



Bangko Sentral ng Pilipinas

CIRCULAR NO. 410
Series of 2003

Pursuant to Section 58 of Republic Act No. 8791, otherwise known as "The General Banking Law of 2000", the Monetary Board, in its Resolution No. 1429 dated 2 October 2003, approved the following rules and regulations that shall govern the selection and delisting by the Bangko Sentral ng Pilipinas (BSP) of external auditors of banks, quasi-banks, trust entities, non-stock savings and loan associations (NSSLAs), their subsidiaries and affiliates engaged in allied activities and other financial institutions which under special laws are subject to BSP supervision:

Section 1. STATEMENT OF POLICY

It is the policy of the Bangko Sentral ng Pilipinas (BSP) to promote high ethical and professional standards in public accounting practice and to encourage coordination and sharing of information between external auditors and regulatory authorities of banks, quasi-banks, trust entities and/or NSSLAs to ensure effective audit and supervision of these institutions and to avoid unnecessary duplication of efforts. In furtherance of this policy and to ensure that reliance by regulatory authorities and the public on the opinion of external auditors is well placed, the BSP hereby prescribes the rules and regulations that shall govern the selection, appointment, reporting requirements and delisting for external auditors of banks, quasi-banks, trust entities, NSSLAs, their subsidiaries and affiliates engaged in allied activities and other financial institutions which under special laws are subject to BSP supervision.

Section 2. GENERAL REQUIREMENTS

Only external auditors included in the list of BSP selected external auditors shall be engaged by banks, quasi-banks, trust entities or NSSLAs for regular audit or special engagements. The external auditor to be hired shall also be in-charge of the audit of the entity's subsidiaries and affiliates engaged in allied activities: *Provided*, that the external auditor shall be changed or the lead and concurring partner shall be rotated every five years or earlier: *Provided further*, that the rotation of the lead and concurring partner shall have an interval of at least two (2) years.

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Banks, quasi-banks, trust entities and NSSLAs which have engaged their respective external auditors for a consecutive period of five (5) years or more as of (date of effectivity of this Circular) shall have a one-year period from said date within which to either change their external auditors or rotate the lead and/or concurring partner. The following are the selection requirements for external auditors:

- a. No external auditor may be engaged by a bank, quasi-bank, trust entity or NSSLA if he or any member of his immediate family had or has committed to acquire any direct or indirect financial interest in the bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates, or if his independence is considered impaired under the circumstances specified in the Code of Professional Ethics for Certified Public Accountants. In the case of a partnership, this limitation shall apply to the partners, associates and the auditor-in-charge of the engagement and members of their immediate family;
- b. The external auditor and the members of the audit team do not have/shall not have outstanding loans or any credit accommodations (except credit card obligations which are normally available to other credit card holders and fully secured auto loans and housing loans which are not past due) with the bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates at the time of signing the engagement and during the engagement. In the case of partnership, this prohibition shall apply to the partners and the auditor-in-charge of the engagement;
- c. The external auditor must not be currently engaged nor was engaged during the preceding year in providing the following services to the bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates:
 1. Internal audit functions;
 2. Information systems design, implementation and assessment; and
 3. Such other services which could affect his independence as may be determined by the Monetary Board;
- d. The external auditor, auditor-in-charge and members of the audit team must adhere to the highest standards of professional conduct and shall carry out services in accordance with relevant ethical and technical standards, such as the Generally Accepted Auditing Standards (GAAS) and the Code of Professional Ethics for Certified Public Accountants;

