VIII. Accounting and Auditing Practices in the Philippines

1. Challenges and Responses

Policies pursued over the past decade have had major positive results, but events over the past four years highlight that much remains to be done. The task is to restore the growth momentum and investor confidence of the mid-1990s through policies that prevent a return to boom-and-bust cycles.

Against this background, two imperatives are to deal with the still quite pervasive legacy of the past, such as low savings rates, widespread poverty, accommodation of rent-seeking activities (e.g., graft and corruption), and a weak public sector; and to successfully manage the challenges of globalization, allowing the country to realize the integration benefits while minimizing the associated risks of excessive leverage, currency overvaluation and sudden capital flow reversals.

In particular, this agenda includes: (i) maintaining prudent macroeconomic policies, with emphasis on avoiding fundamental inconsistencies that risk disruptive shifts in capital flows; (ii) raising domestic savings and investment from the current unsustainable low levels; (iii) further leveling the playing field through domestic and external liberalization, as well as effective programs to assist the poor and to enhance the opportunities for the disadvantaged; (iv) streamlining and strengthening the public sector—the traditional economic "Achilles' heel"; (v) further strengthening prudential, supervisory, and debt resolution frameworks in the financial and corporate sectors (including prudential-based management of foreign currency risk); (vi) accelerating rural development through agricultural modernization and by encouraging the growth of small- and medium-sized enterprises in the countryside, and (vii) improving further the investment climate, including by strengthening governance.

In 1999, government released the Medium-Term Philippine Development Plan 1999-2004, which presents initiatives to address structural economic constraints. It envisages a recovery of growth, and poverty being reduced from 32 percent in 1997 to 25-28 percent in 2004. Furthermore, President Macapagal-Arroyo has stated that heradministration is looking at ways that government can address the concerns of portfolio and direct investors and is committed to reforms that will restore confidence in the country.

Whatever the case, FDI levels have fallen substantially in the past four years. The world economic slowdown is reinforcing this trend. Among a menu of options to make the Philippines a more attractive destination for FDI, one of the more effective choices is to adopt best-practice accounting and auditing standards, and to ensure that these standards are rigorously applied and enforced.

2. Accounting and Auditing in the Philippines

The Philippine accounting and auditing system is directly influenced by US and, more recently, international arrangements and practices. The *Accountancy Act 1923* created the Board of Accountancy (BOA) and gave it the authority to issue CPA certificates. Six years later, the Philippine Institute of Certified Public Accountants (PICPA) was established within the private sector to represent professional interests.

Many of the larger Philippine companies were subsidiaries or branches of American companies and their accounting reflected US practices. Even after independence in 1946, the US maintained close trade and investment links. Philippine accounting and auditing moved away from US influences towards international practices in the 1990s. For instance, IAS became the basis for Philippine accounting standards in 1996.

Today's governing legislative and institutional framework is comprehensive. In common with the US model, arrangements reflect a mixture of government intervention and self-regulation. The key legislative planks of the Philippine accounting and auditing system are the *Revised Accountancy Law (No. 692) 1975*, the *Corporation Code*, the *Revised Securities Act 2000*, and the *National Internal Revenue Code 1999*.

The *Revised Accountancy Law 1975* governs the standardization of accounting education, stipulates the examination process for CPA registration, and regulates the practice of accountancy. The Professional Regulation Commission (PRC), through the BOA, administers the law. The SEC enforces the *Corporation Code*, which governs the creation and operations of limited liability corporations. The SEC also administers the *Revised Securities Act 2000*, which applies to companies listed on the Philippine Stock Exchange. Among other things, the *National Internal Revenue Code 1999* requires that tax agents (including CPAs) be accredited by the Bureau of Internal Revenue (BIR).

Financial reporting disclosure requirements are governed by both mandatory and advisory sources. Mandatory sources include: (i) the legal requirements in the *National Internal Revenue Code 1999*; (ii) Statements of

Financial Accounting Standards (SFASs) issued by Accounting Standards Council (ASC); and (iii) rules and regulations issued by the SEC governing the form and content of financial statements. The *Bangko Sentral ng Pilipinas* (Central Bank of the Philippines) prescribes disclosures for financial institutions. All companies with quarterly sales exceeding P100,000 ($2,000) must have their financial statements audited and signed by a CPA. SEC rules require listed companies to file quarterly reports within 45 days of the quarter-end.

Assessments of financial reporting quality vary. On one hand, a World Bank review of Philippine financial reporting practices favorably concluded that:

> "according to users of financial statements—including banks and investment banks—accounting and disclosure regulations and standards in the Philippines compare favorably with those in many Asian countries. But the same users report that enforcement by regulators is weak and that auditors seldom issue caveats that might raise questions about the reliability of the information contained in client financial statements. In addition, there is no tradition of legal actions by investors and lenders against company officers or auditors in connection with cases of deficient or misleading financial reporting. Hence, the true financial state of companies may not be known sufficiently in advance to arrest a potentially serious deterioration in performance." [61]

However, other studies and surveys have been less positive.

The *Revised Accountancy Law 1975* regulates the auditing profession; Only CPAs may conduct statutory audits. Recent studies have identified concerns regarding auditing practices. Professional firms are regulated by the SEC. The BOA, through the PRC, has recently begun to review and license accountancy firms. All of the large international accountancy firms are represented in the Philippines.

3. Professional Infrastructure

The origins of Philippine public accounting practice can be traced back to the 1700s. However, accountancy was not formally recognized as a profession until the enactment of the *Accountancy Law 1923*. This law established the CPA title for those who passed a written licensure

[61] World Bank. 1999. *Philippines: The Challenge of Economic Recovery*. Washington DC: World Bank. pp. 35-36.

examination. It also created the BOA to regulate the profession. Six years later, in 1929, CPAs organized PICPA, which makes it one of Asia's oldest professional accountancy bodies.

In the past seven decades, PICPA has contributed immensely to the accountancy profession's development. PICPA members have also actively contributed to the international profession (Washington Sycip was IFAC President from 1982 to 1985).

