



# Punongbayan & Araullo

December 8, 2009

**Board of Accountancy**  
P. Paredes Street  
Sampaloc, Manila

20th Floor, Tower 1  
The Enterprise Center  
6766 Ayala Avenue  
1200 Makati City  
Philippines

***Attention: Atty. Eugene T. Mateo***  
***Chairman***

T +63 2 886-5511  
F +63 2 886-5506; +63 2 886-5507  
[www.punongbayan-araullo.com](http://www.punongbayan-araullo.com)

Gentlemen:

As a member of the public practice sector, we thought we would submit our comments on the final draft Rules and Regulations promulgated by the Board of Accountancy (the Board) regarding its Quality Assurance Review (QAR) Program. We hope these comments will be given due consideration by the Board.

The QAR Program is an excellent step in the pursuit of improving the credibility and reliability of financial statements audited by Philippine auditors, especially the financial statements of publicly accountable entities. The Program is also in consonance with a practice that is increasingly becoming a standard around the world.

We recognize that the Board has exerted much effort in fashioning out a QAR Program that meets international expectations and at the same time is suitable to, and permissible under, the Philippine setting. We commend the Board and those who assisted it in designing the structure and rules to implement the concept of a quality assurance review program for Philippine auditors.

We also recognize the constraints, especially the legal ones, that the Board faces in making such a program a reality. Unlike in some foreign jurisdictions, the Board does not have the benefit of a law that specifically imposes such a program. But just the same, we realize that the Board has to develop a program that can be made legally enforceable. Our comments do not carry with them a legal orientation. However, we feel that the essence of the comments, if considered by the Board, can be translated into legally binding rules.

Our comments cover three broad areas, namely:

- structure of the Executive Committee
- classification (categorization) of auditing firms
- funding

We wish to mention that our comments are being made with the aim of trying to help establish a successful QAR Program and to ensure the long-term sustainability of the Program. In making our comments, we do not intend to give reference to any current practices or activities of any of the various personalities or institutions in the accounting profession.

#### **Structure of Executive Committee**

We believe the Executive Committee, which has only three members, is too small. It is not independent.

A membership of only three for such an important inspection body like the QARD does not allow for a broad and varied perspective on such a considerable activity and responsibility, especially since the three members come from only two sources: the Board and PICPA. As a result, the Committee's work may tend to be driven by a narrow line of thinking, precluding a variety of ideas needed in dealing with the many difficult issues that are likely to arise during implementation. To deal effectively with this disadvantage, it would be advisable to increase the membership to, say, seven, and to include non-CPAs, preferably from the corporate management community, in the group. It is possible that expanding membership to people outside the Board may create some legal issues. However, it may still be worth exploring. If there are problems, we hope that legal solutions could be found.

The QARD is not truly independent. It is, in effect, supervised by the Board. As such, it is not shielded from the politics of the members of the Board and interest groups which may influence the appointment of members to the Board. The same is true for the lone member from PICPA. Our comment on the expansion of the members of the Executive Committee is necessarily related to this issue. The expansion itself may be part of the solution to the independence issue, provided that no single sector, including the Board, will have undue influence on the work of the Committee.

Still part of the independence issue is the selection of the members of the Executive Committee. To grant one or two entities (like the Board and PICPA) with the authority to select members may not be the way to achieve the condition of independence. Perhaps providing another layer of authority with the power to select would effectively deal with the independence issue. Perhaps an Eminent Group could be created to which the Board can delegate the authority to select the members of the Executive Committee. This Eminent Group may consist of prominent CPAs, properly balanced (say, 50-50) between practicing CPAs and non-practicing CPAs. This Eminent Group could be expanded (say, 11 members) to provide varied points of view.

We recognize that the creation of another layer of authority like the Eminent Group may also pose some legal issues. If so, it may be worthwhile to also find a solution to these issues.

#### **Classification of Auditors**

In the final draft, auditors are clearly divided between those auditors who audit financial statements using the full IFRS (Category A) and those who audit financial statements not using the full IFRS (Category B). The choice of the latter category (Category B) appears to have anticipated the use of the forthcoming IFRS for SMEs. This classification of A and B ignores the existing condition in the public auditing market. Presently, small- and medium-sized practicing firms (SMPs) also audit financial statements using full IFRS. If this classification is implemented, it may result in two, probably unintended, consequences that may be injurious to the public accounting profession.

