

**AN INDEPENDENT OVERSIGHT BODY
FOR QUALITY ASSURANCE REVIEW
IN THE PHILIPPINES**

FEBRUARY 2009

AN INDEPENDENT OVERSIGHT BODY FOR QUALITY ASSURANCE REVIEW IN THE PHILIPPINES

Table of Contents

	Paragraph Nos.
WHAT IS THIS PROJECT	
- AN OFFSHOOT OF ROSC-A&A,2006	1-4
WORK COVERAGE AND PROJECT DELIVERABLES	
What is Covered	5
What is Not Covered	5
WHAT IS QUALITY ASSURANCE REVIEW (QAR) – Definition	6-8
WHY IS QUALITY ASSURANCE REVIEW (QAR) NECESSARY	9
QAR under the Accountancy Law and its Implementing Regulations	10
QAR under Auditing Standards in the Philippines	11
QAR under International Professional Requirements Of IFAC	12
WHO ARE TO BE COVERED BY QUALITY ASSURANCE REVIEW	16-20
WHAT IS THE STATUS OF QUALITY ASSURANCE REVIEW TODAY	
Status at the BOA and PICPA Level	22-24
Status at the Practitioners' Level	25-27
Analysis Why It is at this Level – Six Components Necessary	28-29
WHAT TO DO	
RECOMMENDATIONS TO ADOPT A QUALITY ASSURANCE REVIEW PROGRAM FOR THE PHILIPPINES	
Introductory Comments	30

SIX COMPONENTS NECESSARY FOR A QAR PROGRAM TO EXIST	31-32
AUTHORITY TO IMPLEMENT THE QAR PROGRAM – First Component	33
The Role of BOA is Key as it is Monumental QAR Program Directly under BOA – Or Not?	34-36 37
CREDIBLE INDEPENDENT ENTITY TO OVERSEE THE QAR PROGRAM –Second Component	38-40
Creation of a credible entity	41-43
Name of Credible Entity	44
Main Purposes and Duties of the QAR Council	45-53
Membership of the QAR Council	54-55
Chairmanship of the QAR Council	56
Memorandum of Agreement Among Accrediting Agencies	57-59
CPA PRACTITIONERS MUST ENROLL/REGISTER IN THE QAR PROGRAM – Third Component	60-62
The Support Group to QARC	63-64
Audit Inspection Unit Housed in SG-QARC	65-66
Organization and Reporting Status of AIU Explained	67
How PICPA will Set up the SG-QARC unit	68-71
Registering CPA Practitioners under the Appropriate Risk Category	72-74
Risk Categories of CPA Practitioners	
Category A	75
Category B	76
Registration Rules	77-79
AUDIT INSPECTION UNIT (AIU) WITH CAPABLE PERSONNEL – Fourth Component	80-81
Head of the AIU or Chief Inspector	82
Basis Minimum Qualifications of the Chief Inspector	83
Appointment of the Chief Inspector of the AIU	84
Main Duties of the Chief of Administration	85
Assistants for the Chief of AIU and Chief of Administration	86
In Charge Level Inspectors	87
The Beginning Plantilla and Salary Levels	88

METHODOLOGY FOR QAR –Fifth Component	89
FUNDING – Sixth Component	90-93
What must BOA do	94
Overcoming Objections from Practitioners	95
Requirement for the Plan to be Equitable	96
Nature of the Practice	97-99
Extent of Quality Assurance Work to be Applied	100
Timing or Frequency of the QAR	101
Why some firms would have annual inspections	102
The Proposed Fund Plan	103
Rationale for the Annual Fee to Practitioners	104
Estimated Collections from Proposed Funding Plan	105
Allowance For Fee Reduction or Non-collection	106
Proposed Funding Plan- Figure 1	107
USE OF COLLECTED FUNDS	
Savings Generated	108
Costs vs. expected revenues	109
Initial Budget - Figure 2	110
SCHEMATIC DIAGRAMS TO SHOW RELATIONSHIPS AND WORKFLOW	111
Figure 3 – Schematic Diagram of Actions BOA Must Undertake to Put QAR Program into Place, and Interrelationships of Entities	
Figure 4- Diagram for QAR Reports Flow and Action, If Needed	
IMPLEMENTATION OF A QAR PROGRAM	
New Quality Assurance Review Regulation or Not	112-116
Conclusion – New Rule is Needed	117
Effects of a New Rule - What Does This Mean	118
Structure of the QAR Regulations	119-120

LINK WITH THE REGULATIONS ON PRACTITIONER ACCREDITATION	121
SANCTIONS AND PENALTIES	122-24
Examples	125
COMMUNICATIONS TO PRACTITIONERS	126--127

APPENDIX

- APPENDIX 1. Rules and Regulations Implementing Section 9(h), Article II of Republic Act No. 9298 Otherwise Known as The Philippine Accountancy Act of 2004 Covering an Oversight Into The Quality of Audits of Financial Statements Through a Quality Assurance Review Program.
- APPENDIX 2. Annex 1 Accompanying the Main Regulations for a Quality Assurance Review Program Concerning (1) the Quality Assurance Review Council, and (2) Audit Inspection Unit.
- APPENDIX 3. Annex 2 Accompanying the Main Regulations for the Quality Assurance Review Program concerning (1) the Support Group to the QAR Council, and (2) the Requirement for all CPA Practitioners to Enroll/Register annually in this Program as herein provided in these Regulations.

AN INDEPENDENT OVERSIGHT BODY FOR QUALITY ASSURANCE REVIEW IN THE PHILIPPINES

WHAT IS THIS PROJECT – AN OFFSHOOT OF ROSC-A&A, 2006

1. This project provides support to a major recommendation in the Philippine Review of Standards and Codes on Accounting and Auditing (ROSC-A&A) completed in May 2006 by the World Bank. The ROSC- A&A brought out that there were major improvements in the accounting and auditing scene since the last ROSC-A&A assessment made in 2001. The improvements that were classified as substantially complete were the adoption of the international standards for accounting, auditing, and professional ethics.

2. One of the recommendations that would **require substantial effort to complete was the monitoring and enforcement mechanism for quality assurance review** of the **work of audit practitioners**. Briefly, the recommendations related to this effort involve:

- setting up an independent oversight body to coordinate the quality assurance review (QAR) program and to provide appropriate transparency in carrying out the QAR function
- set up QAR teams of full time qualified professionals who report directly to this oversight body
- place the QAR function under an organization that would be able to recruit qualified personnel with commensurate compensation
- design quality assurance procedures appropriate to audit firms to be reviewed.

3. **At present there is no QAR program over auditing firms** conducted either by the Philippine professional body (Philippine Institute of Certified Public Accountants-PICPA) or by any government regulatory authority. The Board of Accountancy (BOA) is the designated government regulatory body that supervises the accounting profession and is required to have this QAR program in place to meet its duties imposed by the Accountancy Law.

4. **This project is in response to the request of the BOA for assistance to set up a QAR program in the Philippines and consists of recommendations to implement such a program.**

WORK COVERAGE AND PROJECT DELIVERABLES

5. Described below is what is covered by this report, and what is not covered.

What is covered:

- a. to develop a strategic plan to provide for the adoption and implementation of a QAR program for auditing firms in the Philippines
- b. to develop a cooperative arrangement between Philippine regulatory authorities and the accounting professional body, which also has the mandate of quality assurance , so there would be no duplication of effort.
- c. to develop rules and regulations subjecting auditors and/or auditing firms to such a quality assurance review program. This would include administrative steps to be taken by the relevant government authority to initiate this program.
- d. to develop a medium-term strategic plan for sustainability of the QAR program.
- e. The proposed plan should be the product of working closely with the relevant regulatory body (BOA) and PICPA incorporating their inputs in the study. This should ensure their eventual acceptability for adoption and implementation by these entities.
- f. The deliverables consist of the plans mentioned in a, b, c, and d above.

An important note: This report contains recommendations to set up a QAR program based on existing laws and is not dependent on laws still to be enacted or amended.

What is not covered

- a. The above work coverage specifically excludes the development of operational procedures and methodologies of reviewing accounting and auditing practices because this will be prepared by other consultants and will be contained in another report.
- b. The report does not cover any recommendations for the enactment or amendment of any law to provide for a QAR program.

WHAT IS QUALITY ASSURANCE REVIEW (QAR) – Definition

6. The terms Quality Review and Quality Assurance Review both have the word Quality common to both terms. They are defined in various authoritative literatures, but refer to the same thing – that is, supervision over the work of professional accountants that they do their audit work in accordance with the established standards of the profession.

7. Two definitions are cited below.

- a. Definition under the Implementing Rules and Regulations of the Accountancy Law, RA 9298.

Quality Review – a study, appraisal or review by the Board or its duly authorized representatives, of the quality of audit of financial statements through a review of

the quality control measures instituted by an Individual CPA, Firm or Partnership of CPAs (**henceforth collectively referred to as CPA Practitioners**) engaged in the practice of public accountancy to ascertain his/her/its compliance with prescribed professional, ethical and technical standards of public practice.

b. Definition under International Federation of Accountants (IFAC) Statement of Membership Obligations No. 1 on Quality Assurance:

Quality Assurance Review – a review to determine whether the member (i) is subject to (partner) or has (firm) an adequate system of quality control, (ii) is in compliance with such system, and (iii) has adhered to professional standards and regulatory and legal requirements in performing engagements.

8. As the above two terms refer to the same thing, for clarity and uniformity sakes we shall use the term “**quality assurance review**” or **QAR** to refer to both of them in this report. Some professional literature use the term “**quality control**” to mean **quality assurance**. We shall use these two terms interchangeably.

WHY IS QUALITY ASSURANCE REVIEW (QAR) NECESSARY

9. The need for a quality assurance review system to be implemented arises mainly from three main sources:

- the Accountancy Law, RA 9828
- the auditing standards in the Philippines
- a requirement by the international accounting profession (IFAC) to have member institutes (e.g. PICPA) implement a quality assurance review program as a membership obligation .

10. QAR under the Accountancy Law and its Implementing Regulations. - The Accountancy Law (RA9298) was enacted with the objective of supervising, controlling and regulating the practice of accountancy in the Philippines (Sec. 3). The law gives the power to the Board of Accountancy (BOA) to supervise the registration, licensure and practice of accountancy in the Philippines (Sec. 9c). The law also gives the BOA the power to conduct an oversight into the quality of audits of financial statements through a review of the quality control measures instituted by auditors in order to ensure compliance with the accounting and auditing standards and practices.

11. QAR under Auditing Standards in the Philippines. - The requirements for audit quality are contained in two auditing standards –

- Philippine Standards of Auditing (PSA) No. 220, Quality Control for an Audit of Financial Statements. This standard deals with specific responsibilities of personnel of CPA practitioners regarding quality control procedures for an audit of financial statements.

- Philippine Standards for Quality Control (PSQC) No. 1, Quality Control for Firms that Perform Audits and Review of Financial Statements, and Other Assurance and Related Services Engagements. This standard deals with the CPA practitioners' obligation to establish a system of quality control designed to provide it with reasonable assurance that:
 - o The firm and its personnel comply with professional standards and regulatory and legal requirements, and
 - o The auditors' reports issued by the firm or engagement partners are appropriate in the circumstances.

12. QAR under International Professional Requirements of IFAC. - The worldwide accounting profession is embodied in IFAC. The Philippine accounting profession is embodied in PICPA. The latter is a member of the former.

13. IFAC has issued seven (7) Statement of Membership Obligations (SMO)s which are meant to assist members (e.g.PICPA) in ensuring high quality performance by professional accountants. They cover the member body's obligations to support the work of IFAC, the work of the International Accounting Standards Board, and obligations regarding quality assurance and investigations and discipline.

14. SMO 1 covers the subject Quality Assurance. This subject is addressed at three levels - the engagement level, the firm level and the member body level.

- For specific engagements – PSA 220 is relevant
- For firm's responsibilities – PSQC 1 is relevant
- For member body's responsibilities – SMO 1 is relevant.

15. SMO 1 requires a member body to ensure a mandatory quality assurance review program is in place for those of its members performing audits. Where government, regulators or other appointed authorities perform any of the quality control functions, member bodies should (a) use their best efforts to encourage those responsible for those functions to follow the SMO in implementing them, and (b) assist them in that implementation where appropriate. This means that PICPA cannot shirk from the responsibility for quality assurance even if this may be mandated to be done by other authorities.

WHO ARE TO BE COVERED BY QUALITY ASSURANCE REVIEW

16. CPAs practice the public accounting profession either as:
- an individual practitioner
 - a firm
 - a partnership.

As mentioned previously in this report, the term **CPA Practitioner** will refer to an individual practitioner, a firm or a partnership who performs audits of financial statements.

