

QAU Memo No. 1, s2020



In this issue:

The Securities and Exchange Commission (SEC) recently issued the Revised SRC Rule 68. Revisions made in the previous reporting guidelines include interpretations and clarifications issued thru Financial Reporting Bulletins, and definition of commonly used terms such as fraud, error, and significant subsidiary. Entity and accreditation categories and test of materiality were also revised. Furthermore, Registration of Securities Pursuant to the ASEAN Capital Market Integration (ACMI) was added.

R.S. BERNALDO & ASSOCIATES

TAKING YOU FURTHER

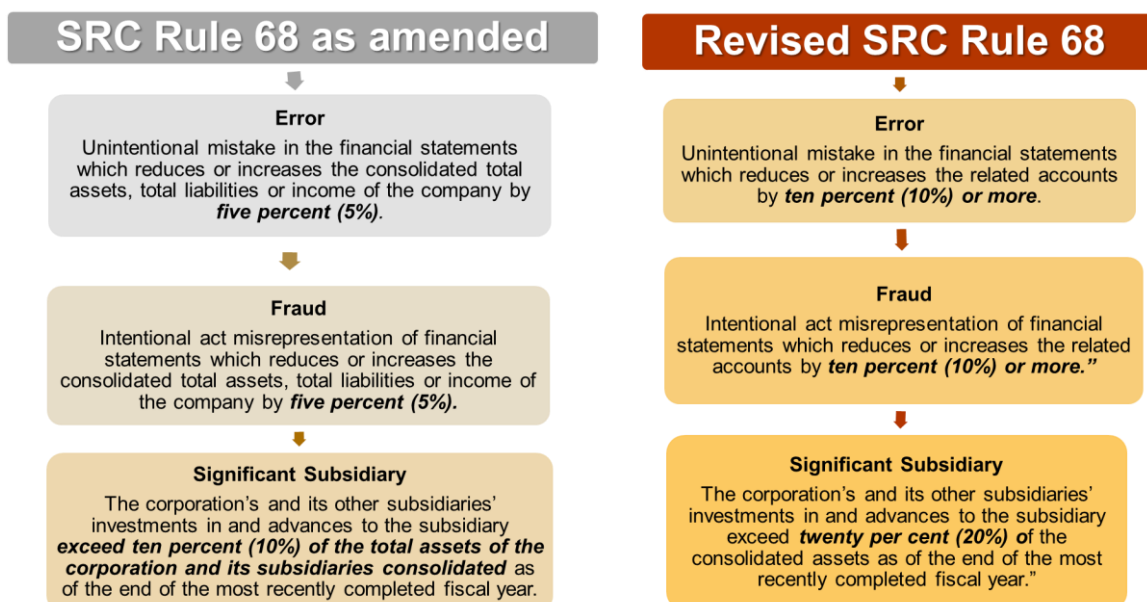
GENERAL FINANCIAL REPORTING REQUIREMENTS

Companies that meet the following threshold are required to file financial statements in SEC:

- **Stock corporations with total assets or total liabilities of ₱600,000 or more.**
(Previously, those with paid up capital stock of ₱50,000 or more.)
- **Non-stock corporations with total assets or total liabilities of ₱600,000 or more.**
(Previously, those with total assets of ₱500,000 or more, or with gross annual receipts of ₱100,000 or more.)