There are now over 100,000 Philippine CPAs. Each year around 14,000 candidates sit the CPA licensure examination, but less than 20 percent are successful. In the absence of empirical evidence, various reasons have been advanced to explain these low passing percentages, including poor English language skills reflecting deficient basic education, lack of training materials and inadequate facilities.

Today, the Philippines accountancy profession is one of the world's most vibrant. It is also one of the most restricted. A mixture of regulation and private involvement characterizes professional organization. The key governing legislation is the *Revised Accountancy Law 1975*. BOA, under the oversight of the PRC, determines and prescribes the minimum requirements for CPA licensure. It is also responsible for supervising, controlling and regulating accountancy practices. The Board administers the CPA examination and issues certificates to successful candidates. Among other things, Philippine CPAs must hold an undergraduate accounting degree and pass a multiple-choice professional examination. In contrast to international guidelines, practical experience is not required and CPE is not mandatory. BOA also investigates violations of the *Revised Accountancy Law 1975* and may suspend, revoke, or reissue registration certificates.

By December 2000, 103,340 CPAs were registered with the PRC, but only about 20 percent were active (i.e., fee-paying) members of professional organizations. Furthermore, it is estimated that there are at least 400,000 accounting graduates who are not CPAs. In 1999, PICPA launched a concerted push for professional integration (i.e., compulsory CPA membership). These efforts increased membership significantly.

As of December 2000, PICPA had 20,323 active members (those who pay membership dues and receive information and services). PICPA regularly organizes seminars on technical subjects such as auditing, taxation, management services, accountancy education, accounting principles, and information technology.

Sectoral PICPA bodies include the Government Association of Certified Public Accountants (GACPA), the Association of Certified Public

Accountants in Public Practice (ACPAPP), the Association of Certified Public Accountants in Commerce and Industry (ACPACI) and the Association of Certified Public Accountants in Education (ACPAE). Furthermore, the National Federation of Junior Philippine Institute of Accountants (NFJPIA) links accountancy students with their professional counterparts. Other professional bodies include the Philippine chapter of the US-based IIA and the Association of Government Internal Auditors (AGIA). AGIA represents internal auditors in government and promotes their professional development. It had 1,177 members in 1999.

In recent years, globalization has focused attention on raising standards to meet the challenge of increased competition. Meanwhile, concerns about CPA licensure procedures and apparently soft disciplinary procedures have undermined the profession's reputation. For example, the BOA has the power to suspend or revoke CPA titles. However, these powers are seldom exercised and when they are, the reasons are usually related to unprofessional conduct rather than the failure to properly execute the duties and responsibilities of an auditor.

> "Big auditing firms do not get sued because their interest is always protected through the influence they have on BOA. The presence of representatives from the big auditing firms on the BOA serves the personal interest of those firms. ... If cases of big auditing firms are filed with the Board, then it is just like saying that they are putting themselves on trial—which really negates the purposes of the Board. This is where the law has a loose end."
>
> – Former PRC Commissioner (1998) [62]

In 1979–1997, 170 cases were filed against individual CPAs and one against an accounting firm. No cases were filed against CPAs on the grounds of gross negligence or incompetence in the practice of their profession, issuing an accountant's certificate covering the examination of client accounts without observing the necessary auditing standards, or conduct discreditable to the accounting profession. But, the SEC has investigated *prima facie* malpractice cases. Two examples involve Engineering Equipment Incorporated (EEI) and Victorias Milling Company (Vicmico). Both cases centered on material misstatements in the companies' certified financial statements. In relation to EEI, the SEC wrote "the auditors may have been

[62] Cited in: Dyball, Maria Cadiz and Lina J. Valcarcel. 1999. The "Rational" and "Traditional": the Regulation of Accounting in the Philippines. *Accounting, Auditing and Accountability Journal*. Vol 12(3). pp. 303-327.

involved or professionally negligent" and recommended a one-year suspension of the firm's accreditation to appear for clients before the SEC. This recommendation was later overturned and the auditors reportedly fined P50,000 ($1,000). The penalty was not reported in the media. Nor did the PRC or the BOA investigate the auditing firm. As for Vicmico, neither the PRC nor the BOA took action, while the SEC pursued the case. Moreover, in the Vicmico case, the auditing firm later withdrew its audit reports for the financial statements in question.

In 2000, PICPA focused on: (i) amending the *Accountancy Law 1975* to support membership growth; (ii) fully computerizing operations; (iii) reviewing and amending the Institute's by-laws; (iv) refining a proposal for PICPA to administer examinations to accounting graduates and unsuccessful CPA examinees to make them Registered Accountants to be accredited with the BIR, SEC and BOA; and (v) promoting the field of environmental accounting. In 2001, PICPA is concentrating on three areas. First, undertaking policy reforms including: (i) improving policy formulation, deliberation, and implementation through the use of sectoral clusters and feedback loops; (ii) strengthening development and training policies; and (iii) preparing structural and organizational changes that require changes in by-laws, the *Revised Accountancy Law 1975*, and the Code of Ethics. Second, strengthening professional development by: (i) continuing progress on establishing the Power Knowledge Institute; (ii) establishing a technical resource pool; (iii) improving library facilities and resources; (iv) extending development forums to Luzon, Visayas, and Mindanao; (v) improving the curriculum and re-tooling CPAs; (vi) enhancing the Institute's Internet site; (vii) updating publications; and (viii) mandating the inclusion of professional development issues in the agendas of chapter meetings. Third, increasing the Institute's focus on social responsibility.

4. Accounting and Auditing Standards

In 1949, PICPA began issuing accounting standards in the form of accounting bulletins, compliance was voluntary. In response to a 1979 PICPA committee report on the state of Philippine financial accounting standards and standard setting, the Institute established the ASC in November 1981.

The ASC issued the first Philippine SFAS in 1983. Until 1996, the ASC based most SFASs upon US accounting standards. Starting in 1996, the ASC issued IAS-based SFASs. The Council's mechanism for standard setting is similar to that of the IASB and FASB. Once approved by the BOA, the PRC's final concurrence gives legal authority to the SFAS and CPA compliance is mandatory.