17. The Accountancy Law makes quality assurance applicable to all practitioners, whether they are an individual practitioner, a firm or a partnership (Sec. 4, o).The IFAC's SMO on Quality Assurance requires this to cover CPA practitioners performing audits of listed companies, as a minimum.

18. The issue here is to decide whether the QAR program should cover all CPA practitioners, or only selected ones such as those doing audits of listed companies. The factors that should be considered in making a decision on coverage in the Philippines are the following:

- a. there are only about 250 listed companies and their audits are concentrated among a few firms. These firms are invariably members of an international network of firms, which usually already have in place an internal assurance review program.
- b. There are about 4000 CPA Practitioners registered to practice with the BOA. Since the professional regulation related to quality assurance has never been in place, anecdotal evidence tend to show that many practitioners do not practice quality assurance to the degree that they should.

19. At this early stage when there is the possibility of setting up a QAR program, one would tend to favor covering all practitioners rather than just a few firms of practitioners, for the following reasons:

- a. The subject of quality assurance, while provided for in the auditing literature, is not known to be widely practiced because there has never been any regulatory or professional supervision checking that it is actually being observed by CPA practitioners.
- b. The CPA practitioners that belong to international networks are known to have their own international quality assurance review programs, but the results of these programs are not made available to the public.
- c. Setting up a QAR program entails a lot of effort. All that effort does not seem worthwhile if only audits of listed companies would be covered, because then only a few CPA practitioner firms would be covered by the program.

20. The audits of listed companies and large companies would require a more rigid observance of quality assurance by the CPA practitioner as compared to the audits of small and medium sized companies. The QAR review program should take this into account when determining the procedures required to review the audits of these different companies.

WHAT IS THE STATUS OF QUALITY ASSURANCE REVIEW TODAY

21. There have been some preliminary steps taken to put into place a QAR program in the Philippines. We shall briefly describe below what has taken place already. One may come to the conclusion that the regulators and the profession are starting on their way to first base, but have not yet reached it.

22. **Status at the BOA and PICPA level.** - As authorized by Annex B of the Rules Covering the Accreditation of CPAs in the Practice of Public Accountancy, the BOA created a Quality Review Committee (QRC) to conduct an oversight into the quality of audits of financial statements by CPA practitioners to determine their compliance with accounting and auditing standards. The QRC is composed of the following:

Chairman, who had been or is presently a senior practitioner in public accountancy	1
Six members coming from:	
BOA	1
PICPA	
Public practice	2
Academe	1
Commerce and Industry	1
Government	1
Total	<u>7</u>

23. The functions of the QRC are:

- a. to conduct quality review on applicants for registration to practice public accountancy and render a report which shall be attached to the application for registration
- b. to recommend to the BOA the revocation of the Certificate of Registration and the professional identification card of the CPA practitioner who has not observed quality assurance measures and who has not complied with the standards of quality prescribed for the practice of public accountancy.

24. A recent talk with the appointed Chairman of the QRC informs us that she is just recently appointed and that only the groundwork is being addressed. No actual QAR has been done yet.

25. Status at the Practitioners' Level. - The only firms known to have been subjected to QARs are those that belong to international networks because it is known that these network firms require internal quality assurance review programs to meet their obligations under existing auditing standards. These QARs however are private in nature and the results are not known or made available to the regulators or the public.

26. The extent of adoption or non-adoption of quality assurance elements in other accounting firms is not known because no authority outside of the firm has asked these CPA practitioners a description of the elements of quality control they practice, nor have any quality assurance reviews been made of their practice.

27. In a nutshell, we can safely say that to institute a QAR program now is probably to start nearly at the very beginning of the process.

28. Analysis why it is at this level – six components necessary. - As will be discussed more fully in the succeeding parts of this report, experience would indicate that there are at least six (6) component parts for a QAR program to function successfully. (See paragraph 31 for an enumeration of these parts). These parts must co-exist. The absence of any one component would lead to the failure of the QAR effort.

29. At the present moment only the authority or mandate to implement a QAR system exists. None of the other 5 components exist – and that is the main cause why the QAR system in the Philippines is nearly at ground zero level.

WHAT TO DO

RECOMMENDATIONS TO ADOPT A QAR PROGRAM FOR THE PHILIPPINES

30. Introductory comments – The recommendations must take into account certain “barriers, realities and facts of life” that exist. Some of these barriers were either mentioned specifically or hinted at in the ROSC A&A study, as follows:

- a. Quality assurance of audit firms is a process that needs highly technical, trained and experienced personnel. These resources are not readily available. They have to be offered market compensation levels to be able to attract them to join the program.
- b. The QAR personnel must be housed in an entity that can pay these levels of compensation. This rules out the BOA because, being a government entity, they would not be able to offer compensation at a level that would be attractive enough.
- c. There is no present funding source for a quality assurance review program whatsoever. This program cost will have to be borne by and allocated on some rational basis to the CPA practitioners.

- d. There is a quirk in government regulations that collections raised by a government entity must be turned over to the coffers of the government. Any program cost of the entity must be provided for in the annual budget appropriations of the entity.
- e. The annual budget appropriations of the BOA (or Professional Regulation Commission or PRC, its supervising entity) have never in all the past years ever provided for the cost of a QAR program.

The recommendations below take into account these barriers and realities.

SIX COMPONENTS NECESSARY FOR QAR PROGRAM TO EXIST

31. The six important components which must co-exist for a quality assurance review program to be successfully implemented and survive are the following:

- **the authority or mandate to implement a QAR program**
- **a credible entity to oversee the program**
- **there is an Audit Inspection Unit with capable personnel**
- **there is a requirement for practitioners to enroll in such a program**
- **there is a prescribed methodology to follow in the program**
- **there is adequate funding for the relevant costs.**

This section of the report describes more fully the steps to take to make the six components become a reality.

32. Only one component actually exists now. This is the legal authority for a QAR program. The other five must be created. Since it is the BOA that has the legislated authority, it falls on their shoulder to create these other components. **The success of implementing a QAR program will be directly proportional to the WILL and TENACITY that the BOA will pursue this project**, because without this dedication the QAR program will never get off the ground.

AUTHORITY TO IMPLEMENT THE QAR PROGRAM – First Component

33. The authority to implement a QAR program is the first but only component that presently exists. In paragraph 10 we have discussed BOA's authority to pursue this project.

34. **The role of BOA is key as it is monumental.** Being expressly authorized by law to pursue this project, it is the only party that can make this project happen.

35. In setting up this program they will be setting a stage with no local precedents, and they can expect many obstacles and resistance from:

- The government sector – BOA will not run out of well meaning as well as ill meaning sectors of the government trying to point out whether BOA has the authority to do something or not to do something.
- The CPA practitioners – many would find some reason to object to this program because they would not like any third party to look into the quality of their work.

36. Facing these obstacles, BOA must have a firm mindset to :

- implement the QAR process in spite of expected obstacles
- obtain the backing of the PRC to which the BOA is accountable
- actively seek ways and overcome obstacles to create the other five components necessary for a QAR process to exist.

37. QAR program directly under BOA – or not? - The regulations related to quality assurance specifically mention that BOA can undertake this work directly, or through its designee. Should the BOA do it directly? The answer must be in the negative because:

- a. BOA as a government entity would not have the ability to hire and pay market rates for qualified personnel to do the program
- b. BOA does not have any budget appropriations at all for this program. They would be unable to use any amounts charged to CPA practitioners for the program because of the quirk that these funds must be turned over to the central government – and cannot be used directly by BOA for the program costs.
- c. BOA, as a government entity with politically appointed members may not have, per se, the appropriate transparency for a program such as this to be acceptable by the CPA Practitioners.

CREDIBLE INDEPENDENT ENTITY TO OVERSEE THE QAR PROGRAM – Second Component

38. A credible entity usually is involved in each country that has an ongoing QAR program. Added credibility is obtained if the entity is independent, meaning accountable and reporting only to the public. In the USA this entity is called the Public Company Accounting Oversight Board; in the UK it is called the Professional Oversight Board of Accountancy; in Canada it is called the Canadian Public Accountability Board.

39. Each of these entities was created to meet the requirements of their country's law and the needs of their accounting profession. So too in the Philippines, the credible entity

should fit the country's existing laws and meet the specific needs of the Philippine accounting profession.

40. The following matters concerning Credible Entity are discussed below:

- its creation
- its name
- its main purpose and duties
- its membership.

41. **Creation of a credible entity.** - At present there is no existing credible entity involved with the Quality Assurance function. This entity should be created by the BOA to put into place the second component of a QAR program. This entity can be created by means of preparing and releasing a new Quality Assurance Regulation where this entity can be mentioned. (This regulation would need PRC approval.) The contents of this Regulation will be discussed later in this report.

42. There are several ways to enhance the credibility of an entity. These are:

- to make it an independent body reporting only to the public
- to broaden membership to various stakeholders interested in financial statements
- to have the chairmanship given to an independent third party well known by the public for his integrity.

43. Can the BOA be this credible entity? Unfortunately the answer is no, because they do not possess all three of the credibility enhancers mentioned above.

44. **Name of Credible Entity** - The name can be anything the BOA would like to call it – but of course for easy identification it should be descriptive of its main function. A name such as “Quality Assurance Review Council” (QAR Council) could be used. For the rest of this report, the QAR Council will be used to identify this credible entity.

45. **Main Purposes and Duties of the QAR Council.** - The main purposes and duties would include the following:

- a. to promote, publicly and proactively, high quality external audits
- b. through its audit inspection unit (AIU), to monitor the quality of audits
- c. to approve the QAR plan for the year
- d. to hire the Chief Inspector of the AIU
- e. to obtain independent technical advice on the subject of quality assurance when needed and appropriate

- f. to receive and evaluate the reports and recommendations of the AIU
- g. to refer matters to the BOA and other regulatory authorities if there is disciplinary action needed
- h. to issue an annual report for the benefit of the public

These are briefly discussed below.

46. To promote publicly and proactively , high quality external audits. This is the reason for being of the QAR Council. The Council is the answer to the oft cited question “Who audits the auditors?”. They stand between the public and the CPA Practitioners attesting to the state of the auditing profession as a whole with regard to their compliance with established auditing rules and standards.

As their main function is to promote high quality audits, they are there to point out any major weaknesses in the auditing profession’s compliance with the established rules so that appropriate corrective action can be instituted by the CPA practitioners. This leads to higher quality audits. CPA Practitioners who have been found to be grossly non compliant with the existing standards of auditing must of course be held accountable for this. But it is only a secondary function of the Council. Disciplinary action for errant CPA practitioners is the area of the appropriate regulator such as the BOA or the SEC. The Council will forward inspection reports on errant CPA practitioners to the relevant regulator for their appropriate disciplinary action.

47. Through its audit inspection unit (AIU), to monitor the quality of audits. The workhorse of the Council is the AIU (another one of the six important components. See paragraph 80 for matters affecting the AIU) . The AIU functionally reports directly to the Council and takes its orders from the Council.

48. Approves the QAR plan for the year. The annual work plan of the AIU will be submitted to the Council for their approval. In this way, any specific direction or instruction that the Council may have for the AIU can be incorporated in the work plan and carried out by the AIU.

49. To hire the Chief Inspector of the AIU. Since the AIU reports directly to the Council, this too would include the chief inspector. The Council should have the prerogative to hire this key figure in the audit assurance review program since they would heavily rely on his work output.

50. To obtain independent technical advice on the subject of Quality Assurance. The members of the Council will in all probability not have professional experience on Audit Quality Assurance, which certainly is a highly technical subject. The Council should seek independent professional advice on the subject whenever they deem it necessary . They may need this advice for instance, when they issue public statements, or when they promulgate policies, rules and regulations that would affect the CPA practitioners.

51. To receive and evaluate the reports of the AIU. An inspection report must be prepared for every QAR performed to show the results of the work performed and the results obtained. These reports must be confidential in nature and therefore will not be published nor made available to the public.

To fulfil its purpose of promoting high quality external audits, the QAR Council will forward a copy of the report to the audit management of the CPA Practitioner that was reviewed so that the latter could make necessary changes or improvement in his practice.

52. Refer matters to the BOA and other regulatory authorities if disciplinary action is required. To fulfil the Council's secondary purpose, it will forward a copy of inspection reports that show gross violations of auditing rules and standards to the BOA and other appropriate regulatory authorities for them to handle the disciplinary action that might be needed.

53. To issue an annual report for the benefit of the public. This annual report will tell the public the results of the QAR Council's "audit" of the auditors. The content of the annual report would be based on the AIU reports for their work during any one year. This report will cover only principal themes and issues arising from the inspection. It will not cover specific inspection reports on any practitioner. This report will be published and made public.

