Financial Reporting Council

June 2017

Consultation

Appendix: ISA (UK) 250 Part A – Consideration of laws and regulations in an audit of financial statements

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

ISA (UK) 250 PART A – CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

Appendix

(Ref: Para. A6)

Money laundering, terrorist financing and proceeds of crime legislation in the United Kingdom[1]

1. In the United Kingdom, the auditor has additional responsibilities that arise as a result of money laundering, terrorist financing and proceeds of crime legislation, including:[2]

   - Proceeds of Crime Act 2002 (POCA) (as subsequently amended by the Serious and Organised Crime and Police Act 2005 (SOCPA)).
   - Terrorism Act 2000 (TACT) (as amended).
   - Crime and Courts Act 2013.
   - Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (SI 692/2017).

   Hereafter known collectively as the "Anti-Money Laundering Legislation".

2. The Anti-Money Laundering Legislation is complex and this Appendix focuses on the impact of the Anti-Money Laundering Legislation on the auditor's responsibilities when auditing and reporting on financial statements.[3] To obtain a full understanding of the legal requirements auditors will need to refer to the relevant provisions of the legislation and, if necessary, obtain legal advice.[4]

Changes under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

3. The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 replace the Money Laundering Regulations 2007. The Regulations apply to persons, acting in the course of business as a statutory auditor within the meaning of Part 42 of the Companies Act 2006, when carrying out statutory audit work within the meaning of Section 1210 of the Companies Act 2006.[5] The 2017 Regulations amend POCA and TACT to make them applicable to those persons carrying out audits in accordance with Section 4(1) of the Local Audit and Accountability Act 2014. Regulation 100 (1) also provides an updated list of public bodies and persons who are obliged to report where they know or suspect money laundering has taken place, or have reasonable ground for suspicion thereof to the NCA. For the purposes of this appendix "person" is interpreted as referring to a UK audit firm that is designated as a "Registered Auditor" to which the Regulations apply.

4. Where a Registered Auditor is not carrying out statutory audit work the Regulations will nevertheless often apply as they also cover a firm or sole practitioner who provides accountancy

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1 The revised guidance has been shared with HM Treasury, HM Revenue and Customs and the National Crime Agency before being finalised.

2 This Appendix reflects the legislation effective at 26 June 2017. Auditors need to be alert to subsequent changes in legislative requirements.

3 The Consultative Committee of Accountancy Bodies has issued revised "Anti-Money Laundering Guidance for the Accountancy Sector" ("CCAB Guidance") which provides general guidance on the legislation for all entities providing audit, accountancy, tax advisory or insolvency related services. This is available on the CCAB website at http://www.ccab.org.uk/documents.php

4 Detailed guidance by the NCA is available at: http://www.nationalcrimeagency.gov.uk/publications/725-sar-glossary-code-and-reporting-routes/file

5 Regulation 11(1) of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (The 2017 Regulations).

services to, or advice about the tax affairs of, other persons[6]. The 2017 Regulations impose requirements on businesses in the regulated sector relating to systems, procedures and training to prevent money laundering, provide identification procedures for clients, maintain records and internal reporting.

To whom does the Anti-Money Laundering Legislation apply?

5. The requirement to make a report under Section 330 and 331 of POCA applies to information which comes to a person in the course of a business, or an MLRO, in the regulated sector. That information may relate to money laundering by persons or businesses inside or outside the regulated sector. The offence of failing to report that another person is engaged in money laundering applies to all money laundering, including conduct taking place overseas that would be an offence if it took place in the UK. For that reason there may be an obligation to report information arising from the audit of non-UK companies or their subsidiaries.

When is an auditor in the UK regulated sector?

6. The regulated sector includes any firm or individual who acts in the course of a business carried on in the UK as an auditor.

7. A person is eligible for appointment as an auditor if the person is a member of a recognised supervisory body, (which is a body established in the UK which maintains and enforces rules as to the eligibility of persons to seek appointment as an auditor and the conduct of audit work, and which is recognised by the Secretary of State by Order) and is eligible for appointment under the rules of that body. A person will fall within the regulated sector in their capacity as an auditor when carrying out statutory audit work within the meaning of Section 1210 of the Companies Act 2006. In summary, this comprises the audit of UK private or public companies, building societies, friendly societies, Lloyds syndicate aggregate accounts, insurance undertakings, limited liability partnerships, qualifying partnerships , those carrying out audits in accordance with Section 4(1) of the Local Audit and Accountability Act 2014 and any other such bodies as the Secretary of State may prescribe by Order.

8. The Anti-Money Laundering Legislation apply to all partners and staff within a UK audit firm who are involved in providing audit services in relation to statutory audit work in the UK. Where they become involved in audit work in the UK, such persons may include experts from other disciplines within the UK audit firm and employees (both audit partners and staff and experts from other disciplines) of non-UK audit firms.

