



# **AUDITORS AND ACCOUNTING STANDARDS MODULE**

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MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-A: Introduction

## AU-A.1 Purpose

AU-A.1.1 This Module presents requirements that have to be met by Islamic bank licensees with respect to the appointment of external auditors. This Module also sets out certain obligations that external auditors have to comply with, as a condition of their appointment by Islamic bank licensees.

AU-A.1.2 This Module is issued under the powers given the Central Bank of Bahrain ("CBB") under Decree No. (64) of 2006 with respect to promulgating the Central Bank of Bahrain and Financial Institutions Law 2006 ("CBB Law"). It supplements Article 61 of the CBB Law, which requires licensees to appoint an external auditor acceptable to the CBB.

### ***Legal Basis***

**AA-A.1.3** This Module contains the CBB's Directive relating to auditors and accounting standards used by conventional bank licensees, and is issued under the powers available to the CBB under Article 38 of the CBB Law. The Directive in this Module is applicable to all conventional bank licensees.

AA-A.1.4 For an explanation of the CBB's rule-making powers and different regulatory instruments, see Section UG-1.1.



<b>MODULE</b>	<b>AU: Auditors and Accounting Standards</b>
<b>CHAPTER</b>	<b>AU-A: Introduction</b>

## **AU-A.2 Module History**

- AU-A.2.1 This Module was first issued as Module AU (Audit Firms) in January 2005, as part of the first release of Volume 2 (Islamic banks) of the CBB Rulebook. It was subsequently reissued in full in July 2006 (and renamed ‘Auditors and Accounting Standards’).
- AU-A.2.2 The reissued Module was one of several Modules modified to reflect the introduction of the CBB’s new integrated license framework. Although the new framework did not change the substance of the requirements contained in this Module, the Module was re-issued in order to simplify its drafting and layout and align it with equivalent Modules in other Volumes of the CBB Rulebook.
- AU-A.2.3 This Module is dated July 2006. Pages that are subsequently changed in this Module are updated with the end-calendar quarter date in which the change was made: Chapter UG-3 provides further details on Rulebook maintenance and version control.
- AU-A.2.4 When the CBB replaced the BMA in September 2006, the provisions of this Module remained in force. Volume 1 was updated in October 2007 to reflect the switch to the CBB; however, new calendar quarter dates were only issued where the update necessitated changes to actual requirements.
- AU-A.2.5 A list of changes made to this Module is provided below:

Module Reference	Change Date	Description of Changes
Whole Module	July 2006	Module renamed as Module AU (Auditors and Accounting Standards). Text redrafted but substance of requirements left unchanged.
AU-A.1	10/2007	New Rule AU-A.1.3 introduced, categorising this Module as a Directive.
AU-1.2	10/2007	Rule AU-1.2.3 redrafted to clarify reporting obligation.
AU-1.5	10/2007	Paragraphs AU-1.5.4 and AU-1.5.6 updated to reflect CBB Law requirements on auditor independence.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-B: Scope of Application

## AU-B.1 Islamic bank Licensees

### AU-B.1.1

The contents of this Module – unless otherwise stated – apply to all **Islamic bank licensees**.

### AU-B.1.2

The contents of Chapters AU-1 to AU-4 apply to both Bahraini Islamic bank licensees and overseas Islamic bank licensees.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-B: Scope of Application

## AU-B.2 Auditors

AU-B.2.1 Certain requirements in this Module indirectly extend to auditors, by virtue of their appointment by Islamic bank licensees. Auditors appointed by Islamic bank licensees must be independent (cf. Sections AU-1.4 and AU-1.5). Auditors who resign or are otherwise removed from office are required with their licensees to inform the CBB in writing of the reasons for the termination of their appointment (cf. Section AU-1.2). Other requirements are contained in Sections AU-1.3 (Audit partner rotation) and AU-3 (Auditor reports).



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-1: Auditor Requirements

## AU-1.1 Appointment of Auditors

**AU-1.1.1** Islamic bank licensees must obtain prior written approval from the **CBB** before appointing or re-appointing their auditors.

AU-1.1.2 As the appointment of auditors normally takes place during the course of the firm's annual general meeting, Islamic bank licensees should notify the **CBB** of the proposed agenda for the annual general meeting in advance of it being circulated to shareholders. The **CBB**'s approval of the proposed auditors does not limit in any way shareholders' rights to subsequently reject the Board's choice.

