

**GUIDELINES TO GOVERN THE SELECTION, APPOINTMENT, REPORTING
REQUIREMENTS AND DELISTING OF EXTERNAL AUDITORS AND/OR AUDITING FIRM
OF COVERED ENTITIES**

(Appendix to Sec. 164 and Sec. 112 on Authority to outsource)

Pursuant to Section 58 of the Republic Act No. 8791, otherwise known as “The General Banking Law of 2000”, and the existing provisions of the executed Memorandum of Agreement (hereinafter referred to as the MOA) dated 12 August 2009, binding the Bangko Sentral, Securities and Exchange Commission (SEC), Professional Regulation Commission (IC) – Board of Accountancy (BOA) and the Insurance Commission (IC) for a simplified and synchronized accreditation requirements for external auditor and/or auditing firm, the Monetary Board, in its Resolution No. 950 dated 02 July 2009, approved the following revised rules and regulations that shall govern the selection and delisting by the Bangko Sentral of external auditors and auditing firms of covered institution which under special laws are subject to Bangko Sentral supervision.

A. STATEMENT OF POLICY

It is the policy of the Bangko Sentral to ensure effective audit and supervision of banks, QBs, trust entities and/or NSSLAs including their subsidiaries and affiliates engaged in allied activities and other FIs which under special laws are subject to Bangko Sentral supervision, and to ensure reliance by Bangko Sentral and the public on the opinion of external auditors and auditing firms by prescribing the rules and regulations that shall govern the selection, appointment, reporting requirements and delisting for external auditors and auditing firms of said institutions, subject to the binding provisions and implementing regulations of the aforesaid MOA.

B. COVERED ENTITIES

The proposed amendment shall apply to the following supervised institution, as categorized below, and their external auditors:

1. *Category A*

- a. UBs/KBs;
- b. Foreign banks and branches or subsidiaries of foreign banks, regardless of unimpaired capital; and
- c. Banks, trust department of qualified banks and other trust entities with additional derivatives authority, pursuant to Section 613 regardless of classification, category and capital position.

2. *Category B*

- a. TBs;
- b. QBs;
- c. Trust department of qualified banks and other trust entities;
- d. National Coop Banks; and
- e. NBFIs with quasi-banking functions.

3. *Category C*

- a. RBs;
- b. NSSLAs;
- c. Local Coop Banks; and
- d. Pawnshops.

The above categories include their subsidiaries and affiliates engaged in allied activities and other FIs which are subject to Bangko Sentral risk-based and consolidated supervision: *Provided*, That an external auditor who has been selected by the Bangko Sentral to audit covered entities under *Category A* is automatically qualified to audit entities under *Category B* and *C* and if selected by the Bangko Sentral to audit covered entities under *Category B* is automatically qualified to audit entities under *Category C*.

C. DEFINITION OF TERMS

The following terms shall be defined as follows:

1. *Audit* – an examination of the financial statements of any issuer by an external auditor in compliance with the rules of the Bangko Sentral or the SEC in accordance with then applicable generally accepted auditing and accounting principles and standards, for the purpose of expressing an opinion on such statements.
2. *Non-audit services* – any professional services provided to the covered institution by an external auditor, other than those provided to a covered institution in connection with an audit or a review of the financial statements of said covered institution.
3. *Professional Standards* – includes:
 - (a) accounting principles that are (1) established by the standard setting body; and (2) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

- (b) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards that the Bangko Sentral or SEC determines (1) relate to the preparation or issuance of audit reports for issuers; and (2) are established or adopted by the Bangko Sentral or promulgated as SEC rules.
4. *Fraud* – an intentional act by one (1) or more individuals among management, employees, or third parties that results in a misrepresentation of financial statements, which will reduce the consolidated total assets of the company by five percent (5%). It may involve:
- a. Manipulation, falsification or alteration of records or documents;
 - b. Misappropriation of assets;
 - c. Suppression or omission of the effects of transactions from records or documents;
 - d. Recording of transactions without substance;
 - e. Intentional misapplication of accounting policies; or
 - f. Omission of material information.
5. *Error* – an intentional mistake in financial statements, which will reduce the consolidated total assets of the company by five percent (5%). It may involve:
- a. Mathematical or clerical mistakes in the underlying records and accounting data;
 - b. Oversight or misinterpretation of facts; or
 - c. Unintentional misapplication of accounting policies.
6. *Gross negligence* – wanton or reckless disregard of the duty of due care in complying with generally accepted auditing standards.
7. *Material fact/information* – any fact/information that could result in a change in the market price or value of any of the issuer’s securities, or would potentially affect the investment decision of an investor.
8. *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, QB, trust entity or NSSLA.
9. *Affiliate* – 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, QB, trust entity or NSSLA and a juridical person that is under common control with the bank, QB, trust entity or NSSLA.

