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INTERNATIONAL STANDARD ON AUDITING (UK) 250 (REVISED NOVEMBER 2019)

Section A—Consideration of Laws and Regulations in an Audit of Financial Statements

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**INTERNATIONAL STANDARD ON AUDITING (UK) 250
(REVISED NOVEMBER 2019)**

**SECTION A—CONSIDERATION OF LAWS AND REGULATIONS
IN AN AUDIT OF FINANCIAL STATEMENTS**

(Effective for audits of financial statements for periods commencing on or after 15 December 2019)

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International Standard on Auditing (UK) (ISA (UK)) 250 (Revised November 2019), *Section A— Consideration of Laws and Regulations in an Audit of Financial Statements*, should be read in conjunction with ISA (UK) 200 (Revised June 2016), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK)*.

Introduction

Scope of this ISA (UK)

1. This International Standard on Auditing (UK) (ISA (UK)) deals with the auditor's responsibility to consider laws and regulations in an audit of financial statements. This ISA (UK) does not apply to other assurance engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.
- 1-1. Guidance on the auditor's responsibility to report direct to regulators of public interest entities and regulators of other entities in the financial sector is provided in Section B of this ISA (UK).^{1a}

Effect of Laws and Regulations

2. The effect on financial statements of laws and regulations varies considerably. Those laws and regulations to which an entity is subject constitute the legal and regulatory framework. The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures in an entity's financial statements. Other laws or regulations are to be complied with by management or set the provisions under which the entity is allowed to conduct its business but do not have a direct effect on an entity's financial statements. Some entities operate in heavily regulated industries (such as banks and chemical companies). Others are subject only to the many laws and regulations that relate generally to the operating aspects of the business (such as those related to occupational safety and health, and equal employment opportunity). Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.

Responsibility for Compliance with Laws and Regulations (Ref: Para. A1–A8)

3. It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.^{1b}

Responsibility of the Auditor

4. The requirements in this ISA (UK) are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations. However, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.
5. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether due to

^{1a} ISA (UK) 250 (Revised November 2019), *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*.

^{1b} In the UK, those charged with governance are responsible for the preparation of the financial statements.

fraud or error.¹ In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs (UK).² In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- There are many laws and regulations, relating principally to the operating aspects of an entity, that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.
- Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.
- Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

Ordinarily, the further removed non-compliance is from the events and transactions reflected in the financial statements, the less likely the auditor is to become aware of it or to recognize the non-compliance.

6. This ISA (UK) distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows: (Ref: Para. A6, A12–A13)
 - (a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations (see paragraph 14) (Ref: Para. A12); and
 - (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (e.g., compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements (see paragraph 15) (Ref: Para. A13).
7. In this ISA (UK), differing requirements are specified for each of the above categories of laws and regulations. For the category referred to in paragraph 6(a), the auditor's responsibility is to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations. For the category referred to in paragraph 6(b), the auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.
8. The auditor is required by this ISA (UK) to remain alert to the possibility that other audit procedures applied for the purpose of forming an opinion on financial statements may

¹ ISA (UK) 200 (Revised June 2016), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK)*, paragraph 5.

² ISA (UK) 200 (Revised June 2016), paragraph A53–A54.

bring instances of non-compliance to the auditor's attention. Maintaining professional skepticism throughout the audit, as required by ISA (UK) 200 (Revised June 2016),³ is important in this context, given the extent of laws and regulations that affect the entity.

9. The auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, which may differ from or go beyond this ISA (UK), such as: (Ref: Para. A8)
 - (a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance, assessing the appropriateness of their response to non-compliance and determining whether further action is needed;
 - (b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g., in an audit of group financial statements); and
 - (c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

Complying with any additional responsibilities may provide further information that is relevant to the auditor's work in accordance with this and other ISAs (UK) (e.g., regarding the integrity of management or, where appropriate, those charged with governance).

Effective Date

10. This ISA (UK) is effective for audits of financial statements for periods commencing on or after 15 December 2019.

Objectives

11. The objectives of the auditor are:
 - (a) To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;
 - (b) To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and
 - (c) To respond appropriately to identified or suspected non-compliance with laws and regulations identified during the audit.

