



SUPERVISORY AND REGULATORY GUIDELINES 2006-PU14-0306

External Auditors  
6<sup>th</sup> September 2006

**GUIDELINES ON THE APPOINTMENT OF EXTERNAL AUDITORS OF  
LICENSEES AND THE RELATIONSHIP BETWEEN THE CENTRAL BANK  
AND EXTERNAL AUDITORS OF LICENSEES**

## **I. INTRODUCTION**

The Central Bank of The Bahamas (*“the Central Bank”*) is responsible for the licensing, regulation and supervision of banks and trust companies operating in and from within The Bahamas pursuant to the Central Bank of The Bahamas Act, 2000 (*“the CBA”*) and the Banks and Trust Companies Regulation Act, 2000 (*“the BTCRA”*). Additionally, the Central Bank has the duty, in collaboration with financial institutions, to promote and maintain high standards of conduct and management in the provision of banking and trust services.

All licensees are expected to adhere to the Central Bank’s licensing and prudential requirements, ongoing supervisory programmes and regulatory reporting requirements, and are subject to periodic onsite examinations. Licensees are expected to conduct their affairs in conformity with all other Bahamian legal requirements.

## **II. PURPOSE**

Pursuant to section 12 of the BTCRA, the appointment of the auditor of any bank or trust company (the “licensee”) licensed by the Central Bank, is subject to the approval of the Governor of the Central Bank (*“the Governor”*). References to external auditor in this guideline shall include a firm of accountants engaged in the practice of public accounting, and where the context requires, an obligation of the auditor shall be construed as an obligation of the partners or members of a firm. References to a “public accountant” hereafter shall include a chartered accountant licensed to engage in public practice, as defined in the Public Accountants Act, 1991, and a member of The Bahamas Institute of Chartered Accountant (*“BICA”*) holding a valid licence to engage in public practice.

This Guideline sets out the criteria by which the Central Bank, in its role as supervisor, assesses the fit and proper status for the appointment of new external auditors. Further, this Guideline takes into account aspects of the Basel Committee paper, *The Relationship between Banking Supervisors and Banks’ External Auditors* issued in 2002. In this regard, the Guideline sets out parameters for reporting and dialogue between a licensee’s

external auditor and the Central Bank with a view that such exchanges would enhance supervisory oversight and monitoring.

### **III. APPLICABILITY**

This Guideline applies to all banks and trust companies licensed in The Bahamas and their external auditors.

### **IV. REQUIREMENTS FOR APPROVAL**

In approving the appointment of an external auditor pursuant to Section 12 of the BTCRA, the Governor will take the following among other factors into account:

1. Whether the nominated accountant is a member, or partners of the nominated firm are members of BICA and whether the nominated accountant or each of the partners of the nominated firm is in possession of a valid licence to engage in public practice;
2. The reputation of the firm, the members of its management, the individual accountant, and their knowledge of auditing, banking, trust, legal, and general financial matters;
3. The firm's resources and its ability to efficiently perform the proposed audit engagement(s);
4. The firm's previous experience in conducting audits of banks or trust companies;
5. Whether the firm has valid professional indemnity insurance which is sufficient and appropriate for its business activities;
6. That there are no direct or indirect interests or relationships by the firm, its management or partners in any of the business affairs of the client licensee(s), its Board of Directors (*"the Board"*) or management, or the licensee's controlling owners;
7. Whether the firm provides services for the client licensee(s) in any capacity other than that of auditor. In particular, the following functions should not be performed by the firm:
  - a) bookkeeping or other services related to the accounting records or financial statements of the audit client;
  - b) financial information systems design and implementation;

- c) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- d) actuarial services;
- e) internal audit outsourcing services;
- f) management functions or human resources;
- g) broker or dealer, investment adviser, or investment banking services;
- h) legal services and expert services unrelated to the audit; and
- i) any other service that the Central Bank determines is impermissible.

However, the Board may, with the approval of the audit committee and subject to the prior approval of the Inspector of Banks and Trust Companies (*“the Inspector”*) allow an auditor or audit firm to provide the non-audit services stated above with the exception of **internal audit** and **book-keeping services**.

The requirement for the prior approval of the Inspector in relation to the specified non-audit services is waived for a licensee provided the following conditions are met:

- i. the aggregate amount of all such non-audit services provided to the licensee constitutes less than 5% of the total amount of revenues paid by the licensee to its auditor (calculated on the basis of revenues paid by the licensee during the fiscal year when the non-audit services are performed); and
- ii. such services are promptly brought to the attention of the audit committee and approved prior to completion of the audit.

## V. TERMS OF APPROVAL

The Governor’s approval will remain in force until:

1. The approval is withdrawn in writing by the Governor, pursuant to section 12 of the Banks and Trust Companies Regulation Act, 2000;
2. Any conditions imposed to govern its use are no longer fulfilled;
3. Material changes occur in any of the criteria used in granting the approval; or,

4. It is determined that the approval was obtained by false information or other improper means.

Licenses should be aware that the Governor may, at his discretion and with proper cause, withdraw the approval of any accountant or accounting firm and consequently require the licenses that have engaged that accountant or accounting firm to appoint a replacement.