10. *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; or
- d. Power to cast the majority votes at meetings of the board of directors or equivalent governing body.

11. *External auditor* – means a single practitioner or a signing partner in an auditing firm.

12. *Auditing firm* – includes a proprietorship, partnership limited liability company, limited liability partnership, corporation (if any), or other legal entity, including any associated person of any of these entities, that is engaged in the practice of public accounting or preparing or issuing audit reports.

13. *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.

14. *Partner* – all partners including those not performing audit engagements.

15. *Lead partner* – also referred to as 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.

16. *Concurring partner* – the partner who is responsible for reviewing the audit report.

17. *Auditor-in-charge* – refers to the team leader of the audit engagement.

D. GENERAL CONSIDERATION AND LIMITATIONS OF THE SELECTION PROCEDURES

1. Subject to mutual recognition provision of the MOA and as implemented in this regulation, only external auditors and auditing firms included in the list of Bangko Sentral selected external auditors and auditing firms shall be engaged by all the covered institutions detailed in Item "B". The external auditor and/or auditing firm 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 and/or auditing firm shall be changed or the lead and concurring partner shall be rotated every five (5) years or earlier: *Provided further*, That the rotation of the lead and concurring partner shall have an interval of at least two (2) years.
2. Category A covered entities which have engaged their respective external auditors and/or auditing firm for a consecutive period of five (5) years or more as of 18 September 2009 shall have a one (1)-year period from said date within which to either change their external auditors and/or auditing firm or to rotate the lead and/or concurring partner.
3. The selection of the external auditors and/or auditing firm does not exonerate the covered institution or said auditors from their responsibilities. Financial statements filed with the Bangko Sentral are still primarily the responsibility of the management of the reporting institution and accordingly, the fairness of the representations made therein is an implicit and integral part of the institution's responsibility. The independent certified public accountant's responsibility for the financial statements required to be filed with the Bangko Sentral is confined to the expression of his opinion, or lack thereof, on such statements which he has audited/ examined.
4. The Bangko Sentral shall not be liable for any damage or loss that may arise from its selection of the external auditors and/or auditing firm to be engaged by banks for regular audit or non-audit services.
5. Pursuant to paragraph (5) of the MOA, SEC, Bangko Sentral and IC shall mutually recognize the accreditation granted by any of them for external auditors and firms of Group C or D companies under SEC, Category B and C under Bangko Sentral, and insurance brokers under IC. Once accredited/ selected by any one (1) of them, the above- mentioned special requirements shall no longer be prescribed by the other regulators.

For corporations which are required to submit financial statements to different regulators and are not covered by the mutual recognition policy of this MOA, the following guidance shall be observed:

- a. The external auditors of UBs which are listed in the Exchange, should be selected/accredited by both the Bangko Sentral and SEC, respectively; and

- b. For insurance companies and banks that are not listed in the Exchange, their external auditors must each be selected/ accredited by Bangko Sentral or IC, respectively. For purposes of submission to the SEC, the financial statements shall be at least audited by an external auditor registered/accredited with BOA.

This mutual recognition policy shall however be subject to the Bangko Sentral restriction that for banks and its subsidiary and affiliate bank, QBs, trust entities, NSSLAs, their subsidiaries and affiliates engaged in allied activities and other FIs which under special laws are subject to Bangko Sentral consolidated supervision, the individual and consolidated financial statements thereof shall be audited by only one (1) external auditor/auditing firm.

6. The selection of external auditors and/or auditing firm shall be valid for a period of three (3) years. The appropriate supervising department of the Bangko Sentral shall make an annual assessment of the performance of external auditors and/or auditing firm and will recommend deletion from the list even prior to the three (3)-year renewal period, if based on assessment, the external auditors' report did not comply with Bangko Sentral requirements.

E. QUALIFICATION REQUIREMENT

1. Individual external auditor

a. General requirements

- (1) The individual applicant must be primarily accredited by the BOA. The individual external auditor or partner in-charge of the auditing firm must have at least five (5) years of audit experience.

- (2) Auditor's independence.

