CIRCULAR LETTER

TO: ALL EXTERNAL AUDITORS, AUDITING FIRMS AND INSURANCE COMMISSION (IC) REGULATED ENTITIES

SUBJECT: REVISED FRAMEWORK ON THE SELECTION OF EXTERNAL AUDITORS

WHEREAS, the Insurance Commissioner under Section 437 of Republic Act (R.A.) No. 10607 (Amended Insurance Code) may issue such rulings, instructions, circulars, orders and decisions as may be deemed necessary to secure enforcement of R.A. No. 10607, to ensure efficient regulation of the insurance industry in accordance with global practices and to protect the insuring public;

WHEREAS, the last paragraph of Section 347 of the Amended Insurance Code provides that no external auditor shall be engaged by supervised persons or entities unless it has been issued an accreditation certificate by the Commissioner. The accreditation certificate shall be valid until December 31 of the third (3rd) year from issuance unless it is revoked or suspended. The Commissioner shall issue rules and regulations to govern the accreditation of the external auditor and revocation or suspension of the accreditation.

WHEREAS, Section 6 (k), (l) and (n) of the R.A. No. 9829 (Pre-need Code) provides that the Insurance Commission (IC) have the power to:

(k) Prepare, approve, amend or repeal rules, regulations, orders, and circulars and issue opinions and provide guidance on, and supervise compliance with, such rules, regulations, orders and circulars;

(l) Formulate policies and recommendations on issues concerning the pre-need industry, including proposed legislations; and

(n) Exercise such other powers as may be provided by law as well as those which may be implied from, or which are necessary or incidental to carry out...
the express powers granted the Commission to achieve the objectives and purposes of the law.

WHEREAS, Section 4 of Executive Order (E.O.) No. 192 series of 2015, provides authority to the IC to formulate rules, regulations to regulate the Health Maintenance Organizations (HMOs) and its related services;

WHEREAS, the existing provisions of the executed Memorandum of Agreement (MOA) dated 12 August 2009, binding the IC, the Bangko Sentral ng Pilipinas (BSP), Securities and Exchange Commission (SEC), Professional Regulatory Commission – Board of Accountancy (BOA) for a simplified and synchronized accreditation requirements for external auditors and/or auditing firms.

WHEREAS, the Financial Sector Forum (FSF), members of which include the IC, the BSP, the SEC and the PDIC, revises framework on the selection of external auditors;

NOW THEREFORE, pursuant to the power vested in this Commission under Section 437 of the Amended Insurance Code, Section 6 of the Pre-need Code of the Philippines, and Section 4 of E.O. No. 192, the IC revised the rules and regulations that shall govern the accreditation and delisting of external auditors of covered institutions as follows:

SECTION 1: POLICY STATEMENT

1.1. The IC is issuing the revised guidelines on the accreditation of the external auditors in accordance with the agreements under the FSF member financial regulators and to ensure that auditing firms and external auditors consistently adhere to audit in compliance with quality control standards and understand the operations and risk exposures of IC-regulated entities, including their subsidiaries and affiliates engaged in allied and related services.

SECTION 2: APPOINTMENT OF EXTERNAL AUDITORS OF IC-REGULATED ENTITIES

2.1. IC-regulated entities shall engage the services of an external auditor included in the List of Accredited External Auditors. In this respect, a regulated entity shall only appoint an external auditor belonging to the same category or from categories higher than the category of the concerned regulated entity as provided in Section 3 of this CL. The external auditor appointed by the regulated entity shall likewise audit its subsidiaries and affiliates engaged allied and related services.

2.2. Application for first time inclusion or renewal of inclusion in the List of Accredited External Auditors shall be submitted to the Securities and Exchange Commission (SEC). Said application shall be evaluated in coordination with the IC and shall be subject to the requirements agreed upon by the members of the FSF.
2.3. The IC shall periodically evaluate the performance of the accredited external auditor through an assessment of the quality of the regulated entity’s financial statements and the supplemental report requirements to be issued by the IC. The results of assessment shall serve as the basis for their continuing inclusion in the List of Accredited External Auditors.

2.4. The external auditor shall be changed or the lead and concurring partner of the audit firm shall be rotated every five (5) years or earlier. Regulated entities shall observe a cooling off period of at least two (2) years before the re-engagement of the same lead and concurring partner of the audit firm or individual external auditor.

SECTION 3: COVERAGE

3.1. Accredited external auditors shall be classified in the following categories and shall extend their services to regulated entities belonging to the same category or from categories lower than the category of the concerned external auditor:

3.1.1. Group A

a. Insurance companies;
b. Professional Reinsurance companies;
c. Mutual Benefit Associations (MBAs);
d. Premed companies; and
e. Health and Maintenance Organizations (HMOs)

3.1.2. Group B

a. Trust for charitable uses; and
b. Insurance, reinsurance, pre-need and HMO brokers.

3.1.3. Group C

a. Microinsurance MBAs
b. General Agents

SECTION 4: AUDIT ENGAGEMENT AND REPORTORIAI REQUIREMENTS

4.1. The regulated entity shall ensure that the scope of external audit work appropriately covers areas relevant to the regulated entity’s operations, risk exposures, and regulatory compliance requirements. These may include, but not limited, to the following:

4.1.1. Review and adoption of applicable reporting framework as well as the assessment of the accuracy, adequacy, and reliability of accounting records and financial reports;
4.1.2. Assessment of the propriety and adequacy of the required and supplemental disclosures or reports in the financial statements as required by the IC;

4.1.3. Assessment of the adequacy and effectiveness of internal controls and risk management policies;

4.1.4. Assessment of the adequacy of the regulated entity's networth or risk-based capital requirements by the IC; and

4.1.5. Evaluation of the quality of corporate governance.

4.2. The engagement contract of regulated entities with the accredited external auditor shall include, at a minimum, the following provisions:

