



Auditing and Assurance Standards Council

Philippine Auditing Practice Statement 1001Ph

**GUIDANCE IN DEALING WITH
“TENTATIVE FINANCIAL STATEMENTS”**

PHILIPPINE AUDITING PRACTICE STATEMENT 1001Ph

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Philippine Auditing Practice Statements (PAPS or Statements) are issued by the Auditing Standards and Assurance Council (AASC) to provide practical assistance to auditors in implementing the Philippine Standards on Auditing (PSAs) or to promote good practice. Statements do not have the authority of PSAs.

This Statement does not establish any new basic principles or essential procedures; its purpose is to assist auditors, and to develop good practice, by providing guidance on the application of the PSAs when conducting an audit of financial statements. The auditor exercises professional judgment to determine the extent to which any of the audit procedures described in this Statement may be appropriate in the light of the requirements of the PSAs and the entity’s particular circumstances.

The Public Sector Perspective (PSP) is set out at the end of PAPS. Where no PSP is added, the PAPS is applicable in all material respects to the public sector.

This particular PAPS issued by the Auditing and Assurance Standards Council is not based on a specific International Auditing Practice Statements (IAPS) issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants but was issued to address a specific situation in the Philippines.

PROPOSED PHILIPPINE AUDITING PRACTICE STATEMENT

GUIDANCE IN DEALING WITH “TENTATIVE FINANCIAL STATEMENTS”

Introduction

1. The purpose of this Philippine Auditing Practice Statement (PAPS) is to provide practical guidance to auditors in dealing with what is currently referred to as “tentative financial statements.” The term “tentative financial statements” is generally used at present to refer to a set of incomplete or unaudited financial statements accompanied by a report of an external auditor who has not yet completed his audit of such financial statements.
2. Companies in the Philippines are required to file financial statements with regulatory agencies such as the Securities and Exchange Commission (SEC), the Bureau of Internal Revenue (BIR) and the Bangko Sentral ng Pilipinas (BSP), among others. As a matter of practice, the Board of Contractors (BOC) also requires the submission of audited financial statements by contractors before they are allowed to bid in construction projects. The financial statements are required to be audited by independent auditors and auditors’ reports are required to accompany the financial statements. Specific deadlines are set by the regulatory agencies for the submission of the financial statements and penalties are imposed on late submission.
3. Except for the BIR and the BOC, government agencies do not accept, as part of a company’s annual filing or as one of the requirements for bidding purposes by contractors, tentative financial statements. The BIR, on the other hand, accepts filing of tentative annual income tax returns (ITR) based on preliminary figures of income and expenses of a company for the taxable year. This is allowed to accommodate filing of tentative annual ITR, accompanied by a set of incomplete or unaudited financial statements and an external auditor’s report, by a company whose audit is not yet completed at the time of filing. In this case, the company is able to avoid the penalties imposed for late filing of ITRs and appears to have complied with the requirement regarding audited financial statements which, in the case of the BIR, is further discussed in paragraph 5. Since the external auditor has not yet completed his audit, the covering auditor’s report contains a disclaimer of opinion on those financial statements. Upon completion of the audit, an amended ITR, accompanied by the audited final financial statements and auditor’s report, is subsequently submitted.