9. Where they are not involved in audit work in the UK such persons may fall within other parts of the regulated sector. For example, the provision of accountancy services to other persons by way of business is within the regulated sector regardless of whether the person providing the services is or is not a member of a UK professional auditing/accountancy body.

10. It is unlikely that it will be practicable or desirable for a UK audit firm which is within the regulated sector to distinguish for reporting purposes between partners and staff who are providing services in the regulated sector and those who are not. Accordingly, UK audit firms may choose to impose procedures across the firm requiring all partners and staff to report to the firm's MLRO[7].

11. The use of the term 'auditor' in this appendix means anyone who is part of the engagement team as defined in ISA (UK) 220 (Revised June 2016).[8] For audits carried out in accordance with the FRC Ethical Standard, the audit team comprises all persons who are directly involved in the acceptance and performance of a particular audit. This includes the audit team (including audit professionals contracted by the firm), professional personnel from other disciplines involved in the audit engagement and those who provide quality control or direct oversight of the audit engagement, but it does not include experts contracted by the firm.

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[6] Regulations 11(3) and 11(4) of the 2017 Regulations.

[7] Persons outside the regulated sector are not obliged to report to their MLRO under POCA Section 330 and Section 331 (the 'failure to report' offence), but can make voluntary reports under POCA Section 337.

[8] ISA (UK) 220 (Revised June 2016), *Quality Control for an Audit of Financial Statements*, paragraph 7(d).

Key legal requirements

12. The Anti-Money Laundering Legislation establishes the following auditor's responsibilities:

- The Anti-Money Laundering Legislation does not extend the scope of the audit, but the auditor is within the regulated sector and is required to report where:
  - The auditor knows or suspects, or has reasonable grounds to know or suspect, that another person is engaged in money laundering;
  - The auditor can identify the other person or the whereabouts of any of the laundered property or that the auditor believes, or it is reasonable to expect the auditor to believe, that information that the auditor has obtained will or may assist in identifying that other person or the whereabouts of the laundered property; and
  - The information has come to the auditor in the course of the auditor's 'regulated' business.
- POCA defines both the money laundering offences and the auditor's reporting responsibilities. The Anti-Money Laundering Legislation imposes a duty to report money laundering in respect of all criminal property.[9]
- Failure by an auditor to report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering in relation to the proceeds of any crime is a criminal offence.[10] Auditors (partners and staff) will face criminal penalties[11] if they breach the requirements.
- The requirement to report is not just related to matters that might be considered material to the financial statements; the auditor has to report knowledge or suspicion, or reasonable grounds for knowledge or suspicion, of crimes that potentially have no material financial statement impact. **The Anti-Money Laundering Legislation does not contain de minimis concessions**.
- A very wide range of offences (e.g., bribery and corruption both in and outside of the UK, and therefore also subject to the provisions of the Bribery Act 2010) may give rise to a responsibility to report money laundering suspicions.
- Where an auditor knows or suspects that the auditor themselves are involved in money laundering, the auditor is required to report this in order that appropriate consent can be obtained.
- The firm must take appropriate measures so that partners and staff are made aware of the provisions of the Anti-Money Laundering Legislation and are given training in how to recognise and deal with actual or suspected money laundering activities.
- The firm is required to adopt rigorous client identification procedures and appropriate anti-money laundering procedures.

Money Laundering Offences

13. There are three principal money laundering offences in POCA which define money laundering to encompass offences relating to the concealment (Section 327), acquisition, retention or use (Section 328) and acquisition, use, and possession (Section 329) of criminal property and involvement in arrangements relating to criminal property. These principal offences apply to all persons and businesses whether or not they are within the regulated sector.

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[9] Property is criminal property if: (i) it constitutes a person's benefit from criminal conduct or it represents such a benefit (in whole or in part and whether directly or indirectly); and (ii) the alleged offender knows or suspects that it constitutes or represents such a benefit.

[10] Subject to the provisions of POCA Section 330(6) relating to information coming to a legal adviser or relevant professional adviser in "privileged circumstances" and Section 330(7A) relating to offences committed overseas.

[11] Criminal penalties are covered under Sections 334 and 336(6) of POCA. The maximum penalty for the three principal money laundering offences on conviction on indictment is fourteen years imprisonment. The maximum penalty on conviction on indictment is five years imprisonment. In all cases, an unlimited fine can be imposed.

14. Under Section 330 of POCA persons working in the regulated sector are required to report knowledge or suspicion, or reasonable grounds for knowledge or suspicion, that another person is engaged in money laundering to a nominated officer where that knowledge or suspicion, or reasonable grounds for knowledge or suspicion, came to those persons in the course of their business or employment in the regulated sector. In audit firms the nominated officer is usually known as a Money Laundering Reporting Officer ("MLRO") and is referred to as such in this appendix (see paragraphs 21 to 23 of this Appendix).[12] If as a result of that report the MLRO has knowledge or suspicion of, or reasonable grounds to know or suspect money laundering, the MLRO then has a responsibility to report to the Financial Intelligence Unit of the National Crime Agency (NCA).

