosures.

9.2 Letter of Findings (LOF)

Significant audit deficiencies at the engagement level and quality management findings at the firm level identified under Section 9.1 (b) of this Circular are summarized in a LOF to confirm the facts of the findings in writing and seek responses from the audit firm for each of the inspection findings identified. The LOF serves as a basis for preparing the Inspection Report. Inclusion in the LOF does not mean that the deficiency remains unremediated after the Audit Inspection Team brought it to the firm's attention.

The inspection findings in this report are based on what was documented in the final audit files in the archived working papers. This report does not consider any subsequent changes to correct any errors or deficiencies in the working papers that may or may not affect the audit conclusion. The archived working papers are viewed as the final audit files and the basis for the auditor's conclusions.

9.3 Inspection Report

The Inspection Report is the final report issued by OGA to the firm after the Commission *En Banc*'s approval. It is prepared based on the Audit Inspection Team's evaluation of the firm's reply to the LOF. The report includes all identified significant audit deficiencies and defects of the firm's internal controls systems for release to the firm (non-public), even if the firm immediately remediated the findings after the inspection.

The contents of this report are the summarized findings gathered during the inspection. Significant findings that are for remediation have been included in the Inspection Report, even for those subsequently remediated after our inspection. The Audit Inspection Team exercises judgment in determining what findings are appropriate to be included in this report following Section 9.1 (b), taking into consideration the significance of the findings to audit quality.

9.4 Evaluation Report of Firm's Remediation

The Evaluation Report of Firm's Remediation is the report issued by OGA to the firm after the Commission *En Banc*'s approval. The content of this report is the summary of findings included in the Inspection Report, the Firm and the engagement teams corresponding remedial actions for each of the identified findings, and the Audit Inspection Team's assessment of whether or not the remedial actions satisfactorily addressed the inspection findings.

9.5 Timeline of the SEC Audit Inspection

The following are the timelines to be followed upon the commencement of the audit inspection:

	Process	Period
1	<u>Visit the covered entity to notify and discuss the inspection of its audit firm</u>	<u>60 days before the commencement of the inspection</u>
2	<u>Notify the audit firm about the scheduled inspection</u>	<u>Immediately after notification of the covered entity within two (2) working days</u>
3	Opening meeting with the audit firm	On the first day of on-site inspection or fieldwork

4	Status meeting to discuss preliminary results and findings and the firm's preliminary responses	On the last day of fieldwork
5	Issuance of Letter of Recommendation and Letter of Findings (LOF) to the firm	Not earlier than 45 days from the status meeting
6	Submission of the firm's reply to the LOF	Within 30 calendar days after the issuance of the LOF
7	Issuance of Inspection Report to the firm	Within 45 calendar days after receipt of the firm's reply to the LOF
8	Submission of the firm's remediation plan, as applicable	Within 60 calendar days after the issuance of the Inspection Report
9	Remediation process	Within 12 months after the issuance of the Inspection Report
10	Issuance of Evaluation Report of Firm's Remediation	Within 30 calendar days after the end of the remediation period
11	Submission of firm's request for reconsideration, if any	Within 15 calendar days after the issuance of the Evaluation Report of Firm's Remediation
12	Publication on the SEC website of the unremediated inspection findings and/or contested findings that have attained finality in favor of the Audit Inspection Team's position and which the firm refuses to remediate	30 calendar days after the issuance of the Evaluation Report of the Firm's Remediation

Firms may request further discussions with the Audit Inspection Team after the status meeting but before the issuance of the LOF to clarify matters raised during the status meeting.

Under special circumstances, the firm may request an extension of time to reply to the LOF or Inspection Report for a number of days not exceeding fifteen (15) calendar days.

Section 10. Consultation with Resource Person/s

- 10.1 To provide expert advice to help resolve findings raised by the Audit Inspection Team that are contested by the audit firm subjected to inspection, or in other circumstances, and in which the Commission finds it necessary and appropriate; the OGA may consult with appropriate resource person/s, in a blind consultation and on a pro bono basis.
- 10.2 OGA is responsible for selecting the appropriate resource person/s and ensuring that the resource person/s is independent and objective and has the necessary competence and capabilities. Similarly, the Commission shall ensure safeguards are in place to preserve the

confidentiality of all information that the Audit Inspection Team will share with the resource person/s.

- 10.3 The Audit Inspection Team shall prepare a consultation memorandum containing details of the facts, findings and basis for the conclusion reached. The consultation memorandum shall be signed by the Audit Inspection Team Leader.
- 10.4 Prior to the consultation, the Audit Inspection Team will inform the audit firm of the particular inspection finding that will be referred for consultation to the resource person/s and that a redacted copy of the audit firm's response to the LOF shall be attached to the consultation memorandum.

The Audit Inspection Team shall ensure that any references, or any other identifying information, in the LOF as to the name of the firm, engagement partner, and covered entity are appropriately blocked out.