BIR Requirements for Filing of Audited Financial Statements

4. Since the BIR accepts tentative financial statements, this PAPS considers mainly the BIR requirements for the filing by taxpayers of audited financial statements in connection with their annual filing of ITRs.
5. Some of the relevant BIR requirements on filing of ITRs and the required documents to accompany the ITRs, including audited financial statements, are cited below:
 - a. Section 232 of the *National Internal Revenue Code* (the Code) of 1997 provides, among others, that corporations, companies, partnerships or persons whose gross quarterly sales, earnings, receipts or output exceed P150,000, shall have their books of accounts audited and examined yearly by independent CPAs and their ITRs accompanied with a duly accomplished Account Information Form (AIF)¹ which shall contain, among others, information lifted from **certified** balance sheets, profit and loss statements, schedules listing income-producing properties and the corresponding income therefrom and other relevant statements.
 - b. For corporate taxpayers, Section 77 (B) of the Code provides, among others, that the annual ITR shall be filed on or before April 15 or on or before the 15th day of the fourth month following the close of the fiscal year, as the case may be. For individual taxpayers, Section 51 (c) of the Code provides, among others, that the return of any individual shall be filed on or before the 15th day of April of each year covering income for the preceding taxable year.
 - c. Revenue Regulation No. 21-2002 requires the filing of audited financial statements together with the annual income tax returns enumerated in the said Regulation. Those financial statements should include the following:
 - i. Balance sheet;
 - ii. Income statement or profit and loss statement;
 - iii. Statement of changes in equity;
 - iv. Statement of changes in financial position; and
 - v. Schedules attached to the aforesaid statements.

The financial statements are required to be accompanied by the auditor's certificate (report) and shall show comparative figures of the current year and the previous year.

¹ The BIR requirement to accomplish an AIF has been temporarily suspended since 2002. At present, taxpayers attach to their ITRs their audited financial statements accompanied by a report of their external auditors as required by RR No. 21-2002 (see paragraph 5c of this PAPS).

Incomplete or Unaudited Financial Statements

6. As currently practiced, when incomplete or unaudited financial statements are drawn up, the audit of such financial statements is not yet completed due to certain reasons such as delays in submission of schedules and late appointment of the auditor, and the status of the audit may be any of the following:
 - a. the auditor has not applied any audit procedures except for the tracing of the balances from the client's general ledger;
 - b. the auditor has applied some audit procedures but there are still significant audit procedures to be performed which could not be completed on time to meet the deadline for the filing of the ITR; or
 - c. the auditor has applied and completed almost all the audit procedures except that a few important confirmations, contracts, minutes of meeting, representation letter and other documentation are still to be obtained without which the report on the financial statements could not be released.

7. Oftentimes, incomplete or unaudited financial statements that accompany tentative ITRs are prepared without including a complete set of financial statements or the required disclosures or notes to the financial statements, simply because the audit has not yet been completed. While such incomplete or unaudited financial statements may be accepted by the BIR, such set of financial statements does not comply with the provision of PAS 1, *Presentation of Financial Statements*, on what constitutes a complete set of financial statements. Paragraph 8 of PAS 1 states that:

“A complete set of financial statements comprises of:

- a. a balance sheet;
- b. an income statement;
- c. a statement of changes in equity showing either:
 - i. all changes in equity, or
 - ii. changes in equity other than those arising from transactions with equity holders acting in their capacity as equity holders;
- d. a cash flow statement; and
- e. notes, comprising a summary of significant accounting policies and other explanatory notes.”

8. As also currently practiced, the auditor's reports accompanying the incomplete or unaudited financial statements described above contain a disclaimer of opinion. One example of such auditor's report currently used to accompany incomplete or unaudited financial statements is presented below:

*Report of Independent Accountants
To the Board of Directors and Stockholders of
(Name of Company)*

We are in the process of auditing the 20CY financial statements of (name of Company). As we have not yet completed our audit, we cannot as yet express an opinion on the accompanying tentative balance sheet of the Company as of December 31, 20CY and the related statements of income, changes in equity and cash flows for the year then ended. These financial statements were prepared from the Company's books of accounts and are in accordance therewith, and are subject to adjustments as may be required upon the completion of the audit. These financial statements are incomplete presentations because they do not include all the disclosures required by generally accepted accounting standards in the Philippines. Our report will be submitted as soon as our audit is completed.

The accompanying tentative financial statements are being issued in compliance with the requirements of the (name of requesting party or government body).

Responsibility over Financial Statements

9. As provided in PSA 200, *Objective and General Principles Governing an Audit of Financial Statements*, the responsibility for preparing and presenting the financial statements is that of the management of the entity. The audit of the financial statements does not relieve management of its responsibility.
10. The responsibility of management cited above applies whether the financial statements are considered incomplete or unaudited or final audited financial statements.
11. On the other hand, an auditor, based on the terms of a regular audit engagement, is responsible for forming and expressing an opinion on the financial statements.