Definition

12. For the purposes of this ISA (UK), the following term has the meaning attributed below:
Non-compliance – Acts of omission or commission intentional or unintentional, committed by the entity, or by those charged with governance, by management or by other individuals working for or under the direction of the entity, which are contrary to the prevailing laws or regulations. Non-compliance does not include personal misconduct unrelated to the business activities of the entity. (Ref: Para. A9–A10)

³ ISA (UK) 200 (Revised June 2016), paragraph 15.

Requirements

The Auditor's Consideration of Compliance with Laws and Regulations

13. As part of obtaining an understanding of the entity and its environment in accordance with ISA (UK) 315 (Revised July 2020),⁴ the auditor shall obtain a general understanding of:
 - (a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and
 - (b) How the entity is complying with that framework. (Ref: Para. A11)
- 13-1. When performing risk assessment procedures and related activities required by ISA (UK) 315 (Revised July 2020), to obtain an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, the auditor shall consider whether there are any indications of non-compliance with laws and regulations. (Ref: Para. A11-2)
14. The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. (Ref: Para. A11-3–A12-1)
15. The auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements: (Ref: Para. A11-3, A13–A14-1)
 - (a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and (Ref: Para. 14-2)
 - (b) Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.
16. During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention. (Ref: Para. A15)
17. The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor. (Ref: Para. A16)
18. In the absence of identified or suspected non-compliance, the auditor is not required to perform audit procedures regarding the entity's compliance with laws and regulations, other than those set out in paragraphs 13–17.

⁴ ISA (UK) 315 (Revised July 2020), *Identifying and Assessing the Risks of Material Misstatement*, paragraph 19.

Audit Procedures When Non-Compliance Is Identified or Suspected

19. If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain: (Ref: Para. A17–A18)
 - (a) An understanding of the nature of the act and the circumstances in which it has occurred; and
 - (b) Further information to evaluate the possible effect on the financial statements. (Ref: Para. A19)
20. If the auditor suspects there may be non-compliance, the auditor shall discuss the matter, unless prohibited by law or regulation, with the appropriate level of management and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements either quantitatively or qualitatively, and where there is more than one occurrence both individually and in aggregate, the auditor shall consider the need to obtain legal advice. (Ref: Para. A20–A22)
21. If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.
22. The auditor shall evaluate the implications of identified or suspected non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action. (Ref: Para. A23–A25-2)

Communicating and Reporting Identified or Suspected Non-Compliance

Communicating Identified or Suspected Non-Compliance with Those Charged with Governance

23. Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor,⁵ the auditor shall communicate, unless prohibited by law or regulation, with those charged with governance matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential.
- 23-1. For audits of financial statements of public interest entities, when an auditor suspects or has reasonable grounds to suspect that irregularities, including fraud with regard to the financial statements of the entity, may occur or have occurred, the auditor shall, unless prohibited by law or regulation, inform the entity and invite it to investigate the matter and take appropriate measures to deal with such irregularities and to prevent any recurrence of such irregularities in the future. (Ref: Para. A25-3–A25-4)

⁵ ISA (UK) 260 (Revised November 2019), *Communication with Those Charged with Governance*, paragraph 13.

24. If, in the auditor's judgment, the non-compliance referred to in paragraph 23 is believed to be intentional and material, the auditor shall communicate the matter with those charged with governance as soon as practicable. (Ref: Para. A25-5)
25. If the auditor suspects that management or those charged with governance are involved in non-compliance, the auditor shall communicate the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board. Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice. (Ref: Para. A25-6)

Potential Implications of Identified or Suspected Non-Compliance for the Auditor's Report on the Financial Statements (Ref: Para. A26–27-1)

26. If the auditor concludes that the identified or suspected non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall, in accordance with ISA (UK) 705 (Revised June 2016), express a qualified opinion or an adverse opinion on the financial statements.⁶
27. If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit in accordance with ISA (UK) 705 (Revised November 2019).⁷
28. If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion in accordance with ISA (UK) 705 (Revised November 2019). (Ref: Para. A27-1)

