

**THE AUDITING PRACTICES BOARD**

# **Practice Note 12 (Revised)**

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***Money laundering – Interim guidance  
for auditors on UK legislation***

**March 2008**

### **THE AUDITING PRACTICES BOARD LIMITED**

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- Standards and guidance for auditing;
- Standards and guidance for reviews of interim financial information performed by the auditor of the entity;
- Standards and guidance for the work of reporting accountants in connection with investment circulars; and
- Standards and guidance for auditors' and reporting accountants' integrity, objectivity and independence,

with the objective of enhancing public confidence in the audit process and the quality and relevance of audit services in the public interest.

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This Practice Note replaces Practice Note 12 (Revised), "Money Laundering – Interim guidance for auditors in the United Kingdom", published in January 2007 which is withdrawn with immediate effect.

**PRACTICE NOTE 12 (REVISED)**

*MONEY LAUNDERING LEGISLATION -*  
INTERIM GUIDANCE FOR AUDITORS IN THE UNITED KINGDOM

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## INTRODUCTION

1. Practice Note 12 (Revised), "Money Laundering", was last issued as interim guidance in January 2007. This version has been updated to take account of recent changes including the issuance of the Money Laundering Regulations 2007 and the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Amendment) Regulations 2007. This version of Practice Note 12 (Revised) has been submitted to HM Treasury for approval in accordance with sections 330 and 331 of the Proceeds of Crime Act 2002 ("POCA") and section 21A of the Terrorism Act 2000 ("TA 2000"). It reflects the legislation effective at 31 January 2008. Auditors need to be alert to subsequent changes in legislative requirements.
2. Practice Note 12 (Revised) focuses on the impact of the UK anti-money laundering legislation on auditors' responsibilities when auditing and reporting on financial statements. It does not provide general guidance on the legislation. The Consultative Committee of Accountancy Bodies has issued "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<sup>1</sup>.
3. The anti-money laundering legislation is complex and some uncertainty still exists as to how the courts will interpret it in practice. Notwithstanding this, it is expected that the courts will take into account guidance issued by authoritative bodies. To obtain a full understanding of the legal requirements auditors refer to the relevant provisions of the legislation and, if necessary, obtain legal advice.
4. The use of the term 'auditor' in this Practice Note means anyone who is part of the engagement team (not necessarily only those employed by an audit firm). The engagement team comprises all persons who are directly involved in the acceptance and performance of a particular audit. This includes the audit team, 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.

### Key legal requirements

5. The key legal requirements introduced by POCA (as subsequently amended by the Serious and Organised Crime and Police Act 2006 (SOCPA)), TA 2000 and the Money Laundering Regulations 2007 (the "ML Regulations") are as follows:
  - Part 7 of POCA consolidated, updated and reformed criminal law in the UK with regard to money laundering. The definition of money laundering<sup>2</sup> comprises three principal money laundering offences<sup>3</sup> (behaviour that directly constitutes money laundering). These

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<sup>1</sup> Cross references in the Practice Note to "CCAB Guidance" are to the guidance issued by the CCAB in December 2007. This is published by the ICAEW as TECH 07/07.

<sup>2</sup> Section 340(11) of POCA states that "Money laundering is an act which:  
(a) constitutes an offence under section 327, 328 or 329,  
(b) constitutes an attempt, conspiracy or incitement to commit an offence specified in paragraph (a),  
(c) constitutes aiding, abetting, counselling or procuring the commission of an offence specified in paragraph (a), or  
(d) would constitute an offence specified in paragraph (a), (b) or (c) if done in the UK."

<sup>3</sup> The principal money laundering offences defined under POCA are:

- s327 "Concealing" criminal property (including concealing or disguising its nature, source, location, disposition, movement, ownership or rights attaching; converting, transferring or removing from any part of the UK).
- s328 "Arranging" (entering into or becoming concerned in an arrangement which the business or an individual knows or suspects facilitates the acquisition, retention, use or control of criminal property by or on behalf of another person).
- s329 "Acquiring, using or possessing criminal property".

include possessing, or in any way dealing with, or concealing, the proceeds of any crime and includes crime committed by an entity or an individual.

- TA 2000 contains similar offences for the laundering of terrorist funds, although in such cases, the funds involved include any funds that are likely to be used for the financing of terrorism. There is no need for funds to have been obtained from a previous criminal offence for them to be terrorist funds.
- POCA and the ML Regulations do not extend the scope of the audit, but auditors are within the regulated sector and are required to report where:
  - they know or suspect, or have reasonable grounds to know or suspect, that another person is engaged in money laundering;
  - they can identify the other person or the whereabouts of any of the laundered property or that they believe, or it is reasonable to expect them to believe that information that they have obtained will or may assist in identifying that other person or the whereabouts of the laundered property; and
  - the information has come to the auditors in the course of their 'regulated' business.
- 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<sup>4</sup>. Auditors (partners and staff) will face criminal penalties<sup>5</sup> if they breach the requirements.
- The requirement to report is not just related to matters that might be considered material to the financial statements; auditors have to report knowledge or suspicion, or reasonable grounds for knowledge or suspicion, of crimes that potentially have no material financial statement impact. POCA does not contain de minimis concessions.
- Firms must take appropriate measures so that partners and staff are made aware of the provisions of POCA, the ML Regulations and the TA 2000 and are given training in how to recognise and deal with actual or suspected money laundering activities.
- Auditors are required to adopt rigorous client identification procedures and appropriate anti-money laundering procedures.

