1989

Accounting Profession in the Philippines; Professional Accounting in Foreign Country Series

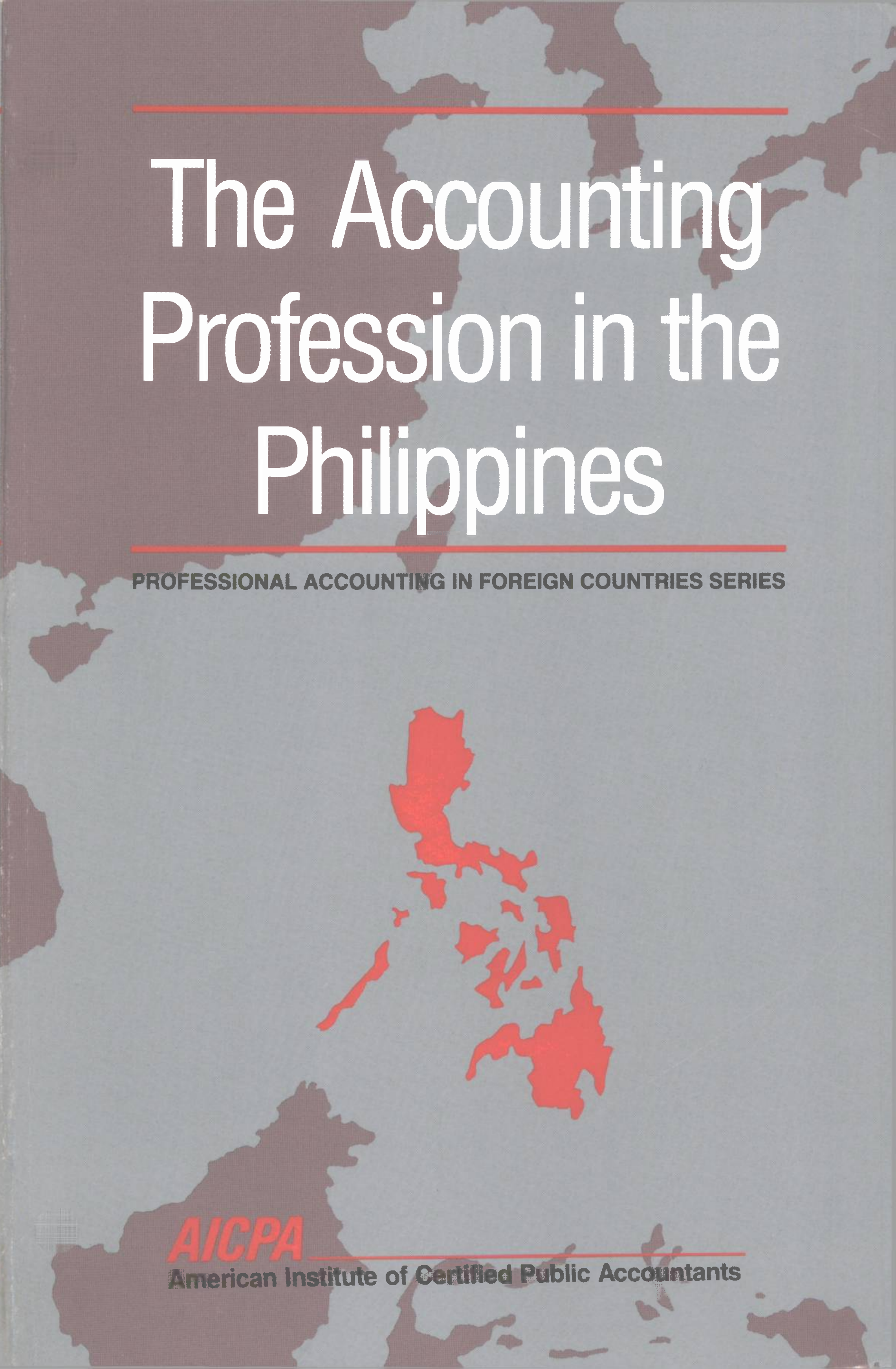
SGV & Co.

Arthur Andersen & Co.

Steven F. Moliterno

The Accounting Profession in the Philippines

PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES



AICPA

American Institute of Certified Public Accountants

The Accounting Profession in the Philippines
PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES
AICPA

NOTICE TO READERS

The Professional Accounting in Foreign Countries series is designed to be educational and used as reference material for the members of the Institute and others interested in the subject. It is not intended to establish standards.

International Practice Committee (1988–1989)

Frank J. Schwitter, *Chairman*
Joseph S. Burns
David W. Cottle
James B. Durnil
Jack R. Fay
John Y. Gray
Stephen D. Harlan
Evan B. Hume
Corliss M. Klinzing
Thomas Lumsden
Herbert A. Morey
Paul E. Neubelt
Howard S. Shapiro
Chris D. Simpson
Thomas S. Watson, Jr.

International Booklets Task Force (1988–1989)

Frank J. Schwitter, *Chairman*
Howard P. Keefe
Jack R. Fay
Gary S. Schieneman

AICPA Staff

John H. Graves, *Director—Technical Services*
Steven F. Moliterno, *Technical Manager, Technical Information Division*

The International Practice Committee gratefully acknowledges the contributions made to the development of this series by former committee chairmen Howard P. Keefe and Harvey D. Moskowitz; former committee members Dale D. Baker, R. Harry Beattie, J. Stanley Blumin, Campbell E. Corfe, John F. Green, James M. Halsey, Perry D. Harbour, W. Edward Hastings, Konrad W. Kubin, Angus McDowell, Alan C. Murphy, Ronald Nash, Walter F. O'Connor, W.C. Brian Peoples, Bruce D. Robertson, Martin Rotheim, and Anthony L. Smith; and former staff aides James F. Flynn and Susan Sgromo. The committee would also like to acknowledge the fine editorial efforts of Carrie Vaccaro and Gene Smith and the production work of Robert DiCorcia, David Chipps and Lisa Schmelzer.

The Accounting Profession in the Philippines

PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES

Prepared by

SGV & Co.
and
Arthur Andersen & Co.

STEVEN F. MOLITERNO, CPA
Series Editor

AICPA
American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, N.Y. 10036-8775

1234567890 TI 89

Library of Congress Cataloging-in-Publication Data
(Revised for vol. 10)

The Accounting profession in the Philippines.

Includes bibliographies.
Contents: [1] Canada/prepared by Fuller Jenks Landau—[2] Netherlands/prepared by Ernst & Whinney—[etc.] — [10] Philippines/prepared by SGV & Co. and Arthur Andersen & Co.
1. Accounting. 2. Comparative accounting. I. American Institute of Certified Public Accountants. II. Title: Professional accounting in foreign countries series.
HF5611.A34 1987 657 87–150526
ISBN 0–87051–058–4

Preface

This booklet is one of a series on professional accounting in foreign countries. The material is current as of August 31, 1988. Changes after this date in the standards of either the United States or the Philippines may alter the comparisons detailed in this publication.

Included are descriptions of the accounting profession, auditing standards, and accounting principles in the Philippines. The booklet also presents brief descriptions of the various forms of business organizations, taxes, and requirements for stock exchange listings and securities offerings. Checklists comparing auditing standards and accounting principles of the Philippines with those generally accepted in the United States are appendixes to the text.

This booklet is not intended to be a comprehensive discussion of auditing standards and accounting principles in the Philippines but is designed instead to focus primarily on differences from those of the United States.

John Graves
Director—Technical Services

Contents

Preface iii

1 The Accounting Profession 1

Requirements for Entry Into the Profession 1
- Domestic Functions and Licensing Requirements 1
- Foreign Reciprocity 2

Roles and Responsibilities of Standard-Setting Bodies 3
- Professional Standards Promulgated by Each Body 3
- Ethics Requirements 4

Professional Public Accounting Organizations 5
- Requirements for Membership 5
- Rights of Membership 5
- Number of Members 6
- CPE Requirements 6

2 Auditing Requirements 7

Statutory Auditing and Reporting Requirements 7
- Purpose of the Statutory Audit 7
- Entities Required to Be Audited 7
- Appointment and Qualifications of Auditors 8
- Auditing and Reporting Responsibilities 8
- Filing of Reports 9

Summary of Significant Auditing Standards and Comparison With U.S. Generally Accepted Auditing Standards (GAAS) 9
- Standards Issued 9
- General Standards 10
- Standards of Fieldwork 10
- Standards of Reporting 11

3 Accounting Principles and Practices **15**
Sources of Accounting Principles 15
Form and Content of Financial Statements 15
Presentation of Statements 15
Types of Statements Prepared 16
Summary of Significant Accounting Principles and Comparison With U.S. Generally Accepted Accounting Principles (GAAP) 16

4 Business Environment **23**
Forms of Business Organization 23
Entities With Corporate Attributes 23
Branches of a Foreign Company 25
Partnership Entities 25
Other Forms of Business Organization—Sole Proprietorship 26
Requirements for Public Sales of Securities and Requirements for Listing Securities on the Stock Exchanges 26
Registration Requirements for Public Sale 26
Requirements for Listing Securities on the Stock Exchanges 26
Taxes 27
Principal Types 27
Tax Returns 29

Appendix A—Outstanding Auditing Pronouncements **33**
Appendix B—Outstanding Accounting Pronouncements **35**
Appendix C—Illustrative Auditor's Report and Financial Statements **37**
Appendix D—Checklist for Comparison of Generally Accepted Auditing Standards (GAAS) in the United States to Auditing Standards in the Philippines **48**
Appendix E—Checklist for Comparison of Generally Accepted Accounting Principles (GAAP) in the United States to Accounting Principles in the Philippines **54**

Bibliography **73**

1

The Accounting Profession

REQUIREMENTS FOR ENTRY INTO THE PROFESSION

Domestic Functions and Licensing Requirements

1. The functions that accountants in the Philippines may perform are defined in the Revised Accountancy Law of 1975, which provides that the following constitute the practice of accountancy:

a. Holding out oneself as knowledgeable in the science and practice of accounting and as qualified to render professional services as a CPA

b. Offering or rendering, or both, to more than one client, on a fee basis or otherwise, services such as—
- The audit or verification of financial transactions and accounting records
- The preparation, signing, or certification for clients of balance sheets and other financial, accounting, and related schedules, exhibits, statements, or reports that are to be used for publication or for credit purposes, or to be filed with a court or government agency, or to be used for any other purpose
- The installation and revision of accounting systems
- The preparation of income tax returns

c. Representing clients before government agencies on tax matters related to accounting

d. Rendering professional assistance in matters relating to accounting procedures and the recording and presentation of financial facts or data.

2. Independent certified public accountants are engaged to examine financial statements of business enterprises filed with government regulatory authorities or tax authorities, or used by investors, stockholders, creditors, and management. They may also be engaged to perform tax or management consulting services.