Within thirty (30) calendar days from the submission of the consultation memorandum to the resource person/s, the Audit Inspection Team shall arrange a meeting with the resource person/s to discuss the position of both the Audit Inspection Team and the audit firm. The Audit Inspection Team shall prepare minutes of meetings for circulation to the attendees of the meeting. If no adverse comments are received, the minutes of the meeting are considered final on the 2nd day of circulation.

- 10.5 The General Accountant, through the Supervising Commissioner, shall present the results of the consultation with the resource person/s to the Commission *En Banc*. The Commission *En Banc* shall make the final decision on the contested findings.

Section 11. Remediation

11.1 Remediation Process

After issuing the LOF to the firm and even before releasing the Inspection Report, the firm must plan how to address the significant audit deficiencies and any findings on quality management systems. The firm must identify the root causes of all findings and place effective remedial measures to address these root causes.

After the issuance of the Inspection Report, a 12-month remediation period shall be provided to the firm and the external auditor. The OGA may allow an extension of time for remedial actions in special circumstances, as requested by the firm, subject to approval by the Commission *En Banc*.

The firm must prepare and submit to the Audit Inspection Team, within sixty (60) calendar days after the issuance of the Inspection Report, a written remediation plan on how to address the significant audit deficiencies and findings on systems of quality management. If the firm has already communicated its remediation plan through its reply to the LOF, it does not need to prepare and submit the said plan separately.

The firm may provide interim written updates on the progress of its remediation or submit and present its documentation on the results of remediation procedures for the Audit Inspection Team's evaluation. All inspected firms are encouraged to have a continual dialogue with the Audit Inspection Team within the remediation period.

The Audit Inspection Team generally avoids prescribing specific remediation approaches or action steps. The Audit Inspection Team's assessment of whether the firm's efforts to

remediate a particular finding are satisfactory depends upon the team's evaluation of whether the firm has identified steps suited to the particular quality management objective and the evaluation of the nature and extent of the firm's efforts to implement those steps. For noted significant audit deficiencies, the Audit Inspection Team's evaluation depends on whether the auditors performed the necessary and appropriate audit procedures to address these deficiencies.

11.2 Evaluation of Remedial Actions

The Commission, through the OGA, shall issue an Evaluation Report of the firm's remediation within thirty (30) calendar days after the end of the remediation period. This report summarizes the Audit Inspection Team's thorough evaluation and assessment of the firm's remedial actions for each of the noted findings on quality management systems and significant audit deficiencies.

a. Consequence when OGA is not satisfied with the firm's remedial actions

Where the firm does not resolve quality management findings and significant audit deficiencies or remedial actions are not satisfactory after the end of the remediation period, the Commission shall publish the inspection findings and the firm's response or remediation plan on the SEC website. Such publication is subject to the Commission *En Banc's* approval.

Within fifteen (15) calendar days after the issuance of the Evaluation Report of Firm's Remediation, the firm may seek reconsideration of the Commission's decision to publish the report by requesting the Commission *En Banc* to review the decision again.

b. Contested Findings

Where a firm refuses to remediate the contested findings, even after proper consultations by the Audit Inspection Team with the appropriate resource person/s, and where the Commission *En Banc* affirms the finality of the decision in favor of the position taken by the Audit Inspection Team, the contested findings shall be published on the SEC website together with the Audit Inspection Team's position and the firm's reply to the specific inspection finding.

Section 12. Public Inspection Report

12.1 The Commission shall issue and publish a Public Inspection Report, which aims to provide the public with insights on observations noted during the audit inspections. This report shall include common findings on firm-wide systems of quality management, common significant audit deficiencies, and good internal controls and audit practices of the inspected firms.

The names of firms and the audit engagements inspected will not be disclosed in the Public Inspection Report.

The firms and the Audit Committees are encouraged to use the report to facilitate audit quality discussions.

12.2 Audit Quality Indicators (AQI) Disclosure Framework

In line with the Commission's commitment to protect investors, promote good corporate governance and ensure fairness, efficiency, and transparency in the market, the firms and Audit Committees are encouraged to sharpen their focus on audit quality that benefits investors and other stakeholders.

The Commission shall develop the Audit Quality Indicators (AQI) Disclosure Framework for the Audit Committees and audit firms. AQIs are a set of quantitative measures supported by qualitative factors that provide insights that contribute to or are indicative of audit quality. The objective is to provide more in-depth information about factors influencing audit quality that will enhance the dialogue between the audit firms and Audit Committees on audit quality matters to assess the performance of audit firms/external auditors. This will ultimately aid the Audit Committees in selecting and appointing appropriate external auditors and effectively exercise its oversight functions of the same to strengthen the external auditor's independence and enhance audit quality under Principle 9 of the Code of Corporate Governance.

This AQI disclosure supplements the requirements of PSQM 1, requiring the firm to communicate with those charged with governance when performing an audit of financial statements of listed entities regarding the manner in which the system of quality management supports the consistent performance of quality audit engagements.