SFASs are broadly consistent with their equivalent IASs, but there are differences in detailed accounting and disclosure requirements. Subject to any modifications that may be required by Philippine regulatory requirements or deemed necessary by the ASC, the final SFASs will be the same as IASs. Furthermore, the Philippines will fully adopt IAS by 2005.

Philippine enterprises are not required to adopt tax rules for financial accounting purposes, for instance, Section 43 of the *Tax Code 1997* provides that "taxable income shall be computed ... in accordance with the method of accounting regularly employed in keeping the [taxpayer's] books." Most enterprises, however, adopt the prescribed tax reporting guidelines for expediency so long as these practices do not contravene prescribed accounting standards. Furthermore, in the absence of a specific SFAS or tax ruling, the BIR will refer to authoritative accounting sources, such as IASs.

PICPA formerly issued auditing guidance as bulletins. In response to the 1979 PICPA committee report that influenced ASC's establishment, PICPA and the ACPAPP established the Auditing Standards and Practices Council (ASPC) in 1986. The ASPC promulgates the *Statements of Auditing Standards of the Philippines* (SASPs) and other guidance on auditing practices and procedures. SASPs are significantly influenced by US auditing standards and IAPC pronouncements. All ASPC-approved SASPs are submitted to the PRC through the BOA and, once approved, CPA compliance is mandatory.

The ASPC was inactive for several years but resumed activities in 2001 under a new chairperson. The rejuvenated ASPC has will complete direct adoption of IAASB pronouncements by 2005.

5. Education and Training

The American colonial period substantially influenced Philippine accountancy education arrangements. Business schools were initially established across the country to provide a skilled labor pool for government and business organizations. Eventually business education progressed to the point where the University of Philippines began to offer accounting courses in 1916.

Today, the Philippine education system, and its graduates, is internationally and regionally recognized as being of a high standard. The top Philippine accountancy faculties are also recognized for the caliber of their graduates and research publications.

Several laws and regulations govern accountancy education and coordination. These include the *Revised Accountancy Act 1975*. BOA recently established an Accounting Education Task Force to help it examine developments in the accountancy profession as they affect accountancy education. The *Higher Education Act 1994* created the Commission on Higher Education (CHED). Among other things, CHED is responsible for: (i) formulating and recommending development plans, policies, priorities, and programs on higher education; (ii) setting minimum standards for programs and institutes of higher education; (iii) monitoring and evaluating the performance of programs and institutions; and (iv) imposing sanctions for poor performance. PICPA is also involved in educational coordination through its representation on CHED's advisory board and in the BOA.

Driven by concerns over educational quality and the issuance of updated international guidance, BOA and PICPA began developing proposals for a revised accountancy curriculum in 1998. CHED approved the revised curriculum in August 2001, which reflects relevant UNCTAD and IFAC guidance.

The Philippines had 164 public and 1,189 private higher education institutions at September 2000. Of these institutions, 367 offered accredited BSA programs. The quality of these programs differs substantially when assessed on the basis of graduate success in the CPA licensure examination. Zero-performing schools—those that had no successful candidates in the CPA licensure examination—comprise around 50 percent of accredited institutions. Students at these schools are predominantly drawn from less wealthy families.

In the 1999-2000 academic year, CHED acted to phase out the accountancy programs of 54 schools. In addition, one school was warned and one school was referred to the Technical Panel for further action. The CHED process is continuing and should reduce the number of substandard schools offering accountancy programs.

As a condition of offering accountancy programs, institutions must have a formal faculty development program. However, in some schools, continuing training for accountancy lecturers and professors is very limited. The absence of relevant materials is perceived as a constraint to staff development (most materials are local adaptations or reprints of US books). These books are based on US GAAP rather than international standards and practices. Furthermore, case studies based on local practices and conditions are rare.

6. Government Budgeting and Accounting

Government accounting and auditing arrangements were formulated in 1947. They have many strengths including the use of double-entry bookkeeping, a mixed cash-accrual accounting base, a cadre of well-trained accountants, and potential access to a large external pool of trained accountants.

Wider public management arrangements are characterized by institutional and regulatory rigidities. Efforts to modernize the public sector have gathered pace in recent years. Among other things, the Government intends to: (i) develop an MTEF; (ii) introduce output and outcome performance measures and targets; (iii) overhaul procurement practices; (iv) introduce three-year baseline budgeting; (v) modernize auditing practices; (vi) introduce computerized financial management information systems; and (vii) prepare for the introduction of full accrual accounting.

The *Constitution 1987* mandates the keeping of government accounts, the promulgation of accounting rules, the audit of financial reports, and the submission of reports covering government's financial operations and position. A raft of laws and decrees are subsidiary to the Constitution and include the *State Audit Code 1978* that specifies the powers and responsibilities of the Commission on Audit (COA). COA audits the general accounts of government, promulgates accounting rules and regulations, and submits the annual government financial report (including government-owned or controlled corporations).

In accordance with the *Constitution 1987*, fund, obligation and cash-disbursement-ceiling accounting methods are used in government. These methods are based on those used in the US government (before it began its move to accrual accounting). Organizations are required to use a COA-prescribed standard chart of accounts. A variety of accounting standards are applied in the preparation of financial reports. These include the prescriptions set out by the GFS system, and COA's accounting rules and chart of accounts. COA is planning the move to full accrual accounting and is considering the appropriateness of IPSAS as the basis for government accounting standards.

The financial reports of government organizations include: (i) current assets; (ii) contingent assets; (iii) fixed assets; (iv) current liabilities; (v) contingent liabilities; (vi) allotted appropriations; (vii) income; (viii) invested surplus; (ix) contingent surplus; (x) national clearing account; (xi) the total surplus; and (xii) assorted notes to the accounts. However, these reports are generally not provided in a timely manner.