15. Auditors who consider that the actions they plan to take, or may be asked to take, will result in themselves committing a principal money laundering offence are required to obtain prior consent to those actions from their MLRO and the MLRO is required to seek appropriate prior consent from the NCA (see paragraphs 47 to 49 of this Appendix).

Firm-wide practices

16. The Anti-Money Laundering Legislation requires the firm to establish risk-sensitive policies and procedures[13] relating to:

    - Customer identification and on-going monitoring of business relationships;
    - Reporting internally and to the NCA;[14]
    - Record keeping;
    - Internal control, risk assessment and management;
    - Training for all relevant employees; and
    - Monitoring and management of compliance with and the internal communication of such policies and procedures.

    In addition, the firm needs to ensure sufficient senior management oversight of the systems used for monitoring compliance with these procedures. It may be helpful for this to be co-ordinated with the responsibility for the firm's quality control systems under ISQC (UK) 1 (Revised June 2016).[15]

Client identification and on-going monitoring of business relationships

17. Appropriate identification procedures,[16] as required by the Anti-Money Laundering Legislation, are mandatory when accepting appointment as auditor. The extent of information collected about the client and verification of identity undertaken will depend on the client risk assessment.

18. Auditing standards on quality control require the firm to consider the integrity of the client. This involves the firm making appropriate enquiries and may involve discussions with third parties, the obtaining of written references and searches of relevant databases. These procedures may provide some of the relevant client identification information but may need to be extended to comply with the Anti-Money Laundering Legislation.

19. It may be helpful for the auditor to explain to the client the reason for requiring evidence of identity and this can be achieved by including this matter in pre-engagement letter communications with

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[12] Requirements relating to internal reporting procedures do not apply to sole practitioners, however, they are still subject to external reporting obligations under POCA still apply. Where a sole practitioner has knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering they have a responsibility to report to the NCA (see paragraph 22 of this Appendix).

[13] Detailed guidance on developing and applying a risk based approach is given in Section 4 of the CCAB Guidance.

[14] Whilst a risk based approach is appropriate when devising policies and procedures, the auditor will not adopt a risk based approach to making reports either internally or to the NCA.

[15] International Standard on Quality Control (UK) 1 (Revised June 2016) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance and Related Services Engagements*.

[16] Guidance on identification procedures, including references to financial restrictions regimes (i.e., sanctions), is given in Section 5 of the CCAB Guidance.

the potential client. It may also be helpful to inform clients of the auditor's responsibilities under the Anti-Money Laundering Legislation to report knowledge or suspicion, or reasonable grounds to know or suspect, that a money laundering offence has been committed and the restrictions created by the 'tipping off' rules on the auditor's ability to discuss such matters with clients. Such wording could be included in the auditor's engagement letter.[17]

20. The activities of and the relationship with the client will be monitored on an on-going basis. For example, if there has been a change in the client's circumstances, such as changes in beneficial ownership, control or directors, and this information was relied upon originally as part of the client identification procedures, then, depending on the auditor's assessment of risk, the procedures may need to be re-performed and documented. However, annual reappointment as auditor does not, in itself, require the client identification procedures to be re-performed.

Money Laundering Reporting Officer

21. The Anti-Money Laundering Legislation requires relevant entities to appoint a nominated officer (usually known as the MLRO). The auditor is required to report where the auditor knows or suspects, or has reasonable grounds to know or suspect, that another person is engaged in money laundering or, for the purposes of obtaining consent, where the auditor knows or suspects that the auditor themselves are involved in money laundering. The Anti-Money Laundering Legislation does not contain de minimis concessions that affect the reporting requirements with the result that reports need to be made irrespective of the quantum of the benefits derived from, or the seriousness of, the offence.

22. A sole practitioner is not required to appoint a Money Laundering Reporting Officer (MLRO), however, the external reporting obligations under the Anti-Money Laundering Legislation remains and where a sole practitioner has knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering they have a responsibility to report to the NCA. References in this guidance to reporting matters to the MLRO should be read as making a report directly to the NCA in the case of a sole practitioner.

23. Partners and staff in audit firms discharge their responsibilities by reporting to the firm's MLRO and, where appropriate, by obtaining consent from the MLRO or the NCA to continue with any prohibited activities. The MLRO is responsible for deciding, on the basis of the information provided by the partners and staff, whether further enquiry is required, whether the matter should be reported to the NCA and for making the report. Partners and staff may seek advice from the MLRO who will often act as the main source of guidance and if necessary act as the liaison point for communication with the firm's own legal counsel, the NCA and the relevant law enforcement agency. When a report has been made to the NCA, partners and staff need to be alert to the dangers of disseminating information that is likely to 'tip off' a money launderer or prejudice an investigation as this may constitute a criminal offence under the Anti-Money Laundering Legislation.