3. The title *certified public accountant* may be used only by those who hold a valid certificate of registration as a certified public accountant. The Board of Accountancy, operating under the supervision of the Professional Regulation Commission, regulates the licensing of certified public accountants. The Board issues a certificate of registration to those who have satisfactorily passed its examination. Such registration shall be renewed every three years during the CPA's birth month in the calendar year immediately following the expiration date appearing in the registration.

4. A candidate for the CPA examination must be a citizen of the Philippines, at least twenty-one years of age, of good moral character, and a holder of a Bachelor of Science in Commerce degree or its equivalent from any institution of learning recognized by the government.

Foreign Reciprocity

5. The Revised Accountancy Law recognizes foreign reciprocity. Foreigners may be admitted to the examination or be registered as a CPA provided that they prove, in accordance with the requirements of the Professional Regulation Commission, that their country, by specific provisions of law, allows Filipino citizens to practice accountancy "after an examination on terms of strict and absolute equality with the citizens, subjects, or nationals of said country, including the unconditional recognition of prerequisite degrees issued by institutions of learning duly recognized by the Government of the Republic of the Philippines."

ROLES AND RESPONSIBILITIES OF STANDARD-SETTING BODIES

Professional Standards Promulgated by Each Body

6. The Accounting Standards Council (ASC) is the independent body created and authorized by the Philippine Institute of Certified Public Accountants (PICPA) to establish and improve accounting standards in the Philippines.

7. It is composed of eight members—four from PICPA, one each from three regulatory agencies (the Securities and Exchange Commission [SEC], the Central Bank, and the Professional Regulation Commission), and one member from the Financial Executives Institute of the Philippines.

8. The ASC issues Statements of Financial Accounting Standards that, when endorsed by the Board of Accountancy and approved by the Professional Regulation Commission, become part of the rules and regulations to which all CPAs must conform. These are therefore mandatory in status. Exposure drafts of proposed Statements of Financial Accounting Standards are distributed for comment before they are made final. From time to time the ASC also issues Interpretations to clarify, explain, or elaborate on a provision of a Statement of Financial Accounting Standards.

9. Before the ASC was established, the Committee on Financial Accounting Standards (previously the Committee on Accounting Principles) of PICPA issued Accounting Principles Bulletins, which provided accounting guidelines that were recommendatory in nature. Only a few bulletins have not yet been superseded by ASC issuances.

10. The Auditing Standards and Practice Council (ASPC) was established in 1986 by PICPA in coordination with the Association of Certified Public Accountants in Public Practice (ACPAPP) to formalize the audit standards-setting process. The ASPC promulgates auditing standards that govern the practice of auditing. It is composed of sixteen members—seven from independent auditing firms in Metro Manila, two each from PICPA and ACPAPP, one each from the Board of Accountancy and the Securities and Ex-

change Commission, and three PICPA members from regions outside metropolitan Manila.

11. The ASPC issues Statements of Auditing Standards of the Philippines (SASP) that become effective from the date stated therein after approval by the Board of Accountancy and the Professional Regulation Commission. Exposure drafts of proposed SASPs are distributed to members of PICPA, ACPAPP, the Philippine Association of Colleges and Schools of Business, auditing firms, and other interested parties for comment before they are made final. From time to time, the ASPC may also issue either interpretations of its statements or opinions on specific queries on auditing matters.

12. Before the ASPC was established, PICPA, through its Committee on Auditing Procedures, had been responsible for issuing auditing literature in the Philippines. The Committee adopted ten generally accepted auditing standards. These standards, for which compliance is required, have been formally adopted by the Professional Regulation Commission. The Committee on Auditing Procedures has also issued audit bulletins on implementing generally accepted auditing standards and audit procedures in the examination of various accounts.

Ethics Requirements

13. With the assistance of PICPA, a Code of Professional Ethics for certified public accountants was promulgated by the Board of Accountancy and approved by the Professional Regulation Commission in 1978. The Code provides ethical rules for all CPAs, whether they are in public accounting practice, private industry, government service, or education. For CPAs in public accounting practice, the Code provides rules on independence in areas such as financial interests in a client, loans to or from a client, and service as a trustee, director, or officer of a client during the period covered by the audit. The Code also gives guidance on reporting on forecasts, contingent fees and commissions, encroachment, offers of employment, and advertising.

14. Advertising by CPAs or their firms is not permitted in the Philippines, and CPAs in public accounting practice are prohibited from seeking clients by solicitation.

15. A CPA may practice public accounting only in the form of a proprietorship or partnership. CPAs are not allowed to practice public accounting by incorporating.

PROFESSIONAL PUBLIC ACCOUNTING ORGANIZATIONS

16. The Philippine Institute of Certified Public Accountants is recognized by the Professional Regulation Commission as the official national professional organization of certified public accountants in the country. In addition, there are four sectorial organizations in the Philippines—the Association of Certified Public Accountants in Public Practice (ACPAPP), the Association of Certified Public Accountants in Commerce and Industry, the Government Association of Certified Public Accountants, and the Association of Certified Public Accountants in Education.

Requirements for Membership

17. Membership in PICPA and in the four sectorial organizations is open to CPAs who hold valid CPA certificates granted by the Board of Accountancy.

Rights of Membership

18. In addition to holding an annual convention, PICPA conducts monthly meetings at which speakers are invited to talk on subjects of current interest to CPAs. PICPA also publishes a monthly newsletter and a semiannual accountant's journal that contains, among other things, articles and information on accounting, auditing, taxes, and management consulting services. ACPAPP similarly conducts seminars and publishes a newsletter for its members.

19. Membership in PICPA or in the sectorial organizations is not a prerequisite for a CPA to practice public accounting or to seek employment in the government or in private enterprises.

Number of Members

20. As of August 1988, PICPA had approximately 25,000 members. Of the total PICPA members, approximately 26 percent are in public accounting practice, 18 percent in government service, 39 percent in commerce and industry, 10 percent in education, and 7 percent in other areas.

CPE Requirements

21. The Board of Accountancy has made continuing professional education (CPE) mandatory for CPAs. This rule became effective in 1988. Under the CPE program, CPAs are required to earn a minimum number of CPE credit hours for each three-year period during which their CPA registration card is valid. This is a condition for the renewal of their registration with the Professional Regulation Commission as licensed professionals.

22. A minimum of 90 CPE credit hours is required in the first three-year period of implementation; 120 hours are required thereafter. CPE programs, which consist of structured learning activities, must be accredited by the CPE Council, the body responsible for implementing and monitoring each CPE program.

2

Auditing Requirements

STATUTORY AUDITING AND REPORTING REQUIREMENTS

Purpose of the Statutory Audit

23. Audits of financial statements are performed to comply with the reporting requirements of some government regulatory authorities, such as the SEC, the Central Bank, and the Office of the Insurance Commissioner, as well as with the income tax filing requirements of the Bureau of Internal Revenue.

Entities Required to Be Audited

24. Companies with authorized capital or paid-in capital of Philippine peso (P) 50,000 or more are required by SEC regulations to file audited financial statements with the Commission.

25. Regulated companies, such as banks and insurance companies, are also required to submit audited financial statements to their respective government regulatory agency, such as the Central Bank and the Office of the Insurance Commissioner.

26. Companies with gross quarterly sales of more than P25,000 are required by the Bureau of Internal Revenue to file audited financial statements together with their income tax return.

Appointment and Qualifications of Auditors

27. There is no specific law governing the appointment of auditors. However, the auditor engaged to report on the financial statements of an enterprise must be an independent CPA or firm. The Code of Professional Ethics for Certified Public Accountants sets forth the rules on independence, which are similar to the corresponding U.S. rules.

28. The auditor is often selected by the management of a company. Depending on the provisions of each company's bylaws, the selection may need the approval of the board of directors, the stockholders, or both.

Auditing and Reporting Responsibilities

29. The management of a company bears primary responsibility for keeping proper books of accounts and other financial records, as well as for preparing annual financial statements. Accordingly, the fairness of presentation of the financial statements is an integral part of management's responsibilities.

30. The management of certain corporations (those with twenty or more stockholders, those whose securities are offered for sale to the public, issuers of registered commercial papers, and financing companies) are required by the SEC to acknowledge their responsibility over the financial statements of their corporations. This is accomplished by submitting a Statement of Management Responsibility to accompany the financial statements filed with the SEC. The responsibility of the independent certified public accountant engaged to audit the financial statements is to express an opinion on the fairness of presentation of the statements.

31. A company's annual report to its stockholders may include information other than the financial statements and auditor's report. This additional information, such as earnings statistics or management's analysis of the results of operations, is the responsibility of management. The auditor's responsibility does not extend beyond the financial statements identified in the auditor's report.

Filing of Reports

32. The auditor's report is attached to the financial statements filed with the government agency. The report may be addressed to the corporation, to its board of directors, or to stockholders.

33. Financial statements filed with the SEC are normally open to public inspection subject to certain terms and conditions laid down by the Commission.

34. Individual CPA practitioners who audit companies required to file financial statements with the SEC must submit a one-time Statement of Representation to the SEC. In this statement, CPAs represent the following to the SEC:

a. That the financial statements are in conformity with generally accepted accounting principles
b. That the independence requirements are complied with
c. That the audit is conducted in accordance with generally accepted auditing standards
d. That no act discreditable to the profession is committed

SUMMARY OF SIGNIFICANT AUDITING STANDARDS AND COMPARISON WITH U.S. GENERALLY ACCEPTED AUDITING STANDARDS (GAAS)

Standards Issued

35. Audit pronouncements in the Philippines consist of (*a*) Statements of Auditing Standards of the Philippines issued by the ASPC and (*b*) audit bulletins, issued by the Committee on Auditing Procedures of PICPA, that have not been superseded by pronouncements of the ASPC. See appendix A for a listing of these audit pronouncements.

36. The SASPs issued by the ASPC starting in 1988 include the ten generally accepted auditing standards (GAAS) previously adopted by PICPA and the Professional Regulation Commission and other standards that give guidance on their application.

37. Before the ASPC was established, PICPA issued audit bulletins through its Committee on Auditing Procedures. These bulletins provided auditing guidelines and procedures and reporting guidelines to implement generally accepted auditing standards.

38. The ten generally accepted auditing standards in the Philippines are similar to those in the United States. U.S. auditing standards and publications are used as references in the development of SASPs and audit bulletins.

39. Recognizing the lack of Philippine literature on auditing standards, many of the larger accounting firms operating in the Philippines have referred to current U.S. auditing standards and literature for guidance in developing and implementing their own standards. It is expected, however, that the recently established ASPC can properly attend to this matter. The ASPC's main objective is to promulgate auditing standards that will govern the practice of auditing.

General Standards

40. The generally accepted auditing standards in the Philippines are as follows:

a. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

b. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.

c. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of Fieldwork

41. The standards of fieldwork, which must be observed in the conduct of an audit, provide that—

a. The work is to be adequately planned and assistants, if any, are to be properly supervised.

b. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

c. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

Standards of Reporting

42. The standards of reporting provide that—

a. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.

b. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.

c. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

d. The report shall contain either an expression of opinion regarding the financial statements taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clearcut indication of the character of the auditor's examination, if any, and the degree of responsibility the auditor is taking.