Section 13. Inter-agency Cooperation

In order to harmonize policies and regulations across financial regulators and exchanges for effective risk management and more comprehensive solutions to collectively foster public trust and investor protection in the capital market, the SEC may coordinate with Bangko Sentral ng Pilipinas (BSP) and Insurance Commission (IC), the primary regulators of banks and insurance companies, respectively, any material findings of the covered entities audited financial statements for further assessment concerning any material implications in the prudential reporting and rules of BSP and IC. Further, the SEC may coordinate with the Philippine Stock Exchange (PSE) regarding any material findings of the covered entities' audited financial statements for further assessment concerning any material implications in the PSE's listing and disclosure rules.

Section 14. Procedures and Sanctions for Violations Identified During the Inspection

- 14.1 **Willful Certification of Incomplete, Inaccurate, False, or Misleading Statements or Reports** – If the Commission determines that the information obtained from the firm during the inspection indicates that the inspected firm or any member of the engagement team or any firm personnel willfully issues a certification and independent opinion as to the fairness of the financial statements or any certification or opinion related to financial statements knowing that the same contain incomplete, inaccurate, false, or misleading information or statements shall be penalized pursuant to Section 162 of the RCC.
- 14.2 **Independent Auditor Collusion** – If the Commission determines that the information obtained from the firm during the inspection indicates that the inspected firm, or any member of the engagement team or any firm personnel who, in collusion with the covered entities' directors or representatives, certifies the covered entities' financial statements despite its incompleteness or inaccuracy, its failure to give a fair and accurate presentation of the covered entities' condition, or despite containing false or misleading statements shall be punished pursuant to Section 163 of the RCC. Further, when the statement or report certified is fraudulent, or has the effect of causing injury to the general public, the auditor

or responsible officer shall be penalized pursuant to Section 163 of the RCC.

- 14.3 If the Audit Inspection Team determines that the information obtained from the firm during the inspection indicates that the inspected firm, any member of the engagement team or any firm personnel may have engaged in any act or omission that violates regulatory requirements, the Audit Inspection Team shall:
- a. Report information concerning such act, practice or omission to the Commission *En Banc*;
 - b. Liaise with the relevant operating departments of the Commission for further investigation of such act, practice or omission or a disciplinary proceeding in accordance with the Rules of the Commission;
 - c. Impose the appropriate penalties and fines pursuant to the provisions of the SRC and RCC; and
 - d. Publish on the SEC website the unremediated inspection findings and/or contested findings as discussed under Section 11.2 that have attained finality in favor of the Audit Inspection Team's position and which the firm refuses to remediate. The publication shall include the firm's name, while the name of the covered entities shall remain confidential.
- 14.4 Should a covered entity, without any justifiable cause, refuses or obstructs the Commission's exercise of its visitorial powers, the Commission may impose any or all of the following sanctions:
- a. A fine ranging from Five Thousand Pesos (PHP 5,000.00) to Two Million Pesos (PHP 2,000,000.00), and not more than One Thousand Pesos (PHP 1,000.00) for each day of continuing violation but in no case to exceed Two Million Pesos (PHP 2,000,000.00);
 - b. Suspension or revocation of any registration for the offering of securities;
 - c. Suspension or revocation of its certificate of incorporation;
 - d. Other penalties and sanctions within the power of the Commission to impose.
- 14.5 Applicable penalties may be imposed in accordance with the provisions of Section 170 of the RCC.

Section 15. Other Matters

15.1 Responsibility of the Covered Entities and their Respective Audit Firms to Cooperate with the SEC Audit Inspection Team

The covered entities and their respective audit firms shall cooperate with the SEC Audit Inspection Team during and until the inspection is completed. Cooperation shall include but not be limited to complying with the requests and requirements of the Audit Inspection Team to:

- a. Accommodate the visit of the SEC Audit Inspection Team for meetings and discussions;

- b. Provide access to all relevant audit quality policies and procedures and audit working papers in the custody of the firm; and
- c. Provide information through interviews and/or written responses.

At least sixty (60) calendar days before the planned inspection, the Audit Inspection Team shall send a list of firm-level and logistical requirements to allow the firm to prepare the necessary documents and arrangements.

At least thirty (30) calendar days before the planned inspection, the Audit Inspection Team shall request information relevant to the selected audit engagement, as discussed in Section 8.3.

15.2 Communications with Audit Committees or Those Charged with Governance

The Audit Committee or those charged with governance of the covered entity shall require the inspected firm to communicate to them all identified inspection findings related to the audit engagement and the actions taken by the firm to address such findings, in addition to the requirements under the applicable auditing and quality management standards on matters to be communicated with those charged with governance.

Section 16. Repealing Clause

All other rules and regulations, circulars, memoranda, or any part thereof, in conflict with or contrary to this Memorandum Circular or any portion hereof, are hereby repealed or modified accordingly.

Section 17. Effectivity and Transition

The Revised Rules and Regulations on the Implementation of the SEC Audit Inspection shall become effective fifteen (15) days after its publication in two (2) newspapers of general circulation.

For the Commission:

EMILIO B. AQUINO
Chairperson