Firstly, the classification may result in the coercive restructuring of the profession. Those SMPs who presently are auditing FS using full IFRS may have to drop these clients if they want to be categorized as B and pay lower fees to QARD. Of course, they may opt to be classified as A and pay higher fees. If most SMPs do this, then there will be few Category B SMPs. So why would we opt for this type of classification?

Secondly and more importantly, this classification will choke the natural development of small firms. Most firms generally start small, but aspire to be big. The prescribed classification will tend to relegate small firms to being perpetually small. This is not good for the public accounting profession and the business community. Of course, small firms already classified as B may subsequently want to be classified as A, provided that they have clients using the full IFRS. But which full IFRS client will avail of a firm's professional service if this small firm is already known as a Category B? Even in the event that a full IFRS client engages a Category B firm, this firm will have to go through the motion of getting reclassified to Category A and will have to deal with the required administrative details and, thereafter, pay a higher fee. The Category B firm has to go through all this just to serve one full IFRS client. Clearly, the prescribed classification erects an unnecessary barrier to a small firm that aims to expand.

There are also other important reasons why the prescribed classification is not appropriate. The present international auditing standards, including the standard on quality control, do not distinguish between big and small accounting firms. The auditors' application of international auditing standards on their audits does not differ whether the client is big or small. Auditors are required to follow the same standards for any size of audit, and practically all standards apply to any audit. Of course, the time needed to accomplish the audit work will be shorter if the clients are small because there are fewer transactions to test and examine. Nevertheless, a small firm will have to develop its practice and do its audit work using the same standards that a bigger firm uses to develop its own practice and do its professional work.

The full IFRS and non-full IFRS distinction is also not directly relevant to the auditors. The IFRS for SMEs was developed to meet the clamor of SMEs in preparing their financial statements, and not to deal with how SMPs should do their audit work. SMEs want less complicated accounting standards. The forthcoming IFRS for SMEs may meet this desire, but not by very much. Basically, the same principles underpin both full IFRS and non-full IFRS. There are of course a number of complexities in the full IFRS that have been made less complex in the IFRS for SMEs. But this development is not necessarily beneficial to the auditors. Auditors still need to understand the general principles that are present in both financial reporting frameworks. More importantly, as mentioned earlier, the auditors will still apply the same auditing standards in the audit of SMEs. It would be wrong to say that the audit of SMEs is less risky than the audit of larger entities. The cost of an audit failure in the audit of an SME may be lower than that in an audit of a large entity, but the weight of the burden of the cost of failure is a relative matter.

There is another matter that we believe the Board should take into consideration. The IFRS for SMEs is yet to be implemented. The extent of the use of this framework is still uncertain. It may well be that no substantial number of Philippine companies will use this framework. If so, Category B auditors will be small in number. So why do we need to make this big distinction if it will not be useful anyway?

Considering all of the above, we propose that the classification of auditors be made solely on the basis of size. Size could be measured in terms of number of personnel or revenue. This kind of classification will avoid the unintended injury that the currently prescribed classification may cause to the public accounting profession in general and to SMPs in particular.

**Funding**

Irrespective of the classification of auditors, we estimate that the number of auditing firms in the Philippines having more than 50 people is less than 10. This size concentration also indicates the concentration of clients, whether listed or not, among the auditing firms. On this basis, the funding for the activities of the QAR Program might be insufficient.

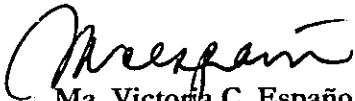
To put the financial affairs of the QAR Program in clearer focus, it may be helpful to develop a budget for the Program for its first year of operation. We believe that there is enough available information to come up with a good estimate of potential revenue. As to the cost, an idea of the extent of the inspection program for the first year would be helpful in determining the personnel structure of the QARD, together with the skill levels and number of personnel that may be required.

For the Program to be effectively implemented, it may be necessary to tap additional sources of revenue. If government funding is out of the question, it may be necessary to obtain funds from the corporate sector with the help of the Philippine Stock Exchange. Of course, the legal implication of sourcing funds from other parties will have to be evaluated.

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We hope that our comments will be useful. We thank the Board for its kind attention regarding these matters.

Very truly yours,



Ma. Victoria C. España  
Managing Partner & COO