Reporting Identified or Suspected Non-Compliance to an Appropriate Authority Outside the Entity

29. If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether law, regulation or relevant ethical requirements: (Ref: Para. A28–A34-1)
 - (a) Require the auditor to report to an appropriate authority outside the entity.
 - (b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

29-1. For audits of financial statements of public interest entities, where the entity does not investigate the matter referred to in paragraph 23-1, the auditor shall inform the authorities responsible for investigating such irregularities. (Ref: Para. A34-2–A34-3)

⁶ ISA (UK) 705 (Revised June 2016), *Modifications to the Opinion in the Independent Auditor's Report*, paragraphs 7–8.

⁷ ISA (UK) 705 (Revised June 2016), paragraphs 7 and 9.

Documentation

30. The auditor shall include in the audit documentation⁸ identified or suspected non-compliance with laws and regulations and: (Ref: Para. A35–A36)
- (a) The audit procedures performed, the significant professional judgments made and the conclusions reached thereon; and
 - (b) The discussions of significant matters related to the non-compliance with management, those charged with governance and others, including how management and, where applicable, those charged with governance have responded to the matter.

Application and Other Explanatory Material

Responsibility for Compliance with Laws and Regulations (Ref: Para. 3–9)

- A1. It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with laws and regulations. Laws and regulations may affect an entity's financial statements in different ways: for example, most directly, they may affect specific disclosures required of the entity in the financial statements or they may prescribe the applicable financial reporting framework. They may also establish certain legal rights and obligations of the entity, some of which will be recognized in the entity's financial statements. In addition, laws and regulations may impose penalties in cases of non-compliance.
- A2. The following are examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations:
- Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
 - Instituting and operating appropriate systems of internal control.
 - Developing, publicizing and following a code of conduct.
 - Ensuring employees are properly trained and understand the code of conduct.
 - Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
 - Engaging legal advisors to assist in monitoring legal requirements.
 - Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

In larger entities, these policies and procedures may be supplemented by assigning appropriate responsibilities to the following:

- An internal audit function.
- An audit committee.

⁸ ISA (UK) 230 (Revised June 2016), *Audit Documentation*, paragraphs 8–11, and A6.

- A compliance function.

A2-1. In the UK, in certain sectors or activities (e.g., financial services), there are detailed laws and regulations that specifically require directors to have systems to ensure compliance. Non-compliance with these laws and regulations could have a material effect on the financial statements.

A2-2. In the UK, the directors are responsible for the preparation of financial statements that give a true and fair view. Accordingly it is necessary, where identified or suspected non-compliance with laws and regulations has occurred which may result in a material misstatement in the financial statements, for the directors to ensure that the matter is appropriately reflected and/or disclosed in the financial statements.

A2-3. In the UK, directors and officers of companies have responsibility to provide information required by the auditor, to which they have a legal right of access.^{8a} Such legislation also provides that it is a criminal offence to give to the auditor information or explanations which are misleading, false or deceptive.

Responsibility of the Auditor

A3. Non-compliance by the entity with laws and regulations may result in a material misstatement of the financial statements. Detection of non-compliance, regardless of materiality, may affect other aspects of the audit including, for example, the auditor's consideration of the integrity of management, those charged with governance or employees.

A4. Whether an act constitutes non-compliance with laws and regulations is a matter to be determined by a court or other appropriate adjudicative body, which is ordinarily beyond the auditor's professional competence to determine. Nevertheless, the auditor's training, experience and understanding of the entity and its industry or sector may provide a basis to recognize that some acts, coming to the auditor's attention, may constitute non-compliance with laws and regulations.

A5. In accordance with specific statutory requirements, the auditor may be specifically required to report, as part of the audit of the financial statements, on whether the entity complies with certain provisions of laws or regulations. In these circumstances, ISA (UK) 700 (Revised November 2019)⁹ or ISA (UK) 800 (Revised)¹⁰ deal with how these audit responsibilities are addressed in the auditor's report. Furthermore, where there are specific statutory reporting requirements, it may be necessary for the audit plan to include appropriate tests for compliance with these provisions of the laws and regulations.