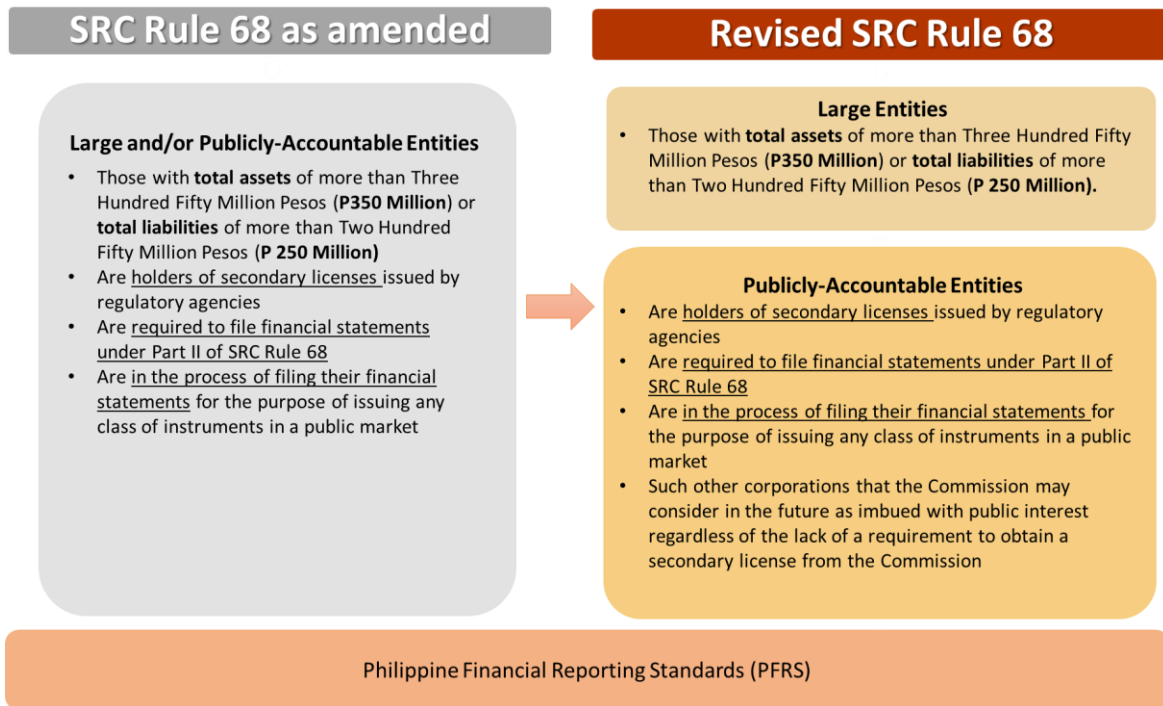
**For branch offices, representative offices and regional operating headquarters of foreign corporations, the threshold remains the same.*

Some definition of terms used in the Rule were revised as follows:



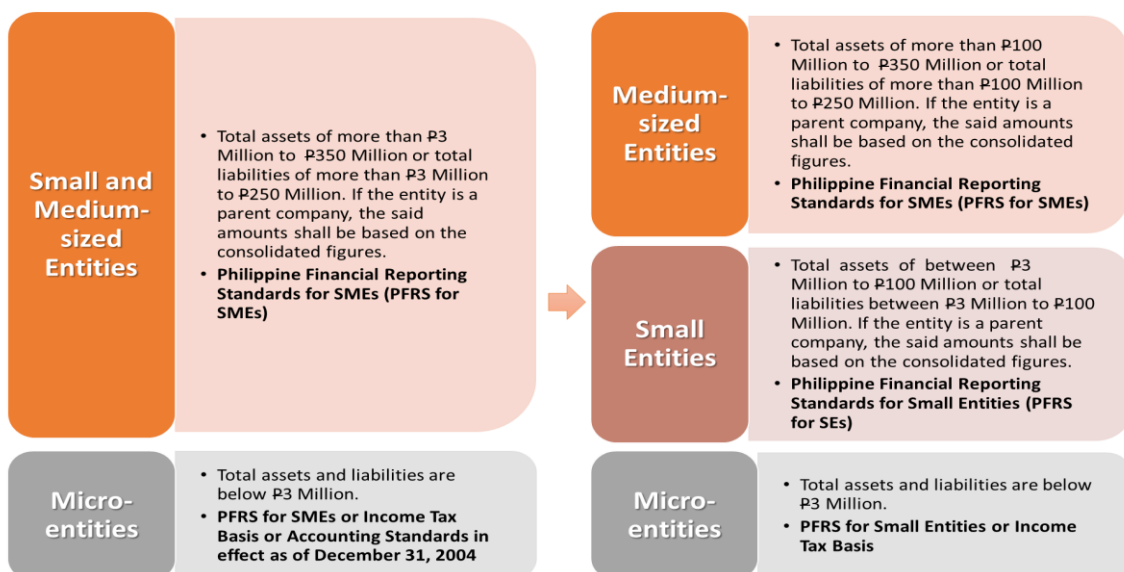
The Revised SRC Rule 68 distinguished large entity from publicly-accountable entity. Small and medium-sized entity is also separated into medium-sized and small entity. Accordingly, PFRS for Small Entities is also adopted in the Revised Rule as the reporting standards for entities that qualify as small entities.