Differences Between Philippine and U.S. Auditing Standards

43. In understanding the differences between Philippine and U.S. auditing procedures one should bear in mind that although there is not as much audit literature in the Philippines as there is in the United States, this does not imply that there are differences in actual practice.

44. Differences in auditing standards between the Philippines and United States include the following:

- In the Philippines, confirming receivables by direct communication with debtors and observing inventory counts are two practices that are only recommended but that are nonetheless predominant.
- SASP 4, *Client Representations,* states that the auditor should obtain written representations. In certain cases, oral representations may suffice if the auditor is satisfied that there are valid and acceptable reasons the client does not provide written representations and that the auditor can rely on the oral representations. In practice, auditors generally do obtain such representations.
- There is no specific standard requiring auditors to make inquiries of the company's legal counsel. Audit Bulletin 19, *An Audit Guide for the CPA,* however, does list as one of the audit procedures relating to contingent liabilities the request of information direct from the legal counsel on any pending litigation or claim. In practice, auditors do request such information from the company's legal counsel.
- There is no standard that requires communication of material weaknesses in internal accounting control to senior management. In practice, however, as an added service to the client, auditors usually do communicate to management observed significant weaknesses in internal accounting controls together with suggestions for improvement.
- There is no specific standard governing the auditor's responsibility for illegal acts and for detecting errors or irregularities when examining financial statements.
- There is no specific standard to identify and verify related party transactions. In practice, auditors perform these procedures, since related party disclosures are now required by the Accounting Standards Council.
- There is no current auditing literature relating to subsequent events. In practice, however, auditors usually do review subsequent events to ascertain the occurrence of such events that may require adjustment to or disclosure in the financial statements.
- The wording of the standard form of auditor's report in the Philippines is identical to the previous standard U.S. two-paragraph short-form report.

- Reporting guidelines in the Philippines regarding the circumstances that may result in a departure from the standard report and the type of report required under such circumstances are similar to the U.S. standards prior to the revision of the U.S. reporting standard in 1988.

3

Accounting Principles and Practices

SOURCES OF ACCOUNTING PRINCIPLES

45. Generally accepted accounting principles (GAAP) in the Philippines are set forth in (*a*) Statements of Financial Accounting Standards (SFASs) and Interpretations issued by the ASC and (*b*) Accounting Principles Bulletins (APBs), previously issued by PICPA's Committee on Financial Accounting Standards, that have not yet been superseded by the ASC pronouncements. See appendix B for a list of these accounting pronouncements.

FORM AND CONTENT OF FINANCIAL STATEMENTS

Presentation of Statements

46. No specific form is prescribed for the presentation of financial statements. The content and related disclosures, however, should conform with the requirements of generally accepted accounting principles.

47. Financial statements are not required to be presented in comparative form under generally accepted accounting principles, although it is a predominant practice to do so. Income statements filed with the Bureau of Internal Revenue for income tax purposes, however, are required to be in comparative form. In addition, the SEC requires financial statements of companies whose shares are sold or offered for sale to the public also to be in comparative form.

48. There is no accounting pronouncement that requires the presentation of consolidated financial statements. However, such statements may be prepared when required by management or government regulation or for some other purpose. For example, banks and nonbank financial intermediaries are required to file, with the Central Bank, consolidated financial statements supported by annual statements of the individual companies.

Types of Statements Prepared

49. Financial statements prepared in conformity with generally accepted accounting principles consist of a balance sheet, a statement of income and retained earnings, and a statement of changes in financial position.

50. Companies whose shares of stock are sold or offered for sale to the public are also required to submit to the SEC supplementary schedules pertaining to, where applicable, cost of goods manufactured and sold; marketable securities; receivables from directors, officers, employees, and principal stockholders (other than affiliates); long-term investments in securities; advances to unconsolidated subsidiaries and affiliates; property, plant, and equipment; accumulated depreciation; intangible and other assets; long-term debt; indebtedness to affiliates; guarantee of securities of other issuers; reserves; and capital stock.

51. Companies filing financial statements with the Bureau of Internal Revenue for income tax purposes are required to file, in addition to the basic financial statements, supplementary schedules pertaining to, where applicable, cost of goods manufactured and sold and taxes paid or accrued. An illustrative set of general-purpose financial statements for commercial or industrial companies is shown in appendix C.

SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES AND COMPARISON WITH U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

52. The development of generally accepted accounting principles in the Philippines is significantly influenced by U.S. account-

ing principles and International Accounting Standards Committee (IASC) pronouncements. Accordingly, Philippine and U.S. accounting principles are similar to a large extent. In certain cases, however, alternative accounting principles that are not acceptable in the United States have been adopted in the Philippines to give recognition to the different economic environment in the country. In other instances, accounting principles that are required in the United States have not yet reached mandatory status in the Philippines.

Revaluation of Property, Plant, and Equipment

53. Property, plant, and equipment are generally carried at cost. However, because of inflation, revaluation of these assets is also permitted in the Philippines. Revaluation of property, plant, and equipment may be based either on index numbers or on an appraisal made by independent experts or specialists. At present, however, no suitable index numbers have been prescribed for revaluation purposes. Appraisal by independent experts has been most commonly used by companies wishing to restate their property, plant, and equipment accounts.

54. SFAS 12, *Revaluation of Property, Plant, and Equipment Through Appraisal*, provides that, after property, plant, and equipment are revalued through appraisal, the depreciation charged to operations should be based on appraised values. Disclosure in the financial statements is required for appraised values, for accumulated depreciation on appraisal and depreciation based on appraised values, and for the historical costs, accumulated depreciation on cost, and depreciation based on cost. The revaluation increment should be shown separately under stockholders' equity.

Foreign Currency Translation

55. Exchange differences arising from foreign currency transactions should normally be recognized in income for the period, although in certain cases the differences may be capitalized or deferred.

56. SFAS 8, *Accounting for the Effects of Changes in Foreign Exchange Rates*, provides that an exchange difference that results from a depreciation of a currency against which there is no practi-

cal means of hedging and that affects liabilities arising directly from the acquisition of assets invoiced and payable in foreign currency may be included in the carrying amount of the related assets, provided that the adjusted carrying amount of the asset does not exceed the lower of replacement cost and the amount recoverable from the use or sale of the asset. SFAS 8 also provides that exchange differences from long-term monetary items, alternatively, may be deferred and recognized in income of current and future periods on a rational and systematic basis, over the remaining lives of the monetary items to which they relate.

57. SFAS 8 does not require the disclosure of aggregate exchange differences included in determining net income for the period, although such disclosure is a predominant practice. SFAS 8 does require, however, the disclosure of the amount of exchange differences capitalized during the period, or the amount of unamortized deferred exchange differences.

58. There is no specific guidance in SFAS 8 on accounting for gains or losses on foreign currency transactions that are intended to hedge a foreign currency commitment. However, it provides that, for short-term transactions covered by a forward exchange contract, the forward rates specified in the forward exchange contract may be used as the basis for measuring and reporting the transactions.

59. The method of translating the financial statements of foreign operations for consolidation purposes is determined by assessing the operational and financial relationships between the parent company and its foreign operations. Thus, financial statements of a foreign operation that is integral to the operations of the parent are translated by means of procedures similar to the remeasurement process under FASB Statement No. 52, *Foreign Currency Translation.* Under this method, monetary items are translated at the closing rate (that is, the spot rate at the balance sheet date) and nonmonetary items are translated at historical rates. Income statement items are translated at the exchange rate at the dates of the transactions. Exchange differences are generally taken to income, except that certain exchange differences may be deferred or capitalized, as discussed in paragraph 57.

60. On the other hand, financial statements of a foreign operation whose activities are not integral to those of the parent (that is, a foreign entity) are translated by means of procedures similar to the current rate method under FASB Statement No. 52. Under the translation method for the financial statements of a foreign entity, assets and liabilities, both monetary and nonmonetary, are translated at the closing rate. Income statement items are translated either at the closing rate or at the exchange rate at the date of the transactions. Translation adjustments are reported in a separate component of stockholders' equity. SFAS 8 requires the disclosure of net exchange differences for the period taken to stockholders' equity. It does not require an analysis of the changes during the period in the translation adjustment component of the stockholders' equity.

Consolidation

61. In the Philippines, when one company has control over another company, consolidated financial statements are not required for fair presentation in conformity with generally accepted accounting principles. Consolidated financial statements, however, may be prepared for inclusion in the annual report to shareholders or for use by management. When such statements are prepared, the provisions of PICPA APB 23, *Consolidated Financial Statements*, are recommended for accounting guidance.

62. Under APB 23, control is indicated by ownership, direct or indirect, through subsidiaries of more than one-half of the voting powers of a company. Subsidiaries are commonly excluded from consolidation if control is likely to be temporary, if the ability of the parent company to control the subsidiary assets and operations is impaired, or if the subsidiary's business activities are so dissimilar from those of the other companies within the group that the presentation of the subsidiary's separate financial statements with the consolidated statements would provide better information for users of the statements.

Receivables

63. Receivables are required to be valued at their face amounts less, if appropriate, allowances for doubtful accounts and for any

anticipated adjustments needed to reduce the receivables to estimated realizable values. An allowance for doubtful accounts should be determined on the basis of either a specific or an overall evaluation of the accounts.

64. There is no requirement to impute interest on receivables not arising in the normal course of business or subject to normal trade terms. SFAS 3, *Summary of Generally Accepted Accounting Principles on Receivables*, allows long-term notes receivable with no interest or an unreasonably low interest rate to be stated at their discounted amounts. This practice, however, is not commonly followed.

Deferred Income Tax

65. Accounting for deferred income tax is permitted but not required. When it is adopted, the provisions of APB 2, *Accounting for Income Taxes*, are recommended for guidance. Under APB 2, which is based on U.S. Accounting Principles Board (APB) Opinion No. 11, *Accounting for Income Taxes*, deferred taxes are provided for all timing differences and are determined on the basis of tax rates in effect at the time the difference originated.

66. Philippine tax laws provide for tax loss carryforwards in limited cases, but not for loss carrybacks. Only certain registered export producers and registered agricultural producers are entitled to tax loss carryforwards. When a company is entitled to a loss carryforward, the tax benefit of the loss carryforward is included in income that is realized as an extraordinary item in the period.

Pension Costs

67. APB 16, *Accounting for Cost of Retirement Plans*, which is based on U.S. APB Opinion 8, *Accounting for the Cost of Pension Plans*, sets forth recommended guidelines on accounting for pension costs which are predominantly followed by companies that have existing pension plans. Pension costs charged to operations generally include normal cost and past service cost determined under the actuarial method used and are disclosed in the financial statements or the notes thereto.