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<sup>4</sup> Subject to the provisions of POCA section 330(6) relating to legal professional privilege and section 330(7A) relating to offences committed overseas.

<sup>5</sup> 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 for the following offences:

- a person in the regulated sector other than a nominated officer failing to disclose (section 330),
- the nominated officer failure to disclose offences (section 331 for the regulated sector, section 332 for those outside this sector),
- the giving of consent by a nominated officer inappropriately to prohibited acts (section 336(5)), and
- the 'tipping off' offence (sections 333A to 333E).

Furthermore in all cases, an unlimited fine can be imposed.

On summary conviction, the maximum penalty for all the above offences is six months' imprisonment and/or a fine not exceeding the statutory maximum. A person guilty of an offence under section 339(1A) of making a disclosure under section 330, 331, 332 or 338 otherwise than in the form prescribed by the Secretary of State or otherwise than in the manner so prescribed is liable on summary conviction to a fine not exceeding level 5 on the standard scale.

### **The Proceeds of Crime Act 2002**

6. 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. Property is criminal property if:
  - (a) 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
  - (b) The alleged offender knows or suspects that it constitutes or represents such a benefit.
7. There are three principal money laundering offences<sup>3</sup> which define money laundering to encompass offences relating to the possession, acquisition, use, concealment or conversion 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.
8. In addition, 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 Practice Note.<sup>6</sup> 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 Serious Organised Crime Agency (SOCA). POCA does not contain de minimis concessions that affect the reporting requirements of auditors with the result that reports need to be made irrespective of the quantum of the benefits derived from, or the seriousness of, the offence. Partners and staff in audit firms need to be alert to the dangers of disseminating information that is likely to 'tip off' a money launderer or prejudice an investigation<sup>7</sup> as this may constitute a criminal offence under the anti-money laundering legislation.
9. 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 SOCA (see paragraphs 48 to 50).

### **The Terrorism Act 2000**

10. For the purposes of this guidance, money laundering includes activities relating to terrorist financing. This extends the money laundering reporting requirements for partners and staff in audit firms to terrorist fund-raising, the use of money or other property for the purposes of terrorism, or the possession of money or other property and arrangements where money or other property is to be made available to another, where a person intends, knows or has reasonable cause to suspect that it may be used for the purposes of terrorism irrespective of whether those funds come from a legitimate source or not.

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<sup>6</sup> Section 20(3) of the ML Regulations recognises that the requirements relating to internal reporting procedures do not apply to sole practitioners, but the external reporting obligations under POCA remain. There is no obligation on a sole practitioner to appoint an MLRO where the sole practitioner does not employ any staff, or act in association with any other person. Where no MLRO is appointed and a sole practitioner has knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering the sole practitioner has a responsibility to report to SOCA.

<sup>7</sup> See guidance on 'tipping off' and prejudicing an investigation in paragraphs 44 to 47.

## The Money Laundering Regulations 2007

11. The Money Laundering Regulations 2007 replace the Money Laundering Regulations 2003. The ML Regulations define the 'regulated sector' as including persons, acting in the course of business as a statutory auditor within the meaning of Part 42 of the Companies Act 2006<sup>8</sup>, when carrying out statutory audit work within the meaning of section 1210 of the Companies Act 2006<sup>9</sup>. For the purposes of this Practice Note "person" is interpreted as referring to a UK audit firm that is designated as a "Registered Auditor" to which the ML Regulations apply. All partners and staff within a UK audit firm who are involved in providing audit services in the UK are subject to the audit firm's requirements under the ML Regulations (see guidance in Appendix 2).
12. Where a Registered Auditor is not carrying out statutory audit work the ML Regulations will nevertheless often apply as they also cover "a firm or sole practitioner who by way of business provides accountancy services to other persons, when providing such services"<sup>10</sup>.
13. The ML Regulations impose requirements on businesses in the regulated sector relating to systems and training to prevent money laundering, identification procedures for clients, record keeping procedures and internal reporting procedures.

## FIRM-WIDE PRACTICES

14. The ML Regulations requires businesses in the regulated sector to establish risk-sensitive policies and procedures relating to:

- Customer identification and on-going monitoring of business relationships;
- Reporting internally and to SOCA<sup>11</sup>;
- 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, audit firms need 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 and Ireland) 1. Detailed guidance on developing and applying a risk based approach is given in section 4 of the CCAB Guidance.

### Client identification and on-going monitoring of business relationships

15. Appropriate identification procedures, as required by the ML Regulations, 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. Guidance on identification procedures is given in section 5 of the CCAB Guidance.
16. Auditing standards on quality control for audits state that acceptance of client relationships and specific audit engagements includes considering the integrity of the principal owners, key management and those charged with governance of the entity. This involves the auditor making

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<sup>8</sup> Before the entry into force of Part 42 of the Companies Act 2006, this applies to a person who is eligible for appointment as a company auditor under Section 25 of the Companies Act 1989 or Article 28 of the Companies (Northern Ireland) Order 1990.

<sup>9</sup> Regulation 3(4) of the Money Laundering Regulations 2007.

<sup>10</sup> Regulation 3(7) of the Money Laundering Regulations 2007.

