

174 AUDITED FINANCIAL STATEMENTS

The following rules shall govern the utilization and submission of AFS of banks.

For purposes of this Section, AFS shall include the balance sheets, income statements, statements of changes in equity, statements of cash flows and notes to financial statements which shall include among other information, disclosure of the volume of past due loans as well as loan-loss provisions. On the other hand, financial audit report shall refer to the AFS and the opinion of the auditor. The AFS of banks with subsidiaries shall be presented side by side on a solo basis (parent) and on a consolidated basis (parent and subsidiaries).

Financial audit. Banks shall cause an annual financial audit by an external auditor acceptable to the Bangko Sentral not later than thirty (30) calendar days after the close of the calendar year or the fiscal year adopted by the bank. Report of such audit shall be submitted to the board of directors or country head, in the case of foreign bank branches, and 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 bank. The report to the Bangko Sentral shall be accompanied by the:

- a. Certification by the external auditor on the: (1) dates of start and termination of audit; (2) date of submission of the financial audit report and certification under oath stating that no material weakness or breach in the internal control and risk management systems was noted in the course of the audit of the bank to the board of directors or country head; and (3) the absence of any direct or indirect financial interest and other circumstances that may impair the independence of the external auditor;
- b. Reconciliation Statement between the AFS and the balance sheet and income statement for bank proper (regular and FCDO) and trust department submitted to the Bangko Sentral including copies of adjusting entries on the reconciling items; and
- c. Other information that may be required by the Bangko Sentral.

In addition, the external auditor shall be required by the bank to submit to the board of directors or country head, a LOC indicating any material weakness or breach in the institution's internal control and risk management systems within thirty (30) calendar days after submission of the financial audit report. If no material weakness or breach is noted to warrant the issuance of an LOC, a certification under oath stating that no material weakness or breach in the internal control and risk management systems was noted in the course of the audit of the bank shall be submitted in its stead, together with the financial audit report.

Material weakness shall be defined as a significant control deficiency, or combination of deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be detected or prevented by the entity's internal control. A material weakness does not mean that a material misstatement has occurred or will occur, but that it could occur. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles. The phrase *more than remote likelihood* shall mean that future events are likely to occur or are reasonably possible to occur.

The board of directors, in a regular or special meeting, shall consider and act on the financial audit report and the certification under oath submitted in lieu of the LOC and shall submit, within thirty (30) banking days after receipt of the reports, a copy of its resolution to the appropriate supervising department of the Bangko Sentral. The resolution shall show, among other things, the actions(s) taken on the reports and the names of the directors present and absent.

The board shall likewise consider and act on the LOC and shall submit, within thirty (30) banking days after receipt thereof, a copy of its resolution together with said LOC to the appropriate supervising department of the Bangko Sentral. The resolution shall show the action(s) taken on the findings and recommendations and, the names of the directors present and absent, among other things.

The country head of foreign banks with branches in the Philippines shall submit a report on the action taken by management (head office, regional, or country, as the case may be) on the financial audit report and the certification under oath submitted in lieu of the LOC within thirty (30) banking days after receipt thereof.

The country head shall likewise submit a report on the action taken by management on the LOC within thirty (30) banking days after receipt thereof.

The LOC shall be accompanied by the certification of the external auditor of the date of its submission to the board of directors or country head, as the case may be.

Government-owned or-controlled banks, including their subsidiaries and affiliates under Bangko Sentral supervision, which are under the concurrent jurisdiction of the Commission on Audit (COA) shall be exempt from the aforementioned annual financial audit by an acceptable external auditor: *Provided*, That when warranted by supervisory concern such as material weakness/breach in internal control and/or risk management systems, the Monetary Board may, upon recommendation of the appropriate supervising department of the Bangko Sentral, require the financial audit to be conducted by an

external auditor acceptable to the Bangko Sentral, at the expense of the institution concerned: *Provided, further,* That when circumstances such as, but not limited to loans from multilateral FIs, privatization, or public listing warrant, the financial audit of the institution concerned by an acceptable external auditor may also be allowed.

Banks under the concurrent jurisdiction of the Bangko Sentral and COA shall, however, submit a copy of the annual audit report (AAR) of the COA to the appropriate supervising department of the Bangko Sentral within forty (40) calendar days after receipt of the AAR by the board of directors. The AAR shall be accompanied by the:

- a. certification by the institution concerned on the date of receipt of the AAR by the board of directors;
- b. reconciliation statement between the AFS in the AAR and the balance sheet and income statement of bank proper (regular and FCDU) and trust department submitted to the Bangko Sentral, including copies of adjusting entries on the reconciling items; and
- c. other information that may be required by the Bangko Sentral.

The board of directors of said institutions, in a regular or special meeting, shall consider and act on the AAR, as well as on the comments and observations and shall submit, within thirty (30) banking days after receipt of the report, a copy of its resolution to the appropriate supervising department of the Bangko Sentral. The resolution shall show the action(s) taken on the report, including on the comments and observations and the names of the directors present and absent, among other things.