In addition to the basic screening procedures of BOA on evaluating auditor's independence, the following are required for Bangko Sentral purposes to be submitted in the form of notarized certification that:

- (a) No external auditor may be engaged by any of the covered institutions under Item "B" hereof if he or any member of his immediate family had or has committed to acquire any direct or indirect financial interest in the concerned covered institution, or if his independence is considered impaired under the circumstances specified in the Code of Professional Ethics for CPAs. In 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 does not have/ shall not have outstanding loans or any credit accommodations or arranged for the extension of credit or to renew an extension of credit (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 covered institutions under Item "B" 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; and
- (c) It shall be unlawful for an external auditor to provide any audit service to a covered institution if the covered institution's CEO, CFO, Chief Accounting Officer (CAO), or comptroller was previously employed by the external auditor and participated in any capacity in the audit of the covered institution during the one-year preceding the date of the initiation of the audit;

- (3) Individual applications as external auditor of entities under Category A above must have established adequate quality assurance procedures, such consultation policies and stringent quality control, to ensure full compliance with the accounting and regulatory requirements.

b. Specific requirements

- (1) At the time of application, regardless of the covered institution, the external auditor shall have at least five (5) years experience in external audits;
- (2) The audit experience above refers to experience required as an associate, partner, lead partner, concurring partner or auditor-in-charge; and
- (3) At the time of application, the applicant must have the following track record:
 - (a) For Category A, he/she must have at least five (5) corporate clients with total assets of at least P50.0 million each.
 - (b) For Category B, he/she must have had at least three (3) corporate clients with total assets of at least P25.0 million each.
 - (c) For Category C, he/she must have had at least three (3) corporate clients with total assets of at least P5.0 million each;

2. Auditing firms

- a. The auditing firm must be primarily accredited by the BOA and the name of the firm's applicant partner's should appear in the attachment to the certificate of accreditation issued

- by BOA. Additional partners of the firm shall be furnished by BOA to the concerned regulatory agencies (e.g. Bangko Sentral, SEC and IC) as addendum to the firm's accreditation by BOA.
- b. Applicant firms to act as the external auditor of entities under *Category A* in Item "B" must have established adequate quality assurance procedures, such consultation policies and stringent quality control, to ensure full compliance with the accounting and regulatory requirements.
 - c. At the time of application, the applicant firm must have at least one (1) signing practitioner or partner who is already selected/accredited, or who is already qualified and is applying for selection by Bangko Sentral.
 - d. A registered accounting/auditing firm may engage in any non-auditing service for an audit client only if such service is approved in advance by the client's audit committee. Exemptions from the prohibitions may be granted by the Monetary Board on a case-by-case basis to the extent that such exemption is necessary or appropriate in the public interest. Such exemptions are subject to review by the Bangko Sentral.
 - e. At the time of application, the applicant firm must have the following track record:
 - (1) For *Category A*, the applicant firm must have had at least twenty (20) corporate clients with total assets of at least P50.0 million each;
 - (2) For *Category B*, the applicant firm must have had at least five (5) corporate clients with total assets of at least P20.0 million each;
 - (3) For *Category C*, the applicant firm must have had at least five (5) corporate clients with total assets of at least P5.0 million each.

H. REPORTORIAL REQUIREMENTS

- 1. To enable the Bangko Sentral to take timely and appropriate remedial action, the external auditor and/or auditing firm must report to the Bangko Sentral within thirty (30) calendar days after discovery, the following cases:
 - a. Any material finding involving fraud or dishonesty (including cases that were resolved during the period of audit);
 - b. Any potential losses the aggregate of which amounts to at least one percent (1%) of the capital;
 - c. Any finding to the effect that the consolidated assets of the company, on a going concern basis, are no longer adequate to cover the total claims of creditors; and

- d. Material internal control weaknesses which may lead to financial reporting problems.
2. The external auditor/auditing firm shall report directly to the Bangko Sentral within fifteen (15) calendar days from the occurrence of the following:
 - a. Termination or resignation as external auditor and stating the reason therefor;
 - b. Discovery of a material breach of laws or Bangko Sentral rules and regulations such as, but not limited to:
 - (1) CAR; and
 - (2) Loans and other risk assets review and classification.
 - c. Findings on matters of corporate governance that may require urgent action by the Bangko Sentral.
 3. In case there are no matters to report (e.g. fraud, dishonesty, breach of laws, etc.) the external auditor/auditing firm shall submit directly to Bangko Sentral within fifteen (15) calendar days after the closing of the audit engagement a notarized certification that there is none to report.

The management of the covered institutions, including its subsidiaries and affiliates, shall be informed of the adverse findings and the report of the external auditor/auditing firm to the Bangko Sentral shall include pertinent explanation and/or corrective action.

