



# **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 investment firm 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 investment firm 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 investment firm 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 investment firm 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>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 April 2006 by the BMA, as part of the first phase of Volume 4 (Investment Business) to be released. Any material changes that have subsequently been made to this Module are annotated with the calendar quarter date in which the change was made: Chapter UG-3 provides further details on Rulebook maintenance and version control.

AA-A.2.2 When the CBB replaced the BMA in September 2006, the provisions of this Module remained in force. Volume 4 was updated in July 2007 to reflect the switch to the CBB; however, new calendar quarter dates were only issued where the update necessitated changes to actual requirements.

AA-A.2.3 A list of recent changes made to this Module is provided below:

Module Ref.	Change Date	Description of Changes
AA-A.1	07/2007	New Rule AA-A.1.3 introduced, categorising this Module as a Directive.
AA-1.2	07/2007	Rule AA-1.2.3 redrafted to clarify reporting obligation.
AA-1.5	07/2007	Paragraphs AA-1.5.4 and AA-1.5.6 updated to reflect CBB Law requirements on auditor independence.
AA-3.1.1	04/2008	Clarified that auditor's review is to be attached to the QPR.
AA-1.5	10/2009	Paragraphs AA-1.5.2 and AA-1.5.3 updated to clarify outsourcing of internal audit function.
AA-3.1.1	10/2009	Updated to reflect requirement in Module BR.
AA-5	07/2010	New Chapter added regarding <u>Reporting Accountants</u> .
AA-A.1.3	01/2011	Clarified legal basis.
AA-1.1.1A	01/2011	Added Guidance referring to the CBB's power to appoint an external auditor should the investment firm licensee fail to do so.
AA-5	10/2011	Chapter amended and content moved to Section BR-3.5 and retitled as Role of External Auditor as Appointed Expert.
AA-3.3	01/2012	Deleted Section on Compliance with Financial Crime Rules.
AA-4.1	10/2014	Clarified the application of accounting standards for investment firms based on whether they undertake conventional and/or Shari'a compliant activities.
AA-3.1	07/2016	Clarified that this requirement only applies to Category 1 and Category 2 investment firm licensees.
AA-3.2.1	10/2017	Amended Paragraph to clarify that licensees are to formally declare in writing that they do not possess any Client assets.

	<b>Central Bank of Bahrain Rulebook</b>	<b>Volume 4: Investment Business</b>
<b>MODULE</b>	<b>AA: Auditors and Accounting Standards</b>	
<b>CHAPTER</b>	<b>AA-A: Introduction</b>	

## AA-A.2 Module History (continued)

### *Superseded Requirements*

AA-A.2.4 This Module supersedes the following provisions contained in circulars or other regulatory instruments:

Circular / other reference	Provision	Subject
Standard Conditions and Licensing Criteria: investment advisers/brokers.	Article 7	Auditors
Standard Conditions and Licensing Criteria: broking company	Article 6	Auditors
Standard Conditions and Licensing Criteria: stockbrokerage	Article 6	Auditors

AA-A.2.5 Guidance on the implementation and transition to Volume 4 (Investment Business) is given in Module ES (Executive Summary).



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

## AA-B.1 Investment Firm Licensees

AA-B.1.1 The contents of this Module – unless otherwise stated – apply to all investment firm licensees.

AA-B.1.2 The contents of Chapters AA-1 to AA-4 apply to both Bahraini investment firm licensees and overseas investment firm licensees.



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

## AA-B.2 Auditors

AA-B.2.1 Certain requirements in this Module indirectly extend to auditors, by virtue of their appointment by investment firm licensees. Auditors appointed by investment firm 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** Investment firm licensees must obtain prior written approval from the CBB before appointing or re-appointing their auditors.

AA-1.1.1A Where an investment firm licensee fails to appoint an external auditor within four months from the beginning of the financial year, Article 61 (b) of the CBB Law provides the CBB with the power to appoint the external auditor.

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

AA-1.1.4 In the case of overseas investment firm 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 an investment 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

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

### AA-1.2.2

Investment firm 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

In accordance with the powers granted to CBB under Article 63 of the CBB Law, auditors of investment firm 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	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, investment firm 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

Investment firm 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

Before an investment firm 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 an investment firm 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.



<b>MODULE</b>	<b>AA: Auditors and Accounting Standards</b>
<b>CHAPTER</b>	<b>AA-1: Auditor Requirements</b>

## **AA-1.5 Licensee/Auditor Restrictions**

### *Financial Transactions with Auditors*

#### **AA-1.5.1**

Investment firm licensees must not provide regulated investment services to their auditors.