Handling of Incomplete or Unaudited Financial Statements

12. PSA 200 provides that an audit in accordance with PSAs is designed to provide assurance that the financial statements taken as a whole are free from material misstatement. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.
13. PSA 500 (Revised), *Audit Evidence*, provides that the auditor shall obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion. Sufficiency is the measure of the quantity of audit evidence. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for, or detecting misstatements in, the classes of transactions, account balances, and disclosures and related assertions.
14. Under the circumstances described in paragraphs 6 – 7 whereby incomplete or unaudited financial statements are drawn up, the auditor has not yet obtained sufficient appropriate audit evidence to be able to draw a conclusion on which to base an audit conclusion. Hence, the financial statements under those circumstances shall be considered as incomplete or unaudited financial statements.
15. PSA 700 (Revised), *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*, requires certain statements to be made by the auditor in the auditor's report on the audited financial statements, which the auditor would not be able to do if the financial statements are incomplete or unaudited. These are as follows:

Paragraph 22 – “The introductory paragraph in the auditor's report should identify the entity whose financial statements have been audited and should state that the financial statements have been audited. The introductory paragraph should also:

- (a) Identify the title of each of the financial statements that comprise the complete set of financial statements;
- (b) Refer to the summary of significant accounting policies and other explanatory notes;...”

Paragraph 28 – “The auditor's report should state that management is responsible for the preparation and the fair presentation of the financial statements in accordance with the applicable financial reporting framework and that this responsibility includes:

- (a) Designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error;
- (b) Selecting and applying appropriate accounting policies; and
- (c) Making accounting estimates that are reasonable in the circumstances.”

Paragraph 32 – “The auditor’s report should state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.”

Paragraph 36 – “PSA 200 specifies what is required in order to conduct an audit in accordance with the PSAs. Paragraph 14 in that PSA explains that the auditor cannot describe the audit as being conducted in accordance with the PSA unless the auditor has complied fully with all of the PSAs relevant to the audit.”

- 16. Accordingly, because the auditor will not be able to attest to the matters discussed in the immediately preceding paragraph, **an auditor shall not be associated with incomplete or unaudited financial statements, i.e., he shall not issue a report on the incomplete or unaudited financial statements or consent to the use of his name in connection with such financial statements.** This is to avoid any risks on the part of the auditor that may arise from being associated with a client’s preliminary figures that may eventually differ materially from the final figures determined at the completion of his audit.
- 17. The above position is consistent with PSA 120, *Framework of Philippine Standards on Auditing*, which provides that an auditor is associated with financial information when the auditor attaches a report to that information or consents to the use of the auditor’s name in any professional manner. If the auditor is not associated in this manner, third parties can assume no responsibility on the part of the auditor.
- 18. **Hence, to avoid any association with incomplete or unaudited financial statements, no report (even a report containing a disclaimer of opinion) shall be issued by the auditor on such incomplete or unaudited financial statements.** The example of the report on incomplete or unaudited financial statements as cited in paragraph 8 above, or any other similar report issued covering incomplete or unaudited financial statements is unacceptable and shall therefore not be used.

Other Considerations

19. The above guidance shall be applied only to the circumstances covered in this PAPS, or similar circumstances. It shall not be applied to situations where the auditor has completed an audit and has concluded that there are scope limitations that affected the audit giving rise to either a qualified opinion or disclaimer of opinion. Such situations are covered in PSA 701 [Amended as a result of PSA 700 (Revised)], *Modifications to the Independent Auditor's Report*.

Effective Date

20. This PAPS shall be effective for engagements to audit financial statements for periods ending on or after December 31, 2007. Earlier application is allowed.

This Philippine Auditing Practice Statement 1001Ph was unanimously approved on June 4, 2007 by the members of the Auditing Standards and Practices Council:

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