



# **AUDITORS AND ACCOUNTING STANDARDS MODULE**



**MODULE: AA (Auditors and Accounting Standards)**

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

## AA-A.1 Purpose

### *Executive Summary*

AA-A.1.1 This Module presents requirements that have to be met by specialised 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 specialised licensees.

AA-A.1.2 This Module is issued under the powers given to 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 **(as amended from time to time)** relating to auditors and accounting standards used by specialised 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 specialised licensees (where applicable).

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

## AA-A.2 Module History

### *Evolution of Module*

AA-A.2.1 This Module was first issued in October 2010. Any material changes that are subsequently made to this Module are annotated with the calendar quarter date in which the change is made; Chapter UG-3 provides further details on Rulebook maintenance and version control.

AA-A.2.2 A list of recent changes made to this Module is provided below:

Module Ref.	Change Date	Description of Changes
AA-A.1.3	01/2011	Clarified legal basis.



<b>MODULE</b>	<b>AA: Auditors and Accounting Standards</b>
<b>CHAPTER</b>	<b>AA-B: Scope of Application</b>

## AA-B.1 Specialised Licensees

AA-B.1.1 The contents of this Module – unless otherwise stated – apply to all specialised licensees. Representative Offices are exempted from this Module.

AA-B.1.2 The contents of this Module apply to both Bahraini specialised licensees and overseas specialised licensees.



<b>MODULE</b>	<b>AA: Auditors and Accounting Standards</b>
<b>CHAPTER</b>	<b>AA-B: Scope of Application</b>

## AA-B.2 Auditors

AA-B.2.1 Certain requirements in this Module indirectly extend to auditors, by virtue of their appointment by specialised licensees. Auditors appointed by specialised licensees must be independent (cf. Sections AA-1.4 and AA-1.5). Auditors who resign or are otherwise removed from office are required to inform the CBB in writing of the reasons for the termination of their appointment (cf. Sections AA-1.2). Other requirements are contained in Sections AA-1.3 (Audit partner rotation) and AA-3.1 (Auditor reports).



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

## AA-1.1 Appointment of Auditors

### AA-1.1.1

**Specialised licensees must obtain prior written approval from the CBB before appointing or re-appointing their auditor.**

AA-1.1.2 As the appointment of auditors normally takes place during the course of the firm's annual general meeting, specialised 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.

AA-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 specialised 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).

AA-1.1.4 In the case of overseas specialised 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 specialised licensee group having different auditors.



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

## AA-1.2 Removal or Resignation of Auditors

### AA-1.2.1

Specialised licensees must notify the CBB as soon as they intend to remove their external auditor, with an explanation of their decision, or as soon as their auditor resigns.

### AA-1.2.2

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

### AA-1.2.3

The external auditor of specialised licensees must inform the CBB in writing, should it resign or its appointment as auditor be terminated, within 30 calendar days, of the event occurring, setting out the reasons for the resignation or termination.





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

### AA-1.3 Audit Partner Rotation

#### AA-1.3.1

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

#### AA-1.3.2

For purposes of Paragraph AA-1.3.1, the first five-year period referred to is for the period ending 31 December 2010.

#### AA-1.3.3

Specialised licensees must notify the CBB of any change in audit partner.



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

#### AA-1.4 Auditor Independence

##### AA-1.4.1

Article 61(d) of the CBB Law imposes conditions for the auditor to be considered independent. Before a specialised 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.

##### AA-1.4.2

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

##### AA-1.4.3

If a specialised 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.

##### AA-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	AA: Auditors and Accounting Standards
CHAPTER	AA-1: Auditor Requirements

## AA-1.5 Licensee/Auditor Restrictions

### *Financial Transactions with Auditors*

**AA-1.5.1** Specialised licensees must not provide regulated services to their auditor.

### *Outsourcing to Auditors*

**AA-1.5.2** Specialised licensees may not outsource their internal audit function to the same firm that acts as their (external) auditor.

