



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

CIRCULAR NO. 1040

Series of 2019

Subject: Revised Framework on the Selection of External Auditors

The Monetary Board, in its Resolution No. 643 dated 25 April 2019, approved the revised framework on the selection of external auditors for Bangko Sentral Supervised Financial Institutions in accordance with the cooperative arrangement among the Financial Sector Supervisors, namely the Bangko Sentral, Securities and Exchange Commission, Insurance Commission, and the Philippine Deposit Insurance Corporation, under the auspices of the Financial Sector Forum.

Section 1. Section 164/4189Q/4189T/4189S/4180N on the selection, appointment, reporting requirements and delisting of external auditors is hereby deleted and replaced with the following:

Section 164/4189Q/4189T/4189S/4180N/ Framework on the Selection of External Auditors

Policy Statement. The Bangko Sentral considers the external auditing profession as a partner in promoting the integrity of financial reports and transparency in the financial system. In this light, the Bangko Sentral is issuing this framework on the selection of external auditors (individual practitioners and audit firms) for Bangko Sentral Supervised Financial Institutions (BSFIs) in line with its cooperative arrangements with the Securities and Exchange Commission (SEC), Insurance Commission (IC), and Philippine Deposit Insurance Corporation (PDIC), under the auspices of the Financial Sector Forum (FSF).

Appointment of External Auditors of BSFIs

- a. BSFIs shall engage the services of an external auditor included in the List of Selected External Auditors for BSFIs. In this respect, a BSFI shall only appoint an external auditor belonging to the same category or from categories higher than the category of the BSFI concerned as provided in this section: *Provided*, That the Monetary Board may require the BSFI to appoint an external auditor from higher categories as part of the Bangko Sentral's supervisory action on the BSFI. The external auditor appointed by the BSFI shall likewise audit the BSFI's trust department as well as its subsidiaries and affiliates engaged in allied activities, as applicable.

- b. External Auditors shall be classified into three categories and shall extend their services to BSFIs belonging to the same category or from categories lower than the category of the external auditor, as follows:
- (1) Group A
 - (a) Universal/Commercial Banks
 - (b) Foreign banks and branches or subsidiaries of foreign banks
 - (c) Banks, trust departments and trust corporations with additional derivatives authority, pursuant to Section 613
 - (2) Group B
 - (a) Thrift Banks
 - (b) Non-bank financial institutions with quasi-banking license
 - (d) Trust departments and trust corporations
 - (3) Group C
 - (a) Rural and Cooperative Banks
 - (b) Non-stock Savings and Loan Associations
 - (c) Pawnshops
 - (d) Remittance and Transfer Companies (RTCs)/Money Changers/Foreign Exchange Dealers (MCs/FXDs), including Virtual Currency Exchanges and Electronic Money Issuers
 - (e) Credit Card Issuers/Acquirers

The above categories shall include their subsidiaries and affiliates engaged in allied activities and other financial institutions subject to Bangko Sentral's consolidated supervision.

- c. External auditors applying for first time inclusion or renewal of inclusion in the List of Selected External Auditors for BSFIs shall submit their application to the SEC. The application shall be subject to the requirements set out by the SEC as agreed upon by the Bangko Sentral, SEC, IC and PDIC.
- d. The inclusion in the List of Selected External Auditors for BSFIs shall be valid for five (5) years or for a shorter period prescribed by the financial sector supervisors.
- e. The Bangko Sentral shall periodically evaluate the performance of the external auditor through an assessment of the quality of the BSFI's audited financial statements and its compliance with the requirements provided under this Section. The results of assessment shall serve as basis for the continuing inclusion of external auditors in the List of Selected External Auditors for BSFIs.
- f. The external auditor, including the engagement and quality control partners of the audit firm, of the BSFI shall be rotated in accordance with the relevant provisions of the Code of Ethics for Professional Accountants in the Philippines as adopted by the Philippine Board of Accountancy.