68. APB 16 recommends (*a*) systematically amortizing past service costs over a ten- to forty-year period, (*b*) spreading actuarial

gains and losses, including realized investment gains and losses, over the current year and future years unless they arise from an extraordinary occurrence not directly related to the operations of the retirement plan, and (*c*) reporting unamortized prior service cost in the balance sheet only if it is a legal liability as imposed by the plan arrangement.

Interest Capitalization

69. Capitalization of interest is not separately addressed in current accounting pronouncements in the Philippines. However, capitalization is implicit in SFAS 6, *Summary of Generally Accepted Accounting Principles on Property, Plant and Equipment*, and the predominant practice is to capitalize interest costs incurred during the construction of fixed assets.

Nonmonetary Transactions

70. Accounting for nonmonetary transactions on the basis of the fair market value of the assets involved is not explicitly required under Philippine accounting pronouncements. However, it is implicit in SFAS 1, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*, and is generally followed in practice.

Other Matters

71. Current accounting pronouncements in the Philippines do not address certain areas that are covered by U.S. accounting pronouncements, including the following:

- Business combinations
- Leases
- Construction contracts
- Research and development costs
- Disclosure of business segments

72. When resolving questions relating to the foregoing subjects, U.S. or International Accounting Standards Committee (IASC) accounting standards are generally referred to for guidance but are not mandatory.

4

Business Environment

FORMS OF BUSINESS ORGANIZATION

73. The forms of business organization in the Philippines—corporation, partnership, and single proprietorship—are similar to those found in the United States.

Entities With Corporate Attributes

74. Corporations may be organized under the provisions of the Corporation Code of the Philippines ("the Code") or they may be created by special laws or charters. The Code, which is the general law providing for the formation, organization, or regulation of private corporations, is based principally on American corporate law.

75. A private corporation may be formed by no less than five and no more than fifteen natural persons, all of legal age, the majority of whom are residents of the Philippines. Each of the incorporators must own or be a subscriber to at least one share of the corporation's capital stock.

76. Corporations organized under the Code must file the articles of incorporation and other required documents, such as the bylaws, with the SEC. A corporation acquires a legal personality from the day the SEC issues its certificate of incorporation. It may exist for a period of up to fifty years unless dissolved sooner or

unless its life is extended for periods not exceeding fifty years. Generally, there is no required minimum authorized capital stock. Capital stock must be subscribed at the time of incorporation and at least 25 percent of the total subscription must be paid upon incorporation. In addition, the paid-up capital should not be less than P5,000. Every corporation must adopt a set of bylaws.

77. Stockholders hold their regular meetings annually on a date fixed in the bylaws or on any day in April of every year, as determined by the board of directors. Stockholders may also hold special meetings at any time deemed necessary or as provided in the bylaws, provided that at least one week's written notice is sent to all stockholders, unless otherwise provided in the bylaws.

78. A corporation has a legal personality distinct from that of its stockholders. The liability of stockholders is limited to their subscriptions.

79. Corporate powers are exercised by the board of directors, although stockholders' approval is required for certain corporate actions, such as increase or diminution of capital stock, issuance of stock dividends, and amendment of the articles of incorporation. The members of the board of directors must be stockholders and the majority of the members must be residents of the Philippines. Each director must own at least one share of stock, which must be registered in his or her name in the corporation's books.

80. The board of directors must present to the stockholders at their regular meeting a financial report of the corporation's operations for the preceding year. The report must include financial statements for the year being reported. Board members who vote for unlawful acts of the corporation, who are guilty of gross negligence or bad faith in directing the affairs of the corporation, or who acquire interests in conflict with their duties are financially liable for resulting damages.

81. Corporations generally are not required to set up legal reserves. However, corporations that hold treasury shares must restrict retained earnings that are equivalent to the cost of the treasury shares held from being declared as dividends.

Branches of a Foreign Company

82. A foreign corporation applying for a license to establish a branch and transact business in the Philippines must submit a certified copy of its articles of incorporation and bylaws to the SEC. The application must set forth the following, among other things:

- The name and address of its resident agent authorized to accept summons and process in legal proceedings
- The names and addresses of the present directors and officers of the corporation
- A statement under oath by the president or any other person authorized by the corporation that the applicant is solvent and in sound financial condition
- Assets and liabilities of the corporation

83. A branch of a foreign corporation is required to deposit with the SEC government securities worth P100,000 after the issuance of its license and additional securities worth 2 percent of its gross income in excess of P5 million after each fiscal year. This is for the benefit of present and future creditors in the Philippines.

Partnership Entities

84. Philippine law on partnerships, found in the Civil Code of the Philippines, is based primarily on the Uniform Partnership Act and the Uniform Limited Partnership Act of the United States.

85. A partnership may be general, composed of all general partners, or limited, composed of at least one general partner and at least one limited partner. A partnership with more than P3,000 in capital must register with the SEC.

86. Like a corporation, a partnership has a legal personality separate and distinct from that of each of the partners; unlike corporations, however, all partnerships must have at least one partner with unlimited liability. All general partners are liable pro rata with their separate property after exhaustion of partnership assets for all obligations binding upon the partnership. Limited partners are not liable to partnership creditors beyond their capital contributions.

Other Forms of Business Organization—Sole Proprietorship

87. A single proprietorship refers to a business or professional activity carried on by an individual as a sole proprietor. A single proprietor must register the business's name with the Bureau of Domestic Trade and must secure a license from the municipality where he or she intends to do business.

REQUIREMENTS FOR PUBLIC SALES OF SECURITIES AND REQUIREMENTS FOR LISTING SECURITIES ON THE STOCK EXCHANGES

Registration Requirements for Public Sale

88. Securities sold or offered for sale or distribution to the public within the Philippines must be registered with the SEC, unless exempt by law. The procedural steps for registration of securities include (*a*) filing of a sworn registration statement that contains information required under section 8 of the Revised Securities Act, (*b*) payment of the required fee, and (*c*) publication of the fact of the filing in two general-circulation newspapers, once a week for two consecutive weeks. The registration statement must include a balance sheet as of a date not more than ninety days before the filing of the registration statement and an income statement for the last three years, reported on by an independent certified public accountant.

Requirements for Listing Securities on the Stock Exchanges

89. Two stock exchanges operate in the Philippines: the Manila Stock Exchange and the Makati Stock Exchange. Each has its own requirements for listing securities, but they are essentially similar.

90. The procedure for listing consists of filing an application form for listing, plus providing all supporting documents. The listing application requires, among other things, general and financial information about the company and its business.

91. The listing application must be accompanied by certain documents, including the registration/licensing order issued by the

SEC and the corporation's latest audited financial statements. A listing fee, the amount of which is based on authorized capital, is also paid.

92. Two copies of the listing application form are filed with the SEC. If the Exchange approves the listing, it sends notice of its approval to the SEC. Listing usually becomes effective three days after the Exchange in turn receives notice of approval from the SEC.

93. The company is requested to furnish the Exchange with copies of the financial statements submitted to the stockholders.

Impact on Accounting Requirements

94. Financial statements included in the registration statement for public sale of securities that is filed with the SEC should include information indicated by law in addition to the usual disclosures required under generally accepted accounting principles, as follows:

- Any loan to or from any officer, director, stockholder, or person directly or indirectly controlling or controlled by the issuer
- The nature and source of the issuer's surplus
- Practice regarding charges, dividends, or other distributions made against the various surplus accounts during the three years presented
- The issuer's liabilities to companies controlling it or controlled by it, as well as detail on use of the proceeds, maturity and repayment schedule, nature of security, interest rate, and other terms and conditions.

TAXES

Principal Types

95. The principal taxes in the Philippines are the income tax, value added tax (VAT), excise tax, percentage tax, and real property tax.

Income Tax

96. Domestic corporations, including joint ventures and partnerships, generally are taxed on their annual taxable income from worldwide sources at the rate of 35 percent. Resident foreign corporations (that is, those incorporated under foreign laws but doing business in the Philippines) generally are taxed in the same manner and at the same rates as domestic corporations, although only on the basis of net income from Philippine sources.

97. The profits after tax, remitted by a branch of a foreign corporation to its head office, are taxed additionally at a rate of 15 percent. On the other hand, the net earnings after tax, remitted as dividends by a subsidiary to its parent, are taxed at 35 percent. That rate may be reduced to 15 percent in certain circumstances.

98. Individual taxpayers are taxed under a modified system of gross income taxation in which individual income is classified as compensation income, business income, or passive income. Compensation income and business income are subject to tax ranging from 1 percent to 35 percent. Passive income, such as interest and dividend income, is subject to a final withholding tax at varying rates.

99. Individual citizens and resident aliens are taxed on their worldwide income. Nonresident aliens are taxed only on their Philippine-source income.

Value Added Tax

100. Effective in 1988, sales of goods and services are subject to a 10 percent VAT except for zero-rated and exempt transactions. A zero-rated sale is a taxable transaction (taxable at 0 percent) for VAT purposes. It does not result in any VAT liability, but allows the seller to claim a tax credit on VAT previously paid on its purchases of goods or services. An exempt sale is not subject to VAT and the seller is not allowed any tax credit on VAT previously paid on its purchases of goods or services. VAT paid by a VAT-registered enterprise may constitute creditable taxes. In general, enterprises engaged in the business of selling goods and services with annual gross sales or receipts exceeding P200,000 are subject to VAT and must register as such. However, enterprises not covered by VAT may elect to be covered by it.

Excise Taxes

101. There are two kinds of excise tax: specific and ad valorem taxes. The specific tax is based on weight, volume capacity, or any other physical unit of measurement. The ad valorem tax, on the other hand, is based on selling price or any other specified value of the article.

102. Excise taxes are applied to articles manufactured or produced in the Philippines for domestic sale, consumption, or any other manner of disposition, as well as to imported articles. In the latter case, excise taxes are collected in addition to any customs duties. Rates for specific and ad valorem taxes vary depending on the article being taxed.

Percentage Taxes

103. Certain service establishments, such as banks and insurance companies, are subject to percentage taxes based on gross receipts, output, or income at varying rates. Taxpayers subject to percentage tax are not subject to VAT.

Real Property Tax

104. Real property tax is an annual tax on real property, such as land, building, machinery, and improvements on the property. This tax is paid to the province or city where the property is located. The rates are based on the assessed value of the property and vary slightly from one location to another. However, the rates cannot be less than one quarter of 1 percent, or more than half of 1 percent, of the assessed value of the property in provinces and municipalities, and not less than half of 1 percent, or more than 2 percent, of such value in cities. In addition to the regular (basic) real property tax, a uniform annual tax of 1 percent of the assessed value of real property is levied and accrues to a special education fund.

Tax Returns

105. Taxable corporations, except nonresident foreign corporations, must file a quarterly summary declaration of their gross income and deductions on a cumulative basis for the preceding

quarter or quarters, which is the basis of computing the income tax liability. The tax so computed is decreased by the amount of tax previously paid or assessed during the preceding quarters and is payable not later than sixty days from the close of each of the first three quarters of the taxable year. A final adjustment return covering the total net income for the preceding year is then filed on or before the fifteenth day of the fourth month following the close of the taxable year. If the sum of the quarterly tax payments made during the taxable year is not equal to the total tax due as computed in the final adjustment return, the corporation must either pay the excess tax still due or seek refund of the excess amount paid. The refundable amount may instead be credited against the corporation's income tax liability for the succeeding taxable quarters.