### *Other Relationships*

**AA-1.5.3** Specialised licensees and their auditor 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.

AA-1.5.4 Article 217(c) prohibits an auditor from (i) being the chairman or a member of the Board of Directors of the licensee he/she audits; (ii) holding any managerial position in the licensee he/she audits; and (iii) acquiring any shares in the licensee he/she audits, or selling any such shares he/she may already own, during the period of his audit. Furthermore, the auditor must not be a relative (up to the second degree) of a person assuming management or accounting duties in the licensee.

AA-1.5.5 Article 61(d) prohibits an auditor from (i) being the chairman or a member of the Board of Directors of the licensee he/she audits; (ii) acting as a managing director, agent or representative of the licensee concerned; and (iii) taking up any administrative work in the licensee, or supervising its accounts, or having a next of kin in such a position.

AA-1.5.6 The restriction in Paragraph AA-1.5.4 applies to overseas specialised licensees as well as Bahraini specialised licensees.



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

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

### *Other Relationships (continued)*

AA-1.5.7

A partner, Director or manager on the engagement team of auditing a specialised 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.

AA-1.5.8

Chapter AU-1.2 sets out the CBB's "controlled functions" requirements.

### *Definition of 'Auditor'*

AA-1.5.9

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



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

## AA-2.1 CBB Access to Auditors

### AA-2.1.1

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

### AA-2.1.2

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



<b>MODULE</b>	<b>AA: Auditors and Accounting Standards</b>
<b>CHAPTER</b>	<b>AA-2: Access</b>

## AA-2.2 Auditor Access to Outsourcing Providers

### AA-2.2.1

Outsourcing agreements between specialised licensees and outsourcing providers must ensure that the licensee's 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.

AA-2.2.2 Further Rules and Guidance on outsourcing are contained in Module RM (Risk Management).



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

## AA-3.1 Review of Quarterly Prudential Returns

### AA-3.1.1

Specialised licensees must arrange for their auditor to review the licensee's Quarterly Prudential Return to the CBB prior to its submission, unless otherwise exempted in writing by CBB. The auditor must complete the prescribed form attesting to its review, which must be attached to the Quarterly Prudential Return.

### AA-3.1.2

Specialised licensees are required to submit a Quarterly Prudential Return (QPR). Specialised licensees may apply in writing to CBB for an exemption from the requirement that the QPR be reviewed by the licensee's external auditor: this exemption would normally only be given where the licensee had established a track record of accurate and timely reporting, and there were no other supervisory issues of concern. Further details on the CBB's reporting and related requirements, including the precise scope of the auditor's review and attestation, will be contained in Module BR (CBB Reporting).



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

## AA-3.2 Review of Financial Disclosures

### AA-3.2.1

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





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

### AA-3.3 Report on Compliance with Financial Crime Rules

**AA-3.3.1** Specialised licensees must arrange for their external auditor to report on the licensee's compliance with the requirements contained in Module FC (Financial Crime), at least once a year.

**AA-3.3.2** The report specified in Rule AA-3.3.1 must be in the form agreed by the CBB, and must be submitted to the CBB within four months of the licensee's financial year-end.

AA-3.3.3 Further information on the above can be found in Section FC-3.3.



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

## AA-4.1 General Requirements

### AA-4.1.1

Specialised licensees must comply with International Financial Reporting Standards / International Accounting Standards and, to the extent that they undertake Shari'a compliant activities, relevant standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

AA-4.1.2 Overseas specialised licensees that do not, at the parent licensee level, apply IFRS/IAS are still required under Paragraph AA-4.1.1 to produce pro-forma accounts for the Bahrain branch in conformity with these standards. Where this requirement is difficult to implement, the Bahraini specialised licensee should contact the CBB in order to agree to a solution.

