

A Case Study

2GO GROUP INCORPORATED ACCOUNTING SCANDAL: AUDIT ETHICAL DILEMMAS & IMPACT TO THE ACCOUNTANCY PROFESSION

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March 27, 2018

2GO
group, inc.

Executive Summary

The purpose of this case study analysis is to provide an evaluation and examination of professional ethics dilemmas of accounting firms with regards to audit due to a huge scandal of 2Go Group Incorporated, a logistics and supply chain company, in the year 2017. The methods used to analyze the case and issues include observations and information research. The people involved in this case are the previous and present management of 2Go Group Incorporated, the auditors of KPMG- R.G Manabat and Co and SyCip Gorres Velayo & Company, and the Securities and Exchange Commission.

Under the new management led by businessman Dennis Uy and the Sy family's SM Investments Corp., the board engaged the audit firm, SyCip, Gorres, Velayo & Company (SGV & Co.), to conduct an opening balance sheet audit of the company and subsidiary as of quarter ended March 31, 2017 to ensure fair presentation of financial statements and establish accountabilities. The audit showed that there is alleged inflation of financial statement since 2015 and this caused a thorough investigation by Securities and Exchange Commission which is still ongoing as of March 2018.

Accounting scandals result to consequences that greatly affect the accounting profession in the Philippines and as a whole. 2Go Group Inc. accounting scandal greatly affected the image of the auditors and accountants. The role of the auditors in the preparation of the Financial Statements is not properly established in the minds of the public and thus the scandal was misunderstood as fraud by the auditors together with the management. The scandal was widely spread nationwide and created various criticisms from the netizens which put the reputation of not only KPMG R.G Manabat but also of the accounting profession as a whole in disrepute.

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INTRODUCTION

Issues on ethics is a critical concern for accountants, and more specifically on auditors, because the profession revolves mainly on integrity and public confidence. The users of the financial statements, including the general public, rely on auditors' findings and opinion to verify the fairness of the financial statements.

A unique indication of the accountancy profession is its recognition of the responsibility to act for the public interest and in order to meet this responsibility, a professional accountant should abide by the Code of Ethics. The Code establishes the minimum ethical requirements for professional accountants and they may not apply less stringent standards than what is set on the code.

Due to several accounting issues, some even turned into one of the most controversial scandals, critics of the profession arose. Ethical misconduct by accountants can be detrimental not only to the profession but also to the society that could result to loss of public trust and disturbance of market processes.

This paper evaluates and examines the ethical misconduct in the auditor's perspective regarding the recent 2Go Group Incorporated issue and discusses furthermore the safeguard that could have been used to prevent the said misconduct.

SYNOPSIS AND BRIEF HISTORY OF 2GO

2GO Group Incorporated is a known logistics services provider in the Philippines. It is engaged in the business of operating vessels, motor boats and watercrafts, aircrafts and trucks, and acts as an agent for domestic and foreign shipping companies for the purpose of transporting cargoes and passengers by air, land, and sea.

The group was formed and organized in May 26, 1949 under the corporate name William Lines, Inc. On December 21, 1995, William Lines, Inc., Carlos A. Gothong Lines, Inc. and Aboitiz Shipping Corporation consolidated their resources and expertise and marked the birth of William, Gothong & Aboitiz, Inc. (WG&A). Then on February 4, 2004, WG&A changed its corporate name to Aboitiz Transport System Corporation as a result of the buyout made by Aboitiz Equity Ventures, Inc. of the Chiongbian and Gothong holdings in WG&A in 2002. The Securities and Exchange Commission approved a subsequent change of the corporate name to the present one on March 09, 2012.

2GO Group owns and operates brands like 2GO Travel, 2GO Freight, 2GO Express and 2GO Logistics. These brands offer logistics and travel services. 2GO's operations include Shipping and Non-Shipping segments. Shipping segment provides passage transportation and cargo freight services while Non-Shipping segment provides logistics services and supply chain management. The group also maintains joint venture partnerships with renowned global companies such as Kerry ATS Logistics, Hapag Lloyd and Hansa Meyer - ATS Projects.