<sup>11</sup> 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 SOCA.

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 ML Regulations.

17. 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 an additional paragraph in the audit engagement letter. Where client identification procedures start before the engagement letter is drafted it might be helpful for the auditor to address this in pre-engagement letter communications with the potential client. The following is an illustrative paragraph that could be included for this purpose:

*“Client identification*

*As with other professional services firms, we are required to identify our clients for the purposes of the UK anti-money laundering legislation. We are likely to request from you, and retain, some information and documentation for these purposes and/or to make searches of appropriate databases. If we are not able to obtain satisfactory evidence of your identity within a reasonable time, there may be circumstances in which we are not able to proceed with the audit appointment.”*

18. It may also be helpful to inform clients of the auditor’s responsibilities under POCA 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 their clients. The following is an illustrative paragraph that could be included in the audit engagement letter for this purpose:

*“Money laundering disclosures*

*The provision of audit services is a business in the regulated sector under the Proceeds of Crime Act 2002 and, as such, partners and staff in audit firms have to comply with this legislation which includes provisions that may require us to make a money laundering disclosure in relation to information we obtain as part of our normal audit work. It is not our practice to inform you when such a disclosure is made or the reasons for it because of the restrictions imposed by the ‘tipping off’ provisions of the legislation.”*

19. Whether or not to include these illustrative paragraphs in the audit engagement letter is a policy decision to be taken by individual firms.
20. The activities of and the relationship with the audit 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 ML Regulations require relevant businesses to appoint a nominated officer (usually known as the MLRO). A sole practitioner who does not employ any staff, or act in association with any other person, is by default an MLRO. Auditors are required to report where they know or suspect, or have reasonable grounds to know or suspect, that another person is engaged in money laundering or, for the purposes of obtaining consent, where they know or suspect that they are involved in money laundering. Partners and staff in audit firms discharge their responsibilities by reporting to their MLRO or, in the case of sole practitioners, to SOCA and, where appropriate, by obtaining consent from the MLRO or SOCA 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 SOCA and for making the report to SOCA. 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 lawyers, SOCA and the relevant law enforcement agency. More detailed guidance on the role of the MLRO is given in section 7 of the CCAB Guidance.

## Training

22. Firms are required to take appropriate measures so that partners and staff are made aware of the relevant provisions of POCA, the ML Regulations and the TA 2000 and are given training in how to recognise and deal with activities which may be related to money laundering. Guidance on training is given in section 3 of the CCAB Guidance. The level of training provided to individuals needs to be appropriate to both the level of exposure of the individual to money laundering risk and their role and seniority within the firm. Senior members of the firm whatever their role need to understand the requirements of POCA and the ML Regulations.
23. Apart from the training referred to in paragraph 22 above, additional training or expertise in criminal law is not required under POCA. However, ISA (UK and Ireland) 250 'Consideration of laws and regulations in an audit of financial statements' requires an auditor to obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry to help identify possible or actual instances of non-compliance with those laws and regulations which provide a legal framework within which the entity conducts its business and which are central to the entity's ability to conduct its business and hence to its financial statements.

## IMPACT OF LEGISLATION ON AUDIT PROCEDURES

### Identification of knowledge or suspicions

24. ISA (UK and Ireland) 250 establishes standards and provides guidance on the auditor's responsibility to consider law 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 32 below, but the normal audit work could give rise to knowledge or suspicion, or reasonable grounds for knowledge or suspicion, that will need to be reported. Such knowledge or suspicion may arise in relation to:
  - law and regulations relating directly to the preparation of the financial statements;
  - law and regulations which provide a legal framework within which the entity conducts its business; and
  - other law and regulations.
25. Auditing standards on law and regulations require the auditor to obtain sufficient appropriate audit evidence about compliance with those laws and regulations that have an effect on the determination of material amounts and disclosures in the financial statements. 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.
26. Auditing standards on law and regulations also require the auditor to perform procedures to help identify possible or actual instances of non-compliance with those laws and regulations which provide a legal framework within which the entity conducts its business and which are central to the entity's ability to conduct its business<sup>12</sup> and hence to its financial statements. These procedures consist of:
  - obtaining a general understanding of the legal and regulatory framework applicable to the entity and the industry and of the procedures followed to ensure compliance with that framework;
  - inspecting correspondence with the relevant licensing or regulatory authorities;

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<sup>12</sup> For example, non-compliance with certain laws and regulations may cause the entity to cease operations, or call into question the entity's status as a going concern.

- enquiring of those charged with governance as to whether they are on notice of any such possible instances of non-compliance with law or regulations; and
- obtaining written representation that those charged with governance have disclosed to the auditor all known actual or possible non-compliance with laws and regulations whose effects should be considered when preparing financial statements, together with, where applicable, the actual or contingent consequences which may arise from the non-compliance.

This work may give the auditor grounds to suspect that criminal offences have been committed.