❑ **Large and/or Publicly-Accountable Entities**



However, a set of financial reporting framework other than the full PFRSs may be allowed by the Commission for certain sub-class (e.g., banks, insurance companies) of these entities upon consideration of the pronouncements or interpretations of any of the regulatory bodies.

❑ **Medium-sized, Small and Micro Entities**



- ✓ Are **not required to file the financial statements under Part II of SRC Rule 68**;
- ✓ Are **not in the process of filing their financial statements** for the purpose of issuing any class of instruments in a public market; and
- ✓ **Are not holders of secondary licenses** issued by regulatory agencies.

Entities shall be exempt from the mandatory adoption of the PFRS for SMEs/PFRS for SEs when they meet certain criteria in which case they have an option to use PFRS/PFRS for SMEs.

In the event where an entity breached the prescribed threshold in terms of total assets or total liabilities and this it falls within a different classification, the Audited Financial Statements of said entity shall be prepared in accordance with the higher framework.

Responsibility for Financial Statements

The Statement of Management’s Responsibility (SMR) for Financial Statements shall be attached to the financial statements.

The SMR shall cover the comparative financial statements and shall indicate therein such periods. It shall be attached to the consolidated financial statements and stand-alone financial statements. The SMR of companies covered under Part II of this Rule shall, in addition to the requirements, be signed under oath. The **Chairman of the Board, Chief Executive Officer** and **Chief Financial Officer** shall all sign the SMR. *Failure to any of the prescribed signatories to sign the SMR constitute a material deficiency in the financial statements.* For registrants of securities, the SMR shall be attached to both audited annual financial statements and reviewed interim financial statements.

In case of branch offices, representative offices or regional operating headquarters of foreign corporations, the SMR shall be signed by its *local manager* who is in charge of its operations within Philippines.

Accreditation Categories

The following regulated entities shall have independent auditors accredited by the Commission under the appropriate category:

Group A

- Issuers of registered securities which have sold a class of securities pursuant to a registration under Section 12 of the SRC except those issuers of registered timeshares, proprietary and non- proprietary membership certificates which are covered in Group B. *This category shall also cover corporations applying for the registration of their securities; (Previously, this is not included.)*
- Issuers with a class of securities listed for trading in an Exchange;
- Public companies or those which have total assets of at least Fifty Million Pesos (P50 Million) or such other amount as the Commission shall prescribe, and having two hundred (200) or more holders each holding at least one hundred (100) shares of a class of its equity securities;

Previously, the following entities are under Group B category:

- Clearing agency and clearing agency as depository; and
- Stock and securities exchange/s and other Self- Regulatory Organizations.

❑ Group B

- Issuers of registered timeshares, proprietary and non-proprietary membership certificates, and corporations applying for the registration of such securities; *(Previously, corporations applying for the registration of such securities is not included.)*
- Investment houses;
- Brokers and dealers of securities;
- Investment companies that are not in the process of registering securities or have no registered securities yet; *(Previously, it was Investment companies only.)*
- Government securities eligible dealers;
- Universal banks registered as underwriters of securities;
- Investment company advisers;
- Special purpose corporations registered under the Securitization Act of 2004 and its implementing rules; and
- Such other corporations which may be required by law to be supervised by the Commission.