The entry salaries and conditions for government accountants compare very favorably with the private sector. Indeed, government agencies have no difficulty attracting high-quality accounting personnel. However, as the government salary structure is flatter than that of the private sector, these personnel are difficult to retain once they have gained experience. Moreover, these comparatively low salaries for senior personnel provide a supportive environment for graft and corruption. In response, several legislative measures have been prepared to raise the remuneration and status of government accounting personnel. However, in the view of a recent study:

> "While the ... study did not allow an examination of the actual performance of government accountants, the consultants engaged in this project were impressed with the professionalism of the accountants they encountered. Provided that they receive adequate technical direction and training, we have no reason to believe that the general competence of accountants is an issue." [63]

Government accounting personnel must hold CPA licenses, but their role is largely limited to bookkeeping, due to the complicated legal accounting framework and the absence of computerized systems. Minimal time is available for financial analysis and providing financial advice to management.

7. Donor Assistance

ADB is supporting broad governance activities through technical assistance and loans. Directly relevant activities include:

- *Loan 1858: Nonbank Financial Governance Program* ($75 million: 2001–2003). The Philippines DSAA provided input into this program's development, which is intended to support the development of stronger financial sector and institutions. Its key pillars are (i) strengthening the governance and enforcement capacity of the regulators, *Bangko Sentral ng Pilipinas* and SEC; (ii) introducing more transparency in the market; and (iii) encouraging equal enforcement of rules and regulations. Loan implementation is supported by *TA 3773: Strengthening Regulatory Market Governance.*

[63] Sycip Gorres and Velayo Audit Firm (SGV)—CoWater International Incorporated. 2000. *Assessment of the National Government Accounting System*. Prepared under UNDP: Enhancing the Public Accountability Program of the Philippine Commission on Audit: A Preparatory Assistance (PHI/97/022). p. 11.

- *Loan 1363: Capital Market Development Program* ($150 million: 1995). The program objectives were to support financial and corporate governance reforms, particularly the development of capital market institutions with a view to enhancing transparency and predictability in the marketplace.
- *AOTA TA 31656-02: Strengthening Public Finance and Planning of LGUs-II* ($0.100 million: 2002). This proposed TA is intended to assist the Government to conduct more detailed analysis of its budget processing and project-monitoring mechanism.
- *TA No. 3310: Capacity Building for Procurement* ($0.400 million: 2000). This project strengthened institutions with procurement responsibilities.
- *TA No. 3245: Nonbank Financial Sector Development* ($2.0 million: 2000–2001). Among other things, this TA has focused on reorganizing and strengthening the SEC.
- *TA No. 3145: Strengthening Public Finance and Planning of Local Government Units* ($0.870 million: 1999–2000). This TA focused on strengthening LGU budgeting and finance capabilities.

World Bank assistance is primarily for tax administration, financial market development, and supervision of financial institutions. In 1998, the World Bank approved a Banking System Reform Project, which aimed to strengthen banking sector regulation and supervision and develop a resolution framework for troubled banks. The release of the second tranche of this loan has been delayed due to the lack of agreement between the Government and the major shareholders on the pricing of government shares in Philippines National Bank (PNB). As a result, the Government has not been able to divest its PNB shares, which is a second tranche loan condition. Furthermore, a proposed loan for $100 million to support public sector reforms was abandoned in 2000. The Local Government Finance and Development Project ($100 million) is assisting participating LGUs to expand and upgrade their basic infrastructure, services, and facilities and to strengthen their capacities in municipal governance, investment planning, revenue generation, and project development and implementation.

UNDP intends to provide support to strengthen the role of the Department of Budget and Management in the public sector reform process. **AusAID** is providing the majority of financing for a UNDP-managed project to strengthen the COA. The Canadian International Development Agency **(CIDA)** is providing technical assistance and training to assist government departments and agencies to further develop their internal mechanisms and structure for increased efficiency in policy formulation, planning, implementation, monitoring and evaluation. CIDA is also providing assistance to enhance the structures and mechanisms of local governments.

Japan does not directly support financial management and governance activities, but provides indirect assistance through Japan-based education and training on financial management and public management. **USAID** is implementing a TA project to (i) develop the capacity of the Philippines Stock Exchange (PSE), (ii) assist in drafting rules for implementing the newly-enacted *Securities Regulation Code 2000*, (iii) review the corporate code, and (iv) facilitate company registration procedures within the SEC. USAID is also supporting improvements to government procurement, local government finance and budget information systems. Furthermore, USAID has supported environmental accounting training initiatives.

8. Issues and Recommendations

This part presents the issues and recommendations that are associated with gaps or weaknesses in Philippine accounting and auditing arrangements. These issues and associated recommendations are consistent with those identified by the subsequent World Bank review of Philippine Corporate Sector Accounting and Auditing Practices, which is not surprising as the World Bank consultants were provided with the final draft of the Philippines DSAA report, before commencing their work.

The Philippines was less affected by the Asian financial crisis than some other countries in the region, largely due to better financial management arrangements. Moreover, accountancy is an elite and respected profession. However, the study revealed a range of issues that need attention if accountancy is to maintain its high status and if the Philippines is to successfully attract investment.

- In the case of **accounting and auditing standards and practices,** the study identifies deficiencies in the standards and in standard-setting arrangements. Several recommendations are made to enhance these arrangements so that the Philippines can have world-class accounting and auditing standards.
- The quality of **financial reporting** is undermined by a lack of compliance monitoring. To this end, the study recommends that financial disclosure monitoring be strengthened.
- Regarding **professional arrangements** the study identifies significant weaknesses in CPA licensure standards and quality assurance arrangements. The Philippines accountancy profession was once among the region's strongest. However, in the meantime, international

standards and practices were continuously enhanced and neighboring countries developed their professions accordingly. The recommendations are intended to support the return of the Philippines accountancy profession to its former status.

- Standards of **accountancy education and training** might also be raised. To this end, recommendations are made to improve course quality and ensure that accountancy teachers keep up-to-date with international developments.

Some constraints can be addressed with minimal resources and effort. For instance, strengthening the profession by making PICPA membership compulsory for all CPAs. Others are more complex and will take time, such as enhancing CPA licensure standards (examination, practical experience and continuing professional education).

The Philippines DSAA was undertaken before the other country studies. The study recommendations were first discussed and debated with representatives from government, the private sector and international organizations at a workshop held at ADB's Manila Headquarters on 12–13 March 2001.