The management of the covered institutions, including its subsidiaries and affiliates, shall be given the opportunity to be present in the discussions between the BSP and the external auditor/auditing firm regarding the audit findings, except in circumstances where the external auditor believes that the entity's management is involved in fraudulent conduct.

It is, however, understood that the accountability of an external auditor/ auditing firm is based on matters within the normal coverage of an audit conducted in accordance with generally accepted auditing standards and identified non-audit services.

I. DELISTING AND SUSPENSION OF SELECTED EXTERNAL AUDITOR/ AUDITING FIRM

1. An external auditor's duly selected pursuant to this regulation shall be suspended or delisted, in a manner provided under this regulation, under any of the following grounds:
 - a. Failure to submit the report under Item "H" of this Appendix or the required reports under Section 174 (Financial Audit);

- b. Continuous conduct of audit despite loss of independence as provided under Item "E.1" or contrary to the requirements under the Code of Professional Ethics;
 - c. Any willful misrepresentation in the following information/documents;
 - (1) application and renewal for accreditation;
 - (2) report required under Item "H"; and
 - (3) Notarized certification of the external auditor and/or auditing firm.
 - d. The BOA found that, after due notice and hearing, the external auditor committed an act discreditable to the profession as specified in the Code of Professional Ethics for CPAs. In this case, the BOA shall inform the Bangko Sentral of the results thereof;
 - e. Declaration of conviction by a competent court of a crime involving moral turpitude, fraud (as defined in the Revised Penal Code), or declaration of liability for violation of the banking laws, rules and regulation, the Corporation Code of the Philippines, the Securities Regulation Code (SRC); and the rules and regulations of concerned regulatory authorities;
 - f. Refusal for no valid reason, upon lawful order of the Bangko Sentral, to submit the requested documents in connection with an ongoing investigation. The external auditor should however been made aware of such investigation;
 - g. Gross negligence in the conduct of audits which would result, among others, in non-compliance with generally accepted auditing standards in the Philippines or issuance of an unqualified opinion which is not supported with full compliance by the auditee with generally accepted accounting principles in the Philippines (GAAP). Such negligence shall be determined by the Bangko Sentral after proper investigation during which the external auditor shall be given due notice and hearing;
 - h. Conduct of any of the non-audit services enumerated under Item "E.1" for his statutory audit clients, if he has not undertaken the safeguards to reduce the threat to his independence; and
 - i. Failure to comply with the Philippine Auditing Standards and Philippine Auditing Practice Statements.
2. An auditing firms; accreditation shall be suspended or delisted, after due notice and hearing, for the following grounds:

- a. Failure to submit the report under Item “H” or the required reports under Section 174 (*Financial Audit*).
- b. Continuous conduct of audit despite loss of independence of the firm as provided under this regulation and under the Code of Professional Ethics;
- c. Any willful misrepresentation in the following information/ documents;
 - (1) Application and renewal for accreditation;
 - (2) Report required under Item “H”; and
 - (3) Notarized certification of the managing partner of the firm.
- d. Dissolution of the auditing firm/ partnership, as evidenced by an Affidavit of Dissolution submitted to the BOA, or upon findings by the Bangko Sentral that the firm/partnership is dissolved. The accreditation of such firm/partnership shall however be reinstated by the Bangko Sentral upon showing that the said dissolution was solely for the purpose of admitting new partner/s have complied with the requirements of this regulation and thereafter shall be reorganized and re-registered;
- e. There is a showing that the accreditation of the following number or percentage of external auditors, whichever is lesser, have been suspended or delisted for whatever reason, by the Bangko Sentral:
 - (1) at least ten (10) signing partners and currently employed selected/accredited external auditors, taken together; or
 - (2) such number of external auditors constituting fifty percent (50%) or more of the total number of the firm’s signing partners and currently selected/accredited auditors, taken together.
- f. The firm or any one (1) of its auditors has been involved in a major accounting/ auditing scam or scandal. The suspension or delisting of the said firm shall depend on the gravity of the offense or the impact of said scam or scandal on the investing public or the securities market, as may be determined by the Bangko Sentral;
- g. The firm has failed reasonably to supervise an associated person and employed auditor, relating to the following:
 - (1) auditing or quality control standards, or otherwise, with a view to preventing violations of this regulations;

- (2) provisions under SRC relating to preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto;
- (3) the rules of the Bangko Sentral under this Appendix; or
- (4) professional standards.

h. Refusal for no valid reason, upon order of the Bangko Sentral, to submit requested documents in connection with an ongoing investigation. The firm should however be made aware of such investigation.