- e. The external auditor should have the following track record in conducting external audits:
1. The external auditor for a universal bank or commercial bank must have at least twenty (20) existing corporate clients with resources of at least P50 million each and at least one (1) existing client universal bank or commercial bank in the regular audit or in lieu thereof, the external auditor or the auditor-in-charge of the engagement must have at least five (5) years experience in the regular audit of universal or commercial banks;
 2. The external auditor for a thrift bank, quasi-bank, trust entity and national cooperative bank must have at least ten (10) existing corporate clients with resources of at least P25 million each and at least one (1) existing client thrift bank, quasi-bank, trust entity or national cooperative bank in the regular audit or in lieu thereof, the external auditor or the auditor-in-charge of the engagement must have at least five (5) years experience in the regular audit of thrift banks, quasi-banks, trust entities or national cooperative banks: *Provided*, that an external auditor who has been selected by the BSP to audit a universal bank or commercial bank is automatically qualified to audit a thrift bank, quasi-bank, trust entity or national cooperative bank; and
 3. The external auditor for a rural bank, NSSLA or local cooperative bank must have at least three (3) years track record in conducting external audit: *Provided*, that an external auditor who has been selected by the BSP to audit a universal bank, commercial bank, thrift bank, quasi-bank, trust entity and national cooperative bank is automatically qualified to audit a rural bank, local cooperative bank and NSSLA;
- f. A bank, quasi-bank, trust entity or NSSLA shall not engage the services of an external auditor whose partner or auditor-in-charge of audit engagement during the preceding year had been hired or employed by the bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates as Chief Executive Officer, Chief Financial Officer, Controller, Chief Accounting Officer or any position of equivalent rank; and
- g. The external auditor must undertake to keep for at least five (5) years all audit or review working papers in sufficient detail to support the conclusions in the audit report which shall be made available to the BSP upon request. Working papers shall include, but shall not be limited to, pre-audit analysis, audit scope and detailed work program.

Section 3. DEFINITION OF TERMS

For purposes of this Circular, the following terms shall be defined as follows:

SUBSIDIARY – a corporation or firm more than fifty percent (50%) of the outstanding voting stock of which is directly or indirectly owned, controlled or held with power to vote by a bank, quasi-bank, trust entity or NSSLA.

AFFILIATE – a corporation, not more than fifty percent (50%) but not less than ten percent (10%) of the outstanding voting stock of which is directly or indirectly owned, controlled or held with power to vote by a bank, quasi-bank, trust entity or NSSLA and a juridical person that is under common control with the bank, quasi-bank, trust entity or NSSLA.

CONTROL – exists when the parent owns directly or indirectly more than one half of the voting power of an enterprise unless, in exceptional circumstance, it can be clearly demonstrated that such ownership does not constitute control. Control may also exist even when ownership is one half or less of the voting power of an enterprise when there is:

- a. Power over more than one half of the voting rights by virtue of an agreement with other stockholders;
- b. Power to govern the financial and operating policies of the enterprise under a statute or an agreement;
- c. Power to appoint or remove the majority of the members of the board of directors or equivalent governing body;
- d. Power to cast the majority votes at meetings of the board of directors or equivalent governing body; or
- e. Any other arrangement similar to any of the above.

ASSOCIATE – any director, officer, manager or any person occupying a similar status or performing similar functions in the audit firm including employees performing supervisory role in the auditing process.

PARTNER – all partners including those not performing audit engagements.

LEAD PARTNER – also referred to as the engagement partner/partner-in-charge/managing partner who is responsible for signing the audit report on the consolidated financial statements of the audit client, and where relevant, the individual audit report of any entity whose financial statements form part of the consolidated financial statements.

CONCURRING PARTNER - the partner who is responsible for reviewing the audit report.

AUDITOR-IN-CHARGE - refers to the team leader of the audit engagement.

Section 4. APPLICATION AND PRE-QUALIFICATION REQUIREMENTS

The application for BSP selection shall be signed by the external auditor or the managing partner, in case of partnership and shall be submitted to the appropriate supervising and examining department of the BSP together with the following documents/information:

a. An undertaking:

1. That the external auditor, partners, associates, auditor-in-charge of the engagement and the members of their immediate family shall not acquire any direct or indirect financial interest with a bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates. Neither shall the external auditor, partners, associates and auditor-in-charge accept an audit engagement with a bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates where they or any member of their immediate family have any direct or indirect financial interest and that their independence is not considered impaired under the circumstances specified in the Code of Professional Ethics for Certified Public Accountants;
2. That the external auditor, partners, associates, auditor-in-charge and members of the audit team do not have nor shall apply for loans or any credit accommodations (except normal credit card obligations and fully secured auto loans and housing loans) nor shall accept an audit engagement with a bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates where they have outstanding loans or any credit accommodations (except normal credit card obligations and fully secured auto loans and housing loans which are not past due).
3. That the external auditor shall not accept an audit engagement with a bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates where he was engaged during the preceding year in providing the following services:
 - a) Internal audit functions;
 - b) Information systems design, implementation and assessment; and
 - c) Such other services, which could affect his independence as may be determined by the Monetary Board from time to time.