❑ Group C

- Transfer agents;
- Previously, the following entities have different description:*
- Financing companies whose assets in the preceding year are above Ten Million Pesos (P10 Million); and
 - Lending companies whose assets in the preceding year are above Five Million Pesos (P5 Million);
- Previously, the following entities are not part of Group C category:*
- Non-stock, non-profit corporations including foundations which solicit or receive annual donations or contributions and/or with fund balance amounting to more than Twenty-Five Million Pesos (P25 Million) and One Hundred Million Pesos (P100 Million), respectively, over the preceding three (3) years, or such higher amount that the Commission may set through order or guidelines; and
 - Such other corporations that the Commission may consider as imbued with public interest regardless of the lack of a requirement to obtain a secondary license from the Commission.

Scope and Limitation of Accreditation

There are no changes in some provisions except for the following:

- ❑ The auditing firms including their respective signing partners who shall be engaged by companies under Groups A, B and C must be accredited by the Commission in accordance with this Rule.
- ❑ Sole practitioners may be accredited by the Commission and may engaged by Group C companies provided that such auditors have proven their capacity and resources for establishing and implementing adequate audit quality controls in accordance with applicable standards and such other rules and regulations as the Commission may prescribe.
Sole practitioners, however, are expected to convert from a Sole Proprietorship to a Partnership structure by 20 June 2022 in order to continue being accredited by the Commission.
- ❑ The evaluation on the financial statements, which are randomly selected using a risk-based approach, of the applicant's corporate clients during the processing of his application covers only the companies' compliance with the applicable financial reporting framework and such is made only on the face of the financial statements and attached schedules and not its supporting documents. The Commission, however, is not precluded from obtaining copies of the audit work papers to support the auditor's responses to the comments on the evaluated AFS.
- ❑ The Commission shall subject to SOAR Inspection Program the accredited auditing firms engaged by companies with equity or debt securities listed in an Exchange and review portions of these firms' audit work for the listed companies. The Commission, however, is not precluded from subjecting the Independent Auditors of other companies for inspection as the circumstances would warrant.
- ❑ The accreditation of an auditing firm, partner or sole practitioner shall be effective unless any of the following occurs:
 - The auditing firm or auditor's request for withdrawal of accreditation is approved by the Commission;
 - The accreditation is suspended or revoked by the Commission, after due notice and hearing, for failure to comply with the SOAR requirements or for such other grounds as provided in this Rule; or
 - The BOA registration and license have expired and no application for renewal has been filed with the BOA.
- ❑ Accreditation under Group A shall be considered a general accreditation which shall allow the independent auditor to also audit companies under Groups B and C. Independent auditors with Group B accreditation can likewise audit companies under Group C. Only accredited partners, with accreditation under the appropriate group category, are allowed to certify financial statements of the firm's clients with secondary licenses.

Mutual Recognition Policy

The Mutual Recognition Policy was revised to recognize the Memorandum of Agreement between and among the commission, Board of Accountancy, Bangko Sentral ng Pilipinas (BSP), and Insurance Commission.

The mutual recognition policy, as prescribed in the Memorandum of Agreement between and among the Commission, BOA, BSP and IC and any of its subsequent amendments, covering auditors of Group C companies is subject to the BSP restriction that for banks and their subsidiaries and affiliate banks; quasi-banks: trust entities: non-stock savings and loan associations and their subsidiaries and affiliates engaged in allied activities: and other financial institutions which, under special laws, are subject to the BSP's consolidated supervision, only one (1) independent auditor or auditing firm shall audit their individual and consolidated financial statements.