4.2.1. That the regulated entity shall be responsible for keeping the auditor fully informed of existing and subsequent changes to prudential regulatory and statutory requirements of the IC and that both parties shall comply with the said requirements;

4.2.2. That the required and supplemental disclosures of information and reports, such as those enumerated in 4.3 of this Section, by the external auditor to the IC shall not constitute a breach of confidentiality on the part of the external auditor nor shall it be ground for civil, criminal, or disciplinary proceedings against the external auditor;

4.2.3. That the external auditor shall be allowed ready-only access to the IC's examination report on the particular regulated entity and that the external auditor shall treat the contents of the examination report appropriately and confidentially; and

4.2.4. That the regulated entity and accredited external auditor shall comply with all the requirements under this CL.

The engagement contract shall be made available to the IC upon request.

4.3. The accredited external auditor shall directly report to the IC within fifteen (15) calendar days upon discovery of any matter adversely affecting the financial condition of the regulated entity, such as, but not limited to the following cases:

4.3.1. Any material findings involving fraud or error;

4.3.2. Losses or potential losses the aggregate of which amounts to at least ten percent (10%) of the consolidated assets of the regulated entity;

4.3.3. Significant doubt as to the ability of the regulated entity to continue as a going concern;
4.3.4. Material breach of laws or IC rules and regulations, such as but not limited to the prescribe net worth and risk-based capital requirements, of the regulated entity;

4.3.5. Material internal control weaknesses which may lead to financial reporting problems; and

4.3.6. Findings on matters of corporate governance that may require urgent action by the IC.

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 the completion of investigation or evaluation.

In case there are no adverse matters to report, the external auditor shall submit directly to the IC within fifteen (15) calendar days after the close of the audit engagement a notarized certification that there is none to report.

It is however, understood that the accountability of an accredited external auditor is based on matters within the coverage of an audit conducted in accordance with the generally accepted auditing standards. The financial statements, together with the supplemental report, submitted to the IC are the primary responsibility of the regulated entity's Board and Management.

4.4. The accredited external auditor shall directly report to the IC within fifteen (15) calendar days from the pre-termination of the engagement contract or from the date of resignation/replacement as external auditor, and stating the reason(s) thereof.

4.5. All reports, as discussed above, shall be submitted to the Financial Examination Group (FEG) of the IC.

SECTION 5: REGULATORY AND SUPERVISORY ENFORCEMENT

5.1. The IC reserves the right to deploy its range of supervisory and regulatory tools to promote adherence with the requirements provided in this CL and bring about timely corrective actions.

5.2. For this purpose, the IC may issue directives, orders, or impose sanctions on the regulated entity and/or its directors and management who approved the appointment of the external auditors and/or audit firm who/which are not in the List of Accredited External Auditors for IC's regulated entities and/or for non-compliance with the provisions of this CL;

5.3. The IC may recommend the suspension or delisting of external auditors and/or audit firm from its List of Accredited External Auditors based on the results of assessment of the quality of the audited financial statements
(AFS) and its supplemental report and non-compliance with Section 4 of this CL.

SECTION 6: PROCEDURE AND EFFECTS OF SUSPENSION/DELISTING

6.1. An accredited 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 accredited external auditor/auditing firm may re-apply for IC accreditation after the period prescribed by the IC.

6.2. The IC shall take into account the nature, gravity, and persistence of issue in determining appropriate sanctions to be imposed. In this respect, the following shall govern the progression of sanctions that shall be imposed:

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<th>Occurrence</th>
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<td>1st Offense</td>
<td>Directives/Instructions</td>
<td>Warning</td>
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<td>2nd Offense</td>
<td>Warning</td>
<td>Conditional Approval or Suspension</td>
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<td>3rd Offense</td>
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<td>Denial of application or revocation/delisting</td>
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6.3. The imposition of sanctions shall be without prejudice to the sanctions or penalty that the other FSF member regulators may impose on concerned external auditor pursuant to their respective rules and regulations.

6.4. The IC shall keep a record of its proceeding/investigation. Said proceedings/investigation shall not be public, unless otherwise ordered by IC for good cause shown, with the consent of the parties to such proceedings.

6.5. A determination of the IC to impose a suspension or delisting under this Section shall be supported by a clear statement setting forth the following:

6.5.1. Each act or practice in which the accredited external auditor or auditing firm, or associated entity, if applicable, has engaged or omitted to engage, or that forms a basis for all or part of such suspension/delisting;

6.5.2. The specific provision/s of this CL which the IC determined as has/have been violated; and

6.5.3. 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.
6.6. The IC shall discipline any accredited external auditor that is suspended or delisted from being associated with any accredited auditing firm, or of any accredited auditing firm that knew, or, in the exercise of reasonable care should have known, of the suspension or delisting of any accredited external auditor, to permit such association, without the consent of the IC.

6.7. The IC shall discipline any regulated entities 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 IC.

SECTION 7: TRANSITORY PROVISIONS

The following transitory provisions shall be observed:

7.1. External auditors/or audit firms whose inclusion in the List of Accredited External Auditors will expire after the audit of 2019 are hereby given one (1) year extension of inclusion in the said list to cover the audit of 2019 financial statements.

7.2. All new applications for inclusion in the List of Accredited External Auditors to audit 2020 financial statements and thereafter shall be filed with SEC starting 01 January 2020.

7.3. All applications approved after 01 January 2020 have a validity of five (5) years of covered audit year.

SECTION 8: EFFECTIVITY

8.1. The issuance of this CL, upon effectivity, supersedes all previously issued Circulars regarding the accreditation of External Auditors/Auditing Firms.

For strict compliance.

DENNIS B. FUNA
Insurance Commissioner