

**SUPERVISORY AND REGULATORY GUIDELINES 2006-PU14-0306****External Auditors****Issued: 6<sup>th</sup> September 2006****Revised: 15<sup>th</sup> April 2014****GUIDELINES ON THE RELATIONSHIP BETWEEN EXTERNAL AUDITORS  
OF LICENSEES AND THE CENTRAL BANK****1. INTRODUCTION**

- 1.1 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”*), as amended, and the Banks and Trust Companies (Auditors) (Facts and Matters of Material Significance) Regulations, 2011. 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.
- 1.2 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 on-site examinations. Licensees are expected to conduct their affairs in conformity with all other Bahamian legal requirements.

**2. PURPOSE**

- 2.1 The external auditor<sup>1</sup> of a licensee plays an essential role in the regulatory framework, which requires an open, cooperative and constructive relationship with the Central Bank to achieve the desired level of supervisory oversight and monitoring. Therefore, the aim of these Guidelines is to enhance the regulatory process and promote effective partnership between the external auditors and the Central Bank.
- 2.2 These Guidelines take into account aspects of the Basel Committee’s paper, *The Relationship between Banking Supervisors and Banks’ External Auditors* issued

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<sup>1</sup> References to external auditor in these guidelines 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 an “accountant” hereafter shall include a chartered accountant licensed to engage in public practice, as defined in the Public Accountants Act, 1991 or certified public accountant, and a member of The Bahamas Institute of Chartered Accountant (*“BICA”*) holding a valid licence to engage in public practice.

in 2002. In this context, the Guidelines set out parameters for reporting and dialogue between the external auditor and the Central Bank, including their respective responsibilities and the scope of information to be disclosed.

- 2.3 As of 1<sup>st</sup> September 2010, the appointment of the external auditors of a licensee is no longer subject to the prior approval of the Central Bank. However, licensees are required to inform the Central Bank of the appointment of their external auditors. These Guidelines therefore set out minimum criteria, which the Central Bank expects licensees to utilize in appointing an external auditor.

### 3. APPLICABILITY

- 3.1 These Guidelines apply to all banks and trust companies licensed in The Bahamas and to their external auditors.

### 4. CRITERIA FOR APPOINTMENT OF AN EXTERNAL AUDITOR OR AUDIT FIRM

- 4.1 Licensees should take into consideration the following factors, inter alia, when appointing an external auditor or audit firm:
- i. Whether the accountant is a member, or partners of the audit firm are members of BICA and whether the accountant or each of the partners of the audit firm is in possession of a valid licence to engage in public practice;
  - ii. The reputation of the audit firm, the members of its management, the individual accountant, and their knowledge of auditing, banking, trust, legal, and general financial matters;
  - iii. The audit firm's resources and its ability to efficiently perform the proposed audit engagement(s);
  - iv. The audit firm's previous experience in conducting audits of banks or trust companies;
  - v. Whether the audit firm has valid professional indemnity insurance which is sufficient and appropriate for its business activities;
  - vi. That there are no direct or indirect interests or relationships by the audit 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 any related company<sup>2</sup>;
  - vii. That the individual accountant, audit firm or partners of the audit firm **do not** have any relationship with the licensee or any related company with respect to any credit facilities or banking or trust services that they have obtained from or that are

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<sup>2</sup> References to a "related company" have the same meaning as specified in Section 12 (7) of the BTCRA.

outstanding with the licensee, which may affect their objectivity;

viii. Whether the audit firm provides non-audit services for the client licensee(s) in any capacity other than that of auditor. In particular, the following non-audit services **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) internal audit outsourcing services;
- c) financial information systems design and implementation;
- d) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- e) actuarial 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 deems impermissible.

4.2 However, the Board may, with the approval of the audit committee and subject to the “**no objection**” of the Inspector of Banks and Trust Companies (“*the Inspector*”), allow an auditor or audit firm to provide the **non-audit services stated above at paragraph 4.1 (viii c-i)**.

4.3 A licensee does not have to seek the Inspector’s “**no objection**” in relation to the non-audit services specified above (**See 4.1 (viii c-i)**), 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 to the auditor or audit

- firm 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.

## 5. REQUIREMENTS FOR LICENSEES

- 5.1 Licensees must **notify** the Central Bank in writing, **within fourteen (14) days of the appointment of the auditor** of the firm. Licensees should submit a copy of the Board resolution sanctioning the appointment of the auditor, as well as advise the Central Bank of the effective date of the appointment.
- 5.2 Licensees should be aware that the Central Bank might at anytime require the replacement of an auditor.
- 5.3 Licensees must **notify** the Central Bank of their **intention to change their audit firm** and provide the Central Bank with an explanation of the reasons for the change.
- 5.4 Notwithstanding the obligation of the external auditor to advise the Inspector of any fact or matter of which the auditor has or had become aware and which is, or likely to be of material significance for the Inspector to discharge his duties in relation to licensees, licensees have a duty to inform the Inspector of all matters listed in paragraph 6.3 below.