Reportorial Requirements

There are no changes in some provisions except for the following:

Additional disclosure on the findings on the entity is required. It must be disclosed by the Audit Committee, or if there is no such committee, by the company's Chairman of the Board to the Commission:

- ✓ Any finding of: (i) violation of SRC Rule 68: (ii) offering of securities without prior registration with the Commission under the SRC: or (iii) engaging in the business of financing or lending without a secondary license; *(Previously, this is not included.)*
- ✓ Any material finding involving fraud or error;
- ✓ Losses or potential losses the aggregate of which amounts to at least ten per cent (10%) of the consolidated total assets of the company;
- ✓ 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; and
- ✓ Material weaknesses in internal control which may lead to financial reporting problems.

Rotation of External Auditors

The independent auditors or key audit partners shall comply with the provisions on long association of personnel (including partner rotation) with an audit client as prescribed in the Code of Ethics for Professional Accountants in the Philippines as adopted by the BOA and PRC and such other standards as may be adopted by the Commission. *(Previously, the signing partner shall be rotated after every five (5) years of engagement and shall observe a two-year cooling off period.)*

Other Documents to be Filed with the Financial Statements

Kindly refer to QAU Memo 2019-15 for the summary of the documents needed to be filed with the Financial Statements for certain types of entities such as:

- Non-Stock and Non-Profit Organizations Including Foundations;
- Issuers of Securities to the Public and Stock Corporations with Unrestricted Retained Earnings in Excess of 100% of Paid-in Capital Stock;
- Regulated Entities Enumerated in Section 3 (B) (i) of Part I of the Rule;
- Financing Companies;
- Mutual Funds;
- Investment Houses;
- Listed Companies and Investment Houses that are part of a Conglomerate or Group of Companies; and
- Listed Companies that recently offered securities to the public (either as initial or additional offering)

Additional Requirements for Issuers of Securities to the Public

Registration of Securities Pursuant to the ASEAN Capital Market

The revised rule added a section for the Registration of Securities Pursuant to the ASEAN Capital Market Integration (ACMI). This states that the registration of securities pursuant to the ACMI Framework will follow Rule 68, subject to the adoption of the International Financial Reporting Standard for the basis of financial statements of foreign companies that look to pursue cross border offerings or listings in the Philippines.

Specific requirements:

- ✓ Adoption of the IFRS as the basis of financial statements of foreign companies that will undergo cross border offerings or listings in the Philippines.
- ✓ Submission by the foreign issuer's financial statements that are audited by a foreign audit firm are subject to the following requirements:
 - The foreign audit firm should be accredited or licensed and/or recognized in its home jurisdiction as qualified to audit issuers of securities to the public.
 - The foreign audit firm should be affiliated with a local firm that is accredited by the Commission under Group A category.
 - The SMR, schedules and other attachments required under SRC Rule 68 should be submitted with the financial statements.
- ✓ Modification of financial statement requirements in cases where the subject of a registration statement is asset-backed securities in order to align with those in other ASEAN countries.

Periodic Presentation

A. Registration Statements

Consolidated Statements of Financial Position

- a. If the registrant has been in existence for less than one (1) fiscal year, there shall be filed an audited Statement of Financial Position as of a date **within one hundred eighty (180) days** of the date of filing the registration statement. *(In SRC Rule 68, as amended, it was one hundred thirty-five (135) days.)*
- b. If a filing on SEC Form 12-1 is made **within one hundred eighty (180) days** after the end of the most recently ended fiscal year, the filing shall include Audited Consolidated Statements of Financial Position as of the end of each of the two (2) most recently ended fiscal years. *(In SRC Rule 68, as amended, it was one hundred five (105) days.)*
- c. If a filing on SEC Form 12-1 is made **more than one hundred eighty (180) days but not more than two hundred seventy-four (274) days** after the end of the most recently ended fiscal year, the filing shall include Audited Consolidated Statements of Financial Position as of the end of each of the two (2) most recently ended fiscal years and a separate Interim Statement of Financial Position as of the end of the first (1st) fiscal quarter subsequent to the most recent fiscal year end. *(In SRC Rule 68, as amended, it was one hundred five (105) days.)*
- d. If a filing on Form 12-1 is **made more than two hundred seventy-four (274) days** after the end of the most recently ended fiscal year, the filing shall include Audited Consolidated Statements of Financial Position as of the end of each of the two (2) most recently ended fiscal years and a separate Interim Statement of Financial Position as of the end of the second (2nd) fiscal quarter subsequent to the most recent fiscal year end. *(In SRC Rule 68, as amended, it was one hundred thirty-five (135) days.)*