As of December 31, 2016, 2GO and its subsidiaries have a total fleet of 24 operating vessels, of which 19 are company-owned ships. Presently, 2GO has four direct subsidiaries and one affiliate, namely, 2GO Express, Inc., The Supercat Fast Ferry Corporation, 2GO Rush

Delivery, Inc., NN-ATS Logistics Management & Holdings Co., Inc., Special Container and Value Added Services, Inc., and MCC Transport Philippines, Inc.

Timeline

May 6, 1949 - 2GO Group, Inc. (2GO) was formed and organized under the corporate name William Lines, Inc.

December 21, 1995 - William Lines, Inc., Carlos A. Gothong Lines, Inc. and Aboitiz Shipping Corporation consolidated their resources and expertise and marked the birth of William, Gothong & Aboitiz, Inc. (WG&A).

February 4, 2004 - WG&A changed its corporate name to Aboitiz Transport System Corporation as a result of the buyout made by Aboitiz Equity Ventures, Inc. of the Chiongbian and Gothong holdings in WG&A in 2002.

March 9, 2012 - The Securities and Exchange Commission approved a subsequent change of the corporate name to the present one on March 09, 2012.

April 2017 - SM Investments Corporation (SMIC) acquired 34.5% stake in 2GO's parent company, NENACO through China ASEAN Marine B.V, who owned 40% of NENACO before the acquisition. Negros Navigation Company Incorporated (NENACO) owns majority, which is 88.31%, of stake in 2GO with the remaining shares owned by public investors. 60% of NENACO is owned by KGLI-NM Holdings Incorporated, the firm owned by Tagud Family-led by NEGROS Holdings Management Corporation , Dennis Uy- led Udenna Investments (31%) and Kuwaiti Gulf

Link Investments (around 9%). Udenna indirectly has 21% voting and 28% beneficial interests in 2GO.

April 2017 - The board of 2GO appointed Uy as president and CEO of the company, replacing Sulficio Tagud Jr. Sulficio Tagud Jr. was the former CEO and president of 2GO. Upon his retirement, Uy was appointed as the new head of the company. Uy is the chairman of Udenna Corporation, the parent of Phoenix Petroleum Philippines, Inc. and Chelsea Logistics Corp. His appointment as director of the board in February marked a major boardroom change that started the entry of SM Group executive and Frederic Dybuncio as new director.

SYNOPSIS OF SCANDAL

SGV & Co. had been 2GO's independent public accountant for almost four decades (from 1977 until 2013). Until KPMG replaced them in 2014 after a “major disagreement” between the management and the auditing firm over the treatment of a deferred tax asset during the 2013 audit.

According to Tagud, prior CEO of 2Go Group Inc., the company turned around in 2014 and because there were losses in the previous two years, there was net loss carryover. He also added that the deferred tax asset, which is more than P300 million, would have been used the following year, 2015, but SGV said that the company needs to have it written-off to make money. And then the board decided to fire SGV because they insisted the write-off.

KPMG R.G Manabat & Company audited the consolidated financial statements of 2GO & its subsidiaries for the year from 2015 to 2016 and issued unqualified opinion stating that the financial statements were fairly presented and in accordance with PFRS.

Under the new management, now controlled by businessman Dennis Uy and the Sy family's SM Investments Corp., the board appointed the audit firm, SyCip, Gorres, Velayo & Company (SGV & Co.), to conduct an opening balance sheet audit of the company and subsidiary as of quarter ended March 31, 2017. The new management's purpose was to establish a firm opening balance sheet for the new shareholders which is customary after an acquisition and to warrant the fair presentation of financial statements and create accountabilities.

The audit disclosed an alleged inflation of the 2015 and 2016 financial statements which required restatement. With the approval of the newly elected members of the audit committee and the board of directors, the management agreed to restate financial statements covering the period

2015 and 2016 together with the unaudited financial statements for the three month-period ending March 31, 2017, to fairly show the state of the business.