27. Laws relating to money laundering will be central to an entity's business, if that business is within the regulated sector as defined by POCA and the ML Regulations<sup>13</sup>. When auditing the financial statements of businesses within the regulated sector the auditor reviews the steps taken by the entity to comply with the ML Regulations, assesses their effectiveness and obtains management representations concerning compliance with the ML Regulations. If the client's systems are thought to be ineffective the auditor considers whether there is a responsibility to report 'a matter of material significance' to the regulator and the possible impact of fines, following non-compliance with the ML Regulations or POCA. Where the entity's business is outside the regulated sector, although the auditor's reporting responsibilities under the money laundering legislation are unchanged, the entity's management is not required to implement the ML Regulations. 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 central to an entity's business for the purposes of ISA (UK and Ireland) 250.
28. In relation to other laws and regulations, auditing standards on laws and regulations require the auditor to be alert to the fact that audit procedures applied for the purpose of forming an opinion on the financial statements may bring instances of possible non-compliance with laws and regulations to the auditor's attention and to be alert for those instances that might incur obligations for partners and staff in audit firms to report money laundering offences.
29. 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 POCA or the ML Regulations. In certain circumstances, even where no offence under POCA has been committed, civil claims may arise or recovery actions by the Assets Recovery Agency (which is to be incorporated within SOCA with effect from 1<sup>st</sup> April 2008) may give rise to contingent liabilities. The auditor will remain alert to the fact that discussions with the client on such matters may give rise to a risk of 'tipping off' (see paragraphs 44 to 47).

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<sup>13</sup> For the purposes of this Practice Note 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 15,000 euro or more
- casinos.

The legislation from which this list is derived is complicated and comprises two sources. If in doubt, an auditor refers to the definitions of:

- the regulated sector, defined in the Proceeds of Crime Act 2002 Schedule 9 Part 1 (as amended by Statutory Instrument 2003/3074 "The Proceeds of Crime Act 2002 (Business in the Regulated Sector and Supervisory Authorities) Order 2003" and Statutory Instrument 2007/3287 "The Proceeds of Crime Act 2002 (Business in the Regulated Sector and Supervisory Authorities) Order 2007"); and
- relevant businesses as defined in paragraph 3(1) of the ML Regulations.

30. 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. As explained in auditing standards on law and regulations, whether an act constitutes non-compliance with law or regulations may involve consideration of matters which do not lie within the competence and experience of individuals trained in the audit of financial information. 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 auditing standards on using the work of an expert.
31. The anti-money laundering legislation requires UK auditors 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. The anti-money laundering legislation does not change the scope of the audit and does not therefore impose any requirement for the UK parent company auditor to change or add to the normal instructions to auditors of overseas subsidiaries. However, when considering non-UK parts of the group audit the UK parent company auditor will need to consider whether information obtained as part of the group audit procedures (for example 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 UK parent company auditor to report to SOCA.

#### Further enquiry

32. Once the auditor suspects a possible breach of law or regulations, the auditor will need to make further enquiries to assess the implications of this for the audit of the financial statements. Auditing standards on laws and regulations require 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 or, for sole practitioners, to SOCA. The anti-money laundering legislation does not require the auditor to undertake any additional enquiries to determine further details of the predicate criminal offence. If the auditor is genuinely uncertain as to whether or not there are grounds to make a disclosure, the auditor will bring the matter to the attention of the audit engagement partner who may wish to seek advice from the MLRO.
33. 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/or the directors are themselves involved in the suspected criminal activity.

#### Reporting to the MLRO and to SOCA

34. In the UK, auditors report to their MLRO or, in the case of sole practitioners, to SOCA where they know or suspect, or have 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 are no de minimis concessions applicable to the auditor contained in POCA, the ML Regulations or the TA 2000. There is no provision for the auditor not to make a report even where the auditor considers that the matter has already been reported (although in such cases the 'limited intelligence value' report may be appropriate).
35. However, the auditor is not required to report where:
- the auditor does not have the information to identify the money launderer and the whereabouts of any of the laundered property, or
  - the auditor 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.

For example, a company involved in the retail business is likely to have been the victim of shoplifting offences, but information that the auditor has is unlikely to be able to identify the money launderer or the whereabouts of any of the laundered property, and the auditor is not required to report knowledge or suspicion of money laundering arising from such a crime.

36. 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 POCA have been satisfied if no report is to be made to the MLRO or to SOCA. 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, auditors need 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 it amount to a 'serious offence' under English law<sup>14</sup> if the conduct had occurred here? If it would have amounted to such an offence, a report is required.

The duties to report on overseas money laundering activity are complex as they rely on knowledge of both overseas and UK law. In practice auditors may choose to report all overseas money laundering activity to their MLRO.

37. During the course of the audit work the auditor might obtain knowledge or form a suspicion about a prohibited act that would be a criminal offence under POCA sections 327, 328 or 329 but it has yet to occur. Because attempting or conspiring to commit a money laundering offence is in itself a money laundering offence, it is possible that in some circumstances a report might need to be made.
38. Where the auditor has made a report to the MLRO and the MLRO has decided that further enquiry is necessary, the auditor will need to be made aware of the outcome of the enquiry to determine whether there are any implications for the audit report or the decision to accept reappointment as auditor.
39. The format of the internal report made to the MLRO is not specified by the ML Regulations. MLROs determine the form in which partners and staff in audit firms report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering offences internally to their MLRO, although this will need to provide the MLRO with sufficient information to enable a report to be made to SOCA if necessary. Reporting as soon as is practicable to the MLRO is the individual responsibility of the partner or audit staff member 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 to the MLRO and, even where the rest of the engagement team disagrees, an individual should not be dissuaded from reporting to the MLRO if the individual still considers that it is necessary. In the case of a sole practitioner, who is not required to appoint an MLRO, the sole practitioner reports directly to SOCA.
40. The MLRO makes the decision as to whether a report is made by the audit firm to SOCA. Suspicious Activity Reports may be made using one of SOCA's forms and methods of submission (<http://www.soca.gov.uk/financialIntel/suspectActivity.html#forms>). The SOCA reporting guidance permits aggregated reporting of suspicious activity that meets the SOCA criteria for 'limited intelligence value' reporting. These criteria are defined in SOCA guidance notes for completing the 'limited intelligence value' report form available on the SOCA website. The forms can be

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<sup>14</sup> 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.

completed either electronically or typed and sent as a hard copy version. Hard copies are available to be downloaded from the website or direct from SOCA.