AU-1.1.3 The **CBB**, in considering the proposed (re-) appointment of an auditor, takes into account the expertise, resources and reputation of the audit firm, relative to the size and complexity of the licensee. The **CBB** will also take into account the track record of the audit firm in auditing Islamic bank licensees within Bahrain; the degree to which it has generally demonstrated independence from management in its audits; and the extent to which it has identified and alerted relevant persons of significant matters. Finally, the **CBB** will also consider the audit firm's compliance with applicable laws and regulations (including legislative Decree No. 26 of 1996; the Ministry of Industry and Commerce's Ministerial Resolution No. 6 of 1998; and relevant Bahrain Stock Exchange regulations).

AU-1.1.4 In the case of overseas Islamic bank licensees, the **CBB** will also take into account who act as the auditors of the parent firm. As a general rule, the **CBB** does not favour different parts of a banking firm or group having different auditors.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-1: Auditor Requirements

## AU-1.2 Removal or Resignation of Auditors

### AU-1.2.1

Islamic bank licensees must notify the CBB as soon as they intend to remove their auditors, or if their auditors intend to resign, with an explanation of their decision, or as soon as their auditors resign.

### AU-1.2.2

Islamic bank licensees must ensure that a replacement auditor is appointed (subject to CBB approval as per Section AU-1.1), as soon as reasonably practicable after a vacancy occurs, but no later than three months.

### AU-1.2.3

In accordance with the powers granted to CBB under Article 63 of the CBB Law, auditors of Islamic bank licensees and their licensees must inform the CBB in writing, should they resign or their appointment as auditor be terminated, within 30 calendar days, of the event occurring, setting out the reasons for the resignation or termination.





MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-1: Auditor Requirements

### AU-1.3 Audit Partner Rotation

#### AU-1.3.1

Unless otherwise exempted by the **CBB**, Islamic bank licensees must ensure that the audit partner responsible for their audit does not undertake that function more than five years in succession.

#### AU-1.3.2

Islamic bank licensees must notify the **CBB** of any change in audit partner.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-1: Auditor Requirements

## AU-1.4 Auditor Independence

### AU-1.4.1

Article 61(d) of the CBB Law imposes conditions for the auditor of a licensee to be considered “independent”. Before an Islamic bank licensee appoints an auditor, it must take reasonable steps to ensure that the auditor has the required skill, resources and experience to carry out the audit properly, and is independent of the licensee.

### AU-1.4.2

For an auditor to be considered independent, it must, among things, comply with the restrictions in Section AU-1.5.

### AU-1.4.3

If an Islamic bank licensee becomes aware at any time that its auditor is not independent, it must take reasonable steps to remedy the matter and notify the **CBB** of the fact.

### AU-1.4.4

If, in the opinion of the **CBB**, independence has not been achieved within a reasonable timeframe, then the **CBB** may require the appointment of a new auditor.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-1: Auditor Requirements

## AU-1.5 Licensee/Auditor Restrictions

### *Financial Transactions with Auditors*

#### AU-1.5.1

Islamic bank licensees must not lend to their auditors, nor enter into any contracts of professional indemnity insurance with their auditors.

### *Outsourcing to Auditors*

#### AU-1.5.2

Section OM-2.7 generally prohibits Islamic bank licensees from outsourcing their internal audit function to the same firm that acts as their external auditors. However, the **CBB** may allow short-term outsourcing of internal audit operations to an Islamic bank licensee's external auditor, to meet unexpected urgent or short-term needs (for instance, on account of staff resignation or illness). Any such arrangement will normally be limited to a maximum period of one year and is subject to **CBB** prior approval.

### *Other Relationships*

#### AU-1.5.3

Islamic bank licensees and their auditors must comply with the restrictions contained in Article 217 (c) of the Commercial Companies Law (Legislative Decree No. (21) of 2001), as well as in Article 61(d) of the **CBB Law**.

#### AU-1.5.4

Article 217(c) prohibits an auditor from (i) being the chairman or a member of the Board of Directors of the company he/she audits; (ii) holding any managerial position in the company he/she audits; and (iii) acquiring any shares in the company he/she audits, or selling any such shares he/she may already own, during the period of his audit. Article 61 (d) prohibits an auditor from (i) being the chairman or a director of the company he/she audits (ii) acting as a managing director, agent or representative of the company concerned; and (iii) taking up any administrative work in the company, or supervising its accounts, or having a next of kin in such a position. Furthermore, the auditor must not be a relative (up to the second degree) of a person assuming management or accounting duties in the company.

#### AU-1.5.5

The restriction in Paragraph AU-1.5.3 applies to overseas Islamic bank licensees as well as Bahraini Islamic bank licensees.

#### AU-1.5.6

A partner, Director or manager on the engagement team of auditing an Islamic bank licensee may not serve on the Board or in a controlled function of the licensee, for two years following the end of their involvement in the audit, without prior authorisation of the **CBB**.