Training

24. Firms are required to take appropriate measures so that partners and staff are made aware of the relevant provisions of the Anti-Money Laundering Legislation and are given training in how to recognise and deal with activities which may be related to money laundering.[18] The level of training provided to partners and staff needs to be appropriate to both the level of exposure of the individual to money laundering risk and the individual's role and seniority within the firm. Senior members of the firm whatever their role need to understand the requirements of the Anti-Money Laundering Legislation. Additional training or expertise in criminal law is not required under the Anti-Money Laundering Legislation. However, ISA (UK) 250 (Revised June 2016)[19] requires the auditor to obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates and how the entity is complying with that framework.

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[17] ISA (UK) 210 (Revised June 2016), *Agreeing the Terms of Audit Engagements*.

[18] Guidance on training is given in Section 3 of the CCAB Guidance.

[19] ISA (UK) 250 (Revised June 2016) Section A—*Consideration of Laws and Regulations in an Audit of Financial Statements*.

IMPACT OF LEGISLATION ON AUDIT PROCEDURES

Identification of knowledge or suspicions

25. ISA (UK) 250 (Revised June 2016) establishes standards and provides guidance on the auditor's responsibility to consider laws and regulations in an audit of financial statements. The Anti-Money Laundering Legislation does not require the auditor to extend the scope of the audit, save as referred to in paragraph 34 of this Appendix, but during the course of the audit, knowledge or suspicion, or reasonable grounds for knowledge or suspicion relating to money laundering activities may arise that will need to be reported.

26. ISA (UK) 250 (Revised June 2016) requires the auditor to obtain:

    - A general understanding of the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates and how the entity is complying with that framework;[20] and

    - Sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements.[21] This may cause the auditor to be suspicious that, for example, breaches of the Companies Act or tax offences have taken place, which may be criminal offences resulting in criminal property.

27. ISA (UK) 250 (Revised June 2016)[22] also requires the auditor to perform procedures to help identify instances of non-compliance with other laws and regulations which may have a material effect on the financial statements. These procedures may include:

    - Enquiring of management and, where appropriate, those charged with governance as to whether the entity is in compliance with such laws and regulations.

    - Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

    These procedures may give the auditor grounds to suspect that criminal offences have been committed.

28. For entities within the regulated sector[23] or public interest entities, other laws and regulations that may have a material effect on the financial statements will include Anti-Money Laundering Legislation. When auditing the financial statements of entities within the regulated sector the auditor reviews the steps taken by the entity to comply with the Anti-Money Laundering Legislation, assesses their effectiveness and obtains management representations concerning compliance with that legislation. If the auditor assesses the entity's internal control as ineffective, the auditor considers whether there is a statutory responsibility to report 'a matter of material significance' to the regulator in accordance with ISA (UK) 250 (Revised June 2016)[24].

29. Where the entity's business is outside the regulated sector, although the auditor's reporting responsibilities under the Anti-Money Laundering Legislation are unchanged, the entity's management is not required to implement the Anti-Money Laundering Legislation. Whilst the principal money laundering offences apply to these entities, the laws relating to money laundering are unlikely to be considered by the auditor to be other laws and regulations that may have a material effect on the financial statements for the purposes of ISA (UK) 250 (Revised June 2016),

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[20] ISA (UK) 250 (Revised June 2016) Section A, paragraph 13.

[21] ISA (UK) 250 (Revised June 2016) Section A, paragraph 14.

[22] ISA (UK) 250 (Revised June 2016) Section A, paragraph 15.

[23] For the purposes of this appendix this includes (but is not restricted to) the following persons acting in the course of business in the United Kingdom: credit institutions; financial institutions (including money service operators); auditors, insolvency practitioners, external accountants and tax advisers; independent legal professionals; trust or company service providers; estate agents; high value dealers when dealing in goods of any description which involves accepting a total cash payment of 10,000 euro or more; and casinos. More detail is provided in Part 2 of the 2017 Regulations.

[24] ISA (UK) 250 (Revised June 2016) Section B—*The Auditor's Statutory Right and Duty to Report to Regulators of Public interest Entities and Regulators of Other Entities in the Financial Sector*.

unless there are other indicators that may lead to a risk of material misstatement of the financial statements.

30. ISA (UK) 250 (Revised June 2016) requires the auditor to be alert to the possibility that audit procedures applied for the purpose of forming an opinion on the financial statements may bring instances of possible non-compliance with other laws and regulations to the auditor's attention. This includes non-compliance that might incur obligations for the auditor to report to a regulatory or other enforcement authority.

31. The auditor also gives consideration to whether any contingent liabilities might arise in this area. For example, there may be regulatory or criminal fines for offences under the Anti-Money Laundering Legislation. Even where no offence under the Anti-Money Laundering Legislation has been committed, civil recovery actions under POCA (Part 5) or other civil claims may give rise to contingent liabilities. The auditor remains alert to the fact that discussions with the entity on such matters may give rise to a risk of 'tipping off' (see paragraphs 43 to 46 of this Appendix).