The special audit, conducted by SyCip Gorres Velayo & Co., showed that 2GO failed to meet key measures required under some of its loan agreements. It was referring to the current ratio and maximum debt-to-equity ratio as of end-March 2017 and end-December 2016. The restatement caused the company's long-term debts amounting to P3.17 billion and P2.7 billion in those respective years to be reclassified from non-current liabilities to current liabilities, meaning they were due in the next 12 months.

2Go's net income in 2015 was supposedly P109.1 million, or lower by 90 percent than the P1.08 billion it had reported. Its net profit for 2016 should be only P344 million, 74 percent lower than the P1.34 billion the company had announced. For the first quarter of 2017, 2Go should have indicated a net loss of P264.8 million, contrary to a positive "net income".

In June 2017, 2GO filed its complete restated financial documents for the year 2015 & 2016, as well as the first quarter of 2017 signed by William Charles Howell as a chief financial officer after the resignation of Jeremias E. Cruzabra. The result showed that the restated items are mostly non-cash and non-recurring. Uy stated that the restatement reflects the commitment of the new management and the board to raise corporate governance standards in the company.

As of March 2018 the issue is still under investigation by the SEC and the results are yet to be announced although they announced in December 2017 that preliminary results will be presented by January.

PARTIES INVOLVED

Former management

The 2GO Board is composed of nine (9) highly respectable individuals — six (6) non-executive directors which includes the Chairman and three (3) executive directors. Of the nine (9), there are three (3) independent directors, including the Chairman, who are experts in their respective fields. The board of directors of 2Go Group Inc. formerly consists of the following:

Chairman : Francis C. Chua, Independent Director
Members : Sulficio O. Tagud, Jr.
Jeremias E. Cruzabra
Nelson T. Yap
Raul Ch. Rabe, Independent Director
Monico V. Jacob, Independent Director
Mark E. Williams Mike
Nikkel Patrick Ip

Splitting up the role of the Chairman and the Chief Executive Officer (CEO) was brought into focus when shortcomings in corporate governance were observed in companies where the two roles are combined. Thus, to foster an appropriate balance of power, increased transparency, accountability and control over company operations, the elected Chairman of the Board, a non-executive director, is separate and distinct from the appointed CEO of 2GO.

The former management of 2Go Group Inc., was led by **Sulficio Tagud Jr.**, former Chief Executive Officer and President. He is the Chairman of the Compensation, Remuneration and Nomination Committee of the Company. Prior to this, he has served as Chairman of the Board of the Company from October 2004 up to July 2011, as Chairman and CEO of C&P Homes, Inc., as President of ML & H Corp., Capital Securities One, Inc. and Bonifacio Land Corporation. He was

a Director of Bonifacio Development Corp. and Public Estates Authority and PEA Tollways. Further, his past positions include the following: Chairman and President of KGLI-NM Holdings, Inc. since July 2008; President, Chief Executive Officer and a Director of NENACO since 2004; Chairman and CEO of Negros Holdings & Management Corporation since December 2006; and Chairman of the Philippine Liner Shipping Association.

Present Management

As of the present, 2Go Group Inc.'s President and CEO is Frederic C. DyBuncio who is also the president of SM Investments Corp (SMIC) which owns 30.47% of 2Go Group Inc after acquiring 34.5% stake of its group mother firm, Negros Navigation Corp (NENACO).

The present Board of Directors consists the following:

Chairman : Dennis Uy
Members : Francis Chua, Vice Chairman.
Joseph Tan
Raul Ch. Rabe, Independent Director
Monico V. Jacob, Independent Director
Laurito Serrano
Conception de Claro

Dennis Uy is an emerging Davao-based business tycoon. He owns and controls the third publicly listed company, Chelsea Logistics, a diversified shipping company that transports both passengers and cargo. In April 2017, he acquired a large stake of 2Go Group Inc.

Uy's indirect holdings in listed 2GO Group has a market value of Php11 billion, or about 20 percent of the shipping group's market capitalization of Php55.8 billion. Uy's stake in 2GO Group are held indirectly through Chelsea Logistics, which owns 80 percent

of KLGNI-NM, which, in turn, has a 39.85-percent stake in Negros Navigation Co. The latter owns 88.3 percent of 2GO Group.

KPMG R.G Manabat & Co.