### *Outsourcing to Auditors*

#### **AA-1.5.2**

Investment firm licensees may not outsource their internal audit function to the same firm that acts as their external auditors.

AA-1.5.3 Further Guidance on this issue is provided in the Risk Management Module.

### *Other Relationships*

#### **AA-1.5.4**

Investment firm 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.

AA-1.5.5 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. Furthermore, the auditor must not be a relative (up to the second degree) of a person assuming management or accounting duties in the company.

AA-1.5.6 Article 61(d) prohibits an auditor from (i) being the chairman or a member of the Board of Directors 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.

AA-1.5.7 The restriction in Paragraph AA-1.5.4 applies to overseas investment firm licensees as well as Bahraini investment firm licensees.



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

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

### *Other Relationships (continued)*

#### AA-1.5.8

A partner, Director or manager on the engagement team of auditing an investment firm 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-1.5.9 Chapter AU-1.2 sets out the CBB's "controlled functions" requirements.

### *Definition of 'Auditor'*

#### AA-1.5.10

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 investment firm licensee.



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

## AA-2.1 CBB Access to Auditors

### AA-2.1.1

Investment firm 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 investment firm licensee to comply with CBB requirements.

### AA-2.1.2

The CBB may, as part of its on-going supervision of investment firm 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	AA: Auditors and Accounting Standards
CHAPTER	AA-2: Access

## AA-2.2 Auditor Access to Outsourcing Providers

### AA-2.2.1

Outsourcing agreements between investment firm 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 will be contained in Module RM (Risk Management), to be issued later in 2007.



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

## AA-3.1 Review of Quarterly Prudential Returns

### AA-3.1.1

In accordance with Paragraph BR-1.1.8, Category 1 and Category 2 investment firm licensees must arrange for their auditors to review the licensee's Quarterly Prudential Return for the quarter ending 30 June (or semi-annually depending on the licensee's financial year-end) prior to its submission to the CBB, unless otherwise exempted in writing by CBB. Auditors must complete the prescribed form attesting to their review, which must be attached to the Quarterly Prudential Return.

### AA-3.1.2

Investment firm licensees are required to submit a Quarterly Prudential Return (QPR). Category 1 and Category 2 investment firm licensees may apply in writing to CBB for an exemption from the requirement that the QPR be reviewed by the licensee's external auditors: 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 Report on Compliance with Client Asset Rules

**AA-3.2.1** Investment firm licensees that hold or control client assets must arrange for their external auditors to report on the licensee's compliance with the requirements contained in Module CL (Client Assets), at least once a year. Investment firm licensees Category 1 and Investment firm licensees category 2 which do not hold or control Client Assets are obligated to confirm the same annually.

**AA-3.2.2** The report 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.

AA-3.2.3 Further information on the above can be found in Section CL-1.5.



<b>MODULE</b>	<b>AA: Auditors and Accounting Standards</b>
<b>CHAPTER</b>	<b>AA-3: Auditor Reports</b>

**AA-3.3** [This Section was deleted in January 2012]



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

## AA-4.1 General Requirements

**AA-4.1.1** Investment firm licensees which deal only in conventional financial instruments must comply with International Financial Reporting Standards / International Accounting Standards.

**AA-4.1.1A** Investment firm licensees that undertake both conventional finance and Shari'a compliant transactions 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). Such firms must also apply AAOIFI Financial Accounting Standard 18, "Islamic Financial Services Offered by Conventional Financial Institutions".

AA-4.1.2 Overseas investment firm licensees that do not, at the parent company 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 overseas investment firm licensee should contact the CBB in order to agree to a solution.

**AA-4.1.3** Investment firm licensees that operate exclusively on a Shari'a compliant basis 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.



MODULE	AA: Auditors and Accounting Standards
CHAPTER	AA-5: Role of External Auditor as Appointed Expert

## AA-5.1 General Requirements

AA-5.1.1 In accordance with Articles 114 and 121 of the CBB Law, the CBB may appoint appointed experts to undertake on-site examinations or report by way of investigations on specific aspects of an investment firm licensee's business. External auditors may be called upon to be appointed experts and should be aware of their role in that capacity by referring to Section BR-3.5.

[The Rules and guidance in this Section were moved to Section BR-3.5 in October 2011]



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

## **AA-5.2 The Required Report**

[The Rules and guidance in this Section were moved to Section BR-3.5 in October 2011]



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

### **AA-5.3 Other Notifications to the CBB**

[The Rules and guidance in this Section were moved to Section BR-3.5 in October 2011]



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

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

[The Rules and guidance in this Section were moved to Section BR-3.5 in October 2011]



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

## **AA-5.5      Trilateral Meeting**

[The Rules and guidance in this Section were moved to Section BR-3.5 in October 2011]