#### AU-1.5.7

Chapter HC-2 sets out the **CBB's** 'controlled functions' requirements.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-1: Auditor Requirements

## AU-1.5 Licensee/Auditor Restrictions (continued)

### *Definition of 'Auditor'*

#### AU-1.5.8

For the purposes of Section AU-1.5, 'auditor' means the partners, Directors and managers on the engagement team responsible for the audit of the Islamic bank licensee.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-2: Access

## AU-2.1 **CBB** Access to Auditors

### AU-2.1.1

Islamic bank licensees must waive any duty of confidentiality on the part of their auditors, such that their auditors may report to the **CBB** any concerns held regarding material failures by the Islamic bank licensee to comply with **CBB** requirements.

### AU-2.1.2

The **CBB** may, as part of its on-going supervision of Islamic bank licensees, request meetings with a licensee's auditors. If necessary, **the CBB** may direct that the meeting be held without the presence of the licensee's management or **Directors**.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-2: Access

## AU-2.2 Auditor Access to Outsourcing Providers

### AU-2.2.1

Rule OM-2.5.1 (c) on outsourcing agreements between Islamic bank licensees and outsourcing providers requires licensees to ensure that their internal and external auditors have timely access to any relevant information they may require to fulfil their responsibilities. Such access must allow them to conduct on-site examinations of the outsourcing provider, if required.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-3: Auditor Reports

## AU-3.1 Review of Financial Disclosures

### AU-3.1.1

Islamic bank licensees that are required to publish financial disclosures in accordance with Chapters PD-2 and PD-3 must arrange for their external auditors to review these prior to their publication, unless otherwise exempted in writing by **CBB**.

### AU-3.1.2

Chapter PD-2 requires overseas Islamic bank licensees operating as retail banks to publish on semi-annual basis summary information on their balance sheet and profit and loss account, in the same format as their annual audited accounts. Chapter PD-3 requires all locally incorporated Islamic bank licensees to publish quarterly financial statements, in accordance with Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). For products and activities not covered by AAOIFI, International Accounting Standards (IAS) should be followed.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-3: Auditor Reports

## AU-3.2 Report on Compliance with Financial Crime Rules

**AU-3.2.1** Islamic bank licensees must arrange for their external auditors to report on the licensee's compliance with the requirements contained in Module FC (Financial Crime), at least once a year.

**AU-3.2.2** The report specified in Rule AU-3.2.1 must be in the form agreed by **CBB**, and must be submitted to the **CBB** within four months of the licensee's financial year-end.

AU-3.2.3 The context to the above requirement can be found in Section FC-4.3.





MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-3: Auditor Reports

### AU-3.3 Review of Compliance with relevant laws

#### AU-3.3.1

Islamic bank licensees must arrange for their external auditors to review the bank's compliance with applicable laws and declare, in the auditors report, that no material violations of the following laws and regulations have taken place:

- (a) The Bahrain Commercial Companies Law of 2001;
- (b) The **CBB** Law 2006; and
- (c) The **CBB's** licensing conditions, and other rules contained in Volume 2 of the **CBB** Rulebook.

AU-3.3.2 For the purposes of Rule AU-3.3.1, material violations are violations that have any material impact on the financial statements of the bank.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-3: Auditor Reports

## AU-3.4 Report on material differences

### AU-3.4.1

Islamic bank licensees must arrange for their external auditors to provide to the **CBB** explanations for any material differences in data reported in the bank's audited accounts and in the following reports provided to the **CBB**:

- (a) Prudential Information Returns for Islamic Banks (PIRI); and
- (b) Monthly Statements of Assets and Liabilities.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-3: Auditor Reports

## AU-3.5 Report on behavioural adjustments

### AU-3.5.1

Islamic bank licensees that have been given **CBB** approval to apply behavioural adjustments to the liquidity data provided in Section E of the PIRI Form, must arrange for their external auditors to verify the supporting data used to support the behavioural adjustments made.

AU-3.5.2 Please refer to Module LM and to Section BR-5.2. Banks that have at least 2 years' worth of supporting data may seek **CBB** approval to apply behavioural adjustments to certain of their reported liquidity data, instead of reporting contractual maturities.



MODULE	AU: Auditors and Accounting Standards
CHAPTER	AU-4: Accounting Standards

## AU-4.1 General Requirements

### AU-4.1.1

Islamic bank licensees must comply with Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). For products and activities not covered by AAOIFI, International Financial Reporting Standards (IFRS) / International Accounting Standards (IAS) must be followed.