AA-4.1.3 Paragraph AA-4.1.1 requires specialised licensees that operate exclusively on a Shari'a compliant basis to apply relevant AAOIFI Financial Accounting Standards, depending on the type of Islamic finance contracts entered into. Specialised licensees that undertake both conventional finance and Shari'a compliant transactions are required by Paragraph AA-4.1.1 to apply AAOIFI Financial Accounting Standard 18, "Islamic Financial Services Offered by Conventional Financial Institutions".



MODULE	AA:	<b>Auditors and Accounting Standards</b>
CHAPTER	AA-5:	<b>Role of Appointed Experts</b>

## AA-5.1 Introduction

**AA-5.1.1** The content of this chapter is applicable to all specialised companies and concerned auditors in the Kingdom of Bahrain.

AA-5.1.2 The purpose of the contents of this chapter is to set out the roles and responsibilities of Appointed Experts when appointed pursuant to Article 114 or 121 of the CBB Law (see EN-7.1.1). These Articles empower the CBB to assign some of its officials or others to inspect or conduct investigations of licensees.

AA-5.1.3 The CBB uses its own inspectors to undertake on-site examinations of licensees as an integral part of its regular supervisory efforts. In addition, the CBB may commission reports on matters relating to the business of licensees in order to help it assess their compliance with CBB requirements. Inspections may be carried out either by the CBB's own officials, by duly qualified "Appointed Experts" appointed for the purpose by the CBB, or a combination of the two.

**AA-5.1.4** Specialised licensees must provide all relevant information and assistance to the CBB inspectors and Appointed Experts on demand as required by Articles 111 and 114 of the CBB Law. Failure by licensees to cooperate fully with the CBB's inspectors or Appointed Experts, or to respond to their examination reports within the time limits specified, will be treated as demonstrating a material lack of cooperation with the CBB which will result in other enforcement measures being considered, as described elsewhere in Module EN. This rule is supported by Article 114(a) of the CBB Law.

AA-5.1.5 Article 163 of the CBB Law provides for criminal sanctions where false or misleading statements are made to the CBB or any person /Appointed Expert appointed by the CBB to conduct an inspection or investigation on the business of the licensee or the listed licensee.



MODULE	AA:	Auditors and Accounting Standards
CHAPTER	AA-5:	Role of Appointed Experts

## AA-5.1 Introduction (continued)

AA-5.1.6 The CBB will not, as a matter of general policy, publicise the appointment of an Appointed Expert, although it reserves the right to do so where this would help achieve its supervisory objectives. Both the Appointed Expert and the CBB are bound to confidentiality provisions restricting the disclosure of confidential information with regards to any such information obtained in the course of the investigation.

AA-5.1.7 Unless the CBB otherwise permits, Appointed Experts should not be the same firm appointed as external auditor of the specialised licensee.

AA-5.1.8 Appointed Experts will be appointed in writing, through an appointment letter, by the CBB. In each case, the CBB will decide on the range, scope and frequency of work to be carried out by Appointed Experts.

AA-5.1.9 Appointed Experts will report directly to and be responsible to the CBB in this context and will specify in their report any limitations placed on them in completing their work (for example due to the relevant specialised licensees' group structure). The report produced by the Appointed Experts is the property of the CBB (but is usually shared by the CBB with the firm concerned).

AA-5.1.10 Compliance by Appointed Experts with the contents of this Chapter will not, of itself, constitute a breach of any other duty owed by them to a particular specialised licensee (i.e. create a conflict of interest).

AA-5.1.11 The CBB may appoint one or more of its officials to work on the Appointed Experts' team for a particular specialised licensee.



MODULE	AA:	Auditors and Accounting Standards
CHAPTER	AA-5:	Role of Appointed Experts

## AA-5.2 The Required Report

**AA-5.2.1** Commissioned Appointed Experts would normally be required to report on one or more of the following aspects of a specialised licensee's business:

- (a) Accounting and other records;
- (b) Internal control systems;
- (c) Returns of information provided to the CBB;
- (d) Operations of certain departments; and/or
- (e) Other matters specified by the CBB.