R.G. Manabat & Co., a member firm of KPMG is the appointed external auditor of 2GO for its 2016 Financial Statements. R.G. Manabat & Co. focuses its review mainly on the financial reporting controls of 2GO in order to express an opinion as to the overall presentation of the financial statements of the Company and that the financial reporting standards are consistently applied in the preparation of the financial reports. R.G. Manabat & Co. is also the external auditor for the 2015 and 2014 Financial Statements.

For the years audited by the audit firm, they issued an unqualified report stating that the financial statements are presented fairly in all material aspects and in accordance with the Philippine Financial Reporting Standards (PFRS).

In relation to the 2Go Accounting scandal, R.G. Manabat & Co. said it was “confident” it had performed the audits of 2GO Group Inc. “in compliance with the Philippine Standards on Auditing.”

KPMG stood by its audit findings, citing its adherence to accounting standards – standard language used by audit firms to preface their findings. According to them, those standards require that they comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

RG Manabat chairman and chief executive Robert Manabat said in an interview at the sidelines of Top Frontier Holdings Inc.'s annual stockholders meeting the restatement of 2015 and 2016 financial performance of 2Go was just "accounting interpretations" and that they "are confident that they will be able to explain their side. Manabat also welcomed the move of the Securities and Exchange Commission to conduct an investigation on the matter.

SyCip Gorres Velayo & Company (SGV)

SGV & Co was the auditor of the Aboitiz group even before the Aboitiz-Negros Navigation merger, and then eventually of 2Go Group Inc. It had been 2Go Group Inc.'s auditor for almost four decades, from 1977 to 2013. In 2014, Tagud replaced them with KPMG RG Manabat & Co after the disagreement over the treatment of the deferred tax asset worth P385M.

In 2017, the new management of 2Go Group Inc. appointed SGV & Co to conduct a special audit for the purpose of establishing accountabilities with the new stockholders through presentation of fairly stated financial statements. Eventually, 2Go Group Inc. replaced KPMG RG Manabat & Co with SGV & Co for the 2017 and 2018 financial statements audit.

Securities and Exchange Commission

SEC is currently investigating the accounting issue of 2Go Group. Ms. Teresita Herbosa, SEC Chairperson, stated that investigation ran longer than expected because there were ten issues at hand that needed to be clarified. SEC's Market and Securities Regulation Department and Office of the General Accountant sought written clarification from the previous management of 2GO, as

well as from auditors R.G. Manabat and SGV, before making any conclusion in its investigation of the discrepancy in 2GO's financial statements.

If ever the SEC can prove that 2GO has violated the Securities Regulation Code due to this accounting issue, the commission can slap the company with a fine of at least a million pesos, plus an additional P10,000 fine for every day since the wrongdoing was discovered.

ANALYSIS OF THE SCANDAL

Ethical Dilemmas

1. *Pre-engagement matter “know your client”*

The reason behind the change in external auditor was the disagreement between 2GO management and SGV as to the treatment of deferred tax assets, with SGV being fired in the process. Management replaced SGV with KPMG R.G. Manabat which accepted the engagement amidst the major disagreement and might have overlooked necessary pre-engagement procedures involving the acceptance of clients.

This dilemma violated the Changes in a Professional Appointment, 210.9 in the IESBA Code of Ethics for Professional Accountants which states that:

A professional accountant in public practice who is asked to replace another professional accountant in public practice, or who is considering tendering for an engagement currently held by another professional accountant in public practice, shall determine whether there are any reasons, professional or otherwise, for not accepting the engagement, such as circumstances that create threats to compliance with the fundamental principles that cannot be eliminated or reduced to an acceptable level by the application of safeguards. For example, there may be a threat to professional competence and due care if a professional accountant in public practice accepts the engagement before knowing all the pertinent facts.

The safeguards that may have been applied includes:

- a. When replying to requests to submit tenders, stating in the tender that, before accepting the engagement, contact with the existing accountant will be requested so that inquiries may be made as to whether there are any professional or other reasons as to why the appointment should not be accepted;
- b. Asking the existing accountant to provide known information on any facts or circumstances that, in the existing accountant's opinion, the proposed accountant needs to be aware of before deciding whether to accept the engagement; or
- c. Obtaining necessary information from other sources.