106. Individual citizens, resident aliens, and nonresident aliens engaged in trade or business in the Philippines, unless exempt by law, must file their tax returns on or before the fifteenth day of April of each year, covering income for the preceding taxable year.

107. The base period for computing the liability for corporate tax is the company's accounting period. Unless it chooses a fiscal year, a corporation's accounting period is the calendar year. Individuals are required to use the calendar year for reporting income. Generally, a taxable period should cover twelve months. However, shorter periods may be allowed in certain instances, such as in the case of dissolution of a corporation, a newly established corporation, or a change in the accounting period.

Use of Forms and Related Schedules

108. Forms are provided by the Bureau of Internal Revenue for use in the preparation of the income tax return. Income reported and expenses claimed are required to be disclosed in detail. Statements, schedules, or both are required to be attached to the return where applicable. For example, if gross receipts from business exceed P25,000 in any quarter, the taxpayer must attach to the return audited financial statements, a schedule of taxes and licenses paid or accrued for the year, and a schedule of income-producing property. If the taxpayer is a manufacturer, a statement of cost of goods manufactured must also be attached.

Requirements for Preparing Accompanying Financial Statements

109. Revenue regulations do not provide guidelines for the preparation of financial statements that accompany the income tax return. Such statements may be prepared in conformity with generally accepted accounting principles or with another comprehensive basis of accounting, such as the cash basis.

APPENDIX A

Outstanding Auditing Pronouncements

Audit pronouncements as of August 1988 are as follows:

ASPC Statements of Auditing Standards of the Philippines (SASPs)

No.	Title
1	*The Objectives, Scope and Responsibilities of an Independent Auditor in Undertaking an Audit*
2	*Generally Accepted Auditing Standards*
3	*Audit Engagement Letters*
4	*Client Representations*
5	*Independent Auditor's Report on Audited Financial Statements*

PICPA Audit Bulletin (AB)

No.	Title
19	*An Audit Guide for the CPA*

This bulletin has codified and replaced all previously issued PICPA audit bulletins. It contains minimum auditing guidelines, and procedures intended to implement the ten generally accepted auditing standards. Certain portions of this bulletin have been superseded by the ASPC statements listed above.

APPENDIX B

Outstanding Accounting Pronouncements

The outstanding accounting pronouncements as of August 1988 are listed below.

ASC Statements of Financial Accounting Standards (SFASs)

No.	Title
1	*Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*
2	*Summary of Generally Accepted Accounting Principles on Cash*
3	*Summary of Generally Accepted Accounting Principles on Receivables*
4	*Summary of Generally Accepted Accounting Principles on Inventories*
5	*Summary of Generally Accepted Accounting Principles on Liabilities*
6	*Summary of Generally Accepted Accounting Principles on Property, Plant and Equipment (Carried at Historical Cost)*
7	*Contingencies and Subsequent Events*
8	*Accounting for the Effects of Changes in Foreign Exchange Rates*
9	*Summary of Generally Accepted Accounting Principles on Intangible Assets*
10	*Summary of Generally Accepted Accounting Principles on Investments*
11	*The Equity Method of Accounting for Investments in Common Stock*
12	*Revaluation of Property, Plant and Equipment Through Appraisal*
13	*Reporting the Effects of Disposal of a Segment of a Business and of Extraordinary Items and Prior Period Adjustments on the Results of Operations of an Enterprise*
14	*Statement of Changes in Financial Position*
15	*Disclosure of Accounting Policies*
16	*Related Party Disclosures*
17	*Accounting Changes*
18	*Summary of Generally Accepted Accounting Principles on Stockholders' Equity*
19	*Summary of Generally Accepted Accounting Principles for the Banking Industry*

ASC Interpretations

No.	Title
1	*Deferred and Related Amortization of Foreign Exchange Differences*
3	*Balance Sheet Presentation of the Portions of Foreign Currency Debts under Moratorium That Have Matured or Are Currently Maturing*

PICPA Accounting Principles Bulletins (APBs)*

No.	Title
2	*Accounting for Income Taxes* (Chapter 14 in the *PICPA Codification of APBs)*
15	*Earnings Per Share* (Chapter 17 in the *PICPA Codification of APBs)*
16	*Accounting for Cost of Retirement Plans* (Chapter 18 in the *PICPA Codification of APBs)*
18	*Information to be Disclosed in Financial Statements* (Chapter 13 in the *PICPA Codification of APBs)*
21	Interim Financial Reporting
23	*Consolidated Financial Statements*
24	*Accounting Responses to Changing Prices*

Special Bulletin

July 1981 *Accounting for "Dacion En Pago" Arrangements*†

---

*These are the remaining Accounting Principles Bulletins that have not yet been withdrawn or superseded by ASC Statements.

†A *dacion en pago* arrangement refers to a settlement of debt by the transfer of property to the creditor to satisfy the debt. The bulletin provides accounting guidance for the debtor in case of a straight *dacion en pago* or a *dacion en pago* accompanied by a conditional sale or a lease.

APPENDIX C

Illustrative Auditor's Report and Financial Statements

The following financial statements are intended for illustrative purposes only. The statements presented are not intended to include all information that Philippine law requires.

The Board of Directors
ABC Company, Inc.

We have examined the balance sheets of ABC Company, Inc. as of December 31, 19CY and 19LY, and the related statements of income and retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company, Inc. as of December 31, 19CY and 19LY, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

[*Auditor's signature*]

February 22, 19NY

ABC COMPANY, INC.
BALANCE SHEETS
December 31, 19CY and 19LY
(in Philippine pesos)

Assets	*19CY*	*19LY*
Current assets		
Cash, including short-term cash investments of P200,000 in 19CY, P250,000 in 19LY	P 546,648	P 391,243
Marketable securities—at cost (approximate market value—P1,102,000 in 19CY and P982,500 in 19LY)	1,072,422	950,828
Accounts and notes receivable:		
Trade (net of allowance for doubtful accounts of P150,000 in 19CY and P100,000 in 19LY)	1,763,150	1,601,729
Other (Note 5)	236,307	123,268
Inventories (Notes 2 and 6)	4,579,817	4,350,265
Marginal deposits on unused letters of credit	185,375	143,418
Prepaid expenses	275,321	175,214
Deferred income tax	97,772	59,590
Total Current Assets	8,756,812	7,795,555
Investments (Note 3)		
Investment in and advances to affiliates	2,836,766	2,510,321
Other investments	1,600,000	1,100,000
	4,436,766	3,610,321
Property, plant and equipment—net of accumulated depreciation (Notes 4 and 7)	7,990,179	7,577,422
Other assets		
Loans to officers and employees (Note 5)	380,560	90,250
Refundable deposits	68,000	68,000
Preoperating expenses, net of amortization	621,300	786,950
	1,069,860	945,200
	P22,253,617	P19,928,498

Liabilities and Stockholders' Equity	*19CY*	*19LY*
Current liabilities		
Bank loans (Note 6)	P 725,000	P 625,000
Accounts payable and accrued expenses	1,781,792	1,549,316
Acceptances payable—net of applicable marginal deposits of P88,400 in 19CY and P46,200 in 19LY	408,391	397,512
Liabilities under trust receipts (Note 2)	704,785	532,809
Estimated liability for product warranty	129,347	70,256
Income tax payable	78,745	48,608
Current portion of long-term debt (Note 7)	1,270,000	1,100,000
Total Current Liabilities	5,098,060	4,323,501
Long-term debt—Net of current portion (Note 7)	5,925,000	6,600,000
Advances from affiliated company	389,800	189,800
Deferred income tax	15,578	11,433
Stockholders' equity		
Preferred stock, 10% cumulative, nonparticipating, P100 par value—Authorized, issued and outstanding—10,000 shares	1,000,000	1,000,000
Common stock—P100 par value Authorized—200,000 shares Issued—86,150 shares in 19CY and 63,000 shares in 19LY	8,615,000	6,300,000
Subscribed—10,000 shares in 19CY and 30,000 shares in 19LY (subscriptions receivable on which amount to P620,000 in 19CY and P2,280,000 in 19LY)	380,000	720,000
Capital in excess of par value	100,000	100,000
Retained earnings (Note 7)	940,179	893,764
	11,035,179	9,013,764
Less cost of 2,000 shares common stock in treasury	210,000	210,000
	10,825,179	8,803,764
	P22,253,617	P19,928,498

See accompanying notes to financial statements.

ABC COMPANY, INC.
STATEMENTS OF INCOME AND RETAINED EARNINGS
For the years ended December 31, 19CY and 19LY
(in Philippine pesos)

	19CY	*19LY*
Net sales	P16,723,559	P13,251,234
Cost of goods sold	13,320,678	10,410,949
Gross profit	3,402,881	2,840,285
Operating expenses	1,468,337	1,165,347
Income from operations	1,934,544	1,674,938
Other income (charges)		
Equity in net earnings of 40%-owned affiliate (Note 3)	126,445	88,996
Dividends	57,906	40,937
Interest expense (net of interest income of P29,000 in 19CY and P36,250 in 19LY)	(1,108,683)	(1,169,959)
Miscellaneous charges	(60,100)	(15,311)
Income before income tax	950,112	619,601
Provision for income tax (Note 9)		
Current	306,189	186,736
Deferred	(34,037)	(18,109)
	272,152	168,627
Net income	677,960	450,974
Retained earnings at beginning of year	893,764	1,024,790
Cash dividends:		
Preferred stock (P10.00 a share)	(100,000)	(100,000)
Common stock (P2.30 a share in 19CY; P2.00 a share in 19LY)	(216,545)	(182,000)
Stock dividends (5%)	(315,000)	(300,000)
Retained earnings at end of year	P 940,179	P 893,764
Earnings per share	P6.14	P3.86

See accompanying notes to financial statements.