41. The timing of reporting by the MLRO to SOCA, or in the case of a sole practitioner their report to SOCA, is governed by section 331(4) of POCA 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. In practice this does not always mean “immediately”. The timing of reports will be influenced by whether:
- The information includes time sensitive information (that may, for example, allow the recovery of proceeds of crime if communicated immediately) in which case the report will be made quickly;
  - further information is required before a report can be made to SOCA, in which case, a report will be made as soon as all the required information has been obtained;
  - the information indicates a minor irregularity but there is nothing to suggest dishonest behaviour, in which case a ‘limited intelligence value’ report can be made as soon as possible after the completion of the audit<sup>15</sup>.

Guidance on the reporting of knowledge and suspicions by the MLRO to SOCA is given in section 7 of the CCAB Guidance.

42. Partners and staff in audit firms follow their firm’s internal documentation procedures when considering whether to include documentation relating to money laundering reporting in the audit working papers. However, 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 client files.

### **Legal privilege**

43. 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.<sup>16</sup> If the auditor is given access to client information over which legal professional privilege may be asserted (for example, 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 and where the auditor is in possession of client information which is clearly privileged (for example, a solicitor's advice to an audit client), the auditor seeks legal advice to determine whether that privilege can be extended to the auditor.

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<sup>15</sup> For the purposes of this Practice Note ‘completion of the audit’ is interpreted as being no later than the date the auditor’s report is signed, although if there is likely to be a significant period between the date the audit work is completed and the date the auditor’s report is signed the auditor considers submitting relevant reports earlier.

<sup>16</sup> 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 (as defined in POCA section 330(10)). Examples may be where a client provides information in connection with the provision by the auditor of advice on legal issues such as tax or company law. The giving of such advice would not normally arise as a result of an audit engagement, but may arise where the auditor has an additional contract with the client, to provide advisory services. In such circumstances, the auditor may discuss their money laundering suspicions with the MLRO without requiring the MLRO to make a disclosure to SOCA. Guidance on privilege reporting exemption is given in paragraphs 7.26 to 7.46 of the CCAB Guidance.

### **'Tipping off' and prejudicing an investigation**

44. In the UK, 'tipping off' is an offence for individuals in the regulated sector under section 333A of POCA. This offence arises:

- (a) When an individual discloses that a disclosure (internal or external) has already been made where the disclosure is 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 following the internal or external disclosure that has been made; 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 disclosure is based came to a person in the course of a business in the regulated sector.

45. There are a number of exceptions to this offence under sections 333B, 333C and 333D of POCA, including where disclosures are made:

- to a fellow auditor employed by a firm that shares common ownership, management or control with the audit 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 client or 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 prevention, detection or investigation of a criminal offence where the auditor is acting as a relevant professional adviser (whether in the UK or elsewhere);
- to the client, for the purpose of dissuading the client from engaging in an offence; or
- in circumstances where the person making the disclosure does not know or suspect that the disclosure is likely to prejudice an investigation.

46. A further offence of prejudicing an investigation is included in section 342 of POCA. Under this provision, 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.

47. ISA (UK and Ireland) 260 requires the auditor to communicate audit matters of governance interest arising from the audit of the financial statements 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. As set out above, under section 333D of POCA a tipping off offence is not committed by an auditor (when he or she is acting as a relevant professional adviser) where a disclosure is made to the client in order to dissuade the client from engaging in a money laundering offence (for example, where an employee is engaged in money laundering using the client's financial systems, the auditor may inform the client of the situation in order to prevent the client from committing a money laundering offence). However, care will be taken as to whom the disclosure is made where senior management of the client or those charged with governance are or are suspected to be involved in the money laundering activity or complicit with it. For example, where a client develops a policy approved by the directors that duplicate payments on its invoices will not be returned to customers and that no credit is given against further invoices, the company may be committing a criminal offence (see Example 2 in Appendix 1 of this Practice Note).

### Reporting to obtain appropriate consent

48. In addition to the auditor's duty to report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering under POCA sections 330 and 331, the auditor may need to obtain appropriate consent to perform an act which could otherwise constitute a principal money laundering offence (subject to the SOCPA amendments to sections 327, 328 and 329 for overseas activities<sup>17</sup>). For example, if the auditor suspected that the audit 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 a company 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 section 328 of POCA. In these circumstances, in addition to the normal procedures, the auditor would generally need to obtain appropriate consent from SOCA 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 section 336 of POCA. Where applicable the auditor understands the applicable time limits. Further guidance on seeking appropriate consent is given in section 8 of the CCAB Guidance.
49. The auditor will also need to consider whether continuing to act for the company could itself constitute money laundering, for example if it amounted to aiding or abetting the commission of one of the principal money laundering offences in sections 327, 328 or 329 of POCA, or if it amounted to one of the principal money laundering offences itself, in particular the offence of becoming involved in an arrangement under section 328 of POCA. 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 the auditor, through the MLRO, may need to seek appropriate consent from SOCA for such an action to be taken.
50. Appropriate consent from SOCA 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 below.