3. Pursuant to paragraph 8 of the aforesaid MOA, the SEC, Bangko Sentral and IC shall inform BOA of any violation by an accredited/selected external auditor which may affect his/her accreditation status as a public practitioner. The imposition of sanction by BOA on an erring practitioner shall be without prejudice to the appropriate penalty that the SEC, IC or Bangko Sentral may assess or impose on such external auditor pursuant to their respective rules and regulations. In case of revocation of accreditation of a public practitioner by BOA, the accreditation by SEC, Bangko Sentral and IC shall likewise be automatically revoked/derecognized.

The SEC, Bangko Sentral and IC shall inform each other of any violation committed by an external auditor who is accredited/selected by any one (1) or all of them. Each agency shall undertake to respond on any referral or endorsement by another agency within ten (10) working days from receipt thereof.

4. Procedure and Effects of Delisting/ Suspension.

- a. An external auditor/auditing firm shall only be delisted upon prior notice to him/it and after giving him/it the opportunity to be heard and defend himself/itself by presenting witnesses/evidence in his favor. Delisted external auditor and/or auditing firm may re-apply for Bangko Sentral selection after the period prescribed by the Monetary Board.
- b. Bangko Sentral shall keep a record of its proceeding/investigation. Said proceedings/investigation shall not be public, unless otherwise ordered by the Monetary Board for good cause shown, with the consent of the parties to such proceedings.
- c. A determination of the Monetary Board to impose a suspension or delisting under this section shall be supported by a clear statement setting forth the following:
 - (1) Each act or practice in which the selected/accredited external auditor or auditing firm, or associated entry, if applicable, has engaged or omitted to engage, or that forms a basis for all or part of such suspension/delisting;

- (2) The specific provision/s of this regulation, the related SEC rules or professional standards which the Monetary Board determined as has been violated; and
 - (3) The imposed suspension or delisting, including a justification for either sanction and the period and other requirements specially required within which the delisted auditing firm or external auditor may apply for re-accreditation.
- d. The suspension/delisting, including the sanctions/penalties provided in Section 164 shall only apply to:
- (1) Intentional or knowing conduct, including reckless conduct, that results in violation or applicable statutory, regulatory or professional standards; or
 - (2) Repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory or professional standards.
- e. No associate person or employed auditor of a selected/accredited auditing firm shall be deemed to have failed reasonably to supervise any other person for purpose of Item "1.2.g" above, if:
- (1) There have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of Bangko Sentral and that would reasonably be expected to prevent and detect any such violation by such associated person; and
 - (2) Such person or auditor has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system, and had no reasonable cause to believe that such procedures and system were not being complied with.
- f. The Bangko Sentral shall discipline any selected external auditor that is suspended or delisted from being associated with any selected auditing firm, or for any selected auditing firm that knew, or in the exercise or reasonable care should have known, of the suspension or delisting of any selected external auditor, to permit such association, without the consent of the Monetary Board.
- g. The Bangko Sentral shall discipline any covered institution that knew or in the exercise of reasonable care should have known, of the suspension or delisting of its external auditor or auditing firm, without the consent of the Monetary Board.
- h. The Bangko Sentral shall establish for appropriate cases an expedited procedure for

consideration and determination of the question of the duration of stay of any such disciplinary action pending review of any disciplinary action of the Bangko Sentral under this Section.

When warranted by supervisory concern, the Monetary Board may, at the expense of the covered institution require the external auditor and/or auditing firm to undertake a specific review of a particular aspect of the operations of these institutions. The report shall be submitted to the Bangko Sentral and the audited institution simultaneously, within thirty (30) calendar days after the conclusion of said review.

K. AUDIT BY THE BOARD OF DIRECTORS

Pursuant to Section 58 of RA. No. 8791, otherwise known as “The General Banking Law of 2000” the Monetary Board may also direct the board of directors of a covered institution or the individual members thereof, to conduct, either personally or by a committee created by the board, an annual balance sheet audit of the covered institution 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.

L. AUDIT ENGAGEMENT

Covered institutions shall submit the audit engagement contract between them, their subsidiaries and affiliates and the external auditor/auditing firm to the appropriate department of the SES within fifteen (15) calendar days from signing thereof. Said contract shall include the following provisions:

1. That the covered institution shall be responsible for keeping the auditor fully informed of existing and subsequent changes to prudential regulatory and statutory requirements of the Bangko Sentral and that both parties shall comply with said requirements;
2. That disclosure of information by the external auditor/auditing firm to the Bangko Sentral as required under Items “H” and “J” hereof, shall be allowed; and
3. That both parties shall comply with all the requirements under this Appendix.

(Circular No. 660 dated 25 August 2009)