ABC COMPANY, INC.
STATEMENTS OF CHANGES IN FINANCIAL POSITION
For the years ended December 31, 19CY and 19LY
(in Philippine pesos)

	19CY	*19LY*
Working capital was provided from		
Net income	P 677,960	P 450,974
Items not requiring working capital:		
Depreciation	562,104	479,090
Amortization of preoperating expenses	165,650	165,650
Deferred income tax—noncurrent	4,145	4,440
Equity in net earnings of affiliate	(126,445)	(88,996)
Total from operations	1,283,414	1,011,158
Proceeds from issuance of preferred stock	—	1,000,000
Collection of subscriptions receivable	1,660,000	720,000
Additional long-term borrowings	680,000	—
Advances from affiliated company	200,000	89,800
Dividends received from affiliate	100,000	60,000
	3,923,414	2,880,958
Working capital was used for		
Additions to property, plant and equipment	974,861	485,258
Payment of cash dividends	316,545	282,000
Reduction of long-term debt	1,355,000	1,100,000
Investment in real estate	500,000	—
Additional loans to officers and employees	290,310	150,450
Additional investments in and advances to affiliates	300,000	300,000
	3,736,716	2,317,708
Increase in working capital	P 186,698	P 563,250
Working capital increased (decreased) by		
Cash and marketable securities	P 276,999	P 106,809
Accounts and notes receivable	274,460	144,460
Inventories	229,552	172,498
Marginal deposits on unused letters of credit	41,957	(16,420)
Prepaid expenses	100,107	48,840
Deferred income tax	38,182	22,509
Bank loans	(100,000)	(225,000)

(Continued on next page)

ABC COMPANY, INC.
STATEMENTS OF CHANGES IN FINANCIAL POSITION *(cont.)*

	19CY	*19LY*
Working capital increased (decreased) by		
Accounts payable and accrued expenses	(232,476)	226,948
Acceptances payable	(10,879)	65,645
Liabilities under trust receipts	(171,976)	61,229
Estimated liability for product warranty	(59,091)	(34,310)
Income tax payable	(30,137)	(9,958)
Current portion of long-term debt	(170,000)	—
Increase in working capital	P 186,698	P 563,250

See accompanying notes to financial statements.

ABC COMPANY, INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Marketable Securities

Marketable securities are carried at the lower of aggregate cost or market value determined at balance sheet date. The cost of marketable securities sold, if any, is based on the average cost of shares held at the time of sale.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out method.

Investments

The Company carries its investment in a 40-percent-owned affiliate at cost plus its equity in net earnings since date of acquisition. Equity in net earnings is adjusted for the straight-line amortization, over a fifteen-year period, of the difference between the Company's cost of such investment and its proportionate share of the underlying net assets at date of acquisition. Unrealized intercompany profits are eliminated to the extent of the Company's proportionate share thereof.

Investments in other affiliates and in shares of stock of other companies and in real estate are carried at cost. An allowance is set up for any substantial and presumably permanent decline in the carrying values of the investments in shares of stock.

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the properties.

The cost of maintenance and repairs is charged to income as incurred; significant renewals and betterments are capitalized. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in income for the period.

Preoperating Expenses

Expenses that were incurred prior to the start of commercial operations and have been capitalized are amortized over a five-year period up to 19NY2.

Income Taxes

Deferred income taxes are provided to reflect the tax effect of timing differences between financial and tax reporting, related to provisions for doubtful accounts and for product warranty costs and undistributed earnings of a 40-percent-owned affiliate.

Pension Plan

The Company funds accrued pension cost on its noncontributory pension plan covering substantially all employees. Past service cost is amortized over ten years.

Earnings Per Share

Earnings per common share are determined by dividing net income, after recognition of the dividend requirements on the 10 percent preferred stock, by the average number of common shares issued and subscribed during each year (after retroactive adjustment for any stock dividends declared in the current year).

2. Inventories

Inventories consist of:

	19CY	*19LY*
Finished goods	P1,485,612	P1,204,617
Work in process	751,350	623,614
Raw materials and supplies	2,342,855	2,522,034
	P4,579,817	P4,350,265

Under the terms of agreements covering liabilities under trust receipts totalling P704,785, certain merchandise have been released to the Company in trust for the bank. The Company is accountable to the bank for the trusteed merchandise or its sales proceeds.

3. Investments

Investments in and advances to affiliates consist of the following:

	19CY	*19LY*
Investments:		
RST Corporation, 40-percent-owned:		
Acquisition cost	P1,440,000	P1,440,000
Equity in net earnings:		
Balance, beginning of year	P 70,321	P 41,325
Equity in net earnings for the year (net of amortization of goodwill amounting to P15,000 for each year)	126,445	88,996

Investments *(cont'd)*:

	19CY	19LY
Dividends received	(100,000)	(60,000)
Balance, end of year	96,766	70,321
	1,536,766	1,510,321
Other affiliated companies—at cost	600,000	500,000
Advances	700,000	500,000
	P2,836,766	P2,510,321

The carrying value of the investment in RST Corporation exceeded the Company's equity in the net assets of the investee by P150,000 and P165,000 at December 31, 19CY and 19LY, respectively.

Other investments consist of the following:

	19CY	19LY
Shares of stock	P1,100,000	P1,100,000
Real estate	500,000	—
	P1,600,000	P1,100,000

The investment in real estate represents a condominium apartment unit held for investment purposes.

4. Property, Plant, and Equipment

	19CY	19LY
Land	P 325,610	P 325,610
Buildings and improvements	3,317,833	2,090,117
Machinery and equipment	5,966,274	5,903,726
Furniture and fixtures	327,519	292,905
Transportation equipment	564,612	564,612
	10,501,848	9,176,970
Less accumulated depreciation	2,511,669	1,941,396
	7,990,179	7,235,574
Construction in progress	—	341,848
	P7,990,179	P7,577,422

Depreciation charged to income amounted to P562,104 in 19CY and P479,090 in 19LY. The annual depreciation rates are 5 percent to 10 percent for buildings and improvements, 5 percent to 20 percent for machinery and equipment, 10 percent to 30 percent for furniture and fixtures and 20 percent for transportation equipment.

5. Related Party Transactions

During the current year, the Company loaned a total of P200,000 to certain of its officers and directors. These loans are payable in five annual installments, beginning March 1, 19NY, at an annual interest rate of 10 percent based on the outstanding balance of the loan each year. The current portion of these loans amounting to P40,000 as of December 31, 19CY, is included in Accounts and Notes Receivable–Others.

6. Bank Loans

The bank loans are collateralized by substantially all of the Company's finished goods inventories.

7. Long-Term Debt

Long-term debt consists of the following:

	19CY	*19LY*
14 percent mortgage note	P6,600,000	P7,700,000
14 percent notes payable	595,000	—
	7,195,000	7,700,000
Less current portion	1,270,000	1,100,000
	P5,925,000	P6,600,000

These loans, which are payable in equal semi-annual installments through 19NY3 and 19NY5, are collateralized by substantially all of the Company's land, buildings and improvements and machinery and equipment with net carrying values of P7,449,000 and P6,605,000 at December 31, 19CY and 19LY, respectively.

The agreement relating to the mortgage note provides that the aggregate of all dividends (other than stock dividends) declared or paid after January 1, 19LY may not exceed 75 percent of the net income since that date. Under this provision, retained earnings amounting to P657,946 and P781,020 at December 31, 19CY and 19LY, respectively, were not restricted.

8. Pension Plan

The Company has two pension plans covering substantially all of its employees. Pension costs charged to operations for the years ended December 31, 19CY and 19LY, totalled P48,346 for both years.

9. Provision for Income Tax

The provision for income tax differs from the amount computed by applying the income tax rates to "income before income tax" for the following reasons:

	19CY	19LY
Computed "expected" provision	P322,539	P206,860
Increase (decrease) resulting from:		
Dividends and interest income subject to final tax	(20,276)	(17,484)
Equity in earnings of 40-percent-owned affiliate subject to a different tax rate (10 percent)	(35,361)	(25,999)
Nondeductible amortization	5,250	5,250
Provision for income tax	P272,152	P168,627

10. Commitments

At December 31, 19CY, the Company has authorized future additions to property, plant and equipment estimated to cost P9,800,000.

Unused letters of credit amounted to US$210,000 as of December 31, 19CY.

11. Contingent Liability

The Bureau of Internal Revenue has assessed the Company for additional income taxes aggregating P180,230 for the years 19LY3 to 19LY1. The Company believes that there is no adequate basis for this assessment and is contesting such assessment. Accordingly, no provision has been made for this contingent liability.

The Company is a guarantor of the promissory note amounting to P800,000 issued by an affiliate to a financing company.

12. Subsequent Event

On January 30, 19NY, the Company borrowed P8,000,000 from a local bank to finance the additions to property, plant and equipment mentioned in Note 10. This loan, which bears interest at 14 percent per year, is payable in equal semiannual installments commencing on June 30, 19NY1. The loan will be collateralized by such additions to property, plant, and equipment.

APPENDIX D

Checklist for Comparison of Generally Accepted Auditing Standards (GAAS) in the United States to Auditing Standards in the Philippines

General Information	Answer	Comments
1. Is a primary purpose of an audit:		
a. to attest to information used by investors, creditors, etc.?	Yes	
b. to satisfy statutory requirements (for example, the Companies Act)?	Yes	
c. for tax purposes?	Yes	
2. A. The United States has ten generally accepted auditing standards including general standards, standards of field work, and standards of reporting. Those standards and their interpretations constitute U.S. generally accepted auditing standards which have been published in *Codification of Statements on Auditing Standards*. Do gener-	Yes	

ally accepted auditing standards exist in your country?					
B. If so, are they published?	Yes. SASP 2				
C. If auditing standards exist in your country, are they similar to U.S. standards?	Yes				
D. If not, what are they?					
3. Who is responsible for promulgating auditing standards (for example, the profession, a governmental body, etc.)?					3. Auditing Standards and Practice Council

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
4. Do auditors confirm receivables? (AU 331)	No	✓			4. See paragraph 44 of text.
5. Do auditors observe inventory counts? (AU 331)	No	✓			5. See paragraph 44 of text.
6. Do auditors receive written representations from management? (AU 333)	Yes	✓			6. See paragraph 44 of text.
7. Do auditors receive written representations from management's legal counsel? (AU 337)	No	✓			

Notes:

Checklist should be completed from the perspective of performing a local audit, *not* a referral audit.
AU numbers refer to sections in the *Codification of Statements on Auditing Standards,* unless otherwise noted.

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
8. A. Do auditors prepare and maintain working papers? (AU 339)	No	✓			
B. If so, do they include a written audit program outlining procedures to be performed? (AU 339)	No	✓			
9. Do auditors study existing internal controls as a basis for reliance thereon in determining the nature, extent, and timing of audit tests to be performed? (AU 320)	Yes. SASP 2	✓			
10. A. Do auditors communicate material weaknesses in internal accounting control to senior management or the client's board of directors? (AU 323)	No	✓			10A,B. Auditors usually communicate material or significant weaknesses in internal accounting controls to management together with suggestions for improvement. This is usually done as an added service to the client and is not a requirement. These comments are usually communicated through a letter of comments to management.
B. If so, is the communication documented? (AU 323)	No	✓			
11. In obtaining evidential matter, does the auditor apply either statistical or nonstatistical procedures? (AU 350)	No	✓			11. Nonstatistical procedures are used.