Some of the recommendations were the subject of intense debate. For instance, Philippine accountants could be licensed as CPAs—and could conduct audits—without ever having worked in accountancy. Some study participants disputed the need for a practical experience component in the CPA qualification. They contended that this requirement would be unworkable in the Philippine environment.

Moreover, some study participants disagreed with the study's general conclusion that Philippine financial disclosure and auditing practices were not consistent with international best practice:

> "There have been instances of fraudulent reporting and audit failures in the US, United Kingdom, Singapore, Hong Kong and other supposedly best practice countries mentioned in the report. On the average, the Philippine accounting and auditing profession, at least those in the top tier, are comparable, if not better, than some of these countries." [64]

Although these countries have had financial reporting and auditing failures—like those in the Philippines—there is a stark contrast in reactions. For instance, in response to recent US financial reporting scandals, stricter controls have been introduced; civil actions have been

[64] Professional Regulation Commission (PRC). 2002 March 11. Comments on the ADB Study on Accounting and Auditing Issues in the Philippines. Letter.

filed against the offending companies, their officers and their auditors; criminal charges have been laid against involved parties; and there has been intense scrutiny through the media and by the US Congress.

In contrast, following the Philippine scandals involving Engineering Equipment Incorporated (EEI) and Victorias Milling Company (Vicmico), neither PRC nor BOA investigated the auditors, the auditors were reportedly fined minimal amounts and these penalties were never reported in the media.

Whatever the case, the Philippines DSAA provided input into the development of the ADB-supported nonbank financial governance program.[65] Some of the government-agreed policy conditions of that program reflect the study recommendations. Furthermore, ADB is providing technical assistance to strengthen the SEC's monitoring capacity in line with the study recommendations.

Significant efforts have already been made to implement the study recommendations. The Philippines country action presented in Chapter X (pp. 117–121) identifies these efforts.

Each study recommendation—and the issues that it is intended to address—is summarized below. The Philippines DSAA report provides further detail.

Advocate Changes to IASB Copyright and Pricing Policies

IASB promulgates IAS and associated guidance materials. The IASCF holds the copyright to these materials. Many developing countries, including the Philippines, are moving towards IAS. Investors, lenders, academics, practitioners and regulators should have access to the IAS and associated materials. However, IASCF's copyrighting and pricing policies effectively limit this access. In doing so, they appear to conflict with the IASB's constitutional objectives. It is **recommended** that ADB raise this issue with other multilateral and bilateral donor organizations, so that a joint approach may be made to the IASB and the international accountancy profession.

Directly Adopt International Accounting Standards

The ASC has recently begun basing IAS-based SFASs. However, (i) SFASs are not being issued as quickly as IASs, (ii) old SFASs are not always modi-

[65] ADB Loan 1858-PHI: *Nonbank Financial Governance Program*, for $75 million, approved on 15 November 2001.

fied to reflect the impacts of new SFASs, (iii) IASs are not necessarily fully adopted as a whole, and (iv) a range of accounting policy choices continues to be available to financial statement preparers.

The direct adoption of IASs offers benefits through; (i) reducing the costs and efforts associated with standard setting, (ii) improving the credibility of Philippine financial reporting, (iii) providing access to a greater range of training materials, (iv) making Philippine CPA skills more transferable on the international market, and (v) enabling Philippine financial reporting standards to be current with international pronouncements and practices. Where an IAS does not address a certain country-specific arrangement, there is a case for promulgating a national accounting standard. For instance, Papua New Guinea uses IASs directly but has released a national accounting standard on Plantation accounting.[66] A Philippine case might possibly be argued for *Dacion en Pago* arrangements.[67]

To accommodate diverse international views, IASs offer a range of accounting policy choices. While the available choices have been significantly reduced since 1996, IASs are still criticized for being too flexible. For instance, IAS 2 *Inventories* allows for several valuation methods. Many countries who have adopted, or who are adopting, IASs limit the available choices to improve the consistency and comparability of financial reporting in their country. In many cases, accounting choices are limited to those allowed for taxation purposes.

It is **recommended** that: (i) the Philippines adopt IASs directly and completely on 1 January 2004, and that existing SFASs be invalidated at that date; (ii) assistance be provided to prepare training and guidance materials on the differences between IAS and existing Philippines GAAP; and (iii) training programs for practitioners, academics, and regulators in this respect be supported. It is further **recommended** that amendments to IAS be: (i) allowed only to remove multiple accounting policy choices, and (ii) effected through overlay regulations rather than a direct amendment to an IAS.

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66 Narayan, Francis B. and Ted Godden. 2000. *Financial Management and Governance Issues in Papua New Guinea*. Manila: ADB. p. 42.

67 See, for instance, Diga, Joselito. 1997. Accounting in the Philippines. Published in Baydoun, Nabil, Akira Nishimura and Roger Willet (eds). *Accounting in the Asia-Pacific Region*. Wiley. pp. 202-203.

Alter Accounting Standard Setting Arrangements

The ASC's accounting standard-setting processes align with international practice, but its structure is heavily weighted in favor of financial statement preparers and auditors. This imbalance is arguably reflected in the wide range of accounting policy choices that SFASs allow. In comparison, the US FASB and IASB reflect users' interests alongside those of preparers. Furthermore, the imprimatur of the PRC, through BOA, is required before accounting standards have legal authority. The BOA, like the ASC, is balanced strongly in favor of the accountancy profession.

The FASB and the IASB are, like the ASC, private sector organizations. The issue of whether accounting standard setting should be a government or private-sector function is a common one faced by many countries—it is influenced by a range of factors.[68,69] Assigning this role to a government agency can be counterproductive. Research has found that government regulation stifles the profession and that accounting standard setting can become a taxation policy instrument, thereby significantly reducing the value of financial statements to other users.[70] In the Philippines, the members of the ASC, and in particular the Chair, have devoted enormous amounts of voluntary time over the past 18 years to develop accounting standards. If the preceding recommendation on direct acceptance of IASs is implemented, the balance of the Council's membership re-weighted, and approval responsibility assigned away from the BOA, there seems no reason why the accounting standard setting process should not continue to remain in the private sector.

