



# **AUDITORS AND ACCOUNTING STANDARDS MODULE**

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

## **AA-A.1 Purpose**

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 the BMA under Article 41 of the BMA Law 1973. It supplements Article 79 of the BMA Law, which requires licensees to appoint an external auditor acceptable to the BMA.

<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, as part of the first phase of Volume 4 (Investment Business) to be released. It is dated April 2006. All subsequent changes to this Module are annotated with the end-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 A list of recent changes made to this Module is provided below:

Module Ref.	Change Date	Description of Changes

### *Superseded Requirements*

AA-A.2.3 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.2.4 Guidance on the implementation and transition to Volume 4 (Investment Business) is given in Module ES (Executive Summary).

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

## **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.

<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 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 must inform the BMA 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 (Auditor reports).

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

## AA-1.1 Appointment of Auditors

### AA-1.1.1

Investment firm licensees must obtain prior written approval from the BMA before appointing or re-appointing their auditors.

- 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 BMA of the proposed agenda for the annual general meeting in advance of it being circulated to shareholders. The BMA'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 BMA, 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 BMA 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 BMA will also take into account who act as the auditors of the parent firm. As a general rule, the BMA does not favour different parts of an investment group having different auditors.

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CHAPTER	AA-1: Auditor Requirements

## AA-1.2 Removal or Resignation of Auditors

**AA-1.2.1** Investment firm licensees must notify the BMA 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 BMA 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** An auditor who resigns or is otherwise removed from the office of auditor must, within 30 days of the resignation or removal, write to the BMA setting out the reasons for the resignation or removal.



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### AA-1.3 Audit Partner Rotation

**AA-1.3.1** Unless otherwise exempted by the BMA, 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 BMA of any change in audit partner.

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

## 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 BMA of the fact.

**AA-1.4.4** If in the opinion of the BMA, independence has not been achieved within a reasonable timeframe, then the BMA 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** Unless otherwise exempted in writing by the BMA, 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 will be provided in the Risk Management Module, when issued. The only circumstances in which BMA may allow such outsourcing to a licensee's auditors, would be 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.

### *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).

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

**AA-1.5.7** 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 BMA.

AA-1.5.8 Chapter AU-1.2 sets out the BMA's "controlled functions" requirements.

<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 (continued)

### *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 investment firm licensee.

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

## AA-2.1 BMA 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 BMA any concerns held regarding material failures by the investment firm licensee to comply with BMA requirements.

AA-2.1.2 The BMA may, as part of its on-going supervision of investment firm licensees, request meetings with a licensee's auditors. If necessary, BMA 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 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 2006.

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

## AA-3.1 Review of Quarterly Prudential Returns

### AA-3.1.1

Investment firm licensees must arrange for their auditors to review the licensee's Quarterly Prudential Return to the BMA prior to its submission, unless otherwise exempted in writing by BMA. Auditors must complete the prescribed form attesting to their review, which must be attached to the annual return.

### AA-3.1.2

Investment firm licensees are required to submit a Quarterly Prudential Return (QPR). Investment firm licensees may apply in writing to BMA 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 BMA's reporting and related requirements, including the precise scope of the auditor's review and attestation, will be contained in Module BR (BMA Reporting), to be issued later in 2006.

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

## 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.

**AA-3.2.2** The report must be in the form agreed by BMA, and must be submitted to the BMA 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.



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** Investment firm 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.

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

AA-3.3.3 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-4: Accounting Standards</b>

## AA-4.1 General Requirements

- AA-4.1.1** Investment firm 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 Organization for Islamic Financial Institutions (AAOIFI).
- 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 Bahraini investment firm licensee should contact the BMA in order to agree a solution.
- AA-4.1.3 Paragraph AA-4.1.1 requires investment firm 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. Investment firm 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".