Interim Financial Statements

The **interim financial statements need not be audited**. However, in case of an **IPO** of securities by a company, such **interim financial statements shall be audited** by an independent auditor accredited by the Commission under the prescribed category and shall be complete in details as in a full fiscal year financial report. *(In SRC Rule 68, as amended, it should be under Group A category.)*

Reviewed Interim Financial Statements may be accepted by the Commission provided that the registrant submits a written justification citing its constraints for having the interim financial statements audited and a certification that there has been no material event or transactions during the interim period that would necessitate the conduct of audit procedures.

Pro-forma Financial Information

- ✓ There are no changes in the provisions of pro forma financial information except for the Report of Independent Auditor.

SRC Rule 68 as amended

Attestation of Independent Auditor

The pro forma financial information that shall be submitted with the registration statement shall be accompanied by a report of an independent auditor accredited by the Commission under Group A category. The said **auditor shall comply with the requirements provided under SEC Memorandum Circular No. 2, Series of 2008**

(Guidelines for Reporting and Attestation on Pro Forma Financial Information) or any amendments thereto.

Revised SRC Rule 68, 2019

Report of Independent Auditor

The pro forma financial information that shall be submitted with the registration statement shall be accompanied by **a report of an independent auditor** accredited by the Commission under Group A category. The said auditor shall **comply with the requirements under Philippine Standard on Assurance Engagements No. 3420 (Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in the Prospectus).**

Consolidated Financial Statements

- The Disclosure about Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons section was deleted in the revised SRC Rule.

In addition to those required under the applicable financial reporting framework, the following requirements shall be complied with by companies covered by Part II of this Rule:

- a. A company covered by Part II of this Rule that has a significant foreign subsidiary or subsidiaries shall submit to the Commission copies of the financial statements of said subsidiaries.
- b. A parent company covered by Part II of this Rule shall submit consolidated AFS accompanied by its separate AFS that is duly received by the BIR or its authorized banks, unless the BIR allows an alternative proof of submission for its authorized banks (e.g., bank slips) or prohibits acceptance of the financial statements in certain cases (e.g., on-going examination).

Penalties and Other General Implementing Provisions

Penalties

There is no change in some provision except for the following:

Violations of Companies subject to penalty:

- ✓ Material misrepresentation in the financial statements;
- ✓ Any material misstatement in the financial statements for failure to comply with the applicable financial reporting framework, such as:
 - Failure to adopt the prescribed financial reporting framework or any accounting standard resulting in a material misstatement; and
 - Failure to disclose required information and other relevant or material information.
- ✓ Failure to submit any basic component of the financial statements;
- ✓ Failure to submit financial statements audited by a qualified independent certified public accountant;
- ✓ Failure to submit a complete SMR; and
- ✓ Failure to comply with any other requirements under Part I or II of this Rule.

**Previously, failure to present the required comparative figures is included.*

Test of Materiality

- ☐ Omissions or misstatements of items shall be **material** if they could individually or collectively, **influence the economic decisions** that users make on the basis of the financial statements. *(Previously, materiality is based on the tests set by the Commission in SEC Memorandum Circular No. 8, Series of 2009)*

Quantitative Test

1. Deficiency or Inconsistency
Failure to submit any component of the financial statements prescribed under this Rule shall be considered a material deficiency.
2. Misstatement
A misstatement of the financial statements may result from a deviation from prescribed policy, misrepresentation, fraud or error.

Qualitative Considerations

Whether the misstatement or error:

- ✓ Affects compliance with debt covenants or other contractual requirements.
- ✓ Relates to the incorrect selection or application of an accounting policy that has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements.
- ✓ Masks a change in earnings or other trends, especially in the context of general economic and industry conditions.
- ✓ Affects ratios used to evaluate the entity's financial position, results of operations or cash flows.