### Reporting to regulators

51. Reporting to SOCA does not relieve the auditor from other statutory duties. Examples of statutory reporting responsibilities include:
- *audits of entities in the financial sector*: the auditor has a statutory duty to report matters of 'material significance' to the FSA which come to the auditor's attention in the course of the audit work;
  - *audits of entities in the public sector*: auditors 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; and
  - *audits of other types of entity*: auditors of some other entities are also required to report matters of 'material significance' to regulators (for example, charities and occupational pension schemes).

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<sup>17</sup> 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 English law (see footnote 14).

52. 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 ML Regulations 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 SOCA. In determining whether such a duty arises, the auditor follows the requirements of auditing standards on reporting to regulators in the financial sector and considers the specific guidance dealing with each area set out in related Practice Notes. A tipping off offence is not committed when a report is made to that person's supervisory authority or in any other circumstances where a disclosure is not likely to prejudice an investigation.

### **The auditor's report on financial statements**

53. Where it is suspected that money laundering has occurred the auditor will need to apply the concept of materiality when considering whether the auditor's report on the financial statements needs to be qualified or 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; or
- the outcome of any subsequent investigation by the police or other investigatory body may have a material effect on the financial statements.

54. If it is known that money laundering has occurred and that directors or senior staff of the company were knowingly involved, the auditor will need to consider whether the auditor's report is likely to include a qualified opinion on the financial statements. In such circumstances the auditor considers whether disclosure in the report on the financial statements, either through qualifying the opinion or referring to fundamental uncertainty, could alert a money launderer.

55. Timing may be the crucial factor. Any delay in issuing the audit 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 lawyers, SOCA and the relevant law enforcement agency.

### **Resignation and communication with successor auditors**

56. The auditor may wish to resign from the position as auditor if the auditor believes that the client or an employee 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 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 need to 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. See section 9 of CCAB Guidance for guidance on cessation of work and resignation.

57. Where such disclosure of circumstances may amount to 'tipping off', the auditor seeks to agree the wording of the section 519 disclosure 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 and if necessary is the liaison point for communication with lawyers, SOCA 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 SOCA. Under section 333C of POCA this would not constitute 'tipping off' if it was done to prevent the incoming auditor from committing a money laundering offence.

However, as an audit opinion is rarely used for money laundering purposes, this is unlikely to apply in an audit situation.

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<sup>18</sup>, the auditor considers whether the disclosure of that information would constitute a ‘tipping off’ offence under section 333A, because it may prejudice an investigation. If the auditor considers a ‘tipping off’ offence might be committed, the auditor speaks to SOCA 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 POCA if that information only is disclosed. For example, if audit files are made available to the incoming auditor containing working papers that detail circumstances which have lead the audit team to suspect the management of a fraud and this suspicion is noted on the file, this will not constitute a ‘tipping off’ offence.
  - If the auditor wishes to disclose any suspicions specifically about money laundering (for example, 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 in relation to the section 519 statement.

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<sup>18</sup> Statutory Instrument 2007/3494 “The Statutory Auditors and Third Country Auditors Regulations 2007” comes into force on 6<sup>th</sup> April 2008 and requires the auditor to make available all relevant information held in relation to holding the office as auditor to a successor auditor.

## Appendix 1

### Examples of situations that may give rise to money laundering offences that auditors may encounter during the course of the audit

*These are examples of some of the situations that auditors may encounter during the course of the audit and some of the factors that auditors may wish to bear in mind when considering reporting suspicions of money laundering. They are intended to demonstrate the breadth of the money laundering legislation. This is not an exhaustive list of offences, nor a guide as to how such offences must be dealt with. The best way to deal with suspected money laundering will vary according to the particular facts of each case and should be dealt with in accordance with the firm's procedures.*

*The examples are based on the legislation and SOCA guidance current at the time the Practice Note was finalised. Auditors will wish to consider whether SOCA guidance has been updated as well as the extent to which they are prepared to follow any SOCA guidance, particularly if SOCA states in its guidance that in a particular type of case no report at all is required.*

#### 1. Offences where the client is the victim (for example, shoplifting)

The auditor acts for a large retail client. The auditor discovers there has been significant stock shrinkage in a number of stores. The client attributes at least some of this to shoplifting. In addition, the auditor is aware that some of the stores hold files detailing instances when the police have been called to deal with shoplifters caught by the security guards.

POCA does not require the auditor to undertake further enquiry outside the auditor's normal audit work to determine whether an offence has occurred or to find out further details of the offence. Accordingly, the auditor does not need to review the files containing the details of the police being called, unless the auditor would otherwise have done so for the purposes of the audit.

Where the auditor does not believe that the information will or may assist in identifying the shoplifter or the whereabouts of any of the goods stolen by the shoplifter, for example where the identity of the shoplifters cannot be deduced from the information and the proceeds have disappeared without trace, the auditor decides not to make a report to the MLRO.