54. Membership of the QAR Council. - To give the appearance of credibility that the Council needs for its work to be accepted by the public, membership should include not only members from the BOA and from the accounting profession, but should include all the stakeholders who use financial statements and who would therefore benefit from a QAR program. To add further credibility, some independent third parties with a good reputation for integrity should be added to the Council. Furthermore, the Council should not have more than five (5) CPAs as members.

55. A proposed membership should include at least the following:

- Designees of regulatory agencies
 - Board of Accountancy
 - Securities Exchange Commission
 - Bangko Central ng Pilipinas
 - Office of the Insurance Commissioner
- Designee of PICPA
- Designee of the Philippine Stock exchange
- At least one person from the business community with known integrity
- The chief inspector of the AIU

56. Chairmanship of the QAR Council. - Credibility to the public is usually enhanced when the Chairmanship of an activity is given to an independent outside party. Consideration should be given to naming someone with known high integrity in the

business sector to chair the Council. A vice-chairmanship could be given to the member designated by the BOA.

57. Memorandum of Agreement Among Accrediting Agencies. -Under existing rules and regulations the following government entities accredit professional accountants who may be engaged to do work that will ultimately be submitted to them:

- Board of Accountancy
- Securities and Exchange Commission
- Banko Sentral ng Pilipinas
- Bureau of Internal Revenue
- Office of the Insurance Commissioner

58. A proposed Memorandum of Agreement is being worked out by some of the regulators so that the BOA will spearhead the accreditation function and the other regulators will recognize this accreditation. The purpose of the MOA is to avoid duplication of the accreditation process by each government agency. The MOA provides the following:

- the primary requirement for accreditation of SEC, IC and BIR shall be the BOA accreditation of CPA practitioners. The BOA accreditation process will take into account the specific requirements of the other agencies in addition to that which the BOA needs.
- The SEC BOA, BSP, BIR and IC shall form a “Council for Accreditation and Quality Control for Practicing CPAs.”
- The BOA was recognized as responsible for the conduct of the review of the quality control measures instituted by auditors to ensure their compliance with the accounting and auditing standards and practices.

59. The above “Council for Accreditation and Quality Control for Practicing CPAs” could be considered the forerunner of the QAR Council and the quality control aspect of the former council can be folded into the latter.

CPA PRACTITIONERS MUST ENROLL/REGISTER IN THE QAR PROGRAM- Third Component

60. In previous sections of this report we have shown that:

- BOA has the legal authority to conduct QAR work – but it does not have capability to do so.
- PICPA has the professional requirement to put in place a QAR program, but does not have the legal authority to enforce it.

61. Both BOA and PICPA could work together to successfully put in place a QAR program. Both their requirements could be met without duplicating efforts and resources to be used. To accomplish this, BOA should mandate:

- that PICPA create and house the Support Group to the QAR Council (SG-QARC) within its own organization
- all CPA practitioners to enroll in the QAR Program of the QAR Council through its Support Group.

62. BOA should include this mandate in the previously mentioned Quality Assurance Regulation that it would issue and to be discussed later in this report. This mandate is necessary because (a) we cannot expect PICPA to create and house the SG-QARC on its own; also, (b) we cannot expect the CPA Practitioners to voluntarily register for a QAR Program because, generally speaking, they would prefer not to have their professional work reviewed by a third party if they can avoid it.

63. The Support Group to QAR Council. – This unit would be rather self-contained with three main functions, which are:

- to accept and manage the registration of CPA Practitioners for the QAR program being put into place. The practitioners will be registering in different categories described below, depending mainly on the nature and size of their practice.
- To allocate and collect from CPA Practitioners registered with the QAR Program their allocated share in the program costs in an equitable manner.
- To house the Audit Inspection Unit (AIU) in a way to be further described below.

64. We describe the SG-QARC as self-contained because it will operate as follows:

- it will have its own specialized personnel dedicated to carrying out the QAR program.
- It will receive reimbursement for the QAR costs from registration fees imposed on CPA practitioners which funds should be segregated from PICPA's general funds and should be used only for the costs of the QAR program
- There should be separate accounting for the funds received and costs incurred to assure that the funds are used only for QAR program costs.

65. -Audit Inspection Unit Housed in SG-QARC. - The AIU will be manned by qualified personnel to be headed by the Chief Inspector. (see main discussion of the AIU starting with paragraph 80). The AIU will do the quality assurance review work on practitioners. It is the workhorse of the QAR Council and therefore must report directly to the Council.

66. The AIU needs a legal entity where it can be attached to because the QAR Council, as it is being presently constituted, does not have to be a legal entity. We have previously mentioned that it is not suitable to house the AIU directly under the BOA. The SG-QARC would be the ideal place to house the AIU for the following reasons:

- PICPA is already an existing private legal entity. The SG-QARC and the AIU are both directly identified with and support the QAR program
- As a non-government entity the SG-QARC is more flexible to pay market rates for personnel and to accommodate the needs of the AIU especially in the early stages of implementing the QAR program.

67. Organization and Reporting status of AIU Explained. - The organization and reporting status of the AIU needs to be further explained because previously it was mentioned that the AIU reports directly to the QAR Council. We then mention that the AIU should be housed in the SG-QARC. This apparent contradiction needs to be explained, as follows:

- a. The AIU is the workhorse of the QAR Council. As such it should operationally report directly to the Council and take instructions from it and be guided by its policies.
- b. The AIU is being housed within PICPA's SG-QARC unit so that it can have a legal personality when it acts.
- c. The AIU reports to PICPA for administrative purposes only.
- d. The term for administrative purposes means:
 - The AIU will nominally be PICPA employees. They will be subject to its normal office rules such as office hours, holidays etc.
 - The AIU will not be subject to the authority of PICPA's board of directors or any of its officers with respect to the following:
 - i. determining their compensation levels
 - ii. determining their work plan for the year
 - iii. determining the nature, time and extent of their work for individual inspections
 - iv. their work and their reports which are to be considered confidential

68. How PICPA will set up the SG-QARC Unit. - PICPA's organizational Objectives are contained in Section 1, Article 1 of its By-laws entitled Name, Objectives and Values, which states:

“PICPA adheres to the highest ideals of professionalism and commitment to service and upholds such values as: integrity, professional excellence, innovation, discipline, teamwork, social responsibility and commitment.”

69. The QAR program clearly falls within many of the above-cited objectives, to wit:

- it will enhance professionalism
- it will uphold integrity, professional excellence, discipline, social responsibility and commitment.

70. Since the QAR function falls clearly within the objectives of PICPA there is no need to amend PICPA's by laws for it to create this Unit. Since this function is a purely operational matter, the creation of the SG-QARC unit could be done similar to the creation of other operating units like a training unit, an accounting unit or an administrative unit. These units are created simply by Board of Directors action resolving and approving the creation of the unit.

71. The only logical opposition PICPA could go against the mandate of the BOA to created the SG-QARC , which would be quite unlikely, is :

- if they are against supporting a QAR program
- if they can propose and support an alternative set up for the QAR program

72. Registering CPA Practitioners under the Appropriate Risk Category. - The CPA Practitioners in the Philippines range from Firms that have a large number of clients to single practitioners with just a few small clients. The clientele of CPA practitioners can fall under three general categories or practices, each category attracting a certain degree of risk exposure to the public if an audit failure takes place:

- a. Practices that have for their clients listed companies, large companies, and small and medium-sized companies. Their work for listed companies gives them the highest risk exposure rating because any audit failure exposes the practitioner to a very large public.
- b. Practices that have for their clients large companies, and small and medium companies (No listed companies as clients) – Their risk exposure can be considered less than the previous category because any audit failure exposes the practitioner to a smaller public than the previous category.
- c. Practices that have for their clients only small and medium sized companies – Their risk exposure can be considered the least because audit failure exposes the practitioner to the smallest public.

73. The nature, timing and extent of the quality assurance review procedures to be applied to a CPA practitioner would normally be determined by the size and nature of his practice. The practitioner must enroll in the SG-QARC under the category appropriate to them.

74. Risk Categories of CPA Practitioners. -While there may be many ways to categorize the CPA practitioners, we suggest the following categories for enrollment:

75. Category A – registration for CPA practitioners handling clients that use the full IFRS- these would cover listed companies, those with public accountability and those meeting a certain size criteria specified by the Financial Reporting Standards Council (FRSC). This category will be further broken down into four sub categories:

Category	CPA Practitioners with
A (1)	Over 10 listed companies as clients
A (2)	1 to 10 listed companies as clients
A (3)	Over 10 non listed companies as clients
A (4)	1 to 10 non listed companies as clients

76. Category B – registration for CPA practitioners handling clients that use the IFRS for small and medium- sized companies. This category will be further broken down into four sub categories:

Category	CPA Practitioners issuing in one year
B (1)	over 200 audit reports
B (2)	101 to 200 audit reports
B (3)	51 to 100 audit reports
B (4)	1 to 50 audit reports

77. Registration Rules. - The following registration rules must be observed:

- a. A CPA practitioner can only register in one division.
- b. Practitioners registered under Category B cannot audit companies that use the full IFRSs, unless he upgrades his registration to Category A.
- c. A CPA practitioner registered under Category A must upgrade his registration if he exceeds the number of clients he registered for.
- d. A CPA practitioner registered under Category B must upgrade his registration if he exceeds the number of audit reports he registered for.

78. The CPA Practitioner will be subjected to the QAR procedures applicable to the category he registered in. Penalties must of course be assessed by the BOA on the practitioner who deliberately registers under the wrong category.

79. To strengthen control that the practitioner does not deliberately enroll in a lower category that he should, the documentation to be submitted by the Practitioner should clearly describe the nature and size of his practice to justify such enrollment.

AUDIT INSPECTION UNIT (AIU) WITH CAPABLE PERSONNEL- Fourth Component

80. Quality assurance review is a function that needs capable personnel to properly carry out the assignment. QAR is in effect “auditing the auditors”. They must have a capability to be better or at least equal to the auditors they will review, or they might be given a run around when they perform their work.

81. The AIU must have at least two key persons. The head of the AIU or the Chief Inspector would also be the head of the SG-QARC. The other key person would be the Chief of Administration, who reports to the head of the AIU.

82. Head of the AIU or Chief Inspector . -The main duties of the Head of the AIU would cover at least the following:

- a. Reports directly to the QAR Council and is a member of the Council
- b. Assists the QAR Council in determining the Quality Assurance policies
- c. Prepares the QAR review plan for each year, to be approved by the QAR Council
- d. Selects the CPA Practitioners to be reviewed for the year, in accordance with the annual plan
- e. Has the final authority for all inspection reports
- f. Approves the specific inspection plan for each practitioners selected for review, which sets forth the nature, extent and timing of such work
- g. Reviews and approves the individual inspection reports
- h. Assists the QAR Council to prepare the Annual Report
- i. Approves the hiring of technical and administrative personnel
- j. Provides for technical training of inspection personnel.

83. Basic minimum qualifications of the Chief Inspector. - A large portion of the time of the inspectors will be spent reviewing the audits of listed companies and other large companies with public accountability. The chief inspector must have experience in the audits of these companies (big audits) or he will find the work above his head. This fact, plus the other duties enumerated in the previous section of this report dictate that the Chief Inspector should have at least the following qualifications:

- a. He must have reached the level of senior manager or partner of a large accounting firm that has listed companies as clients.
- b. He must have at least 10 years of auditing experience, three years of which must be as a manager.
- c. He must not have left his firm because of infractions of auditing standards.
- d. He must have acceptable communication skills, both oral and written.

84. Appointment of the Chief Inspector of the AIU. - The appointment of the Chief Inspector must be approved by the QAR Council because of the impact of his work on the duties and responsibilities of the Council. The Council should be comfortable with the personality and the abilities of the Chief Inspector.

85. Main Duties of the Chief of Administration. - Another key person in the SG-QARC would be the person designated as Chief of Administration. He would be responsible for all the non-technical part of the QAR program. He reports to the Chief Inspector as Head of the Unit. The main duties of the Chief of Administration would include the following:

- a. Supervises the registration of CPA Practitioners in their appropriate categories
- b. Supervises the process of obtaining reimbursement of the QAR Program costs from registered CPA Practitioners
- c. Supervises the production of the technical inspection reports and the annual report
- d. Supervises the preparation of the regular financial statements of the Unit
- e. Hires administrative personnel, subject to approval by the Head of Unit
- f. Supervises the administrative aspect of training to personnel
- g. Supervises communications to all Practitioners.

The term “supervises” includes:

- ensuring that an appropriate system exists for the function that he is supervising, and
- appropriate personnel have been assigned to do the job.

86. Assistants for the Chief of AIU and Chief of Administration. - The Chief of AIU will hire technical assistants who have audit experience to assist him carry out the inspection work plan for the year approved by the QAR Council. They should carry out their inspection work in accordance with the prescribed methodology. They will report directly to the Chief of AIU.