This requirement shall not, however, affect audit engagement existing as of the date of effectivity of this circular.

4. That the external auditor and members of the audit team shall adhere to the highest standards of professional conduct and shall carry out their services in accordance with relevant ethical and technical standards of the accounting profession;
 5. That the lead or concurring partner and auditor-in-charge shall not accept employment with the bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates being audited during the engagement period and within a period of one (1) year after the audit engagement;
 6. That the external auditor shall not accept an audit engagement with a bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates where an officer (i.e., Chief Executive Officer, Chief Financial Officer, Controller, Chief Accounting Officer or other senior officer of equivalent rank) had been a partner of the external auditor or had worked for the audit firm and had been the auditor-in-charge of the audit engagement of said entities during the year immediately preceding the engagement;
 7. That the external auditor shall keep all audit or review working papers for at least five (5) years in sufficient detail to support the conclusions in the audit report; and
 8. That the audit work shall include assessment of the audited institution's compliance with BSP rules and regulations, such as, but not limited to the following:
 - a. Capital adequacy ratio; and
 - b. Loans and other risk assets review and classification.
- c. Other documents/information:
1. List of existing corporate clients with resources of at least P50 million each for external auditor of a universal bank or a commercial bank; for a thrift bank, quasi-bank, trust entity and national cooperative bank, list of existing corporate clients with resources of at least P25 million each; and list of existing clients and/or details of three (3) years track record in external audit for external auditors of a rural bank, NSSLA and a local cooperative bank;

2. If the external auditor for a universal bank or commercial bank has no existing universal bank or commercial bank client, and the external auditor for a thrift bank, quasi-bank, trust entity and national cooperative bank, has no existing client thrift bank, quasi-bank, trust entity or national cooperative bank, a notarized certification that the external auditor or the auditor-in-charge of the engagement has at least five (5) years experience in the regular audit of banks of appropriate category mentioning the banks they have audited;
3. Updated Professional Regulation Commission (PRC) license (for individual auditors) and business license for the partnership;
4. Copy of the proposed engagement contract between the bank, quasi-bank, trust entity or NSSLA and the external auditor where applicable; and
5. Certification from PRC that the external auditor, lead partner, concurring partner, auditor-in-charge and members of the audit team have no derogatory information, previous conviction or any pending investigation. However, in the event that the certification cannot be obtained because of the pendency of a case, the BSP may dispense with this requirement upon determination by the Monetary Board that the case involves purely legal question, or does not, in any way, negate the auditor's adherence to the highest standards of professional conduct nor degrade his integrity and objectivity.

Section 5. INCLUSION IN BSP LIST

In case of partnership, inclusion in the list of BSP selected external auditors shall apply to the audit firm only and not to the individual signing partners or auditors under its employment. The BSP will circularize to all banks, quasi-banks, trust entities and NSSLAs the list of selected external auditors once a year. The BSP, however, shall not be liable for any damage or loss that may arise from its selection of the external auditors to be engaged by banks, quasi-banks, trust entities or NSSLAs for regular audit or special engagements.

Section 6. SPECIFIC REVIEW

When warranted by supervisory concern, the Monetary Board may, at the expense of the bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates require the external auditor to undertake a specific review of a particular aspect of the operations of these institutions. The report shall be submitted to the BSP and the audited institution simultaneously, within thirty (30) calendar days after the conclusion of said review.

Section 7. REQUIRED REPORTS

- a. To enable the BSP to take timely and appropriate remedial action, the external auditor must report to the BSP within thirty (30) calendar days after discovery, the following cases:
 1. Any material finding involving fraud or dishonesty (including cases that were resolved during the period of audit); and
 2. Any potential losses the aggregate of which amounts to at least one percent (1%) of the capital.
- b. The external auditor shall report directly to the BSP within fifteen (15) calendar days the occurrence of the following:
 1. Termination or resignation as external auditor and stating the reason therefor;
 2. Discovery of a material breach of laws or BSP rules and regulations such as, but not limited to:
 - a. Capital adequacy ratio; and
 - b. Loans and other risk assets review and classification.
 3. Findings on matters of corporate governance that may require urgent action by the BSP.