32. In some situations the audit client may have obtained legal advice to the effect that certain actions or circumstances do not give rise to criminal conduct and therefore cannot give rise to criminal property. Whether an act constitutes non-compliance with laws and regulations may involve consideration of matters on which an auditor is not competent to give a view. Provided that the auditor considers that the advice has been obtained from a suitably qualified and independent lawyer and that the lawyer was made aware of all relevant circumstances known to the auditor, the auditor may rely on such advice, provided the auditor has complied with ISA (UK) 500[25] and ISA (UK) 620 (Revised June 2016)[26].

33. The Anti-Money Laundering Legislation requires the auditor to report the laundering of the proceeds of conduct which takes place overseas if that conduct would constitute an offence in any part of the UK, subject to certain exceptions. The Anti-Money Laundering Legislation does not change the scope of the audit and does not therefore impose any requirement for the group engagement team to change or add to the normal instructions to component auditors of overseas subsidiaries. However, when considering non-UK parts of the group audit the group engagement team will need to consider whether information obtained as part of the group audit procedures (e.g., reports made by non-UK subsidiary auditors, discussions with non-UK subsidiary auditors or discussions with UK and non-UK directors) gives rise to knowledge or suspicion, or reasonable grounds for knowledge or suspicion, such that there is a requirement for the auditor to report to the NCA. The auditor will also wish to consider whether such conduct constitutes an offence under Section 6 of the Bribery Act 2010.

Further enquiry

34. Once the auditor identifies or suspects non-compliance with laws and regulations, the auditor will need to make further enquiries to assess the implications of this for the audit of the financial statements. ISA (UK) 250 (Revised June 2016)[27] requires that when the auditor becomes aware of information concerning a possible instance of non-compliance, the auditor should obtain an understanding of the nature of the act and the circumstances in which it has occurred, and sufficient other information to evaluate the possible effect on the financial statements. Where the auditor knows or suspects, or has reasonable grounds to know or suspect, that another person is engaged in money laundering, a disclosure must be made to the firm's MLRO. The Anti-Money Laundering Legislation does not require the auditor to undertake any additional enquiries to determine further details of the predicate criminal offence. Where the auditor is uncertain as to whether or not there are grounds to make a disclosure, the engagement partner may wish to seek advice from the firm's MLRO.

35. In performing any further enquiries in the context of the audit of the financial statements the auditor takes care not to alert a money launderer to the possibility that a report will be or has been made, especially if management and, where applicable, those charged with governance are themselves involved in the suspected criminal activity.

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[25] ISA (UK) 500 *Audit Evidence*.

[26] ISA (UK) 620 (Revised June 2016) *Using the Work of an Auditor's Expert*.

[27] ISA (UK) 250 (Revised June 2016) Section A, paragraph 19.

Reporting to the MLRO and to the NCA

36. The auditor reports to the firm's MLRO where the auditor knows or suspects, or has reasonable grounds to know or suspect, that another person is engaged in money laundering. Money laundering reports need to be made irrespective of the quantum of the benefits derived from, or the seriousness of, the offence. There is no provision for the auditor not to make a report even where the auditor considers that the matter has already been reported, unless the auditor:

    - Does not have the information to identify the money launderer and the whereabouts of any of the laundered property, or
    - Does not believe, and it is unreasonable to expect the auditor to believe, that any information held by the auditor will or may assist in identifying the money launderer or the whereabouts of any of the laundered property.

37. Where suspected money laundering occurs wholly or partially overseas in relation to conduct that is lawful in the country where it occurred the position is more complicated, and the auditor needs to be careful to ensure that the strict requirements of the Anti-Money Laundering Legislation have been satisfied if no report is to be made to the MLRO or to the NCA. In these circumstances, the auditor considers two questions:

    - Where the client or third party's money laundering is occurring wholly overseas: is the money laundering lawful there? If it is, a report is not required. However, the auditor needs to be careful to ensure that no consequences of the criminal conduct are, in fact, occurring in the UK;
    - Where the client or third party's money laundering is occurring in the UK in relation to underlying conduct which occurred overseas and was lawful there: would the conduct amount to a 'serious offence' under UK law[28] if it had occurred here? If it would have amounted to such an offence, a report is required. The auditor should also consider whether such conduct would be an offence under Section 6 of the Bribery Act 2010.

    The duties to report on overseas money laundering activity are complex as they rely on knowledge of both overseas and UK law. In practice, the auditor may choose to report all overseas money laundering activity to the firm's MLRO, subject to the auditor having the information set out in paragraph 36 of this Appendix.

38. During the course of the audit the auditor may obtain knowledge or form a suspicion about a prohibited act that would be a criminal offence under the Anti-Money Laundering Legislation but has yet to occur. Because attempting or conspiring to commit a money laundering offence is in itself a money laundering offence, a report might need to be made.