2. Lack of Professional Skepticism (KPMG)

KPMG RG Manabat claimed that its audit was based on the judgment and estimates made by 2GO management and in addition, it adhered to all standards and best practices in auditing financial statement. The new management appointed SGV to conduct a special audit and found out that there was a noticeable discrepancy in the audit of financial statements seeing as there is material difference with KPMG's audited Financial Statements and SGV's restated ones. Professional skepticism as an attitude that includes a questioning mind and a critical assessment of audit evidence. Due to material difference, there is an inadequate professional skepticism in the public practice which means lack of structured consideration of an alternative point of view. This dilemma particularly violates the ethical principles on professional competence and due care. This claim is further supported by noticeable disagreement in the audit of financial statements.

Safeguards that should have been applied to this situation is alertness to audit evidence that contradicts other audit evidence obtained, to information that brings into questions the reliability of documents and responses to inquiries to be used as audit evidence, to possible conditions that may indicate possible fraud, and to circumstances that suggest the need for audit procedures in addition to those required by the PSAs. KPMG failed to diligently observe their quality control systems that might have helped engagement teams improve the application of professional skepticism in a number of ways, including setting a proper tone at the top that emphasizes the need for professional skepticism; implementing and maintaining appraisal, promotion, and compensation processes that enhance rather than discourage the application of professional skepticism; assigning personnel with the necessary competencies to engagement teams; establishing policies and procedures to assure appropriate audit documentation, especially in areas involving significant judgments; and appropriately monitoring the quality control system and taking necessary corrective actions to address deficiencies, such as, instances in which engagement teams do not apply professional skepticism.

3. Lack of Professional Competence and Due Care (KPMG)

Difference in the conduct of audit further stressed the deviation of the audit results from the liberalized audit of KPMG and the more conservative method of SGV and Co due to their different roles in auditing. SGV clearly conducted a conservative approach because they were tasked to do a special audit. However, KPMG RG Manabat & Co's approach on audit is not an excuse; should they have performed the audit conservatively or less liberally, the discrepancy would be none or immaterial if ever there was. The results from the conducted restatements showed a material discrepancy in the presentation of each year's net income, with 2015's

supposedly 109.131 million net income turned to 1.08 billion, 2016’s alleged 1.34 Billion when it should have been 344.035 million instead and also during 2017’s first quarter that should have showed a loss of 264.86 million but was stated as an income of 267 million. It is evident that the audit process of KPMG RG Manabat & Co’s may have lacked the necessary procedures to be used.

Facts supporting this dilemma include: (2GO’s restated financial statements for the years 2015 and 2016 revealed the following:

TABLE 1. RESTATEMENT ITEMS OF THE 2GO FINANCIAL STATEMENTS

<p><u>Provision for doubtful receivables</u></p> <p><i>In PAS 39 Paragraph 4, it states that</i></p> <p><i>“ An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (see paragraph 59). If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.”</i></p>	<p>SGV’s audit findings revealed that for the periods covered by the restatements, there was no provision for the recognition of doubtful accounts. To follow the standard, 2GO was required to determine whether there was any objective evidence that receivables are impaired on a specific and collective basis and it was to occur at the end of each reporting period. For those receivables such as those unpaid invoice balances that were deducted outright by customers upon payment and disengagement, there was no specific allowance for doubtful account provided. For the remaining past due receivables, the Group’s collective impairment assessment policy has not been applied.</p>
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PPE-related adjustment

PAS 16 par. 7 requires that

“The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if: (a) it is probable that future economic benefits associated with the item will flow to the entity; and (b) the cost of the item can be measured reliably.

PAS 16 par 12 further states

“Under the recognition principle in paragraph 7, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts.

For the periods covered by the restatements, SGV and Co.’s audit revealed that 2GO capitalized the cost of repainting, repairs and maintenance as part of property and equipment, when in fact it should have been expensed, and the company also failed to depreciate fixed assets that were available for use. Also, in 2016, 2GO failed to shorten the estimated useful life of its vessels in accordance with the re-fleeting plan.