The management of the bank, quasi-bank, trust entity, NSSLA, its subsidiaries and affiliates shall be informed of the adverse findings and the external auditor's report to the BSP shall include its explanation and/or corrective action.

The management of the bank, quasi-bank, trust entity, NSSLAs, its subsidiaries and affiliates shall be given the opportunity to be present in the discussions between the BSP and the external auditor regarding the audit findings, except in circumstances where the external auditor believes that the entity's management is involved in fraudulent conduct.

Section 8. AUDIT ENGAGEMENT CONTRACT

Banks, quasi-banks, trust entities and NSSLAs shall submit the audit engagement contract between them, their subsidiaries and affiliates and the external auditor to the appropriate supervising and examining department of the BSP within fifteen (15) calendar days from signing thereof. Said contract shall include the following provisions:

- a. That the bank, quasi-bank, trust entity or NSSLAs shall be responsible for keeping the auditor fully informed of existing and subsequent changes to prudential, regulatory and statutory requirements of the BSP and that both parties shall comply with said requirements;
- b. That disclosure of information by the external auditor to the BSP as required under Sections 6 and 7 hereof, shall be allowed; and
- c. That both parties shall comply with all of the requirements under this Circular.

Section 9. DELISTING OF EXTERNAL AUDITORS

a. GROUNDS FOR DELISTING

External auditors may be delisted from the list of BSP selected external auditor for the bank, quasi-bank, trust entity or NSSLAs for violation of, or non-compliance with any provision of this Circular or in case of dissolution of the audit firm except when said dissolution was solely for the purpose of admitting new partner/s and the new partner/s have complied with the requirements of this Circular.

b. PROCEDURE FOR DELISTING

An external auditor shall only be delisted upon prior notice to him and after giving him the opportunity to be heard and defend himself by presenting witnesses/evidence in his favor. Delisted external auditor may re-apply for BSP selection after the period prescribed by the Monetary Board.

Section 10. AUDIT BY THE BOARD OF DIRECTORS.

Pursuant to Section 58 of R.A. NO. 8791, otherwise known as "The General Banking Law of 2000" the Monetary Board may also direct the board of directors of a bank, quasi-bank, trust entity, NSSLA or the individual members thereof, to conduct, either personally or by a committee created by the board, an annual balance sheet audit of the bank, quasi-bank, trust entity or NSSLA to review the internal audit and the internal control system of the concerned entity and to submit a report of such audit to the Monetary Board within thirty (30) calendar days after the conclusion thereof.

Section 11. SANCTIONS

The applicable sanctions/penalties prescribed under Sections 36 and 37 of Republic Act No. 7653 to the extent applicable shall be imposed on the bank, quasi-bank, trust entity, NSSLA, its audit committee and the directors approving the hiring of external auditors who are not in the BSP list of selected auditors for bank, quasi-bank, trust entity and NSSLA or for hiring, and/or retaining the services of the external auditor in violation of any of the provisions of this Circular and for non-compliance with the Monetary Board directive under Section 10 above. Erring external auditors may also be reported by the BSP to the PRC for appropriate disciplinary action.

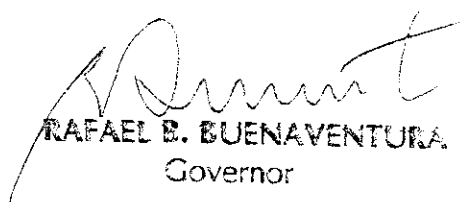
Section 12. REPEALING CLAUSE

This Circular repeals BSP Circular No. 245 dated 25 May 2000 as amended by Circular No. 318 dated 30 January 2002.

Section 13. EFFECTIVITY

This Circular shall take effect after fifteen (15) days following its publication either in the Official Gazette or in any newspaper of general circulation.

FOR THE MONETARY BOARD:


RAFAEL B. BUENAVENTURA
Governor

October 29 2003