39. The format of the internal report made to the MLRO is not specified by the Anti-Money Laundering Legislation. MLROs determine the form in which partners and staff report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering offences. The form and content of these reports will need to provide the MLRO with sufficient information to enable a report to be made to the NCA if necessary, and it may be helpful, therefore, for the reports to use the NCA templates available online for the purposes of gathering information.[29] The auditor follows the firm's internal documentation procedures when considering whether to include documentation relating to money laundering reporting in the audit working papers. In order to prevent 'tipping off' where another auditor or professional advisor has access to the audit file, the auditor may wish to have all details of internal reports held by the MLRO and exclude these from audit files. Reporting as soon as is practicable to the MLRO is the responsibility of the auditor and although suspicions would normally be discussed within the engagement team before deciding whether or not to make an internal report to the MLRO this should not delay the report.

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[28] A 'serious offence' is conduct that would constitute an offence punishable by imprisonment for a maximum term in excess of 12 months if it occurred in any part of the UK, with the exception of:

(a) an offence under the Gaming Act 1968;

(b) an offence under the Lotteries and Amusements Act 1976; or

(c) an offence under Section 23 or 25 of the Financial Services and Markets Act 2000.

[29] http://www.nationalcrimeagency.gov.uk/about-us/what-we-do/economic-crime/ukfiu/how-to-report-sars

40. The MLRO makes the decision as to whether a report is made by the firm to the NCA. Suspicious Activity Reports may be made using one of the NCA's manual or on-line forms.[30]

41. The timing of reporting by the MLRO is governed by the Anti-Money Laundering Legislation which requires the disclosure to be made "as soon as is practicable" after the information or other matter comes to the attention of the MLRO.[31] Where the information includes time sensitive information (e.g., that may allow the recovery of proceeds of crime if communicated immediately) the report will need to be made quickly.

Legal privilege

42. Legal privilege can provide a defence for a professional legal adviser to a charge of failing to report knowledge or suspicion of money laundering and is generally available to the legal profession when giving legal advice to a client or acting in relation to litigation.[32] If the auditor is given access to client information over which legal professional privilege may be asserted (e.g., correspondence between clients and solicitors in relation to legal advice or litigation) and that information gives grounds to suspect money laundering, the auditor considers whether the auditor is nevertheless obliged to report to the MLRO. There is some ambiguity about how the issue of legal privilege is interpreted and a prudent approach is to assume that legal privilege does not extend to the auditor. Where the auditor is in possession of client information which is clearly privileged (e.g., a solicitor's advice to an entity), the auditor seeks legal advice.

'Tipping off' and prejudicing an investigation

43. In the UK, 'tipping off' is an offence for individuals in the regulated sector under the Anti-Money Laundering Legislation. This offence arises:

    (a) When an individual discloses that a report has been made based on information that came to that individual in the course of a business in the regulated sector and the disclosure by the individual is likely to prejudice an investigation which might be conducted; or

    (b) When an individual discloses that an investigation is being contemplated or is being carried out into allegations that a money laundering offence has been committed and the disclosure by the individual is likely to prejudice that investigation and the information on which the report is based came to a person in the course of a business in the regulated sector.

44. There are a number of exceptions to this offence under the Anti-Money Laundering Legislation, including where disclosures are made:

    - To a fellow auditor employed by a firm that shares common ownership, management or control with the firm (some network firms may not meet this test);
    - To an auditor in another firm in the EEA (or an equivalent jurisdiction for money laundering purposes, where both are subject to equivalent confidentiality and data protection obligations), in relation to the same entity and a transaction or service involving them both, for the purpose of preventing a money laundering offence;
    - To a supervisory authority for the person making the disclosure;
    - For the purpose of the detection, investigation or prosecution of a criminal offence (whether in the UK or elsewhere);
    - Where the auditor is acting as a relevant professional adviser to the client, for the purpose of dissuading the client from engaging in an offence; or

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30 http://www.nationalcrimeagency.gov.uk/about-us/what-we-do/economic-crime/ukfiu/how-to-report-sars

31 Guidance on the reporting of knowledge and suspicions by the MLRO to the NCA is given in Section 7 of the CCAB Guidance.

32 Statutory Instrument 2006/308 "The Proceeds of Crime Act 2002 and Money Laundering Regulations 2003 (Amendment) Order 2006" extended this defence to accountants, auditors or tax advisers who satisfy certain conditions where the information on which their suspicion of money laundering is based comes to their attention in privileged circumstances. In such circumstances, the auditor may discuss their suspicions with the MLRO without requiring a disclosure to the NCA.

- In circumstances where the person making the disclosure does not know or suspect that the disclosure is likely to prejudice an investigation.