Reversal of recognized revenue

PAS 18 par. 14 provides that

“Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:

- a. The entity has transferred to the buyer the significant risks and rewards of ownership of the goods;*
- b. The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;*
- c. The amount of revenue can be measured reliably;*
- d. It is probable that the economic benefits associated with the transaction will flow to the entity; and*
- e. The costs incurred or to be incurred in respect of the transaction can be measured reliably (underscoring ours).*

For the periods covered by the restatements, there were revenue recognized that did not meet the revenue recognition criteria under PAS 18. Such revenue include those transactions without proof of delivery, unrecorded returns and deliveries in the inappropriate period.

<p><u>Impairment of goodwill of SOI</u></p> <p><i>PAS 30, Paragraph 10 states that:</i></p> <p><i>“An impairment loss shall be recognized for a cash-generating unit (the smallest group of cash-generating units to which goodwill or a corporate asset has been allocated) if, and only if, the recoverable amount of the unit (group of units) is less than the carrying amount of the unit (group of units).”</i></p>	<p>The audit results showed that the Group impaired the goodwill on SOI in 2015 because SOI incurred operating loss during that year, resulting to its capital deficiency position, and its recoverable value based on its value in use is lower than its carrying amount.</p>
<p><u>Asset held for sale</u></p> <p><i>PFRS 5, Noncurrent Assets Held for Sale and Discontinued Operations paragraph 6 requires that</i></p> <p><i>“An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.”</i></p>	<p>In September 2015, the Company’s Board of Directors approved the sale of one of its vessels. Management assessed that the vessel would qualify as asset held for sale on the date of BOD approval for its sale. Accordingly, the Group reclassified its vessel from property and equipment to assets held for sale in the December 31, 2015 consolidated statement of financial position and recognized impairment loss in the 2015 consolidated statement of profit or loss.</p>

<p><u>Inventory related adjustments</u></p> <p><i>PAS 2, Inventories provides that</i></p> <p><i>“The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.”</i></p>	<p>The prior period adjustments arose from physical count-to-books reconciliation, additional provision for inventory obsolescence on expiring stocks, and write-down of costs to reflect net realizable values.</p>
<p><u>Related party transactions and balances</u></p> <p><i>PAS 1 par. 27 requires</i></p> <p><i>“An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.</i></p>	<p>The Group adjusted certain related party transactions and balances that did not reconcile due to differences among subsidiaries in accruing intercompany revenue and costs and timing differences when recognizing income and expense.</p>

<p><u>Provisions for contingencies</u></p> <p>PAS 37 states that</p> <p><i>“A provision shall be recognised when:</i></p> <ul style="list-style-type: none"> <i>a. An entity has a present obligation (legal or constructive) as a result of a past event;</i> <i>b. It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and</i> <i>c. A reliable estimate can be made of the amount of the obligation. “</i> 	<p>In consultation with its legal counsels, the Group assessed it is probable that certain exposures on litigations and claims would require an outflow of resources to settle based on the status of the cases in 2015.</p>
<p><u>Recognition of costs and expenses</u></p> <p>PAS 1 par. 27 and 28 provides that</p> <p><i>“An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting. When the accrual basis of accounting is used, an entity recognizes items as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the Framework”</i></p>	<p>The prior period adjustments pertain to unrecorded liabilities/expenses which have already been incurred and the expensing out of certain deferred expenses.</p>

Derecognition of deferred tax assets - PAS 12, Income taxes paragraph 5 & PAS 12 paragraph 24

PAS 12, Income Taxes paragraph 5 defines deductible temporary differences as follows:

“Deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.”

PAS 12 paragraph 24 requires

“A deferred tax asset shall be recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized”

2GO assessed that deferred income taxes on certain deductible temporary differences would not qualify for recognition due to insufficient available taxable income in the future to which the deductible temporary differences and excess Minimum Corporate Income Tax (MCIT) can be applied.

Reclassification of non-current portion of long-term debt to current liabilities

PAS 1 requires

“When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.”