In the circumstances where the information possessed by the client will assist in identifying the shoplifter or the whereabouts of any of the goods stolen by the shoplifter, the auditor must make a report to the MLRO briefly describing the situation and stating where the information on the identity of shoplifters may be found.

#### 2. Offences that indicate dishonest behaviour (for example, overpayments not returned)

Some customers of the audit client have overpaid their invoices and some have paid twice. The auditor discovers that the audit client has a policy of retaining all overpayments by customers and crediting them to the profit and loss account if they are not claimed within a year.

The auditor considers whether the retention of the overpayments might amount to theft by the audit client from its customer. If so, the client will be in possession of the proceeds of its crime, a money laundering offence.

In the case of minor irregularities where there is nothing to suggest dishonest behaviour, (for example where the client attempted to return the overpayments to its customers, or if the overpayments were mistakenly overlooked), the person making the report may be satisfied that no criminal property is involved and therefore a report is not required.

If there are no such indications that the company has acted honestly, the auditor concludes that the client may have acted dishonestly. Following the firm's procedures, which take into account the SOCA guidance about minor irregularities where dishonest behaviour is suspected, and about multiple suspicions of limited intelligence value which arise during the course of one audit, the auditor

must make a report to the MLRO at the end of the audit, briefly describing the situation and any other matters of limited intelligence value.

**3. Companies Act offences that are civil offences (for example, illegal dividend payments)**

During the course of the audit, the auditor discovers that the audit client has paid a dividend based on draft accounts. Audit adjustments subsequently reduce distributable reserves to the extent that the dividend is now illegal under the Companies Act.

The auditor recognises that the payment of an illegal dividend is not per se a criminal offence because the Companies Act imposes only civil sanctions on companies making illegal distributions and decides not to report the matter to the MLRO.

**4. Offences that involve saved costs (for example, environmental offences)**

The client has a factory which manufactures some of the goods sold in its retail business. In the course of reviewing board minutes, the auditor discovers that the client has been disposing of waste from the factory without a proper licence. There are concerns that pollutants from the waste have been leaking into a nearby river. The client is currently in discussion with the relevant licensing authorities to try to get proper authorisation.

The auditor has reasonable grounds to suspect that the client may have committed offences of disposing of waste without the relevant licence and of polluting the nearby river. The client has saved the costs of applying for a licence. It is also apparent that its methods of disposing of the waste are cheaper than processing it properly. These saved costs may represent the benefit of the client's crime. The client is in possession of the benefit of a crime and the auditor therefore suspects that it has committed a money laundering offence.

The firm's procedures take into account the SOCA guidance which states that in the case of regulatory matters, where the relevant government agency is already aware of an offence which also happens to be an instance of suspected money laundering, a limited intelligence value report can be made. A limited intelligence value report can also be made where the only benefit from criminal conduct is in the form of cost savings.

The authorities are aware of the licensing issue and the pollution of the nearby river. As the only benefit to the company is in the form of cost savings, the auditor decides to include this matter in the limited intelligence value report to the MLRO at the end of the audit.

Alternatively, if the client has accrued for back licence fees, fines and/or restitution costs, there may be no remaining proceeds to the original offence and therefore no need to report.

**5. Conduct committed overseas that is a criminal offence under English law (for example, bribery, because English Law on bribery applies to overseas conduct)**

The client plans to expand its retail operations into a country where it has not operated before. Construction of its first outlets is underway and it is in consultation with the overseas Government about obtaining the necessary permits to sell its goods (although these negotiations are proving difficult). The client has engaged a consultancy firm to oversee the implementation of its plans and liaise 'on the ground', although it is not clear to the auditor exactly what the firm's role is. The auditor notices that the payments made to the firm are very large, particularly in comparison to the services provided. The auditor reviews the expenses claimed by the consultant and notes that some of these are for significant sums to meet government officials' expenses.

The auditor considers whether the payments may be for the consultant to use in paying bribes, for example to obtain the necessary permits. The country is one where corruption and facilitation payments are known to be widespread. The auditor makes some enquiries about the consultancy firm but cannot establish that it is a reputable business.

Taking into account compliance with legislation relating to 'tipping off' the auditor questions the client's Finance Director about the matter and the FD admits that the consultant has told him that some 'facilitation payments' will be necessary to move the project along and the FD agreed that some

payments should be made to get the local officials to do the jobs that they should be doing anyway; for example, to get the traffic police to let the construction vehicles through nearby road blocks. The FD thought that such payments were acceptable in the country in question.

The auditor suspects that bribes have been paid and the auditor is aware that bribery, including the bribery of government officials, is a criminal offence under UK law. Bribery of foreign public officials, by UK nationals and corporations, is a criminal offence even where it occurs wholly outside the UK, under Part 12 of the Anti-terrorism Crime and Security Act 2001. Accordingly, the auditor decides to make a full report to the MLRO.

## **6 Lawful Conduct Overseas which would amount to a serious offence if it occurred in England and Wales (for example, a cartel operation)**

The client's overseas subsidiary is one of three key suppliers of goods to a particular market in Europe. The subsidiary has recently significantly increased its prices and margins and its principal competitors have done the same. There has been press speculation that the suppliers acted in concert, but publicly they have cited increased costs of production as driving the increase. Whilst this explains part of the reason for the increase, it is not the only reason because of the increase in margins.