## **VI. REQUIREMENTS FOR LICENSEES**

1. Licensees must notify the Inspector in writing of their intention to appoint an audit firm.
2. Licensees must notify the Inspector of their intention to change their audit firm and provide the Inspector with an explanation of the reasons for such change.
3. Every licensee must annually furnish a copy of the finalized management letter from its external auditor to the Inspector within ten days of its receipt by the licensee and not later than 45 days after the expiration of the deadline for the submission of the financial statement.

## **VII. REQUIRED DISCLOSURES BY THE EXTERNAL AUDITORS**

As part of the application process to act as external auditor of a licensee, the auditor or audit firm should agree to the following:

1. To disclose all relations with the licensee which may affect the objectivity of the individual auditor or audit firm or its partners or management (with particular relevance to any credit facilities or other banking or trust services or products that they have obtained from or that are outstanding with the licensee);
2. To communicate to the Inspector any material issues<sup>1</sup> related to the licensee(s) which are identified during the course of their engagement(s); and
3. To provide all of the necessary background information indicated for the application, as prescribed by the Inspector.

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<sup>1</sup> Material issues are issues which in the opinion of the accountant or accounting firm, represents or could lead to a significant weakening of the system of internal controls or unduly increased risk of loss to depositors, other creditors, clients or shareholders.

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**VIII. DISCLOSURES BY THE INSPECTOR TO THE EXTERNAL AUDITOR**

The Inspector may at his discretion bring a matter to the attention of a licensee and its external auditor:-

1. When the Inspector believes that the disclosure is of such importance that the auditor's knowledge of it could significantly affect the form of his audit or other report or the way in which he performs his audit or other reporting responsibilities; and
2. When the disclosure is for the purpose of enabling or assisting the Inspector to discharge his functions under the BTCRA.
3. When the disclosure is a prudential standard, or a requirement under statute or regulation, a specific or general directive, or any of the terms or conditions of a bank or trust company's licence.

**IX. RELATIONSHIP OF THE EXTERNAL AUDITORS WITH THE INSPECTOR**

1. The external auditor may wish to arrange a meeting with the Inspector prior to the commencement of an audit to discuss prudential standards, statutory and regulatory requirements, directives, any terms or conditions (or change thereof) of licensing and any other issues relating to the audit. Alternatively, the external auditor could make a formal request to the Central Bank for the aforementioned information on a licensee as part of its audit planning process.
2. The external auditor is encouraged to immediately inform the Inspector, if the auditor becomes aware that:-
  - (a) A licensee is insolvent, or there is a significant risk that the licensee will become insolvent or the licensee fails to meet its minimum capital requirements as set by the Central Bank;
  - (b) A licensee has failed to comply with a prudential standard, a requirement under statute or regulation, a specific or general directive, or any of the terms or conditions of its licence;
  - (c) A state of affairs exists or prospectively could exist in a licensee that may materially prejudice the interests of depositors, creditors, or other clients of the licensee;
  - (d) A licensee has not taken action, within a reasonable time, to correct significant deficiencies identified by the Inspector, internal auditor or the external auditor; or,

- (e) There are other material weaknesses<sup>2</sup> and significant deficiencies<sup>3</sup> that a licensee has not reported to the Inspector.
3. The external auditor shall provide written notification to the Inspector of its intention to resign its appointed capacity to a licensee, including the reasons for such resignation.
  4. Where an external auditor has decided to issue a qualified or an adverse opinion or to disclaim an opinion, the auditor should notify the Inspector immediately.
  5. The external auditor should notify the Inspector of any scope limitations requested or imposed by the licensee, or of any obstacles to, or difficulties in obtaining information necessary to perform an audit. The notification should be immediate, particularly if the circumstances indicate that the submission of the audit or other report will be delayed, or that the audit report will be qualified.
  6. At the conclusion of each annual audit and not later than 30 days after the expiration of the deadline for the submission of the financial statement, the external auditor will produce a Management Letter detailing any issues of material concern for the licensee.

Notwithstanding the obligation of the external auditor to advise the Inspector pursuant to Section 13 of the BTCRA, licensees have a duty to inform the Inspector of all matters listed in points 1 to 4 above.

## **X. SPECIAL REQUIREMENTS ISSUED BY THE INSPECTOR**

1. The Inspector may request a licensee's external auditor or, where appropriate, another auditor, to undertake a specific review of a licensee's operations or risk management system. The cost of these specific reviews will be borne by the licensee.
2. The Inspector may require a licensee's external auditor, or other appointed auditor to:

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<sup>2</sup> A material weakness is a significant deficiency or combination of significant deficiencies that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

<sup>3</sup> A significant deficiency is a control deficiency or combination of control deficiencies, that adversely affects the company's ability to initiate, authorise, record, process or report licensee's financial data reliably in accordance with International Financial Reporting Standards (IFRS) such that there is more than a remote likelihood that a misstatement of the licensee's financial statements that is more than inconsequential will not be prevented or detected.

- (a) submit such additional information in relation to the audit as the Inspector considers necessary;
  - (b) perform special procedures or audits or examinations of licensees; and
  - (c) submit special reports on any matter(s).
3. The Inspector may issue instructions on the form and content of the reports, the cost of which will be borne by the licensee.

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