The Chief of Administration will hire appropriate clerical assistants to help him/her carry out the administrative tasks of the Unit. The hiring of these assistants must be approved by the Head of Unit. These assistants will report directly to the Chief of Administration

87. In Charge Level Inspectors. - The In-charge is defined as the person who is responsible for the fieldwork of a QAR assignment. The minimum qualifications of this person require competence and experience in the audit of large companies so that they could do their work credibly. These qualifications should be:

- a. he must have reached the level of a senior auditor in a large accounting firm
- b. he must have at least 3 years experience in the audit of a large or publicly listed company

- c. the reason for leaving his accounting firm should not be on the basis of “incompetence” or because he was rated below average.

88. The Beginning Plantilla and Salary levels. - The Beginning Plantilla and salary levels of the SG-QARC, which would include both the AIU and the Administration complement is shown below.

Position	No.	Salary Per Month	Annual Cost
Technical			
Chief of AIU	1	120,000	1,560,000
In charge level	3	80,000	3,120,000
Assistants	3	50,000	1,950,000
Administrative			
Chief	1	60,000	780,000
Assistants	3	30,000	1,170,000

As the AIU gathers steam, the need to increase the number of in charges and assistants should be considered in the future.

METHODOLOGY FOR QAR- Fifth Component

89. Under the terms of reference of this engagement, the methodology for quality assurance review is to be worked on by another group of consultants. Their work will be submitted in a separate report accompanying this report.

The work methodology should :

- a. be tailor-made to suit the Philippine environment , and
- b. cover basically the QAR work of practitioners enrolled in Division A-companies using full IFRSs (usually large-sized practice) .

This methodology will be adapted by the AIU to suit the QAR work of practitioners enrolled in Division B – companies using the IFRSs for small and medium-sized companies (practices that are medium and small-sized).

The QAR personnel would need to receive orientation and training on the QAR methodology that they will use.

FUNDING- Sixth Component

90. The ability to implement a QAR program for the Accounting Profession in the Philippines would depend on the ability to raise the funds for its cost. The following factors should be considered in determining a funding plan:

- a. There is no present funding provision anywhere except where the Accountancy Law mentions that the functions of the Board of Accountancy should be provided in the Annual Budget of PRC. There has never been any budget provision for this function in the past.
- b. In some countries the quality assurance function costs are shared by accounting practitioners by an annual fee which is meant to cover the registration, conducting the QAR review for the year, issuing reports on individual review jobs, and making an annual public report.

91. The ability to raise funds for the project will be directly in proportion to the desire of the BOA to carry out the QAR function. They must be able to use their authority in ways never used before, and be able to face any criticism they may encounter in their efforts.

92. In the absence of any legislation on the matter, the idea suggested below is **one way** to go about funding the QAR program in the Philippines. There are several traditional sources of funds for any professional project. These would include (1) contributions from the professionals themselves, (2) contributions from professional and civic organizations, (3) contributions from the government, (4) others, such as interest income from unused funds. These alternatives are not considered at this time.

93. Initially, the funds should be derived from QAR fees collected from Practitioners as their equitable share in the cost of the QAR program. The other sources can be tapped later on.

94. **What must BOA do.** - To start off the QAR program and ensure its financial viability, the BOA must:

- a. Require all practitioners to register in the QAR Program of the QAR Council. Registration will be handled by the SG-QARC.
- b. Permit the program costs to be charged and recovered from the CPA practitioner participants under an equitable plan.

The requirement for the plan to be equitable is discussed in starting with paragraph 96.

95. Overcoming Objections from Practitioners, - Initially we can expect objections from the CPA practitioners for any assessments imposed on them for the QAR. The BOA must impress on them that:

- a. Having a QAR program in place in a country is a measure of the maturity and quality of the accounting profession in a country
- b. Failing to have a QAR program in place would be a black mark on the accounting profession as a whole, because in the whole accounting architecture in the Philippines, the QAR is the big missing link.
- c. The Philippine CPAs have in the past received desirable recognition from their peers regionally and internationally without them having to pay anything for it.
- d. Continuing this recognition and sustaining the respectability by establishing a QAR program now will cost – and the CPAs should be willing to bear their fair share of this cost as they are the direct beneficiaries of this recognition.
- e.

96. Requirement for the Plan to be Equitable. - Any funding plan which intends to be imposed on the CPA Practitioners (to be referred to as Annual Fee) must be equitable. To be equitable the annual fee must take into account the following factors:

- the **nature** of the practice
- the **extent** of quality assurance work to be applied
- the **timing** or frequency of the QAR.

We discuss below briefly the above three factors:

97. Nature of the Practice.- The nature of a practice can be described by the clientele that the CPA practitioners have and their risk exposure to the public for any audit failure that might occur. For example, practitioners who have listed companies among their clients have much higher risk exposure to the public. The QAR work would be more extensive in their case, and therefore they would be allocated a higher amount of annual fee.

98. Their nature could also be described by the relative size of their practice. At present there is no complete data about the relative size of all the Practitioners in the Philippines. There are some general impressions about the relative size of some of the larger Practitioners - but none whatsoever for the smaller- sized ones.

99. Because of this lack of data on size, the proposed funding plan takes size into consideration by **assuming** that the greater number of audit reports issued by a Practitioner in a year, the larger is his practice. Therefore the larger the annual fee.

100. Extent of Quality Assurance Work to be Applied. - The extent of quality assurance work to be applied to a Practitioner will be determined by the Risk category that he falls into. For instance, a practitioner that has publicly listed companies among its clientele falls within category A (1) which has the highest risk exposure. This practitioner would get a full scope QAR as provided for by the QAR methodology adopted.

101. Timing or frequency of the QAR. - Timing or frequency of the QAR will be determined by either the risk or size profile of a CPA Practitioner, or both. The

Practitioner with the highest risk profile would be subject to an annual QAR. Those determined to have a lesser risk profile would be subject to a less frequent QAR. Every effort should be made to cover all practitioners over a three-year period.

102. Why some firms would have annual inspections. - Practitioners may ask why some of them would have annual inspections and not say every three years. The answer is that the Practitioners who are targeted for annual audits are the larger ones who have certainly more than one partner. For a multi-partnered firm it would not be possible to do a QAR for all the partners in one year. The succeeding annual QAR would cover the work of partners not reviewed in previous years.

103. The Proposed Funding Plan . - The following **Figure 1** on page 29 sets forth the proposed fund plan. The information used and rationale for the amount charged to a CPA practitioner are also shown below.

As mentioned earlier, data on the size of Practitioners is not available. The only information we can work on is the following:

Total number of practitioners accredited by the SEC	116
Total number of practitioners accredited by the BOA (excluding the 116 with SEC)	4006

The SEC breakdown of the 116 Practitioners is as follows:

SEC Class A – practitioners of public- listed corporations, public corporations with total assets of at least P50 million, or with 200 or more stockholders, each owning at least 100 shares of a class of equity securities	33
SEC Class B, C and D – practitioners of all other corporations which need SEC accreditation (examples – pre- need, brokers and dealers of securities, investment companies, financing companies, transfer agents, etc.)	83
Total	<u>116</u>

104. Rationale for the Annual Fee to Practitioners. - The rationale for the annual charge to practitioners is based on the previous discussion on requirements for the plan to be equitable .

Category	Annual Fee	Rationale
Listed		
Over 10 companies- A (1)	250,000	Riskiest, annual QAR, full scope
		QAR, largest- sized firm
1-10 companies – A (2)	200,000	Riskiest, annual QAR, full scope
		QAR, larger- sized firm
Not listed		
Over 10 companies- A (3)	150,000	Less risky, QAR every two years,
		full scope, larger- sized firm
1-10 companies- A (4)	100,000	Less risky, QAR every two years,
		full scope, smaller sized firm
Small, medium sized		
Companies- audit reports issued		
Over 200 - B (1)	30,000	Least risky, QAR every three
		years, scope for SME, largest
		of this category
Over 100 to 200- B (2)	20,000	Least risky, QAR every three
		years, scope for SME, smaller
		than previous category
Over 50-100 - B (3)	8,000	Least risky, QAR only when
		selected in a sample for the
		Year, scope for SME *
1-50 - B(4)	4,000	Same as previous category,
		but smaller *

*Explanatory note –All CPA Practitioners will be covered by the QAR Program at least once every three years. The frequency “when selected in a sample for the year” refers only to SITE VISITS. Those not sampled for a site visit would be included in the program by requiring them to answer a questionnaire, submit a description of their quality control procedures, or comply with some other requirements short of a site visit.

105. Estimated Collections from Proposed Funding Plan. - The proposed plan, based on assumptions and rationales described in previous paragraphs of this report, is depicted in **Figure 1** (page 29)

The first iteration, based on assumptions of risk profile and probable size of practitioners gives an estimated annual fee collection of P32.5 to P36.0 million

The second iteration, which takes a more conservative assumption that all practitioners of small and medium sized clients pay the minimum annual fee of P4,000 P29.7 million

106. Allowance for fee reduction or non-collection. - If we provide for an overall 25% allowance for reduction of fees or from non-collection, the estimated collectible amounts to the following:

First iteration P24 to P27 million
Second iteration P22 million

107. Proposed Funding Plan

First Iteration						
Category	% Of Population	Est. No. Practitioners		Annual Fee	Total Fee	
		From	To		From	To
Class A (IFRS)						
Listed						
over 10 companies		2	4	250,000	500,000	1,000,000
1-10 companies		3	6	200,000	600,000	1,200,000
Non-listed						
over 10 companies	33-50%	30	50	150,000	4,500,000	7,500,000
1 to 10 companies	67-50%	81	56	100,000	8,100,000	5,600,000
Subtotal		116	116		13,700,000	15,300,000
Class B (SME)						
Number of audit reports issued / year						
over 200	1 to 2%	40	80	30,000	1,200,000	2,400,000
101 to 200	2 to 3%	80	120	20,000	1,600,000	2,400,000
51 to 100	3 to 4%	120	160	8,000	960,000	1,280,000

1 to 50	94 -91	3,760	3,640	4,000	15,040,000	14,560,000
Subtotal		4,000	4,000		18,800,000	20,640,000
Total collectible – First Iteration						32,500,000
Second Iteration						
Assuming class B all pay the minimum		4,000		4,000	16,000,000	
From the larger firms – see above					13,700,000	
Total collectible - Second Iteration						29,700,000

Figure 1.

USE OF THE COLLECTED FUNDS

108. Savings Generated. - Housing the Audit Inspection Unit (AIU) under PICPA has mutual benefits to both the QAR program and to PICPA. The QAR program is relieved of paying certain monthly fixed costs such as office rental, utilities (light and water) and other occupancy expenses such as security, janitorial and other services. On the other PICPA benefits directly because it is relieved of paying the direct costs of the QAR function (payroll and direct operating expenses), which it had to do if it were to carry out the QAR program itself

109. Costs vs. expected revenues - Based on an initial budget shown below as **Figure 2**, expected costs for operating one year amounts to the following:

Salary costs	P 12,000,000
Operating expenses	7,900,000
First time costs – computers, furniture etc	<u>1,000,000</u>
Total	<u>P 20,900,000</u>
Rounded	<u>P 21,000,000</u>

This P21,000,000 falls below the expected collections, as follows:

First iteration of revenues	24 to 27 million
Second iteration	22 million

It looks like the costs and expected revenues are doable.