On reviewing the accounting records, the auditor sees significant payments for consultancy services. He seeks an explanation for these costs and is informed that these relate to the recent price increase. Apparently, this related to an assessment of the impact of the price increase on the market as well as some compensation for any losses the competitors suffered on their business outside of Europe. Some of the increased profits have flowed back to the client parent company. The client informs the auditor that there is not a criminal cartel offence under local law.

The auditor has a number of concerns:

- the subsidiary may be engaged in conduct amounting to money laundering overseas. However, because the conduct is not criminal there it also does not constitute money laundering under local law. No report is therefore required about the subsidiary.
- the parent company has received profits from the subsidiary and may therefore be engaged in money laundering in England. The auditor suspects that the subsidiary's conduct, whilst lawful where it occurred, would be unlawful under English law if it was committed here, since the auditor suspects that the agreement to fix prices would have been dishonest. The auditor therefore makes a full disclosure to the MLRO.

In rare circumstances where the auditor is also concerned about being involved in a prohibited arrangement, the auditor also needs to consider whether the overseas conduct would amount to a serious criminal offence if it was committed in England and Wales. As a cartel offence is serious a report would be made to the MLRO and the auditor would await consent from the MLRO before proceeding further.

## **7. Offences committed overseas that are not criminal offences under UK law (for example, breach of exchange controls and importing religious material)**

During the course of the audit, the auditor forms a suspicion that one of the overseas subsidiaries has been in breach of a number of local laws. In particular:

- Dividends have been paid to the parent company in breach of local exchange control requirements.
- The subsidiary has imported religious materials intended for the preaching of a particular faith, which is contrary to the laws of that jurisdiction.

Money laundering offences include conduct occurring overseas which would constitute an offence if it had occurred in the UK. Because the UK has no exchange control legislation and the preaching of any faith is allowed it is possible that neither of the offences committed by the overseas subsidiary constitute offences under UK law. The auditor considers whether any other offence might have been committed if this conduct took place in the UK, but the auditor decides not to make a report to the MLRO in these circumstances.

## Appendix 2

### Guidance as to whom the anti-money laundering legislation applies

#### To whom does the reporting requirement apply?

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 (see paragraph 36 of this Practice Note). 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?

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

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.

For the purposes of this Practice Note the AML reporting requirements apply to all partners and staff within a UK audit firm who are involved in 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.
- Experts from outside the UK audit firm.
- Employees of non-UK audit firms for example, an auditor from an overseas office of an international firm.

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.

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<sup>19</sup>.

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<sup>19</sup> 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 of information they obtain in the course of their trade, profession, business or employment which causes them to know or suspect, or gives reasonable grounds for knowing or suspecting, that another person is engaged in money laundering. Such reports are protected from breach of client confidentiality in the same way as reports made under POCA section 330 and section 331.

The following table illustrates how the reporting requirements might apply to a number of different audit/client scenarios.<sup>20</sup> This table is intended as a guide and it is recognised that there may be factual scenarios which do not fall within the categories above. In case of any doubt, auditors should refer to the provisions of POCA and the ML Regulations, which take precedence over any guidance in this Appendix.

Persons	Offence discovered as part of audit of:	
	UK companies (including UK subsidiaries of UK or non-UK companies)	Non-UK companies (including non-UK subsidiaries of UK or non-UK companies)
• working in UK for UK audit firm	Yes	Yes
• working in UK for non-UK audit firm <sup>21</sup>	Possibly. Where the auditor or audit firm is not eligible for appointment as a UK auditor, in practice, it is likely that the auditor or firm would be providing accountancy services and therefore fall within the UK regulated sector.	
• seconded to UK audit firm	Yes	Yes
• working temporarily outside UK or on foreign secondments, or working permanently outside UK but employed by a UK audit firm	<p>The position of an auditor working temporarily outside the UK or on foreign secondments, or working permanently outside the UK but still within a UK audit firm (but not necessarily employed by the UK firm), is more difficult. For example the duty to report may be influenced by the terms of the secondment.</p> <p>The following is a non-exhaustive list of issues to consider and firms may wish to take legal advice in relation to the need for their employees to comply with the UK's money laundering reporting regime as well as any local legal requirements.</p> <p>Issues to consider include:</p> <ul style="list-style-type: none"> <li>▪ If the auditor's work outside the UK is part of a UK audit then in some circumstances that information may have come to the auditor's attention in the course of engaging in UK regulated activities and therefore be reportable.</li> <li>▪ In the case of an auditor working permanently outside the UK for a UK firm, it may be appropriate to consider whether the auditor is working at a separate firm or at a branch office of a UK firm.</li> <li>▪ An auditor should be particularly cautious about any decision not to make a report on their return to the UK if the information relates to work that the auditor is undertaking in the UK.</li> <li>▪ Regardless of the strict legal position, firms may wish to consider putting in place a business-wide anti-money laundering strategy to protect their global reputation and UK regulated business.</li> <li>▪ An auditor working permanently or temporarily outside the UK considers the anti-money laundering legislation in their host country.</li> </ul>	
• working permanently outside UK for non- UK audit firm	No	No

<sup>20</sup> The audit/client reporting scenarios do not take into account the exemptions for activities occurring outside the UK.

<sup>21</sup> It is recognised that it would not be possible for a non-UK audit firm or auditor to be appointed as the auditor of a UK company. However, these categories have been included for completeness.