45. A further offence of prejudicing an investigation is included in the Anti-Money Laundering Legislation. Under this provision,[33] it is an offence to make any disclosure which is likely to prejudice an investigation of which a person has knowledge or suspicion, or to falsify, conceal, destroy or otherwise dispose of, or cause or permit the falsification, concealment, destruction or disposal of, documents relevant to such an investigation.

46. ISA (UK) 260 (Revised June 2016) requires the auditor to communicate significant findings from the audit with those charged with governance of an entity. The auditor will consider whether there is a need to communicate suspicions of money laundering to those charged with governance of an entity. Under the Anti-Money Laundering Legislation a 'tipping off' offence is not committed by an auditor where a disclosure is made to the entity in order to dissuade the entity from engaging in a money laundering offence (e.g., where an employee is engaged in money laundering using the entity's financial systems, the auditor may inform management, or, where applicable, those charged with governance of the situation in order to prevent the entity from committing a money laundering offence). However, care will be taken as to whom the disclosure is made where management or those charged with governance are, or are suspected to be, involved in the money laundering activity or complicit with it.

Reporting to obtain appropriate consent

47. In addition to the auditor's duty to report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering under the Anti-Money Laundering Legislation, the auditor may need to obtain appropriate consent to perform an act which could otherwise constitute a principal money laundering offence.[34] For example, if the auditor suspected that the auditor's report was necessary in order for financial statements to be issued in connection with a transaction involving the proceeds of crime, or if the auditor was to sign off an auditor's report on financial statements for an entity that was a front for illegal activity, the auditor might be involved in an arrangement which facilitated the acquisition, retention, use or control of criminal property under the Anti-Money Laundering Legislation. In these circumstances, in addition to the normal procedures, the auditor would generally need to obtain appropriate consent from the NCA via the MLRO as soon as is practicable. Consent may be given expressly or may be deemed to have been given following the expiry of certain time limits specified in the Anti-Money Laundering Legislation.[35]

48. The auditor will also need to consider whether continuing to act for the entity could itself constitute money laundering, for example, if it amounted to aiding or abetting the commission of one of the principal money laundering offences, or if it amounted to one of the principal money laundering offences itself, in particular the offence of becoming involved in an arrangement under the Anti-Money Laundering Legislation. In those circumstances the auditor may want to consider whether to resign, but should firstly contact the MLRO, both to report the suspicions and to seek guidance in respect of 'tipping off'. If the auditor wishes to continue to conduct the audit they may need to seek NCA consent for such an action to be taken.

49. Appropriate consent from the NCA will protect the auditor from committing a principal money laundering offence but will not relieve the auditor from any civil liability or other professional, legal or ethical obligations. As an alternative to seeking appropriate consent, the auditor may wish to consider resignation from the audit but, in such circumstances, is still required to disclose suspicions to the MLRO. Further guidance on resignation is given in paragraphs 56 to 60 of this Appendix.

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[33] Section 342 of POCA.

[34] Subject to the SOCPA amendments to Sections 327, 328 and 329 for overseas activities which state that it is not a money laundering offence for a person to deal with the proceeds of conduct which that person knows, or believes on reasonable grounds, occurred in a particular country or territory outside the UK, and which was known to be lawful, at the time it occurred, under the criminal law then applying in that country or territory, and does not constitute a 'serious offence' under UK law (see footnote 10).

[35] Further guidance on seeking appropriate consent is given in the NCA publication: *Requesting a Defence from the NCA under POCA and TACT* which can be downloaded from http://www.nationalcrimeagency.gov.uk/publications/713-requesting-a-defence-under-poca-tact/file.

Reporting to regulators

50. Reporting to NCA does not relieve the auditor from other statutory duties. Examples of statutory reporting responsibilities include:

    - *Audits of public interest entities and other entities in the financial sector*: the auditor has a statutory duty to report matters of 'material significance' to the FCA or PRA (or other appropriate authority outside the entity) which come to the auditor's attention in the course of the audit.
    - *Audits of entities in the public sector*: the auditor of some public sector entities may be required to report on the entity's compliance with requirements to ensure the regularity and propriety of financial transactions. Activity connected with money laundering may be a breach of those requirements.
    - *Audits of other types of entity:* the auditor of some other entities are also required to report matters of 'material significance' to regulators (e.g., charities and occupational pension schemes).

51. Knowledge or suspicion, or reasonable grounds for knowledge or suspicion, of involvement of the entity's directors in money laundering, or of a failure of a regulated business to comply with the Anti-Money Laundering Legislation would normally be regarded as being of material significance to a regulator and so give rise to a statutory duty to report to the regulator in addition to the requirement to report to the NCA. A 'tipping off' offence is not committed when a report is made to that entity's supervisory authority and where a disclosure is not likely to prejudice an investigation.