110. **Initial Budget.** – The initial budget for one year’s operations is as follows:

INITIAL BUDGET

Salaries - technical	Per month (in Php)		Per year (in Php)
Salaries - administrative, fringe benefits			
contingencies (See details below)			
Total salaries			12,000,000
Operating expenses			
Honoraria - council members	100,000		1,200,000
Travel	200,000		2,400,000
Communications	50,000		600,000
Supplies	100,000		1,200,000
Meeting expenses	10,000		120,000
Training			500,000
Misc	150,000		1,800,000
Total Operating expenses			7,820,000
Total salaries and expenses			19,820,000
Rounded off			20,000,000
Details of Salary Costs			
Technical			
Chief Inspector		120,000	1,560,000
In charge level		80,000	3,120,000
Assistants		50,000	1,950,000
			6,630,000
Administrative			
Aministrative head	1	60,000	780,000
Assistants	3	30,000	1,170,000
Bookkeeping		25,000	300,000
			2,250,000
Subtotal			8,880,000
Fringe benefits			1,120,000
Subtotal			10,000,000
Contingencies			2,000,000
Total Salary Cost			12,000,000
First Time Expenditures			
Computers			

Technical staff		50,000		150,000
Admin staff		50,000		50,000
Furniture				300,000
Others not specified				500,000
Total				1,000,000

Figure 2

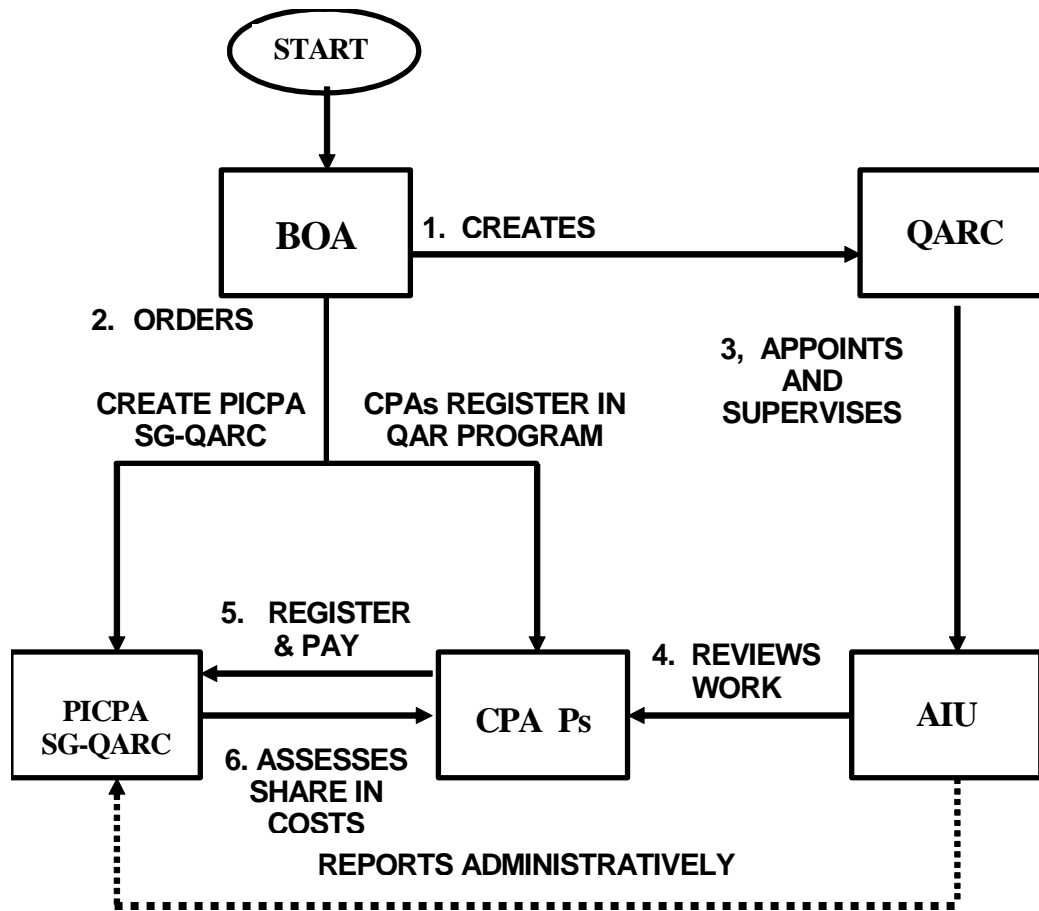
SCHEMATIC DIAGRAMS TO SHOW RELATIONSHIPS AND WORKFLOW

111. To recap the previous discussions we show below two diagrams, which are self-explanatory when read with the explanations below them. These are:

- **Schematic Diagram of Actions BOA Must Undertake to Put the QAR Program into Place, and Interrelationships of Entities – Figure 3**
- **Diagram for QAR Reports Flow, and Action If Needed –Figure 4**

(This space is left blank- continue next page)

SCHEMATIC DIAGRAM OF ACTIONS BOA MUST UNDERTAKE TO PUT QAR PROGRAM INTO PLACE, AND INTERRELATIONSHIPS OF ENTITIES



Legend:

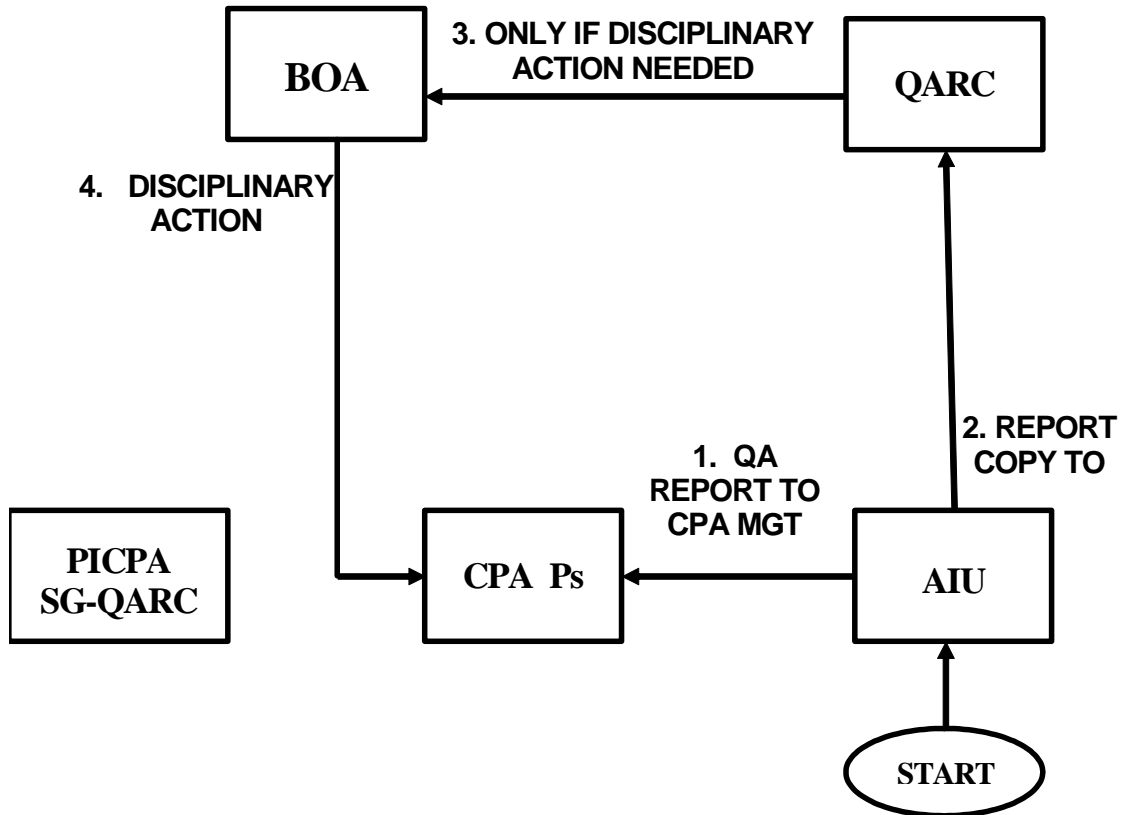
- BOA** = Board of Accountancy
- QARC** = Quality Assurance Review Council
- AIU** = Audit Inspection Unit
- PICPA SG-QARC** = PICPA Support Group to QARC
- CPA Ps** = CPA practitioners

Steps:

- 1 BOA creates the QARC, an independent body
- 2 BOA mandates (a) PICPA to create a Support Group to QARC and (b) mandates Practitioners to register with the Quality Assurance Review Program of QARC.
3. QARC appoints AIU and supervises its work.
4. AIU reviews work of Practitioners under the QAR Program.
5. Practitioners register and pay their share of costs to PICPA SG-QARC.
6. SG-QARC assesses share in costs of CPA Ps in the QAR Program.

Figure 3

DIAGRAM FOR QAR REPORTS FLOW, AND ACTION IF NEEDED



The previous diagram shows that the AIU will review the quality control of selected practitioners. This will result in a report on the inspection. The workflow of this report is as follows:

The QAR reports will be sent to:

1. the CPA Ps audit management for their corrective action, if any is needed
2. the QAR Council for their information and use:
 - a. to forward a copy to the BOA if any disciplinary action is needed
 - b. to use as basis for preparing the annual report to the public
3. BOA will receive the reports on those that require disciplinary action. The Board would then start disciplinary action whenever warranted.

Figure 4

IMPLEMENTATION OF A QAR PROGRAM

112. QAR Program Regulations. -. A major first step in putting in place a QAR program is to issue a Regulation on the subject. Paragraphs 41 and 62 of this Report mentions the need for issuing a Quality Assurance Review Regulation. This section of the Report will discuss the following matters about this regulation:

- should this be a new regulation or an add-on to an existing regulation
- structure of the regulation
- contents of the regulation
- draft of the regulation

113. New Regulation or not.- What does the law (RA9298) state?

Sec. 9. Powers and Functions of the Board. – The board shall exercise the following specific powers, functions and responsibilities:

(h) to conduct an oversight into the quality of audits of financial statements through a review of the quality control measures instituted by auditors in order to ensure compliance with the accounting and auditing standards and practices.

Commentary:

- the law gives the BOA unequivocally the power to set up a QAR program. This is a stand alone authority, not dependent on other factors
- there is a specific purpose for QARs stated in the law. Its purpose should not be mixed up with other provisions of the law which may have other purposes
- the QAR program is usually a rather long and involved process.

114. What do the existing Implementing Rules and Regulations (IRR) state? - It states that Registration with the PRC and BOA is a necessary procedure for all CPA Practitioners if they want to be accredited by the BOA to practice Public Accountancy. This is required by RA 9298, Article 1V, Practice of Accountancy, Sec. 31, Accreditation to practice public accountancy.

115. The IRR of the Accountancy Law has been provided with Annex B covering rules for the Accreditation of CPA Practitioners. Paragraph 3 (a) of these rules entitled Quality Review specifically **provide that a quality review is a condition to registration for accreditation**, or any renewal thereof. We cite this paragraph below:

3 (a) The Board shall require as a condition to registration or any renewal thereof for the individual CPA, Firms or Partnerships of CPAs to undergo quality review in such manner as the Board may specify, provided, however, that any such requirement shall include reasonable provisions for compliance by a registrant

showing that he/she /it has undergone a satisfactory quality review performed for other purposes which is substantially equivalent to quality review and shall be made applicable to all Individual CPAs, Firms or Partnerships.

116. Commentary - The power to accredit accounting firms is also another specific function of the BOA and the law specifically provides that registration of the Practitioner with the PRC or BOA achieves this purpose. Registration is usually a relatively simple and short process.

- Accreditation has its own purpose quite different from the purpose of a QAR program. It may not be appropriate to mix these two purposes together.
- Accreditation is accomplished by proper registration of the Practitioner. Registration is rather a short process and would be much simpler than a QAR program.
- The IRR Annex B requirement for quality review to be a condition precedent to registration should be modified. The enrollment in the QAR program should be the condition precedent- not the quality review itself.

117. Conclusion – a new rule is needed - From the commentary in the previous paragraph it is quite evident that it would not be appropriate to make the QAR process a condition precedent to the accreditation process, because:

- the QAR program and accreditation are each stand-alone authorities of the BOA.
- the nature of a QAR program is rather long and complicated; that of accreditation is shorter and easier.
- they each have their own objectives, which are quite different from each other.

We must conclude that the Quality Assurance Review Regulation must be a new Regulation to support Article II, Sec. 9 (h).

118. Effects of a New Rule - What does this mean?- It means that **the** requirement for a QAR to be condition to registration for accreditation should be dropped:.

- Therefore all paragraphs in Annex B pertaining to QAR should be excised from this Annex.
- The 3-year registration rule provided in the law and IRR is applicable only to registration for accreditation. Since the QAR program is not part of accreditation, then this 3-year rule does not apply to the QAR program.
- The registration requirement of Practitioners with the PRC and BOA provided in the law and IRR is applicable only for the accreditation process. BOA's requirement for Practitioners to enroll in the QAR Program does not violate any law or regulation because none presently exists for this program.

119. Structure of the QAR Regulations. - The parties who would be affected by a QAR regulation would be the following:

- the stakeholders interested in improving the audits of financial statements
- PICPA, because they would have to create the SG-QARC unit
- Practitioners, because they are the ones on which the QAR program is being imposed on.

120. The structure of the Regulation would follow the needs of parties mentioned above. There would be the main regulation followed by two annexes, as follows:

- **Main regulation (Appendix 1)** – this describes the authority, the reasons for, and the overall plan for setting up and administering the QAR program
- **Annex 1 (Appendix 2)** – this describes the creation, composition and operation of the independent Quality Assurance Review Council; it will also describe the Audit Inspection Unit, the workhorse of the Council
- **Annex 2 (Appendix 3)**– this describes the role of the Support Group – QARC of PICPA in the QAR Program, and the obligation of all CPA Practitioners to enroll under such program.

Drafts of these regulations are attached as Appendix 1, 2 and 3 of this report.