**AA-5.2.2** Appointed Experts will be required to form an opinion on whether, during the period examined, the specialised licensee is in compliance with the relevant provisions of the CBB Law and the CBB's relevant requirements, as well as other requirements of Bahrain Law and, where relevant, industry best practice locally and/or internationally.

AA-5.2.3 The Appointed Experts' report should follow the format set out in Appendix AA-1, in part B of the CBB Rulebook.

**AA-5.2.4** Unless otherwise directed by the CBB or unless the circumstances described in Section AA-5.3 apply, the report must be discussed with the Board of directors and/or senior management in advance of its being sent to the CBB.

**AA-5.2.5** Where the report is qualified by exception, the report must clearly set out the risks which the specialised licensee runs by not correcting the weakness, with an indication of the severity of the weakness should it not be corrected. Appointed Experts will be expected to report on the type, nature and extent of any weaknesses found during their work, as well as the implications of a failure to address and resolve such weaknesses.



MODULE	AA:	Auditors and Accounting Standards
CHAPTER	AA-5:	Role of Appointed Experts

## AA-5.2 The Required Report (continued)

### AA-5.2.6

If the Appointed Experts conclude, after discussing the matter with the specialised licensee, that they will give a negative opinion (as opposed to one qualified by exception) or that the issue of the report will be delayed, they must immediately inform the CBB in writing giving an explanation in this regard.

### AA-5.2.7

The report must be completed, dated and submitted, together with any comments by directors or management (including any proposed timeframe within which the specialised licensee has committed to resolving any issues highlighted by the report), to the CBB within the timeframe applicable.



MODULE	AA:	Auditors and Accounting Standards
CHAPTER	AA-5:	Role of Appointed Experts

### AA-5.3 Other Notifications to the CBB

**AA-5.3.1** Appointed Experts must communicate to the CBB, during the conduct of their duties, any reasonable belief or concern they may have that any of the requirements of the CBB, including the criteria for licensing a specialised licensee (see Module AU), are not or have not been fulfilled, or that there has been a material loss or there exists a significant risk of material loss in the concerned specialised licensee, or that the interests of customers are at risk because of adverse changes in the financial position or in the management or other resources of a specialised licensee. Notwithstanding the above, it is primarily the specialised licensee's responsibility to report such matters to the CBB.

AA-5.3.2 The CBB recognises that Appointed Experts cannot be expected to be aware of all circumstances which, had they known of them, would have led them to make a communication to the CBB as outlined above. It is only when Appointed Experts, in carrying out their duties, become aware of such a circumstance that they should make detailed inquiries with the above specific duty in mind.

AA-5.3.3 If Appointed Experts decide to communicate directly with the CBB in the circumstances set out in Paragraph AA-5.3.1 above, they may wish to consider whether the matter should be reported at an appropriate senior level in the specialised licensee at the same time and whether an appropriate senior representative of the specialised licensee should be invited to attend the meeting with the CBB.



MODULE	AA:	Auditors and Accounting Standards
CHAPTER	AA-5:	Role of Appointed Experts

#### AA-5.4 Permitted Disclosure by the CBB

##### AA-5.4.1

Information which is confidential and has been obtained under, or for the purposes of, this chapter or the CBB Law may only be disclosed by the CBB in the circumstances permitted under the Law. This will allow the CBB to disclose information to Appointed Experts to fulfil their duties. It should be noted, however, that Appointed Experts must keep this information confidential and not divulge it to a third party except with the CBB's permission and/or unless required by Bahrain Law.





<b>MODULE</b>	<b>AA:</b>	<b>Auditors and Accounting Standards</b>
<b>CHAPTER</b>	<b>AA-5:</b>	<b>Role of Appointed Experts</b>

## AA-5.5 Trilateral Meeting

AA-5.5.1 The CBB may, at its discretion, call for a trilateral meeting(s) to be held between the CBB and representatives of the relevant specialised licensee and the Appointed Experts. This meeting will provide an opportunity to discuss the Appointed Experts' examination of, and report on, the specialised licensee.