12. Is the auditor responsible for planning his examination to search for errors or irregularities that would have a material effect on the financial statements? (AU 327)	No		✓	
13. A. Does the auditor perform procedures to identify related party transactions and their effect on the financial statements? (AU 334) B. If so, list the procedures.	No	✓		13A,B. There are no specific auditing standards on related party transactions. The auditor, however, may have to perform certain procedures to ascertain that the financial statements being audited are in conformity with the current ASC standards on related party disclosures, receivables, and payables. These standards require disclosure of related party transactions and the separate presentation of significant receivables from and payables to related parties, such as the parent company subsidiaries, affiliates, officers, directors, employees, and stockholders.
14. Does the auditor consider the adequacy of cut-off procedures to insure that movements into and out of inventories are properly identified in the accounting records? (AU 313)	No	✓		
15. A. Are specific auditing procedures applied to transactions occurring after the balance sheet date? (AU 560)	No	✓		

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
B. Are other auditing procedures applied to ascertain the occurrence of subsequent events that require adjustment to or disclosure in the financial statements? (AU 560)	No	✓			
16. The concept of "joint auditors" in certain countries (e.g., U.K., Canada, and Australia) is that two auditors or audit firms jointly audit the financial statements of a company and issue a single report signed by the two firms. This practice is not generally followed in the U.S. Does the concept of "joint auditors" exist in your country?	No			✓	
17. When a principal auditor is reporting on financial statements that include one or more subsidiaries, divisions, branches, or investees: (AU 543)					
A. Must the principal auditor assume responsibility for the work of the other auditor as it relates to the principal auditor's opinion?	No		✓		
B. May the principal auditor decide not to assume that responsibility by making reference to	No	✓			

the other auditor and indicating the division of responsibility?			
18. A. Is there a standard form of auditor's report? (AU 509)	No	✓	18A. Identical to previous U.S. standard two-paragraph form of auditor's report.
B. List the circumstances that require a departure from the standard report and indicate the type of report required. (AU 509)			18B. Identical to U.S. standards prior to revision of the U.S. reporting standard.
19. A. Does the auditor's report express an opinion on the consistency of application of accounting principles? (AU 420)	Yes. SASP 2	✓	
B. If not, does it imply that either consistency exists or the financial statements disclose the inconsistency?			
20. A. Is the auditor's report dated as of the last day of field work? (AU 530)	No	✓	
B. If not, what date is used?			
21. To express an opinion, must the auditor be independent? For the purpose of this checklist, independence is defined as being free of financial interest in the client. (*Code of Professional Conduct*, Rule 101)	Yes. *Code of Professional Conduct*	✓	
22. Please describe any standards in the Philippines for which there are no corresponding U.S. standards.			22. None

APPENDIX E

Checklist for Comparison of Generally Accepted Accounting Principles (GAAP) in the United States to Accounting Principles in the Philippines

General Information	Answer	Comments
1. Are there generally accepted accounting principles in the Philippines? If so, are they codified?	Yes	
2. Who is responsible for promulgating accounting principles (for example, the profession, a governmental body, etc.)?		2. Accounting Standards Council (ASC).

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
3. Are assets and liabilities recorded on the historical cost basis?	Yes. SFAS 1 (Sec. F, par. 7, M-1A, M-1C)	✓			

4. Are interest costs, incurred while activities that are necessary to get an asset ready for its intended use are in progress, capitalized as part of the historical cost of an asset? (I67)	No	✓		4. There is no separate pronouncement on the capitalization of interest costs. However, SFAS 6, paragraph 8, does provide that "financing costs that are attributable to a construction project and that are incurred up to the completion of construction are also included in the gross carrying amount of the asset to which they relate."
5. A. Is a general revaluation (either upward or downward) of assets permitted? (D40)	Yes. SFAS 12 (par. 8)		✓	
B. If so, define the basis.				5B. Revaluation of property, plant, and equipment may be based either on index numbers or an appraisal made by independent experts or specialists. At present, however, no suitable index numbers have been prescribed for revaluation purposes. The appraisal method has been most commonly used by companies for revaluation.
6. Are nonmonetary transactions that culminate an earnings process accounted for on the basis of the	No	✓		6. There is no separate pronouncement on accounting for nonmonetary assets. However,

Notes:

References to the U.S. Generally Accepted Accounting Principles column are to sections in the *FASB Current Text,* unless otherwise noted.
(1) Statement of Financial Accounting Standards issued by the Accounting Standards Council (SFAS)
(2) Accounting Principles Bulletin issued by the Committee on Financial Accounting Standards of PICPA (APB)

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
fair market value of the assets involved when that value is determinable within reasonable limits? (N35)					SFAS 1, Sec. F, paragraph 7 does provide that in exchanges in which neither money nor promises to pay money are exchanged, the assets acquired are generally measured at the fair value of the assets given up. However, if the fair value of the assets received is more clearly evident, the assets acquired are measured at that amount.
7. Is revenue recognized when it is earned and its realization is reasonably assured (rather than when money is received)? (Statement of Financial Accounting Concepts No. 5)	Yes. SFAS 1 (Sec. D, par. 8; Sec. E, par. 16)	✓			7. The accrual basis is one of the basic features of financial accounting.
8. Are costs recorded when incurred rather than when money is paid? (Statement of Financial Accounting Concepts No. 5)	Yes. SFAS 1 (Sec. D, par. 8; Sec. E, par. 10, 20)	✓			8. See comments for question 7.
9. A. Are consolidated financial statements required when one company has control over another company? (C51)	No		✓		
B. Is control usually indicated by ownership of over fifty percent of the outstanding voting shares? If not, how is control indicated?	No	✓			

10. A. Are there instances when an entity would not be consolidated even though control is present? (C51)	No	✓		
B. If so, list them.				10B. See paragraph 62 of text.
11. If consolidation is not otherwise appropriate, is the equity method used for unconsolidated subsidiaries, corporate joint ventures, and other investees, if the investments give the investor the ability to exercise significant influence over the investees' operating and financial policies? (I82)	Yes. SFAS 11 (par. 3)		✓	
12. Are there two methods of accounting for business combinations—the pooling of interests method and the purchase method? (B50)	No	✓		12-14B. There is no Philippine pronouncement on accounting for business combinations. Accounting standards contained in U.S. GAAP or in International Accounting Standards (IAS) Statement 22, Accounting for Business Combinations, are generally referred to for guidance but are not mandatory.
13. Is the method used to account for a business combination disclosed? (B50)	No	✓		
14. A. Do criteria exist for treatment of business combinations as poolings of interests? (B50)	No	✓		
B. If so, list the criteria.				
15. A. Is goodwill arising from a business combination accounted for as an asset? (I60)	Yes. SFAS 9 (par. 7)	✓		

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
B. If so, is it amortized as a charge to income over the period estimated to be benefited?	Yes. SFAS 9 (par. 9)	✓			
16. Are the following disclosures made for related party transactions: (R36)					
a. the nature of the relationship?	Yes. SFAS 16 (par. 8)	✓			
b. a description of the transactions for the periods presented?	Yes. SFAS 16 (par. 8)	✓			
c. the amounts of the transactions for the periods presented?	Yes. SFAS 16 (par. 8)	✓			
d. the amounts due to or from related parties at the balance sheet date?	Yes. SFAS 16	✓			
17. Is an estimated loss from a loss contingency accrued only if it is probable that an asset has been impaired or a liability incurred and the amount of loss can be reasonably estimated? (C59)	Yes. SFAS 7 (par. 7)	✓			
18. If a loss contingency is not accrued because both conditions for accrual listed in question 17 are not met, is disclosure of the contingency required when there is at least a reasonable possibility that a loss may have been incurred? (C59)	Yes. SFAS 7 (par. 9)	✓			

19. Are guarantees of the indebtedness of others or other loss contingencies disclosed in financial statements even though the possibility of loss may be remote? [In the U.S., guarantees are usually disclosed as loss contingencies even if the possibility of loss is remote.] (C59)	Yes. SFAS 7 (par. 11)	✓		
20. Are the following items disclosed in an enterprise's financial statements for each industry segment: (S20)				
a. sales to outsiders and intersegment sales?	No		✓	
b. operating profit or loss?	No		✓	
c. identifiable assets and related depreciation, depletion, and amortization expense?	No		✓	
d. capital expenditures?	No		✓	
e. equity in net income and net assets of unconsolidated subsidiaries and other investees?	No		✓	
f. effect of a change in accounting principle?	No		✓	
21. A. Are there any requirements to disclose the effects of inflation? (C27)	No		✓	
B. If so, list the disclosures required.				
22. Are assets segregated into current and noncurrent classifications with	No	✓		22. Disclosure of the components of working capital, by clas-

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
a total for current assets presented? (B05)					sifying current assets and liabilities, is presumed to be useful in manufacturing, trading, and some service enterprises, although it is not required.
23. A. Are noncurrent assets those not expected to be realized within one year or the current operating cycle? (B05)	Yes. SFAS 1 (Sec. F, par. 16, R-7A)	✓			
B. If not, how are noncurrent assets defined?					
24. A. Is an allowance established for uncollectible receivables? (C59)	Yes. SFAS 3 (par. 4)	✓			
B. If so, what is the basis (e.g., percentage of sales, aging of receivables, etc.) for calculating the allowance?					24B. See paragraph 63 of text.
25. Are receivables and payables, not arising in the normal course of business or subject to normal trade terms, recorded at an amount which takes imputed interest into account? (I69)	No		✓		25. Long-term notes receivable may be stated at their discounted amounts when the notes nominally bear no interest or an interest rate that is unreasonably low.
26. A. Is inventory stated at the lower of cost or market (or net realizable value)? (I78)	Yes. SFAS 4 (par. 9)	✓			
B. If not, how is inventory stated?					
C. Is the basis disclosed?	Yes. SFAS 4	✓			

27. Does cost for inventory purposes include: (I78)				
a. materials?	Yes. SFAS 4 (par. 4)	✓		
b. direct labor?	Yes. SFAS 4 (par. 4)	✓		
c. factory overhead?	Yes. SFAS 4 (par. 5)	✓		
d. if the answer to *c.* is yes, is an allocable share of all factory overhead included?	Yes. SFAS 4, (par. 5)	✓		
28. A. Are the following cost methods permitted for reporting purposes: (I78)				
a. first-in, first-out (FIFO)?	Yes. SFAS 4 (par. 8)	✓		
b. last-in, first-out (LIFO)?	Yes. SFAS 4 (par. 8)		✓	
c. average cost?	Yes. SFAS 4 (par. 8)	✓		
B. Are the same methods permitted for tax purposes?				28B. LIFO is not permitted for tax purposes.
29. Is the inventory costing method used disclosed? (I78)	Yes. SFAS 4 (par. 14)	✓		
30. A. Are fixed assets depreciated over their estimated useful lives by systematic charges to income? (D40)	Yes. SFAS 6 (par. 12)	✓		
B. If so, is an accumulated depreciation account used?	Yes. SFAS 6 (par. 19)	✓		
31. Are disclosures made of: (D40)				
a. depreciation expense for the period?	Yes. SFAS 6 (par. 27)	✓		