Audit Engagement and Reportorial Requirements

- a. The BSFI's Audit Committee/board of directors/board of trustees shall ensure that the scope of external audit work appropriately covers areas relevant to BSFI's operations and risk exposures. These include the following:
 - (1) Review of the adoption of applicable reporting framework as well as the assessment of the accuracy, adequacy, and reliability of accounting records and financial reports;
 - (2) Assessment of the propriety and adequacy of disclosures in the financial statements;
 - (3) Assessment of the adequacy and effectiveness of internal controls and risk management systems;
 - (4) Assessment of the quality of capital in relation to risk exposures; and
 - (5) Evaluation of the quality of corporate governance.
- b. The engagement contract of BSFIs with the external auditor shall include, at a minimum, the following provisions:
 - (1) That disclosure of information, such as those enumerated under Item "c" of this Section (*Audit engagement and reportorial requirements*), by the external auditor to the Bangko Sentral and/or other financial sector supervisors shall not constitute a breach of confidentiality on the part of the external auditor nor shall it be a ground for civil, criminal, or disciplinary proceedings against the external auditor;
 - (2) That the external auditor shall be allowed read-only access to the Bangko Sentral's Report of Examination on the BSFI and that the external auditor shall appropriately consider the contents thereof and maintain its confidentiality; and
 - (3) That the BSFI concerned and external auditor shall comply with all the requirements under this Section.

The engagement contract shall be made available by the BSFI to the Bangko Sentral upon request.

- c. The external auditor shall report to the appropriate supervising department of the Bangko Sentral within fifteen (15) calendar days upon discovery of any matter adversely affecting the condition or soundness of the BSFI, such as, but not limited to the following cases:
 - (1) Any material finding involving fraud or error;
 - (2) Actual or potential losses, the aggregate of which amounts to at least ten percent (10%) of the consolidated total assets of the BSFI;
 - (3) Significant doubt as to the ability of the BSFI to continue as a going concern;
 - (4) Material breach of laws or Bangko Sentral rules and regulations such as but not limited to prescribed capital and liquidity ratios, significant deficiency in allowance for credit losses, material weaknesses in fair value measurement methodology, and significant vulnerabilities to money laundering and combating the financing of terrorism;
 - (5) Material internal control weaknesses which may lead to financial reporting problems; and
 - (6) Findings on matters of corporate governance that may require urgent action by the Bangko Sentral.

Where a thorough investigation or evaluation of facts is necessary on the noted case, an initial report shall be submitted within the prescribed timeline: *Provided*, That a complete report is submitted not later than fifteen (15) calendar days from completion of investigation or evaluation.

In case there are no matters to report, the external auditor shall submit to the appropriate supervising department of the Bangko Sentral, not later than 120 calendar days after the close of the calendar year or the fiscal year adopted by the BSFI, a certification that there is none to report.

- d. The board of directors and management of the BSFI shall be primarily responsible for the financial statements submitted to the Bangko Sentral. External auditors are expected to conduct the audit of financial statements in accordance with the provisions of the Philippine Standards on Auditing.
- e. The external auditor shall directly inform the appropriate supervising department of the Bangko Sentral of the pre-termination of the engagement contract or his/her resignation/replacements as external auditor as well as the reasons thereto, within fifteen (15) calendar days of the pre-termination of the contract or his/her resignation/replacement.

Supervisory Enforcement Action

The Bangko Sentral reserves the right to deploy its range of supervisory enforcement actions to promote adherence with the requirements set forth in this Section and bring about timely corrective actions. For this purpose, the Bangko Sentral may issue directives or impose sanctions on BSFIs and/or its directors/trustees who approved the appointment of the external auditor, who/which are not in the List of Selected External Auditors for BSFIs, and/or for non-compliance with the provisions of this Section. The Bangko Sentral may likewise shorten the period of validity of inclusion of an external auditor in the List of Selected External Auditors for BSFIs, suspend, or delist external auditors from its List of Selected External Auditors for BSFIs based on the results of assessment of the quality of audited financial statements (AFS) as well as non-compliance with the provisions of this Section.

Transitory provisions

- a. External auditors whose inclusion in the List of Selected External Auditors for BSFIs is valid to cover the audit of 2018 financial statements are hereby given one (1) year extension on their inclusion in the List of Selected External Auditors for BSFIs allowing them to engage in the audit of the 2019 financial statements.
- b. All applications (new and renewal) for inclusion in the List of Selected External Auditors for BSFIs to cover in the audit of 2020 financial statements and thereafter shall be filed with the SEC starting June 2019.

Section 2. The provisions in Section 1 is hereby adopted to the newly created Section 4180P and Section 4105C.

Section 3. Section 4191P Records and Reports is hereby amended to read, as follow:

"Section 4191P Records and Reports

X x x

Pawnshop operators shall hire, and/or engage the services of, external auditors, who will assist in the preparation, and/or render an opinion on the fairness, of the pawnshop's financial statements. For holders of "B", "C" and "D" pawnshop operator license issued by the Bangko Sentral they shall engage the services of an external auditor included in List of Selected External Auditors for BSFIs. In this respect, the provisions under Section 4180P shall be adopted.