The financial audit report required to be submitted shall in all respect be PFRS/PAS compliant: *Provided,* That banks shall submit to the Bangko Sentral adjusting entries reconciling the balances in the financial statements for prudential reporting with that in the audited annual financial statements.

Banks as well as external auditors shall strictly observe the requirements in the submission of the financial audit report and reports required to be submitted under *Appendix 55*.

The reports and certifications of institutions concerned, schedules and attachments required under this Section shall be considered *Category B* reports, wherein Delayed/Unsubmitted reports are subject to the penalties under Sec. 171 (*Sanctions on reports for non-compliance with the reporting standards*).

Posting of audited financial statements. Local banks shall post in conspicuous places in their head offices, all their branches and other banking offices, as well as in their respective websites, their latest financial audit report.

The abovementioned documents shall also be posted by foreign bank branches in all their banking offices in the Philippines.

Disclosure of external auditor's adverse findings to the Bangko Sentral; sanction.

a. *Findings to be disclosed.* Banks shall require their external auditors to report to the Bangko Sentral any matter adversely affecting the condition or soundness of the bank, such as, but not limited to:

- (1) Any serious irregularity, including those involving fraud or dishonesty, that may jeopardize the interest of depositors and creditors;
- (2) Losses incurred which substantially reduce the capital funds of the bank; and
- (3) Inability of the auditor to confirm that the claims of creditors are still covered by the bank's assets.

The disclosure of information by the external auditor to the Bangko Sentral shall not be a ground for civil, criminal or disciplinary proceedings against the former.

Bank management shall be present during discussions or at least be informed of the adverse findings in order to preserve the concerns of the supervisory authority and external auditors regarding the confidentiality of information.

b. *Sanction.* The auditing firm(s) shall be blacklisted by the Monetary Board for a period as the Board may deem appropriate for their failure to perform their duty of reporting to the Bangko Sentral any matter adversely affecting the condition or soundness of the bank. Banks shall not be allowed to engage the services of the blacklisted auditing firm.

Disclosure requirement in the notes to the audited financial statements. Banks shall require their external auditors to include the following additional information in the notes to financial statements:

a. Basic quantitative indicators of financial performance such as return on average equity, return on average assets and net interest margin;

For purposes of computing the indicators, the following formulas shall be used:

$$(1) \quad \text{Return on Average Equity (\%)} = \frac{\text{Net Income (or Loss) after Income Tax} \times 100}{\text{Average Total Capital Accounts}}$$

	Where: Average Total Capital Accounts	=	Sum of Total Capital Accounts as of the 12-month ends in the <u>calendar/fiscal year adopted by the bank</u> 12
(2)	Return on Average Equity (%)	=	$\frac{\text{Net Income (or Loss) after Income Tax} \times 100}{\text{Average Total Assets}}$
	Where: Average Total Assets	=	Sum of Total Capital Accounts as of the 12-month ends in the <u>calendar/fiscal year adopted by the bank</u> 12
(3)	Net Interest Margin (%)	=	$\frac{\text{Net Interest Income} \times 100}{\text{Average Interest Earning Assets}}$
	Where: Net Interest Income	=	Total Interest Income - Total Interest Expense
	Where: Average Interest Earning Assets	=	Sum of Total Interest Earning Assets as of the 12-month ends in the <u>calendar/fiscal year adopted by the bank</u> 12

- b. Risk-based capital adequacy ratio under Section 34 of R.A. No. 8791 and applicable and existing capital adequacy framework;
- c. Concentration of credit as to industry/economic sector where concentration is said to exist when total loan exposures to a particular industry/economic sector exceeds thirty percent (30%) of total loan portfolio;
- d. Breakdown of total loans as to secured and unsecured and breakdown of secured loans as to type of security;
- e. Total outstanding loans to bank's DOSRI, percent of DOSRI loans to total loan portfolio, percent of unsecured DOSRI loans to total DOSRI loans, percent of past due DOSRI loans to total DOSRI loans and percent of non-performing DOSRI loans to total DOSRI loans;
- f. Nature and amount of contingencies and commitments arising from off-balance sheet items [include direct credit substitutes (e.g., export LCs confirmed, underwritten accounts unsold), transaction-related contingencies (e.g., performance bonds, bid bonds, standby LCs), short-term self-liquidating trade-related contingencies arising from the movement of goods (e.g., sight/usance domestic LCs, sight/usance import LCs), sale and repurchase agreements not recognized in the balance sheet; interest and foreign exchange rate related items; and other commitments];
- g. Provisions and allowances for losses and how these are determined;

- h. Aggregate amount of secured liabilities and assets pledged as security; and
- i. Accounting policies which shall include, but shall not be limited to, general accounting principles, changes in accounting policies/practices, principles of consolidation, policies and methods for determining when assets are impaired, recognizing income on impaired assets and losses on non-performing credits, income recognition, valuation policies and accounting policies on securitizations, foreign currency translations, loan fees, premiums and discounts, repurchase agreements, premises/fixed assets, income taxes and derivatives.

(Circular Nos. 963 dated 27 June 2017, 957 dated 17 April 2017, 890 dated 02 November 2015, and 827 dated 28 February 2014)