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
b. balances of major classes of depreciable assets?	Yes. SFAS 6 (par. 27)	✓			
c. the methods used to compute depreciation for the major asset classes?	Yes. SFAS 6 (par. 27)	✓			
d. accumulated depreciation, either by major class of assets or in total?	Yes. SFAS 6 (par. 27)	✓			
32. A. Do criteria exist for classifying leases as operating leases? (L10)	No	✓			32A. There is no Philippine pronouncement on accounting for leases. Accounting standards contained in U.S. GAAP or in IAS 17, Accounting for Leases, are generally referred to for guidance but are not mandatory.
B. If so, list the criteria, and disclosure requirements.					
33. A. Do criteria exist for classifying leases as other than operating leases for the lessor and lessee? (L10)	No	✓			33A. See comment for question 32A.
B. If so, list the criteria, type of lease, and disclosure requirements.					
34. Are liabilities segregated into current and noncurrent classifications with a total for current liabilities presented? (B05)	No	✓			

35. A. Are noncurrent liabilities those whose liquidation is not expected to require the use of current assets or the creation of current liabilities? (B05)	Yes. SFAS 1 (Sec. F, par. 16, R-7A), SFAS 5 (par. 7, 9)	✓		
B. If not, how are noncurrent liabilities defined?				
36. For notes payable, is disclosure made of: (C59 and Statement of Financial Accounting Concepts No. 5)				
a. interest rates?	Yes. SFAS 5 (par. 14)	✓		
b. maturities?	Yes. SFAS 5 (par. 14)	✓		
c. assets pledged as collateral?	Yes. SFAS 5 (par. 10)	✓		
d. covenants to reduce debt?	Yes. SFAS 5 (par. 14)	✓		
e. minimum working capital requirements?	Yes. SFAS 5 (par. 14)	✓		
f. divided restrictions?	Yes. SFAS 5 (par. 14)	✓		
37. A. For long-term construction-type contracts, are the percentage-of-completion and completed contract method used? (C04)	No	✓		37A. Although there is no specific pronouncement on accounting for long-term construction-type contracts, use of these methods is recognized under SFAS No. 1, section E, paragraphs 16 and 18.
B. If so, what are the criteria for determining the method to be used?				37B. In evaluating which method to use, the accounting standards contained in U.S. GAAP

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
					or IAS 11, Accounting for Construction Contracts, are generally referred to for guidance, but are not mandatory.
38. A. Are research costs charged to expense when incurred? (R50)	No	✓			38A. There is no Philippine pronouncement on accounting for research and development costs. Accounting standards in U.S. GAAP or IAS 9, Accounting for Research and Development Activities, are generally referred to for guidance, but are not mandatory.
B. Are such costs disclosed?	No		✓		
39. A. Are development costs charged to expense when incurred? (R50)	No	✓			39A. See comment for question 38A.
B. Are such costs disclosed?	No		✓		
40. A. In the U.S., events and transactions are presented in the income statement as extraordinary items when they are unusual in nature and are of the type that would not reasonably be expected to recur in the foreseeable future. Do similar criteria for identifying extraordinary items exist in the Philippines? (I17)	Yes. SFAS 13 (par. 20)	✓			
B. If not, what are the criteria?					

41. Are material events or transactions that are unusual in nature or expected to occur infrequently but not both (and thus do not meet the criteria for classification as extraordinary) shown as a separate component of income or expense? (I22)	Yes. SFAS 13 (par. 33)	✓	
42. A. Are disclosures required for:			
a. extraordinary items? (I17)	Yes. SFAS 13 (par. 25-32)	✓	
b. material events or transactions not classified as extraordinary items? (I22)	Yes. SFAS 13 (par. 33)	✓	
c. disposal of a segment of a business? (I13)	Yes. SFAS 13 (par. 12, 15)	✓	
B. Indicate the financial statement presentation of these items.			42B. The statements should disclose: • income before extraordinary item • extraordinary item net of applicable tax • net income Material events or transactions not classified as extraordinary items should be reported as a separate component of income from continuing operations.
43. A. Are pension costs provided for covered employees over the term of employment? (P15)	No	✓	
B. If so, do they include charges for costs assigned under the ac-			

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
tuarial method used to years prior to the plan's inception?					
44. A. Are specific disclosures required relating to pension plans? (P15)	No	✓			
B. If so, list them.					44B. Where pension costs are provided for, the following disclosures should be made in financial statements or their notes: • A statement that such plan exists, identifying or describing the employee groups covered • A statement of the company's accounting and funding policies • The provision for retirement plan cost for the period • The excess, if any, of the actuarially computed value of vested benefits over the total of the retirement fund and any balance sheet pension accruals, less any pension prepayments or deferred charges • Nature and effect of significant matters affecting comparability for all periods presented, such as changes in

				accounting methods (actuarial cost methods, amortization of past and prior service cost, treatment of actuarial assumptions, etc.) or adoption of amendment of a plan (APB 16, par. 21).
45. A. When accounting income and taxable income differ, are deferred income taxes recorded for differences (as opposed to permanent differences)? (I24)	No		✓	45A,B. Deferred tax accounting is not required but is permitted. Where it is adopted, the provisions of APB 2 are recommended for guidance.
B. If so, are deferred taxes provided for all timing differences (as opposed to only those meeting certain criteria)?	No	✓		
C. If deferred taxes are provided only for those timing differences meeting certain criteria, what are the criteria?				
46. A. Are deferred taxes determined on the basis of tax rates in effect at the time the difference originated? (I24)	No	✓		46A,B. See comments for question 45A.
B. If not, on what basis?				
47. A. Is specific information related to income taxes required to be disclosed? (I28)	No	✓		47A,B. The following are disclosure requirements relating to income taxes (APB 2, par. 19, 21, 22): • Components of income tax expense, such as taxes estimated to be payable, tax effects of timing differences, and tax effects of operating losses

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
					• Amounts of tax effects identified with adjustments of retained earnings and other stockholders' equity accounts • Amounts of any operating loss carryforwards not recognized in the loss period, together with expiration dates • Reasons for significant variations in the customary relationships between income tax expense and net income before tax, if not otherwise apparent from the financial statements or from the nature of the entity's business • The nature of significant differences between net income before tax and taxable income For companies not following deferred tax accounting, the last two items described above are usually disclosed.
B. If so, list the requirements.					
48. A. Are operating losses reported on the income tax return allowed to be carried backward to earlier periods? (I37)	See Comment				48A,B. Philippine tax laws do not provide for losses to be carried back.

B. If so, are the tax effects of a loss carryforward included in the income in the period?				
49. A. Are operating losses reported on the income tax return allowed to be carried forward? (I37)	No		✓	49A. Relatively few companies are entitled to the benefit of a loss carryforward. Only certain export producers and registered agricultural producers under the Omnibus Investments Code are entitled to carry over net operating losses for tax purposes.
B. If so, are the tax effects of a loss carryforward included in the income in the period realized?	No	✓		49B. When a company is entitled to a loss carryforward, the tax benefit of a loss carryforward is included in income in the period realized.
50. Are financial statements of a foreign entity prepared for consolidation purposes measured in the currency of the primary economic environment in which the entity operates? (F60)	Yes. SFAS 8 (par. 13)	✓		
51. Are all elements of financial statements translated at current exchange rates? (F60)	Yes. SFAS 8 (par. 32)	✓		51. See paragraphs 55 through 60 of text.
52. A. Are translation adjustments reported separately? (F60)	Yes. SFAS 8 (par. 32, 39)	✓		
B. Are they accumulated in a separate component of stockholders' equity until ultimately realized?	Yes. SFAS 8 (par. 33)	✓		

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
C. Is there an analysis of the changes during the period in the component of stockholders equity relating to translation adjustments?	No		✓		52C. ASC 8 (par. 39) only requires the disclosure of net exchange differences for the period taken to stockholders' equity.
53. A. Are gains and losses resulting from transactions, denominated in a currency other than that of the environment in which the entity operates, included in determining net income for the period in which the exchange rate changes? (F60)	Yes. SFAS 8	✓			53A. See paragraphs 55 through 56 of text.
B. Is the aggregate transaction gain or loss included in determining net income for the period disclosed in the financial statements or notes?	No	✓			
54. Are gains or losses on foreign currency transactions that are intended to hedge a foreign currency commitment deferred and included in the related transaction? (F60)	No	✓			54. See paragraph 58 of text.
55. What information is disclosed about foreign currency restrictions.	None specifically required				55. However, SFAS 2 provides that material deposits in foreign countries that are subject to foreign exchange restrictions should be shown separately

			from the cash account and the restrictions clearly indicated.
56. Are significant events arising subsequent to the balance sheet date reflected in the financial statements or notes thereto?	Yes. SFAS 7 (par. 19, 23)	✓	
57. Please list any standards for the Philippines for which there are no corresponding U.S. standards.			57. Revaluation of property, plant, and equipment through appraisal.

Bibliography

Accounting Bulletin Nos. 21–24. Manila: Philippine Institute of Certified Public Accountants, 1980 (individual bulletins issued by PICPA).

Accounting Standards Council. *Statements of Financial Accounting Standards and Interpretations.* Manila: ASC, 1983–1986 (individual statements and interpretations issued by the ASC).

An Audit Guide for the CPA. Manila: Philippine Institute of Certified Public Accountants, 1970.

Audit Bulletin No. 20, The Independent Auditor's Report. Manila: Philippine Institute of Certified Public Accountants, 1975.

Batasang Pambansa. *The Corporation Code of the Philippines.* Manila: Government Printing Office, 1980.

Batasang Pambansa. *The Revised Securities Act.* Manila: Government Printing Office, 1982.

Corporation Code of the Philippines (CCP) No. 1—Rules Governing Redeemable and Treasury Shares. Manila: Securities and Exchange Commission (SEC), 1982.

Generally Accepted Accounting Principles, A Codification of Accounting Principles Bulletins as of December 1977. Manila: Philippine Institute of Certified Public Accountants, 1978.

President of the Philippines. *Presidential Decree (PD) No. 692, The Revised Accountancy Law.* Manila: Government Printing Office, 1975.

Regulations Covering Form and Content of Financial Statements Required to be Filed by Corporations whose Shares of Stock Are Sold or Offered for Sale to the Public. Manila: Securities and Exchange Commission (SEC), 1973.

SGV & Co. *1988: Doing Business in the Philippines.* SGV & Co., 1988.

The SGV Group. *Comparative Accounting Practices in ASEAN.* Hong Kong: Sing Cheong Printing Co. Ltd., 1984.

Professional Accounting in Foreign Countries Series

The Accounting Profession in the United Kingdom (1987)
The Accounting Profession in Canada (1987)
The Accounting Profession in the Netherlands (1987)
The Accounting Profession in Sweden (1987)
The Accounting Profession in Italy (1987)
The Accounting Profession in Japan (1988)
The Accounting Profession in Hong Kong (1988)
The Accounting Profession in France (1988)
The Accounting Profession in Mexico (1988)

Series binder also available.

TECHNICAL HOTLINE

The AICPA Technical Information Service answers inquiries about specific audit or accounting problems.

Call Toll Free

(800) 223-4158 (Except New York)
(800) 522-5430 (New York Only)

This service is free to AICPA members.

010110