LINK WITH THE REGULATIONS ON PRACTITIONER ACCREDITATION

121. These regulations are linked with the regulations on practitioners' accreditation only in the following ways.

- (a) these regulations supersede the existing provisions on the subject of quality control incorporated in the rules and regulations implementing Section 31, Article 1V of the Republic Act No. 9298 otherwise known as the Philippine Accountancy Act of 2004 covering the accreditation of individual CPA firms and partnerships of CPAs engaged in the practice of public accountancy.
- (b) Withholding, suspending or cancelling a CPA Practitioner's accreditation arises for failure to register in the QAR Program of the QAR Council, or failure to register in the proper risk category.

SANCTIONS AND PENALTIES

122. The main purpose of a QAR program is to determine the extent of compliance with prescribed professional, ethical and technical standards of public practice. The intention is to **uplift** the practice of the profession to an acceptable higher level. To ensure

compliance with this program and to encourage the improvement of sub-par audit performance, sanctions and penalties must be imposed.

123. Violations of these regulations would usually be in the nature of the following:

- Violations in not complying with these regulations:
 - (a) failure to register with the SG-QARC unit of PICPA, annually, and pay the annual fee
 - (b) failure to register in the correct risk category, whether intentional or unintentional
 - (c) failure to cooperate in the QAR required of them.

- Violations or non-compliance with prescribed standards as determined by the QAR on the audit practice. These violations have a wide range and could cover such matters as the following:
 - (a) failure to adopt quality control standards in the practice
 - (b) issuing audit reports without adequate evidence of work done
 - (c) issuing improper audit reports based on the evidence gathered.

- Failure to correct deficiencies noted in the QAR.

124. The sanctions and penalties to be imposed should be determined on a case to case basis based (a) on a progressive disciplinary system, and b) the severity of the offense, such as:

- warnings, fines, or a combination of both
- increase in the frequency of QAR imposed on a practitioner
- suspension of accreditation of the BOA with or without fines
- suspension of the CPA license, with or without fines
- cancellation of the CPA license.

Suspension of accreditation – this means during the period of suspension the practitioner cannot issue any audit report. If he does so, each audit report issued is invalid and would be subjected to a penalty because it would be a violation of his suspension.

Suspension of the CPA license – this means during the period of suspension the practitioner cannot practice at all. This is reserved for serious violations.

Note: - The monetary penalties are necessary to recognize that there is additional time and effort required of the AIU in keeping track of violators and their efforts to improve the quality of their work. The penalties also have to be large enough to discourage the practitioner from just agreeing to pay the penalties without making necessary improvements in his practice.

125. **Examples of violations and penalties.** - Since penalties and sanctions are determined on a case to case basis and is dependent on the nature and the seriousness of the violation, we cite below some examples of violations and the penalty it should draw. This will give a flavor and a general idea what violators can expect to face. The examples also illustrate the application of the progressive disciplinary system previously mentioned.

Example 1

Violation/Sanction – failure to register with the QAR program – warning plus fine of P1000, plus requirement to register within 60 days.

Failure to register within 60 days – penalty of P5,000 plus warning of suspension of accreditation, plus requirement to register within 30 days.

Failure to register within 30 days – suspension of accreditation for 60 days, plus fine of P20,000 plus requirement for registration before reinstatement of accreditation .

Example 2

Violation/Sanction – registration in the wrong risk category. Failure to register in Category A when it is required is serious because there is a serious misclassification of the practitioners risk exposure – fine of P100,000 for first offense, P200,000 for second offense, Suspension of accreditation for third offense; Misclassification in Category B is not so serious. Fine of P20,000 for first violation; P50,000 for second violation; suspension of accreditation for third violation.

Example 3 - progressive disciplinary action when a serious violation of auditing standard is found.

Violation/Sanction - failure to perform sufficient work to support an audit opinion ; none or insufficient audit working papers.

First violation -Penalty of P50,000 plus suspension of accreditation for 30 days; Conditional reaccreditation upon practitioner’s affirmation to properly support his audit work with required working papers plus agreement for another QAR of his work after one year.

Second violation – penalty of P75,000 plus suspension of CPA certificate for 60 days plus QAR after another one-year period.

Third violation- cancellation of CPA license.

COMMUNICATIONS TO PRACTITIONERS

126. Whenever there are regulations for any particular field of activity, there is a need to :

- inform those affected by the regulations about the existence of such regulations, or any additions or changes thereto.
- correspond to parties subject to the regulations about their particular involvement.

127. In this day and age, it is not expecting too much to assume that anyone practicing public accounting should possess or have access to a computer. Based on this premise, these regulations set forth the manner of informing CPA practitioners about the QAR program and communicating to them individually, as follows:

- these regulations on the QAR Program and any future additions or amendments thereto will be posted in the BOA and PICPA websites on the subject of QAR Program. Posting in this website will be deemed sufficient notice to all CPA practitioners who are now obligated to be aware of these regulations as posted, and to keep track of any changes thereto.
- All practitioners are required to have an official E-mail address which they must inform the SG-QARC unit of PICPA and the BOA accordingly of any changes thereto. Any communication to a CPA practitioner from the QAR Council or its Audit Inspection Unit by E-mail will be considered official communication to the Practitioner . Failure to heed or respond to such e-mail communication would be considered a non-compliance violation.

APPENDIX 1

RULES AND REGULATIONS IMPLEMENTING SECTION 9 (h), ARTICLE II OF REPUBLIC ACT NO. 9298 OTHERWISE KNOWN AS THE PHILIPPINE ACCOUNTANCY ACT OF 2004 COVERING AN OVERSIGHT INTO THE QUALITY OF AUDITS OF FINANCIAL STATEMENTS THROUGH A QUALITY ASSURANCE REVIEW PROGRAM

(The short name for these rules will be the Regulations for a QAR program)

AUTHORITY FOR A QUALITY ASSURANCE REVIEW PROGRAM

1. Section 9 (h), Article II of RA 9298 gives the specific authority to the Board of Accountancy (BOA) to conduct an oversight into the quality of audits of financial statements, as cited below.

“Sec 9. Powers and Functions of the Board. -

(h) to conduct an oversight into the quality of audits of financial statements through a review of the quality control measures instituted by the auditors in order to ensure compliance with the accounting and auditing standards and practices.” (This program will be referred to as the Quality Assurance Review (QAR) program.

2. **Quality Assurance Review.** – Definition. This is a study, appraisal or review by the BOA or its duly authorized representatives, of the quality of audit of financial statements through a review of the quality control measures instituted by an Individual CPA, Firm or Partnership of CPAs (henceforth collectively referred to as CPA Practitioners) engaged in the practice of public accountancy to ascertain his/her/its compliance with prescribed professional, ethical and technical standards of public practice.

Having a QAR program in place benefits those who use or rely on financial statements information because it answers their often asked question “who audits the auditors that they comply with the established standards of the profession?”

3. These regulations are being issued pursuant to the above stated provisions of RA 9282, and come in three parts, as follows:

- **Main regulation** – this describes the authority, the reasons for, and the overall plan for setting up and administering the QAR program

- **Annex 1** – this describes the creation, composition and operation of the independent Quality Assurance Review Council (QAR Council) which body will administer the QAR program as the duly appointed representative of the BOA. It also describes the Audit Inspection Unit (AIU) which will be the workhorse of the QAR Council.
- **Annex 2** – this describes the role of the Support Group to the QAR Council (SG-QARC) of PICPA in the QAR Program, and the requirement for all CPA Practitioners to enroll annually in the QAR program herein provided and share in the cost of such program.

MAIN REGULATION

WHY IS QUALITY ASSURANCE REVIEW (QAR) NECESSARY

4. The need for a QAR program to be implemented arises mainly from three main sources:

- the accountancy law, RA 9298
- the auditing standards in the Philippines
- a requirement by the International Federation of Accountants (IFAC) to have member institutes (e.g.PICPA) implement a quality assurance review program as a membership obligation.

5. QAR under the Accountancy Law. - The need for a QAR program under the law arises from the Accountancy Law (RA 9298) as previously cited above, which specifically authorizes the BOA to conduct such a program.

6. QAR under Auditing Standards in the Philippines.- The requirements for audit quality are contained in two auditing standards –

- Philippine Standards of Auditing (PSA) No. 220, Quality Control for an Audit of Financial Statements. This standard deals with specific responsibilities of personnel of CPA practitioners regarding quality control procedures for an audit of financial statements.
- Philippine Standards for Quality Control (PSQC) No. 1, Quality Control for Firms that Perform Audits and Review of Financial Statements, and other Assurance and Related Services Engagements. This standard deals with the CPA practitioners' obligation to establish a system of quality control designed to provide it with reasonable assurance that:
 - o The firm and its personnel comply with professional standards and regulatory and legal requirements, and

- The auditors' reports issued by the firm or engagement partners are appropriate in the circumstances.

The terms quality assurance and quality control are used interchangeably in these regulations.

7. The QAR program will in fact determine the extent that the CPA practitioners are observing the two above-mentioned standards when they audit financial statements of their clients.

8. QAR under International Professional Requirements of IFAC. - The worldwide accounting profession is embodied in IFAC. PICPA is the member Institute from the Philippines.

9. IFAC has issued seven (7) Statements of Membership Obligations (SMOs) which are meant to assist members (e.g. PICPA) in ensuring high quality performance by professional accountants. They cover the member body's obligations to support the work of IFAC, the work of the International Accounting Standards Board (IASB), and obligations regarding quality assurance and investigations and discipline.

10. SMO 1 covers the subject Quality Assurance. This subject is addressed at three levels - the engagement level, the firm level and the member body level.

For specific engagements – PSA 220 is relevant

For firm's responsibilities – PSQC 1 is relevant

For member body's responsibilities – SMO 1 is relevant.

11. SMO 1 requires a member body to ensure a mandatory QAR program is in place for those of its members performing audits. Where government, regulators or other appointed authorities perform any of the quality control functions, **member bodies should (a) use their best efforts to encourage those responsible for those functions to follow the SMO in implementing them, and (b) assist them in that implementation where appropriate.** This means that PICPA cannot shirk from the responsibility for quality assurance even if this may be mandated to be done by other authorities.

WHO ARE TO BE COVERED BY THE QAR PROGRAM

12. CPAs practice the public accounting profession either as an individual practitioner, a firm or a partnership. **The term CPA Practitioner or Practitioner will refer to either an individual practitioner, a firm or a partnership who perform audits of financial statements.**

13. The IRR of the Accountancy Law makes quality assurance applicable to all practitioners, whether they are an individual practitioner, a firm or a partnership (Sec.4,o) The auditing standards on quality control do not exempt small practitioners from the

standards – in fact there are special provisions on how they can comply with the standards. The IFAC’s SMO on Quality Assurance requires this to cover CPA practitioners performing audits of listed companies, as a minimum.

14. The factors that should be considered in making a decision whether the QAR program should cover all CPA practitioners, or only selected ones such as those doing audits of listed companies, are the following:

- a. there are only about 250 listed companies and their audits are concentrated among a few firms. These firms are invariably members of an international network of firms which usually already have in place an internal assurance review system.
- b. There are about 4000 CPA Practitioners registered to practice with the BOA. Since the professional regulation related to quality assurance has never been in place, anecdotal evidence tends to show that many practitioners do not practice quality assurance to the degree that they should.

15. The BOA has decided that these QAR Program Regulations will cover all CPA Practitioners, for the following reasons:

- a. Both the law and the applicable auditing standards do not make any exclusions from the coverage of the QAR Program .
- b. The subject of quality assurance, while provided for in the auditing literature, is not known to be widely practiced because there has never been any regulatory or professional supervision checking that it is actually being observed by CPA practitioners.
- c. The few CPA practitioners that belong to international networks which are known to have their own international quality assurance review programs, but the results of these programs are not made available to the public.
- d. Setting up a quality assurance review system entails a lot of effort. All that effort does not seem worthwhile if only audits of listed companies would be covered, because then only a few CPA practitioner firms would be covered by the program.
- e. There is a need to uplift the practice of accountancy in the Philippines to a higher acceptable level.

16. The audits of listed companies and large companies would require a more rigid observance of quality assurance by the CPA practitioner as compared to the audits of small and medium- sized companies. The QAR program would take this into account when determining the procedures required to review the audits of these different companies.

IMPORTANT COMPONENTS FOR A SUCCESSFUL QAR PROGRAM

17. Aside from the authority to initiate a QAR program (which already exists), there are five other important components that must co-exist. These are:

- **a credible entity to oversee the program**
- **a requirement for Practitioners to enroll in such a program**
- **an audit inspection unit with capable personnel**
- **a prescribed methodology to follow in the program**
- **adequate funding for the relevant costs.**

THE QUALITY ASSURANCE REVIEW COUNCIL (QAR Council)

18. A credible entity usually is involved in each country that has an ongoing quality control review program. Added credibility is obtained if the entity is independent, meaning accountable and reporting only to the public.