- ✓ Affects segment information presented in the financial statements.
- ✓ Has the effect of increasing management compensation, for example, by ensuring that the requirements for the award of bonuses or other incentives are satisfied.
- ✓ Is significant having regard to the auditor's understanding of known previous communications to users, for example, in relation to forecast earnings.
- ✓ Affects compliance with regulatory requirements (including BIR, BSP and other government agencies).
- ✓ Relates to items involving particular parties (for example, whether external parties to the transaction are related to members of the entity's management).
- ✓ Is an omission of information not specifically required by the applicable financial reporting framework but which, in the judgment of the auditor, is important to the users' understanding of the financial position, financial performance or cash flows of the entity.
- ✓ Affects other information that will be communicated in documents containing the AFS (for example, information to be included in a "Management *Discussion and Analysis*" or an "Operating and *Financial Review*") that may reasonably be expected to influence the economic decisions of the users of the financial statements.

Re-issuance of Financial Statements

- Except for banks, the Commission shall make a determination whether misstatement or incompleteness is significantly material that it would necessitate the re-issuance of such financial statements. Any re-issuance shall be required within forty-five (45) calendar days from receipt of the order of the Commission. Such amendment shall comply with the re-issuance requirements under applicable auditing standards. The issue on whether or not the financial statements of a bank and an insurance company should be re-issued shall be endorsed by the Commission to the BSP and the IC, respectively, for appropriate action.
- For corporations not covered by the above provisions, they may re-issue their financial statements subject to compliance with the requirements under existing standards. However, issuers of securities to the public shall not re-issue their AFS without prior request from and approval by the Commission, BSP and IC, as applicable.
- A corporation covered by SRC Rule 68 Part II and re-issuing its AFS shall notify all concerned parties, such as its stockholders, creditors and investors of such amendment through publication of a notice in a newspaper of general circulation indicating the reason for the amendment and the fact that the financial statements have been submitted to the Commission.
- An amendment or re-issuance of the financial statements shall not exonerate the company and the auditors from the penalty that may be assessed by the Commission against a corporation due to the material deficiency or misstatement of the original financial statements.

The are no changes in the following sections of the Rule:

- Qualifications and Reports of Independent Auditors
 - Independence of the Auditors
 - Engagement of Independent Auditors
 - Audit Reports of Independent Auditors
 - Supplemental Written Statement of Auditor
 - Comparative Financial Statements
- Periodic Presentation
 - Registration Statements
 - Consolidated Statements of Comprehensive Income
 - Consolidated Statements of Changes in Equity
 - Consolidated Statements of Cash Flows
 - Age Requirement for Financial Statements
 - Annual Reports (SEC Form 17-A)
 - Information Statements (SEC Form 20-IS)
- Interim Financial Statements
- Pro-forma Financial Information (except for the Report of Independent Auditor)

Effectivity and Transition

- ✓ Unless otherwise specified, the Revised SRC Rule 68, shall become effective for Audited Financial Statements covering periods ending 31 December 2019 and onwards, and for interim financial statements starting the first quarter of 2020, and thereafter.
- ✓ The financial statement requirements for registration of securities under Part II of this Rule shall be effective starting 1 January 2020 unless an earlier application for pending registration statements is requested and approved by the Commission.

Compliance with the Two (2) Partner Requirement

- ✓ Auditing firms which have less than two (2) partners as of the date of the effectivity of this Rule shall be given until 30 June 2022 within which to comply with the new two (2) partner requirement.

Compliance with the Transition from Sole Proprietorship to Partnership

- ✓ Sole practitioners as of the date of the effectivity of this Rule shall be given until 30 June 2022 within which to comply with the requirements to convert to a Partnership structure from Sole Proprietorship in order to continue being accredited by the Commission.

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Comments and suggestions are welcome.

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