Section 4. Appendices 39/Q-30/S-8/N-5 are hereby amended and re-named to Guidelines on the Suspension/Delisting of the External Auditor in the List of the Selected External Auditors for BSFIs as shown in Attachment I. This guideline shall also be adopted as Appendix P & C.

Section 5. Section 174/ Subsection 4190Q.3 of the MORB/MORBNBFI on the disclosures of external auditor's adverse findings to the Bangko Sentral are hereby deleted.

Section 6. Effectivity. This Circular shall take effect fifteen (15) calendar days following its publication either in the Official Gazette or in a newspaper of general circulation.

FOR THE MONETARY BOARD:

CC

BENJAMIN E. DIOKNO

Governor

20 May 2019

**Appendix 39/Q-30/S-8/N-5 of the Manual of Regulation for Banks
and Non-Bank Financial Institutions**

**Guidelines on the Suspension/Delisting of External Auditor in the List of Selected
External Auditors for Bangko Sentral Supervised Financial Institutions (BSFIs)**

Section 1. Grounds for Suspension/Delisting of External Auditors

An external auditor included in the List of Selected External Auditors for BSFIs shall be suspended or delisted by the Bangko Sentral, without prejudice to the imposition of other sanctions by the Securities and Exchange Commission (SEC)¹, under any of the following grounds:

- a. Gross negligence in the conduct of the audit or failure to comply with the Philippine Standards on Auditing and such other issuances of the Auditing and Assurance Standards Council;
- b. Issuance of an unqualified opinion which is not supported by full compliance by the auditee with the applicable financial reporting framework due to material deficiencies or misstatements in the financial statements;
- c. Conduct of an audit despite the lack or eventual loss of independence as provided for under the Code of Ethics for Professional Accountants in the Philippines;
- d. Conduct of any non-audit services for his statutory audit clients, if he has not undertaken the safeguards to reduce the threat to his independence;
- e. Any material misrepresentation in the reports submitted to the Bangko Sentral;
- f. Failure to comply with the provisions set forth under Section 164/4189Q/4189T/4189S/4180N;
- g. Refusal for no valid reason, upon lawful order of the Bangko Sentral, to submit requested documents in connection with an ongoing investigation. The external auditor shall, however, be made aware of such investigation; and

¹ Accrediting Agency duly designated by the member-agency of the Financial Sector Forum, comprising of the Bangko Sentral ng Pilipinas, Securities and Exchange Commission, Insurance Commission, and Philippine Deposit Insurance Corporation.

- h. Failure to obtain from the Securities and Exchange Commission an accreditation appropriate to the client's category provided under Section 164/4189Q/4189T/4189S/4180N on the appointment of external auditor.

Section 2. Procedures and Effects of Delisting/Suspension

- a. On the basis of the results of the assessment of the quality of audited financial statements and evidence on the existence of the grounds for suspension or delisting under Section 1 above, the external auditor shall be notified in writing by the appropriate supervising department of the Bangko Sentral of the existence of the ground for his/her suspension or delisting in the List of Selected External Auditors for BSFIs and shall be allowed to submit within fifteen (15) calendar days from receipt of such notice an explanation on why he/she should not be suspended/delisted, together with the evidence in support of his/her position.

An external auditor shall only be suspended or delisted after due notice and opportunity to defend/clear himself/herself.

- b. Failure of the external auditor concerned to reply within the period prescribed under Item "a" above, shall be considered as a waiver on his/her part of the opportunity to defend/clear himself/herself. In this respect, the appropriate supervising department of the Bangko Sentral shall proceed with the evaluation of the case based on available records/evidence.
- c. Upon approval by the Monetary Board, the external auditor concerned shall be informed in writing by the appropriate supervising department of the Bangko Sentral of his/her suspension or delisting in the List of Selected External Auditors for BSFIs.
- d. A suspended or delisted external auditor shall be automatically included in the Bangko Sentral's Watchlist Disqualification File "B" (temporary).
- e. The Securities and Exchange Commission shall be immediately informed of the suspension or delisting of the external auditor.
- f. Suspended external auditors may re-apply for inclusion in the List of the Selected External Auditors for BSFIs after the lapse of five (5) years from the date of effectivity of the suspension.