2GO breached its financial ratios required under its long-term debt agreements. Accordingly, the Group reclassified the noncurrent portion of its long-term debt that are subject to such covenants or with cross-default provision in the loan agreements to current liabilities.

It is questionable how KPMG could have missed these misstatements probably committed by 2GO’s management when in fact, they have a lot of tools such as KPMG Clara, KPMG Audit Methodology and eAudit which they can apply at their disposal in the handling of the audit.

Safeguards that could have been followed include proper implementation of the following which are found in KPMG’s Global Code of Conduct: complete training and confirm understanding of applicable code of conduct upon joining member firm and on a biennial basis thereafter, training delivered using a blend of classroom, digital learning and performance report to assist auditors on the job(70-20-10), educational, training and experience requirements for entry into the profession and Continuing Professional Development (CPD) requirements.

Another safeguard is that they should not have been too complacent in their audit approach. It would have been safer if they conducted the audit conservatively to detect material misstatements.

4. *Constructive Negligence (KPMG)*

2GO's 2015 restated profit is at P109.131 million which is 90% lower than the P1.08-billion profit it earlier disclosed in its 2015 annual report. For 2016, 2GO said its restated profit is P344.035 million, a 74% decline from the P1.34-billion net income it earlier reported. For the first quarter of 2017, the company should have reported a net loss of P264.86 million, instead of a P267.562-million profit. The discrepancies between the restatement of SGV and the audit made by KPMG is substantial such that KPMG's integrity is questioned. On the case at hand, extreme negligence can be observed but the intent to deceive or do harm on the part of KPMG is yet to be proven. KPMG RG Manabat & Co might not intend to defraud or deceive but the scandal made it appear to be because of their negligence.

This dilemma particularly violates the ethical principle on professional competence and due care. Ensuring that the appropriate accounting principles have been employed could have been a safeguard for this dilemma. In exercising professional judgement, the engagement team should have been keen on applying professional skepticism and they could have utilized accounting experts on areas involving estimates.

5. *Second opinion (SGV & Co)*

During the audit process for both auditors there is an imminent threat that information used may not be based on the same set of facts that were made available to the prior auditors. During

the conduct of their special audit on 2GO, SGV & Co. did not grant KPMG the “courtesy procedure” to discuss its restatement and “seek concurrence.” The ethical principle violated is the Code of Ethics on Second Opinions section 230.1, 230.2 and 230.3

230.1 Situations where a professional accountant in public practice is asked to provide a second opinion on the application of accounting, auditing, reporting or other standards or principles to specific circumstances or transactions by or on behalf of a company or an entity that is not an existing client may create threats to compliance with the fundamental principles. For example, there may be a threat to professional competence and due care in circumstances where the second opinion is not based on the same set of facts that were made available to the existing accountant or is based on inadequate evidence. The existence and significance of any threat will depend on the circumstances of the request and all the other available facts and assumptions relevant to the expression of a professional judgment.

230.2 When asked to provide such an opinion, a professional accountant in public practice shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level.

230.3 If the company or entity seeking the opinion will not permit communication with the existing accountant, a professional accountant in public practice shall determine whether, taking all the circumstances into account, it is appropriate to provide the opinion sought.

Furthermore, according to Independent Regulatory Board for Auditor's (IRBA) Circular, on Giving Second Opinions, "the second auditor should make inquiries of the current auditor with the permission of the client...In the event that the client will not allow the second auditor to carry out any one of the steps referred to in this paragraph, the second auditor should decline to act."

It is clear that SGV & Co continued with the engagement and issued an opinion despite not having communication with KPMG RG Manabat & Co.

In the case of SGV and Co. with them auditing the past audited financial statements of KPMG and being the predecessor auditor of 2GO before KPMG, the process of giving a second opinion may impose a self-interest threat wherein the option-giver's objectivity may be impaired by the prospect of securing another client. Even if self-interest threat may not be a factor, there is still an imminent risk to objectivity (Paragraph 1.3 of ICAEW's Guide to Professional Ethics).