The auditor's report on financial statements

52. Where it is suspected that money laundering has occurred the auditor will need to apply the concept of materiality (both quantitatively and qualitatively) when considering whether the auditor's report on the financial statements needs to be modified, taking into account whether:

    - The crime itself has a material effect on the financial statements;
    - The consequences of the crime have a material effect on the financial statements, including whether; or
    - The outcome of any subsequent investigation by the police or other investigatory body may have a material effect on the financial statements.

53. If it is known that money laundering has occurred and that management or those charged with governance were knowingly involved, the auditor will need to consider whether the auditor's report should be modified in accordance with ISA (UK) 705 (Revised June 2016).[36]

54. However, the auditor needs to consider whether including information in the auditor's report about any identified or suspected money laundering activities, for example, through modifying the auditor's opinion or communicating key audit matters,[37] could alert a money launderer.

55. Timing may be the crucial factor. Any delay in issuing the auditor's report pending the outcome of an investigation is likely to be impracticable and could in itself alert a money launderer. The auditor seeks advice from the MLRO who acts as the main source of guidance and if necessary is the liaison point for communication with the firm's own legal counsel, the NCA and the relevant law enforcement agency.

Resignation and communication with successor auditors[38]

56. The auditor may wish to resign from the position as auditor if the auditor believes that the entity or an employee of that entity is engaged in money laundering or any other illegal act, particularly where a normal relationship of trust can no longer be maintained. Where the auditor intends to

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[36] ISA (UK) 705 (Revised June 2016) *Modifications to the Opinion in the Independent Auditor's Report*.

[37] Paragraph A24 of ISA (UK) 260 (Revised June 2016) *Communication with Those Charged With Governance* describes the circumstances in which the auditor is required or may otherwise consider it necessary to include additional information in the auditor's report in accordance with the ISAs (UK).

[38] Section 9 of the CCAB Guidance provides more general guidance on cessation of work and resignation.

cease to hold office there may be a conflict between the requirements under Section 519 of the Companies Act 2006 for the auditor to deposit a statement at a company's registered office of any circumstances that the auditor believes should be brought to the attention of members or creditors and the risk of 'tipping off'. This may arise if, for example, the circumstances connected with the resignation of the auditor include knowledge or suspicion of money laundering and an internal or external disclosure being made.

57. Where such disclosure of circumstances may amount to 'tipping off', the auditor seeks to agree the wording of the Section 519 statement with the relevant law enforcement agency and, failing that, seeks legal advice. The auditor seeks advice from the MLRO who acts as the main source of guidance, including from the firm's own legal counsel, the NCA and the relevant law enforcement agency. The auditor may as a last resort need to apply to the court for direction as to what is included in the Section 519 statement.

58. The offence of 'tipping off' may also cause a conflict with the need to communicate with the prospective successor auditor in accordance with legal and ethical requirements relating to changes in professional appointment. For example, the existing auditor might feel obliged to mention knowledge or suspicion regarding suspected money laundering and any external disclosure made to the NCA. Under the Anti-Money Laundering Legislation this would not constitute 'tipping off' if it was done to prevent the incoming auditor from committing a money laundering offence.

59. If information about internal and external reports made by the auditor is considered relevant information for the purposes of Paragraph 9 of Schedule 10 of the Companies Act 2006,[39] the auditor considers whether the disclosure of that information would constitute a 'tipping off' offence under the Anti-Money Laundering Legislation, because it may prejudice an investigation. If the auditor considers a 'tipping off' offence might be committed, the auditor speaks to the NCA to see if they are content that disclosure in those circumstances would not prejudice any investigation. The auditor may, as a last resort, need to apply to the Court for directions as to what is disclosed to the incoming auditor.

60. Where the only information which needs to be disclosed is the underlying circumstances which gave rise to the disclosure, there are two scenarios to consider:

    - Where the auditor only wishes to disclose the suspicions about the underlying criminal conduct and the basis for those suspicions, the auditor will not commit an offence under the Anti-Money Laundering Legislation if that information only is disclosed. For example, if audit files are made available to the incoming auditor which detail circumstances which have lead the audit team to suspect management of a fraud, this will not constitute a 'tipping off' offence.[40]

    - If the auditor wishes to disclose any suspicions specifically about money laundering (e.g., if the working papers in the example above indicated that the suspected fraud also constituted a suspicion of money laundering), then as a matter of prudence, the approach adopted follows that described in paragraphs 56 and 57 of this Appendix in relation to the Section 519 statement.

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[39] Statutory Instrument 2016/649 - The Statutory Auditors and Third Country Auditors Regulations 2016 came into force on 15 June 2016 and amended the Companies Act requiring auditors to make available all relevant information held in relation to holding the office as auditor to a successor auditor.

[40] Where the auditor knows or suspects that a confiscation, civil recovery, detained cash or money laundering investigation is being or is about to be conducted, the auditor also considers Section 342 of POCA. If the auditor suspects that the disclosure of the working papers would be likely to prejudice that investigation, the auditor takes the approach described in paragraphs 56 and 57 of this Appendix in relation to the Section 519 statement.

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