It is **recommended** that the *Revised Accountancy Law 1975* be amended to reflect the following improvements to accounting standard setting arrangements: (i) accord legal status to the ASC; (ii) prescribe the Council's composition and appointment processes—the composition should reflect a balance of constituency views; and (iii) define the ASC's role as being limited to reviewing IASs and identifying policy choice exclusions in IASs.

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68 Zeff, Stephen. 1987. Setting Accounting Standards: Some Lessons from the US Experience. *Accountant's Magazine*. December. p. 27.

69 Narayan, Francis B., Ted Godden, Barry Reid, and Maria Rosa Ortega. 2000. *Financial Management and Governance Issues in Selected Developing Member Countries: A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam*. Asian Development Bank. pp. 25-26.

70 Armstrong, Mikael and Katerina Hellström. 1998 April. A Case Study of the Czech Republic. Stockholm School of Economics: Paper presented at 21st EAA Congress: Accounting in Times of Transition. Antwerp.

Strengthen Financial Disclosure Monitoring

There is evidence that financial statements do not comply with financial disclosure requirements. It is **recommended** that assistance be provided to the Office of the General Accountant (OGA) of the SEC to develop and implement; (i) a strict monitoring regime over financial disclosures; and (ii) an automatic system of penalties for corporations who breach financial disclosure requirements and for auditing firms that do not qualify audit opinions where financial disclosure requirements are substandard.

Directly Adopt IAASB Auditing Pronouncements

The ASPC promulgates SASPs, but is inactive. Consequently, SASPs have a narrow coverage and are behind IAASB pronouncements.

It is **recommended** that: (i) the Philippines adopt ISAs, IAPSs and all other IAASB pronouncements directly on 1 January 2004, and that existing SASPs be invalidated at that date; (ii) assistance be provided to prepare training and guidance materials on the differences between these pronouncements and SASPs; and (iii) training programs for practitioners, academics, and regulators in this respect be supported. It is further **recommended** that the *Revised Accountancy Law 1975* amended to require that audits be conducted in accordance with the pronouncements of the IAASB.

Strengthen Compliance with Auditing Practices

It appears that Philippine auditing practices differ substantially from international and regional guidelines and norms in four areas: (i) auditor appointment and dismissal; (ii) auditor independence; (iii) audit reporting procedures; and (iv) exposure of auditors to liability. It is **recommended** that assistance be provided to develop and implement regulations covering the following areas: (i) auditor appointment and dismissal (e.g., appointments made by shareholders, automatic resignation at AGM, and mandatory requirement for communications between incoming and outgoing auditors); (ii) auditor independence (e.g., restrictions on interests, restrictions on services, antilow-balling rules, mandatory rotation of audit firms or audit partners, mandatory disclosures of challenges to objectivity); (iii) audit reporting procedures (e.g., mandatory disclosure of fraud, illegal acts and internal control weaknesses in audit reports); and (iv) exposure of auditors to liability (e.g., remove legal liability caps). It is further **recommended** that assistance be provided to the OGA of the SEC so that it can develop the capacity and procedures to ensure compliance with these requirements.

Amend the Accountancy Law so that Licensure Standards can be Raised

Qualifying as a CPA has four stages: academic, experience, examination and CPE. The Philippine CPA title meets international standards and regional norms on the first stage. It falls short on the others. There are three possible implications. First, the recently established IFAC Compliance Committee will be reviewing member body compliance with IFAC guidelines and standards in the next few years. PICPA will have to explain deviations. The IFAC Compliance Committee is responsible for recommending actions to IFAC's Board and Council when member bodies fail to comply with guidelines and standards. Second, ISAR is embarking on a project to benchmark CPA qualifications from around the world. The "grade" given to a country CPA qualification will be based on compliance with international guidelines and practices. This grade will directly affect the international standing and transferability of CPA titles. Third, as a condition of membership, IFAC member bodies are required to comply with guidelines and standards. In this respect, IFAC has issued guidance on the procedures to be followed when agreeing mutual recognition of qualifications. It appears that the Philippine WTO-GATS and Asia Pacific Economic Cooperation negotiation strategy, in relation to accountancy services, is to conclude Mutual Recognition Agreements (MRAs). Under IFAC guidelines, member bodies must take education, examination and experience requirements into account when negotiating MRAs. As a significant exporter of accountancy services, the Philippines appears to be at a negotiating advantage. The legality of any MRAs which the Philippines concludes with other ASEAN countries might be open to challenge, from other Asia Pacific Economic Cooperation and WTO members, based on the quality of CPA licensure procedures.

The accountancy profession is attempting to raise standards—for instance, requiring mandatory CPE—but is hamstrung by the regulatory environment. A particular impediment is the uniform regulation approach applied through the PRC—which oversees 43 diverse professions. The story of CPE over the past decade has been one of endless legal proposals, reversals and court challenges. It is difficult to see how CPA licensure standards can be raised in the existing environment, without enabling legislative changes.

In order to create an environment that will enable CPA licensure standards to be raised, it is **recommended** that the *Revised Accountancy Law 1975* and other laws and regulations be amended to enable the introduction of; (i) practical experience requirements for CPA licensure, (ii) a written component to the CPA licensure examination, and (iii) mandatory CPE as a condition of license renewal.

Address CPA Licensure Examination Issues

International guidelines recommend that a significant component of a CPA exam should be written, but the Philippine CPA licensure examination is entirely multiple choice. This approach was taken deliberately to minimize serious "leakage" problems in the examination process—it has been extremely effective in this sense. The tension between minimizing leakage and preparing high quality examinations is also reflected in the quality of examination questions. Examiners individually prepare one section each, but the other examiners do not review their efforts. The Microsoft certification approach provides a successful example of how technology can be employed to ensure that integrity is maintained while examinees are practically tested. This represents an updated approach to that used for the computerized CPA licensure examination. It is **recommended** that options for restructuring the CPA licensure examination be investigated with the objective of; (i) introducing a written component into the examination, and (ii) implementing quality reviews over examination question setting.