## 6 REQUIRED DISCLOSURES BY THE EXTERNAL AUDITORS

- 6.1 There is specific provision in the BTCRA for the external auditors of licensees to **share confidential information with the Inspector** relevant to the functions and responsibilities of the Inspector under the BTCRA.<sup>3</sup>
- 6.2 Pursuant to Section 12 (4) of the BTCRA, the external auditor of a licensee **is required to inform** the Inspector in writing, if the auditor becomes aware of any fact or matter of which the auditor has or had become aware and which is, or is likely to be of material significance for the Inspector in relation to the discharge of his duties in relation to licensees under the BTCRA.
- 6.3 In this context, **facts and matters of material significance** include any of the following where an auditor:

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<sup>3</sup> Section 13(5) of the BTCRA provides that “no duty of confidentiality to which an auditor or former auditor of a licensee may be subject shall be regarded as having been breached by reason of his communicating in good faith to the Inspector any information or opinion which is relevant to the functions and responsibilities of the Inspector under this Act, whether or not such information or opinion is provided in response to a request made by the Inspector.”

- (a) Identifies a material misstatement in the financial statements of a licensee resulting from fraud, error or illegal acts, or the consequences of them;
- (b) Concludes that there is substantial doubt as to the ability of a licensee to continue to operate as a going concern for a period of one (1) year from the balance sheet date;
- (c) Identifies adjustments to the financial statements which individually or in aggregate indicate to him that the previous year's audited annual financial statements, or the current year's unaudited interim financial statements, prepared according to generally accepted accounting principles and issued to the shareholders were materially misstated;
- (d) Identifies a material weakness in internal control;
- (e) Has unresolved disagreements with management pertaining to the application of generally accepted accounting principles that could reasonably be expected to lead in the future to material misstatements of the annual or interim financial statements, prepared according to generally accepted accounting principles, to be issued to the shareholders in the ensuing financial year;
- (f) Identifies any evidence of deliberate attempts by a chief executive or other senior executive to mislead the Inspector through the provision of materially false or misleading information;
- (g) Identifies evidence of fraud or attempted fraud by a chief executive or other senior executive, or has concerns of such a serious nature as to damage materially his confidence in the integrity of the senior management of the institution;
- (h) Identifies that 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;
- (i) Identifies that a state of affairs exists or may come into existence in a licensee that may materially prejudice the interests of depositors, creditors, or other clients of the licensee;
- (j) Identifies that 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

- (k) Identifies other material weaknesses<sup>4</sup> and significant deficiencies<sup>5</sup> that a licensee has not reported to the Inspector.
- 6.4 In addition, pursuant to Section 12(3) (b) of the BTCRA, the external auditor is **required to inform** the Inspector **immediately** in writing of the following:
- (a) His intention to resign before the expiration of his term in office, including the reason(s) for such resignation;
  - (b) His intention not to seek to be reappointed, including the reason(s) for not seeking reappointment; and
  - (c) A decision to include a modification in his report on the licensee's financial statements and, in particular, a qualification or denial of his opinion or the statement of an adverse opinion.
- 6.5 Furthermore, 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.
- 6.6 At the conclusion of each annual audit and not later than **thirty (30) days** after the expiration of the deadline for the submission of the financial statements, the external auditor will produce a **Management Letter**, detailing any issues of material concern for the licensee. The auditor must annually furnish a copy of the finalised management letter to the Inspector within **ten (10) days** of sending it to the licensee and not later than **forty-five (45) days** after the expiration of the deadline for the submission of the financial statements to the Central Bank.

## 7 PENALTY FOR NON-DISCLOSURE

- 7.1 Pursuant to Section 12(5) of the BTCRA, where the external auditor fails to comply with the requirements set out in **paragraphs 6.2 and 6.4** above, he may be **subject to a fine of twenty-five thousand (\$25,000) dollars** on summary conviction.

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<sup>4</sup> A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

<sup>5</sup> A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects a licensee'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.

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## 8 DIALOGUE BETWEEN THE CENTRAL BANK AND THE EXTERNAL AUDITOR

- 8.1 The Inspector may at anytime bring, at his discretion, a matter to the attention of the external auditor of a licensee if:
- i. 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;
  - ii. the disclosure is for the purpose of enabling or assisting the Inspector to discharge his functions under the BTCRA; and
  - iii. the disclosure relates to a prudential standard, or a requirement under statute or regulation, a specific or general directive, or any of the terms or conditions of a licensee's licence.

## 9 SPECIAL REQUIREMENTS OF THE INSPECTOR

- 9.1 The Inspector may pursuant to Section 13 of the BTCRA 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.
- 9.2 The Inspector may require a licensee's external auditor, or other appointed auditor to:
- (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).
- 9.3 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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