19. The BOA hereby creates the independent Quality Assurance Review Council (QAR Council) to act as the oversight body for the QAR Program.

20. To enhance the independence in fact and in appearance of the QAR Council, it shall have the following attributes:

- The Council will report only to the public. Where disciplinary action over a Practitioner is required, the BOA and other concerned regulatory agencies, will be provided information about the matter.
- The Chairman of the Council will not be either from the BOA or from PICPA. He should be someone independent with a good reputation for integrity.

21. Annex 1 of this Regulation will cover other relevant matters about the QAR Council such as its:

- composition and membership
- main purposes and duties

AUDIT INSPECTION UNIT (AIU)

22. The AIU is the workhorse of the QAR Council. As such it reports operationally directly to the QAR Council and takes instructions from it and is guided by its policies. On the other hand, it is housed in PICPA's Support Group to the QAR Council (SG-QARC) unit . It receives only administrative support from PICPA.

23. Annex 1 of this Regulation covers other relevant matters about the AIU such as its:

- organization and reporting status
- key personnel – qualifications and duties

CPA PRACTITIONERS MUST ENROLL/REGISTER IN THE QAR PROGRAM

24. This part of the regulation:

- **instructs PICPA to set up the SG-QARC unit**
- **requires CPA Practitioners to register in the proper risk category of the QAR Program of the QAR Council .**

25. SG-QARC unit of PICPA. - PICPA has a professional mandate imposed by the worldwide accounting profession to ensure a mandatory quality assurance review program is in place for those of its members performing audits. Where government regulators (like the BOA) perform this function, PICPA must use its best efforts to assist them to meet this requirement. **In this light we instruct PICPA to create a Support Group to the QAR Council as a Unit within its own organization.** The main functions of this Unit are to:

- accept and manage the registration in the appropriate risk category of CPA Practitioners in the QAR program
- house the Audit inspection unit
- allocate and collect from CPAs enrolled in the QAR program their share in the program costs in some equitable manner.

26. Annex 2 of these regulations will cover other relevant matters concerning the SG-QARC unit such as:

- how PICPA can set up the SG-QARC unit
- Risk categories
- Requirement for CPA practitioners to register in the appropriate risk category of the SG-QARC and pay their share of costs in the QAR program.

27. Registering CPA Practitioners under the Appropriate Risk Category. - These regulations hereby require all CPA practitioners to register with the SG-QARC of PICPA under their appropriate risk Category, as discussed further below. The registration is good for one year, to be renewed annually for as long as the CPA Practitioner intends to issue audit reports on financial statements of their clients.

28. These regulations hereby require all CPA practitioners to support the QAR Program by sharing in the cost of running the QAR program. In many other countries, this share of costs represents a legitimate cost of operating an accounting practice.

29. Risk Categories of CPA Practitioners. - The risk categories in PICPAs QAR Division in which each Practitioner must choose to enrol in are the following:

Category A – registration for CPA practitioners handling clients that use the full IFRS- these would cover listed companies, those with public accountability and those meeting a certain size criteria specified by the Financial Reporting Standards Council (FRSC). This category will be further broken down into four sub categories:

Category	CPA Practitioners with
A (1)	Over 10 listed companies as clients
A (2)	1 to 10 listed companies as clients
A (3)	Over 10 non listed companies as clients
A (4)	1 to 10 non listed companies as clients

Category B – registration for CPA practitioners handling clients that use the IFRS for small and medium- sized companies. This category will be further broken down into four sub categories:

Category	CPA Practitioners issuing in one year
B (1)	over 200 audit reports
B (2)	101 to 200 audit reports
B (3)	51 to 100 audit reports
B (4)	1 to 50 audit reports

30. Registration rules. -The following registration rules must be observed:

- a. A CPA practitioner can only register in one division
- b. Practitioners registered under Category B cannot audit companies that use the full IFRSs, unless he upgrades his registration to Category A.
- c. A CPA practitioner registered under Category A must upgrade his registration if he exceeds the number of clients he registered for.
- d. A CPA practitioner registered under Category B must upgrade his registration if he exceeds the number of audit reports he registered for.

Registration in the wrong category will result in penalties, which will be described under the section of penalties in this regulation.

31. Annex 2 of these Regulations cover other relevant matters concerning the registration fee for each category, and the rationale for each.

LINK WITH THE REGULATIONS ON PRACTITIONER ACCREDITATION

32. These regulations are hereby linked with the regulations on practitioners' accreditation the following way.

- (a) these regulations supersede the provisions on the subject of quality control incorporated in the rules and regulations implementing Section 31 , Article 1V of the Republic Act No. 9298 otherwise known as the Philippine Accountancy Act of 2004 covering the accreditation of individual CPA firms and partnerships of CPAs engaged in the practice of public accountancy.
- (b) failure to register with the QAR program of the QAR Council and failure to register in the proper risk category may cause the withholding of the accreditation of the Practitioner until the proper registration is accomplished

SANCTIONS AND PENALTIES

33. The main purpose of a QAR program is to determine the extent of compliance with prescribed professional, ethical and technical standards of public practice. The intention is to uplift the practice of the profession to an acceptable level, rather than to drag it down to the lowest level. To ensure compliance with this program and to encourage the improvement of sub-par audit performance, sanctions and penalties must be imposed.

34. Violations of these regulations would usually be in the nature of the following:

- Violations in not complying with these regulations:
 - (a) failure to register with the QAR Program annually, and pay the annual fee for share of costs
 - (b) failure to register in the correct risk category, whether intentional or unintentional
 - (c) failure to cooperate in the quality assurance review required of them.
- Violations or non compliance with prescribed standards as determined by the QAR on the audit practice. These violations have a wide range and could cover such matters as the following:
 - (a) failure to adopt quality control standards in the practice
 - (b) issuing audit reports without adequate evidence of work done
 - (c) issuing improper audit reports based on the evidence gathered

- Failure to correct deficiencies noted in the QAR.

35. The sanctions and penalties to be imposed will be determined on a case to case basis based on a progressive disciplinary system or the severity of the offense, such as:

- warnings, fines, or a combination of both
- increase in the frequency of QAR imposed on a practitioner
- temporary suspension of accreditation of the BOA with or without fines
- suspension of the CPA license, with or without fines
- cancellation of the CPA license.

Meaning of the following:

Suspension of accreditation – this means during the period of suspension the practitioner cannot issue any audit report. If he does, each audit report would be considered invalid and subjected to a penalty.

Suspension of the CPA license – this means during the period of suspension the practitioner cannot practice at all. This is reserved for serious violations.

Note: - The monetary penalties are necessary to recognize that there is additional time and effort required of the AIU in keeping track of violators and their efforts to improve the quality of their work.

36. Since penalties and sanctions are determined on a case to case basis and are dependent on the nature and the seriousness of the violation, we cite below some examples of violations and the penalty it should draw. This will give a flavor and a general idea what violators can expect to face. The examples also illustrate the application of the progressive disciplinary system previously mentioned.

Examples of violations and sanctions imposed

37. Violation /sanction – failure to register with the QAR program – warning plus fine of P1000, plus requirement to register within 60 days; failure to register within 60 days – penalty of P5,000 plus warning of suspension of accreditation, plus requirement to register within 30 days; failure to register within 30 days – suspension of accreditation for 60 days, plus fine of P20,000 plus requirement for registration before reinstatement of accreditation .

38. Violation /sanction – registration in the wrong risk category. Failure to register in Category A when it is required is serious because there is a serious misclassification of the practitioners risk exposure - a fine of P100,000 for first offense, P200,000 for second offense, suspension of accreditation for third offense; Misclassification in

Category B is not so serious. Fine of P20,000 for first violation; P50,000 for second violation; suspension of accreditation for third violation.

Example of progressive disciplinary action when a serious violation of auditing standard is found.

39. Violation /Sanction- failure to perform sufficient work to support an audit opinion ; none or insufficient audit working papers- First violation, penalty of P50,000 plus suspension of accreditation for 30 days; Conditional reaccreditation upon practitioner's affirmation to properly support his audit work with required working papers plus agreement for another QAR of his work after one year. Second violation, penalty of P75,000 plus suspension of CPA certificate for 60 days plus QAR after another one year period. Third violation, cancellation of CPA license.

COMMUNICATIONS

40. Whenever there are regulations for any particular field of activity, there is a need to:

- inform those affected by the regulations about the existence of such regulations, or any additions or changes thereto.
- correspond to parties subject to the regulations about their particular involvement.

41. In this day and age, it is not expecting too much to assume that anyone practicing public accounting should possess or have access to a computer. Based on this premise, these regulations set forth the manner of informing CPA practitioners about the QAR program and communicating to them individually, as follows:

- these regulations on the QAR Program and any future additions or amendments thereto will be posted in the BOA and PICPA website on the subject of QAR Program. Posting in this website will be deemed sufficient notice to all CPA practitioners who are now obligated to be aware of these regulations as posted, and to keep track of any changes thereto.
- All practitioners are required to have an official E-mail address which they must inform the PICPA SG-QARC unit and the BOA accordingly of any changes thereto. Any communication to a CPA practitioner from the QAR Council or its Audit Inspection Unit by E-mail will be considered official communication to the Practitioner . Failure to heed or respond to such e-mail communication would be considered a non-compliance violation.

42. Effectivity Date. These rules will take effect--

Annex 1 Accompanying the Main Regulations for a Quality Assurance Review Program Concerning (1) the Quality Assurance Review Council, and (2) Audit Inspection Unit.

Quality Assurance Review Council (QAR Council)

1. Creation. - The QAR Council was created by virtue of the Main Regulations which this Annex 1 is accompanying.

2. Main Purposes and Duties of the QAR Council. – The purposes and duties include the following:

- a. to promote, publicly and proactively, high quality external audits
- b. through its audit inspection unit (AIU) to monitor the quality of audits
- c. to approve the QAR plan for the year
- d. to hire the Chief Inspector of the AIU
- e. to obtain independent technical advice on the subject of quality assurance when needed and appropriate
- f. to receive and evaluate the reports and recommendations of the AIU
- g. to refer matters to the Board of Accountancy (BOA) if there is disciplinary action needed
- h. to issue an annual report for the benefit of the public.

These are briefly discussed below.

3. To promote publicly and proactively, high quality external audits. This is the reason for being of the QAR Council. The Council is the answer to the oft cited question “Who audits the auditors?”. They stand between the public and the CPA Practitioners attesting to the state of the auditing profession as a whole with regard to their compliance with established auditing rules and standards.

As their main function is to promote high quality audits, they are there to point out any major weaknesses in the auditing profession’s compliance with the established rules so that appropriate corrective action can be instituted by the CPA practitioners. This leads to higher quality audits. CPA Practitioners who have been found to be grossly non compliant with the existing standards of auditing must be held accountable for this. But it is only a secondary function of the Council. Disciplinary action for errant CPA practitioners is the area of the appropriate regulator such as the BOA or the SEC. The Council will forward inspection reports on errant CPA practitioners to the relevant regulator for their appropriate disciplinary action.

4. Through its audit inspection unit (AIU), to monitor the quality of audits. The work horse of the Council is the AIU. Matters affecting the AIU are discussed further below. The AIU functionally reports directly to the Council and takes its orders from the Council.

5. Approves the QAR plan for the year. The annual work plan of the AIU will be submitted to the Council for their approval. In this way, any specific direction or instruction that the Council may have for the AIU can be incorporated in the work plan and carried out by the AIU.

6. To hire the Chief Inspector of the AIU. Since the AIU reports directly to the Council, the Council should have the prerogative to hire the Chief Inspector. He is a key figure in the audit assurance review process because the Council would heavily rely on his work output.

7. To obtain independent technical advice on the subject of Quality Assurance. The members of the Council will in all probability not have professional experience on Audit Quality Assurance, which certainly is a highly technical subject. The Council should seek independent professional advice on the subject whenever they deem it necessary. They may need this advice for instance, when they issue public statements, or when they promulgate policies, rules and regulations that would affect the CPA practitioners.

8. To receive and evaluate the reports of the AIU. An inspection report must be prepared for every QAR performed to show the results of the work performed and the results obtained. These reports must be confidential in nature, will be submitted to the QAR Council, but will not be published nor made available to the public.

To fulfil its purpose of promoting high quality external audits, the QAR Council will forward a copy of the report to the audit management of the CPA Practitioner that was reviewed so that the latter could make necessary changes or improvement in his practice.

9. Refer matters to the BOA and other appropriate regulatory authorities if disciplinary action is required. To fulfil the Council's secondary purpose, it will forward a copy of inspection reports that show gross violations of auditing rules and standards to the BOA and other appropriate regulatory authorities for them to handle the disciplinary action that might be needed.