Safeguards that should have been used include seeking client permission to contact existing accountant (KPMG), describing the limitation surrounding any opinion and providing the existing accountant with a copy of the opinion. It is vital in order to ascertain the circumstances in which the second auditor has been consulted, apprise himself/herself of all the facts relevant to the issue at the time the opinion is given and determine whether the client has sought an opinion from its current auditor or other registered auditor(s). In the event that the client will not allow the second auditor to carry out any one of the steps referred to in this paragraph, the second auditor (SGV) should have declined to act.

Impact to the Accountancy Profession

In the last decade, the auditing environment has changed. Enron's accounting scandal was perhaps the biggest single catalyst for change, but other corporate scandals also led to serious concern about the quality of financial reporting and corporate behavior. Some of the reasons considered as the factors of the scandals include inadequate audits, poor corporate governance, lax standards and insufficient regulatory oversight. In particular, the regulation of accounting firms and their auditing practices came under intense scrutiny throughout the world even in places that had not suffered from a serious scandal.

As audit relies heavily on trust and the fulfillment of fiduciary responsibilities, the importance of ethical judgments for the profession is always fundamental to the practice of the accountancy profession. To violate these ethical conduct, firms and professionals will face consequences that may be long term or short term. Such consequences do not only affect themselves but the accountancy profession in general as well.

The recent accounting scandal of 2Go Group Inc. spread nationwide and through various available social media, the news was heard in an instant. The role of the auditors is not properly established in the country thus there was a misunderstanding between people who are not aware of the profession and those who practice the profession. This is the primary impact of the scandal. Rumors spread and put the name of KPMG R.G Manabat in disrepute. A lot of criticism of the auditors from posts and comments on social media pages, which clearly portrayed misstatement of the auditing profession, affect the image of an auditor in the eyes of the

public especially the uninformed netizens. Due to this, the integrity of the accountants is in question and creates a stereotype of those who practice the profession.

The following are additional impacts of the 2Go Group Inc. accounting scandal to the accountancy profession in the Philippines and as a whole:

Table 2. IMPACT ON THE ACCOUNTANCY PROFESSION IN THE PHILIPPINES
<p><u>Public trust is affected</u></p> <p>Questions regarding the profession were raised in the nationwide PICPA Accountancy Week. Seeing as 2GO's scandal occurred around the same time as Metrobank fraud scandal, attendees feared for the credibility and reputation of the profession. Even professionals started to question the future of the profession, what more those clients that make use of the services</p>
<p><u>Less opportunities abroad for Filipino Accountants</u></p> <p>The integrity of the Filipino accountants might be questioned and may be deemed uncompetitive by foreign firms</p>
<p><u>Bad reputation of the profession as to uninformed public on the role of the accountants</u></p> <p>There are many uninformed Filipinos especially in the internet regarding the work of the auditor and accountants thus the rumors create a bad name on the profession especially now that social media and internet accessible.</p>
<p><u>Creation of new rulings</u></p> <p>Due to the scandal and its conflicts, new rulings might be created after the results and judgement of the 2Go accounting scandal.</p>
<p><u>Decrease of CPAs due to strict examinations</u></p> <p>Scandals might result to stricter standards, rulings and examinations thus there will be fewer CPAs in the future.</p>

Table 3. IMPACT ON THE ACCOUNTANCY PROFESSION AS A WHOLE

Stereotyped profession

Because of the increasing number of scandals globally, there is a stereotype on the practice of accountancy profession especially in auditing. The public tends to question the integrity of CPAs and their intention in working with the financial statements.

Investors' confidence

Investors rely on the reasonable assurance an external auditor gives but because of the scandals, they might continually question the fairness of the Financial Statements.

Lesser enrollees for the course

A study was conducted on the views of students on the accounting profession after knowing about several accounting scandals and it resulted to a decreasing popularity of accounting as a career choice.

The positive impact

As a result of the occurrence of accounting scandals, consequences arose but there will also be positive impacts that may result from the event. A greater call of transparency is a key variable. Firms in general will start to aim to become more transparent in their operations and in their statements.

There will be a greater call for a stricter policy implementation in order to lessen the risk of the reoccurrence of such scandals especially heightened awareness on the Code of Ethics in both academe and fieldwork.

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