Introduce an Experience Prerequisite for the CPA Title

The absence of a practical-experience prerequisite for CPA licensure does not accord with international standards or regional norms. Philippine accountants can be licensed as CPAs and conduct audits, without ever having worked in accountancy. An analogy would be issuing a pilot's license, based on an examination, to a person who has never flown an aircraft. IFAC has published two documents to guide member bodies on how to meet the requirements of IEG 9.[71,72] The effective and fair implementation of these requirements in the Philippine environment poses

71 IFAC. Study 1: An Advisory on Examination Administration Based on the Practices of Selected IFAC Member Bodies. New York: IFAC.

72 IFAC. Discussion Paper on Work Experience. New York: IFAC.

some clear challenges; implementation and monitoring arrangements will need to be very carefully designed. It is **recommended** that specified practical experience be introduced as a prerequisite requirement for the CPA title.

Introduce Mandatory Continuing Professional Education

PICPA supports the introduction of mandatory CPE requirements—which international guidelines require. It is **recommended** that: (i) mandatory CPE requirements be introduced through enabling legislative changes, and (ii) assistance be provided to design and implement appropriate procedures for monitoring CPE compliance.

Reassign Responsibilities for Monitoring and Investigating Certain Ethical Matters

BOA and PICPA are unwilling to investigate cases involving; (i) gross negligence or incompetence, (ii) issuance of an accountant's certificate covering the examination of the client's accounts without observing the necessary auditing standards, or (iii) conduct discreditable to the accounting profession. This is perhaps because accounting firms have a strong representation in these bodies. In contrast, the SEC has shown willingness to investigate these types of ethical matters. Furthermore, the SEC is being restructured so that it can meet its responsibilities under the *Revised Securities Code 2000*. The restructure involves the creation of the OGA. This position was unfilled at February 2001.

It is **recommended** that responsibility for investigating cases involving; (i) gross negligence or incompetence, (ii) issuance of an accountant's certificate covering the examination of the client's accounts without observing the necessary auditing standards, or (iii) conduct discreditable to the accounting profession; be assigned to the Office of the General Accountant of the SEC. It is further **recommended** that assistance be provided to; (i) identify and draft the necessary legislative amendments to effect this reassignment; (ii) identify OGA requirements for implementing these responsibilities; and (iii) support the development of OGA capacity to meet these responsibilities.

Implement Quality Control and Assurance Arrangements

The accountancy profession places minimal emphasis on quality control assurance over professional practices—a recent limited initiative has been for the BOA to recognize accounting firms, based on their internal review processes. In contrast, IFAC recommends that member bodies, including PICPA; (i) adopt quality control standards and require individual accounting firms to implement these, (ii) develop and implement programs to review compliance with these standards, (iii) establish programs to review compliance with relevant professional standards for assurance engagements, and (iv) require accounting firms to make appropriate improvements in quality arrangements and procedures when these fail to meet standards. Neighboring countries have adopted robust programs of this nature.

It is **recommended** that assistance be provided for a project to improve professional supervision. The project would involve: (i) studying the existing structures and processes of CPA firms, (ii) examining, and drawing useful lessons from international experience with regards to supervisory regimes (including peer review regimes); (iii) designing a supervisory system for the Philippines that reflects local conditions and provides sufficient flexibility to deal with environmental changes; (iv) implementing the supervisory system and associated reporting systems; (v) reviewing and, where necessary, revising CPA legal responsibilities and associated disciplinary regulations; and (vi) improving the capacity of managers with supervisory responsibilities through training.

Introduce Provisional CPA Title

International practice is for CPA titles to be issued, only after candidates have completely met academic, practical experience, and licensure examination requirements. In the period between meeting the academic requirements and receiving the full CPA license, accountants are accorded provisional status. They are not, however, allowed to sign audit reports or undertake certain other activities. It is **recommended** that PICPA and BOA establish a provisional CPA title for those who met academic requirements and are gaining prescribed practical experience.

Introduce Accounting Technician Membership Category

PICPA essentially has one individual membership category—that of the CPA. It has been estimated that the Philippines has a further 400,000 accountants. It is common international practice for professional bodies to have a range of membership categories with differing qualification criteria—particularly that of Accounting Technician. The establishment of at least one subsidiary membership category within PICPA would provide a transitional route for aspiring CPAs and professional representation for nonCPAs. It would also improve their societal status, and improve their knowledge and competence. Furthermore, this initiative would strengthen PICPA's membership and revenue base. It is **recommended** that PICPA and BOA consider establishing a professional membership category for accounting technicians.

Develop Annual Financial Management Scorecard

The establishment and systematic monitoring of financial management indicators, would provide a impetus for raising standards. The BOA's initiative, of preparing examination result analyses and distributing these to under-performing academies, is an excellent example. It is **recommended** that assistance be provided to the OGA to: (i) design a financial management scorecard; (ii) design and develop the data-collection methods to support the annual preparation of the scorecard; and (iii) prepare a scorecard for the 2001 calendar year.

Improve Monitoring of Accountancy Courses

There is a wide disparity in the quality of accountancy courses. Students from poorer families attend institutions with poor educational records in the hope that they will pass the CPA board examination. The BOA has initiated an excellent program to provide feedback to educational institutions on the quality of their courses. It is **recommended** that assistance be provided to the BOA to broaden its educational monitoring initiative.

Provide Continuing Training to Professors and Lecturers

There is a wide disparity in the quality of professors and lecturers. Anecdotal evidence contends that professors and lecturers, who teach accountancy courses to less-wealthy students, are not conversant with modern accounting and auditing practices. It is **recommended** that assistance be provided to design and implement a continuing education program for accounting lecturers and professors.

Define Accounting Information System Requirements

COA aims to increase the computerization of government accounting and auditing. Before further progress can be made, several policy issues must first be examined and a position agreed. Among others, these include: (i) the accounting policy basis, (ii) consolidation policies and methodologies, (iii) the respective emphasis on financial and management accounting, (iv) the desirability of the Canadian practice of modified accrual accounting, and (v) the future of obligation and fund accounting. It is **recommended** that assistance be provided to COA to analyze these issues and develop agreed policies and plans to implement these policies.