10. To issue an annual report for the benefit of the public. This annual report will tell the public the results of the QAR Council's "audit" of the auditors. The content of the annual report would be based on the AIU reports for their work during any one year. This report will cover only principal themes and issues arising from the inspection. It will not cover specific inspection reports on any practitioner. This report will be published and made public.

Membership of the QAR Council

11. Rationale – To obtain public acceptance of the QAR Council the membership of this Council should include not only members from the BOA and from the accounting profession, but should include all the stakeholders who use financial statements and who would therefore benefit from a QAR program. To add further acceptance, an independent third party with a good reputation for integrity should be added to the Council.

12. Council membership. - The Council will consist of the following:

- Designees of regulatory agencies
 - Board of accountancy
 - Securities and Exchange Commission
 - Bangko Central ng Pilipinas
 - Office of the Insurance Commissioner
- Designee of PICPA
- Designee of the Philippine Stock exchange
- At least one person from the business community with known integrity
- The chief inspector of the AIU

13. Chairmanship and vice-chairmanship of the QAR Council. - the independent outside party with known high integrity should be Chairman, to give added credibility to the Council. The member designated by the BOA will be the Vice-chairman of the Council.

AUDIT INSPECTION UNIT (AIU).

THE AIU WITH CAPABLE PERSONNEL

14. Rationale - QAR is a function that needs capable personnel to properly carry out the assignment. QAR is in effect “auditing the auditors”. They must have a capability to be better or at least equal to the auditors they will review, or they might be given a run around when they perform their work.

Organization and Reporting status of AIU Explained

15. The AIU will be manned by qualified personnel to be headed by the Chief Inspector. The AIU will do the quality assurance review work on practitioners. It is the workhorse of the QAR Council and therefore reports directly to the Council and takes its orders directly from the Council.

The AIU will however be physically housed in PICPA's Support Group to the QAR Council (SG-QARC). This means that it receives only administrative support from PICPA.

16. The phrase administrative support from PICPA means:

- The AIU will nominally be PICPA employees. They will be subject to its normal office rules such as office hours, holidays etc.
- The AIU will **not** be subject to the authority of PICPA's board of directors or any of its officers with respect to the following:
 - i. determining their compensation levels
 - ii. determining their work plan for the year
 - iii. determining the nature, time and extent of their work for individual inspections
 - iv. their work and their reports which are to be considered confidential .

17. Reason for Confidentiality. - The main reason for this confidentiality is because the work of the AIU gives them access and knowledge of the operations of Practitioners they are inspecting. This information is confidential and their accessibility to the PICPA board members or officers would raise questions of conflicts of interest, divulging of confidential information, etc. which could wreck the whole QAR program.

18. Key personnel of the AIU. - The AIU must have at least two key persons. The head of the AIU or the Chief Inspector would also be the head of the SG-QARC unit of PICPA. The other key person would be the Chief of Administration, who reports to the head of the AIU.

19. Head of the AIU or Chief Inspector . -The main duties of the Head of the AIU are at least the following:

- a. Reports directly to the QAR Council and is a member of the Council
- b. Assists the QAR Council in determining the Quality Assurance policies
- c. Prepares the QAR review plan for each year, to be approved by the QAR Council
- d. Selects the CPA Practitioners to be reviewed for the year, in accordance with the annual plan
- e. Has the final authority for all inspection reports
- f. Approves the specific inspection plan for each practitioners selected for review, which sets forth the nature, extent and timing of such work.
- g. Reviews and approves the individual inspection reports
- h. Assists the QAR Council to prepare the Annual Report
- i. Approves the hiring of technical and administrative personnel
- j. Provides for technical training of inspection personnel.

20. Basic minimum qualifications of the Chief Inspector. - A large portion of the time of the inspectors will be spent reviewing the audits of listed companies and other large companies with public accountability. The Chief inspector must have experience in the audits of these companies (big audits) or he will find the work above his head. This fact, plus the other duties enumerated in the previous section of this report dictate that the Chief Inspector should have at least the following qualifications:

- a. He must have reached the level of senior manager or partner of a large accounting firm that has listed companies as clients.
- b. He must have at least 10 years of auditing experience, three years of which must be as a manager
- c. He must not have left his firm because of infractions of auditing standards
- d. He must have acceptable communication skills, both oral and written.

21. Appointment of the Chief Inspector of the AIU. - The appointment of the Chief Inspector must be approved by the QAR Council because of the impact of his work on the duties and responsibilities of the Council. The Council should be comfortable with the personality and the abilities of the Chief Inspector.

22. Main Duties of the Chief of Administration. - Another key person in SG- QARC unit would be the person designated as Chief of Administration. He would be responsible for all the non-technical part of the QAR program. He reports to the Chief Inspector as Head of the Unit. The main duties of the Chief of Administration would include the following:

- a. Supervises the registration of CPA Practitioners in their appropriate categories
- b. Supervises the collection of registration fees
- c. Supervises the production of the technical inspection reports and the annual report
- d. Supervises the preparation of the regular financial statements of the Unit
- e. Hires administrative personnel, subject to approval by the Head of Division
- f. Supervises the administrative aspect of training to personnel
- g. Supervises communications to all Practitioners

The term “supervises” includes:

- ensuring that an appropriate system exists for the function that he is supervising, and
- appropriate personnel have been assigned to do the job.

23. Assistants for the Chief of AIU and Chief of Administration. - The Chief of AIU will hire technical assistants who have audit experience to assist him carry out the inspection work plan for the year approved by the QAR Council. They should carry out their inspection work in accordance with the prescribed methodology. They will report directly to the Chief of AIU.

The Chief of Administration will hire appropriate clerical assistants to help him/her carry out the administrative tasks of the SG-QARC unit. The hiring of these assistants must be approved by the Head of Unit. These assistants will report directly to the Chief of Administration

24. In Charge Level Inspectors. - The In-charge is defined as the person who is responsible for the field work of a QAR assignment. The minimum qualifications of this person require competence and experience in the audit of large companies so that they could do their work credibly. These qualifications should be:

- a. he must have reached the level of a senior auditor in a large accounting firm
- b. he must have at least 3 years experience in the audit of a large or publicly listed company
- c. the reason for leaving his accounting firm should not be on the basis of “incompetence” or because he was rated below average.

APPENDIX 3

Annex 2 Accompanying the Main Regulations for the Quality Assurance Program concerning (1) the Support Group to the QAR Council and (2) the Requirement for all CPA Practitioners to Enroll/Register annually in this Program as herein provided in these Regulations.

SUPPORT GROUP TO THE QAR COUNCIL (SG-QARC) OF PICPA

1. The accompanying Main Regulation on the Quality Assurance Review (QAR) program instructs PICPA to set up and house the Support Group to the QAR Council (SG-QARC) because (1) this is consistent with its own organizational objectives; and (2) its membership obligation to the International Federation of Accountants (IFAC) requires it to perform the QAR function or to assist the entity who may have the legal mandate to perform the function.

ON SETTING UP THE SG-QARC UNIT

2. PICPA's organizational Objectives are contained in Section 1, Article 1 of its By-laws entitled Name, Objectives and Values, which states:

“PICPA adheres to the highest ideals of professionalism and commitment to service and upholds such values as: integrity, professional excellence, innovation, discipline, teamwork, social responsibility and commitment.”

The QAR program clearly falls within many of the above-cited objectives, to wit:

- it will enhance professionalism
- it will uphold integrity, professional excellence, discipline, social responsibility and commitment.

3. Since the QAR function falls clearly within the objectives of PICPA there is no need to amend PICPA's by laws for it to create this Unit. Since this function is a purely operational matter, the creation of the SG-QARC unit could be done similar to the creation of other operating units like a training unit, an accounting unit or an administrative unit. These units are created simply by Board of Directors action resolving and approving the creation of the Unit.

REGISTRATION OF CPA PRACTITIONERS IN THE QAR PROGRAM

4. The Board of Accountancy (BOA) requires all CPA Practitioners to:

- register in the appropriate risk category with the SG-QARC
- support the QAR program by sharing in the cost of running the program, with other participants of the program , on some equitable basis (also referred to as the Annual Fee).

5. Quality Assurance – a necessary cost for operating a practice. - CPA practitioners must consider this new obligation as , specifically, their compliance with the required auditing standards on Quality Control ; and generally, their contribution for the good of the Philippine accountancy profession, as follows:

- Having a QAR program in place in a country is a measure of the maturity and quality of the accounting profession in the country. It answers the question “How do we know that Philippine CPAs actually follow the auditing standards that they say they are following when issuing audit reports on financial statements.”
- Failing to have a QAR program in place is a black mark on the accounting profession, as a whole, because in the whole accounting architecture in the Philippines, the QAR program is the big missing link.
- The Philippine CPAs have in the past received favourable recognition from their peers regionally and internationally without the having to pay anything for it.
- Continuing this recognition and sustaining the respectability by establishing a QAR program now will have a cost – and the CPA practitioners should bear their fair share of this cost as they are the direct beneficiaries of this recognition.
- Quality assurance is a required cost for running an audit practice just as a practitioner would have to pay for occupancy cost or salaries .

6. Equitable sharing in the cost of a QAR program. - To be equitable, the annual charge to Practitioners takes into account the following factors:

- the **nature** of the practice
- the **extent** of quality assurance work to be applied
- the **timing** or frequency of the QAR.

These are discussed below briefly:

7. Nature of the Practice. - The nature of a practice can be described by the clientele that the CPA practitioners have and their risk exposure to the public for any audit failure that might occur. For example, practitioners who have listed companies among their

clients have a much higher risk exposure to the public and therefore are allocated a higher annual fee.

8. Their nature could also be described by the relative size of the practice. At present, however, there are no adequate data about the relative size of all the Practitioners in the Philippines. There are some general impressions about the relative size of some of the larger sized Practitioners - but none whatsoever for the smaller- sized ones. Because of this lack of data on size, the Annual Fee takes size into consideration by **assuming** that the greater number of audit reports issued by a Practitioner in a year, the larger is his practice; therefore a greater exposure to the public – hence a larger annual fee.

9. Extent of Quality Assurance Work to be Applied. - The extent of quality assurance work to be applied to a Practitioner will be determined by the Risk category (described in Paragraph 12) that he falls into. For instance ,a practitioner that has publicly listed companies among its clientele falls within category A (1) which has the highest risk exposure. This practitioner would get a full scope quality QAR inspection as provided for by QAR methodology adopted – therefore he gets a higher annual fee.

10. Timing or frequency of the QAR. - Timing or frequency of the QAR will be determined by either the risk or size profile of a CPA Practitioner, or both. The Practitioner with the highest risk profile would be subject to an annual QAR. Those determined to have a lesser risk profile would be subject to a less frequent QAR. Every effort should be made to ensure that all Practitioners would have a QAR every three years.

11. Why some firms would have annual inspections. - Practitioners may ask why some of them would have annual inspections and not say every three years. The answer is that the Practitioners who are targeted for annual audits are the larger ones who have certainly more than one partner. For a multi-partnered firm it would not be possible to do a QAR for all the partners in one year. The succeeding annual QAR would cover the work of partners not reviewed in previous years.

Annual FEE For the QAR Program -

12. The annual fee (registration fee) depends on which risk category the Practitioner registers with the SG-QARC unit of PICPA. The risk category, annual fee, and rationale for the fee are described below:

Risk Category	Annual Fee	Rationale
----------------------	-------------------	------------------

Category A. - Using the FULL IFRS

Listed – No. of clients

A(1) with over 10 companies	250,000	Riskiest, annual QAR, full scope QAR, largest- sized firm
A(2) with 1- 10	200,000	Riskiest, annual QAR, full scope QAR, larger- sized firm
Not listed- No. of clients		
A(3) -Over 10 companies	150,000	Less risky, QAR every two years, full scope, larger- sized firm
A(4) – 1 to 10 companies	100,000	Less risky, QAR every two years, full scope, smaller- sized firm
Category B- using the SME Accounting standards – No. of Audit reports issued		
B(1) Over 200	30,000	Least risky, QAR every three years, scope for SME, largest of this category
B(2) 101 – 200	20,000	Least risky, QAR every three years, scope for SME, smaller than previous category
B(3) 51-100	8,000	Least risky, QAR only when selected in a sample for the year, scope for SME (see*)
B(4) 1 – 50	4,000	Same as previous category, but smaller (see*)

* Explanatory note – All CPA Practitioners will be covered by the QAR program at least once every three years. The frequency “when selected in a sample for the year” refers to SITE VISITS. Those not selected for a site visit would be included in the program by asking them to answer a questionnaire, submit a description of their current quality control procedures, or comply with some other requirement short of a site visit.