Directly Adopt IFAC Pronouncements on Ethics

The BOA and PICPA *Code of Professional Ethics*, and procedures for dealing with potential ethical breaches, do not accord with international guidelines. Two examples follow. First, the Board and the Institute should have the authority to investigate potential ethical breaches, even when no complaint has been made. Second, the Board and the Institute should publicize potential breaches and investigative actions as a matter of course, rather than as a matter of exception. It is **recommended** that the *Revised Accountancy Law 1975* be amended so that: (i) the IFAC *Code of Professional Ethics* and other IFAC promulgations on ethical matters be accorded legal status, (ii) existing pronouncements and procedures on ethics be revoked, and (iii) the procedures of BOA and PICPA be amended to accord with IFAC promulgations.

Limit Proxy Voting in PICPA Meetings and Elections

Proxy voting is employed in PICPA elections. It has been contended that large accounting firms collect proxies and cast block votes. It is **recommended** that PICPA's by-laws be amended to limit the number of proxy votes that individual members can exercise at meetings or during elections.

Make PICPA Membership Compulsory for CPAs

Despite efforts to make it so, membership of the Accredited Professional Body—PICPA—is not compulsory—only about 20 percent of CPAs are members. This limits quality control and educational efforts. It also undermines the financial position of the professional accountancy bodies. It is **recommended** that the Accountancy Law be amended to require membership of PICPA, a requirement for retaining the CPA title.

Exempt CPAs from Tax Agent Accreditation

In 1999, under the *National Internal Revenue Code*, the BIR required that tax agents be accredited. This requirement took legal effect from 1 January 2001, but has yet to be implemented in practice. It has been suggested that accreditation will encourage rent-seeking behavior. Moreover, as attorneys are exempt from accreditation, it has also been contended that this exemption should also apply to CPAs. It is **recommended** that the BIR treat CPAs in the same manner as attorneys for the purpose of tax agent accreditation.

Limit Accountancy Degree Courses to Four Years

PICPA proposes that a five-year accountancy curriculum be introduced. In contrast, the BOA recommends that a four-year curriculum be continued and that focus be directed towards improving curriculum quality and teaching quality. This study supports the BOA's stand for two reasons. First, IFAC recommends a minimum three-year curriculum—a longer education program will not necessarily address quality issues. Second, a five-year curriculum will limit opportunities for less wealthy students. It is **recommended** that a four-year course limit be placed upon accountancy degree courses.

Separate Accounting and Auditing Responsibilities

The Commission on Audit is exclusively responsible, for promulgating accounting and auditing rules—per Article IX of the *Constitution 1987*. Their coexistence is inconsistent with the concept of auditor objectivity and independence. Moves are already underway to address this issue—for instance, Senate Bill No 439 (2000) seeks to create a government accounting office under the DBM—this could be constitutionally troublesome unless carefully designed. However, a proposed ADB TA will examine COA's structure and responsibilities with the intention of recommending a solution that is in keeping with the Constitution. This study supports efforts to separate government accounting and auditing responsibilities. But, it is **recommended** that initiatives to separate government accounting and auditing functions, be planned in full acknowledgement of Constitutional requirements.

Adopt International Public Sector Accounting Standards

There is no consistent set of accounting standards for budgeting and reporting. Major reporting differences result. COA is considering what accounting standards might be appropriate as it prepares for the introduction of accrual accounting. There are three sets of international standards available: (i) IMF GFS; (ii) UN SNA; and (iii) IPSAS. ADB, World Bank, IMF and UNDP have funded the development of IPSASs and are represented on the PSC. The International Organization of Supreme Audit Institutions (INTOSAI) is also represented on the PSC.

Most countries use the cash-based GFS and SNA standards. Furthermore—given that IPSASs are entirely grounded in IASs—a number of governments indirectly use them for preparing financial statements on the accrual accounting basis. While differences remain between GFS, SNA and IPSASs, significant progress has been made towards harmonization. As demonstrated by several governments, the IPSAS basis provides the necessary information to prepare GFS and SNA financial statements. Three advantages would accrue through the adoption of the IPSASs. First, government and private sector accounting practices would be the same. This would enable direct transferability of accounting skills between the two sectors. Second, training and guidance materials are available from governments that have already moved to an IPSAS-compatible accrual basis (e.g., Australia and New Zealand, among others). Third, as IPSASs are essentially IASs under another name, choices in computerized accounting systems are not limited to those with special functionality.

It is **recommended** that IPSASs be adopted if the Government moves to full accrual accounting.

Minimize Compliance (Transaction) and VFM Auditing

Auditors spend the majority of their time on compliance auditing (checking transactions). Minimal time is spent on financial attest auditing as more effort is applied to value-for-money (VFM) audits. A proposed ADB TA will focus on strengthening financial attest auditing and VFM capacities. While this study strongly supports resources being redirected from compliance auditing to financial attest auditing, it cautions against similar redirection to VFM auditing, for three reasons. First, VFM audits are essentially policy evaluations but generally take place long after policies have been implemented. Strengthening the policy-making function, through policy evaluations, is more effective in this sense. Second, in contrast to a well-designed policy evaluation function, VFM audits are generally targeted on the basis of questionable criteria. A review of VFM reports from SAIs around the world would reveal, in keeping with public choice theory, that issues are targeted for their media worthiness—not necessarily for their impact on significant public policy outcomes. Third, the skills required to conduct a policy evaluation or a VFM audit are generally not those of a CPA. This requires that organization capacity be established. Fourth, even if VFM audits do represent value for money, they inevitably divert resources away from financial attest auditing—a key tool in reducing graft and corruption. For instance, COA already devotes more resources to VFM auditing than it does to financial attest auditing. The SAIs of developed countries, which have a strong financial attest auditing capacity, can afford to divert resources to VFM auditing. It is questionable whether the same is true of developing countries.

It is **recommended** that COA: (i) continues to reduce the resources that are directed towards compliance (transaction) audits; (ii) continues to strengthen financial attest auditing capacity; and (iii) consider the appropriateness of directing scarce resources towards VFM auditing in the absence of a strong financial attest auditing capability.