Categories of Laws and Regulations (Ref: Para. 6)

A6. The nature and circumstances of the entity may impact whether relevant laws and regulations are within the categories of laws and regulations described in paragraphs 6(a) or 6(b). Examples of laws and regulations that may be included in the categories described in paragraph 6 include those that deal with:

^{8a} In the UK, under Section 499 of the Companies Act 2006.

⁹ ISA (UK) 700 (Revised November 2019), *Forming an Opinion and Reporting on Financial Statements*, paragraph 43.

¹⁰ ISA (UK) 800 (Revised) *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*, paragraph 11.

- Fraud, corruption and bribery.
- Money laundering,^{10a} terrorist financing and proceeds of crime.
- Securities markets and trading.
- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

A6-1. In the UK, legislation relating to money laundering, terrorist financing and proceeds of crime imposes additional responsibilities on the auditor. The Appendix contains further guidance on these responsibilities.

Considerations Specific to Public Sector Entities

A7. In the public sector, there may be additional audit responsibilities with respect to the consideration of laws and regulations which may relate to the audit of financial statements or may extend to other aspects of the entity's operations.

Additional Responsibilities Established by Law, Regulation or Relevant Ethical Requirements (Ref: Para. 9)

A8. Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA Code) requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed. Such steps may include the communication of identified or suspected non-compliance with laws and regulations to other auditors within a group, including a group engagement partner, component auditors or other auditors performing work at components of a group for purposes other than the audit of the group financial statements.¹¹

Definition (Ref: Para. 12)

A9. Acts of non-compliance with laws and regulations include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, by management or by other individuals working for or under the direction of the entity.

A10. Non-compliance also includes personal misconduct related to the business activities of the entity, for example, in circumstances where an individual in a key management position, in a personal capacity, has accepted a bribe from a supplier of the entity and

^{10a} 'Money laundering' is defined in UK legislation and in general terms involves an act which conceals, disguises, converts, transfers, removes, uses, acquires or possesses property resulting from criminal conduct.

¹¹ See, for example, paragraphs R360.16–360.18 A1 of the IESBA Code.

In the UK, the auditor has regard to any specific requirements of the auditor's relevant professional body.

in return secures the appointment of the supplier to provide services or contracts to the entity.

The Auditor's Consideration of Compliance with Laws and Regulations

Obtaining an Understanding of the Legal and Regulatory Framework (Ref: Para. 13)

A11. To obtain a general understanding of the legal and regulatory framework, and how the entity complies with that framework, the auditor may, for example:

- Use the auditor's existing understanding of the entity's industry, regulatory and other external factors;
- Update the understanding of those laws and regulations that directly determine the reported amounts and disclosures in the financial statements;
- Inquire of management as to other laws or regulations that may be expected to have a fundamental effect on the operations of the entity;
- Inquire of management concerning the entity's policies and procedures regarding compliance with laws and regulations; and
- Inquire of management regarding the policies or procedures adopted for identifying, evaluating and accounting for litigation claims.

A11-1. When obtaining audit evidence to understand how the entity is complying with the legal and regulatory framework applicable to the entity, the auditor may obtain that understanding through a combination of inquiries and other risk assessment procedures (i.e., corroborating inquiries through observation or inspection of documents).

Indications of Non-Compliance with Laws and Regulations (Ref: Para. 13-1)

A11-2. The following matters may be an indication of non-compliance with laws and regulations:

- Investigations by regulatory organizations and government departments or payment of fines or penalties.
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.
- Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.
- Payments without proper exchange control documentation.
- Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorized transactions or improperly recorded transactions.

- Adverse media comment.

Materiality in Relation to Non-Compliance with Laws and Regulations (Ref: Para. 6, 12–13)

A11-3. The auditor considers both quantitative and qualitative factors when considering both categories of laws and regulations as described in paragraph 6, including in circumstances where the direct effect on the determination of amounts and disclosures in the financial statements is not quantitatively material. For example, acts of non-compliance may not generate material fines or penalties, but may have a direct effect on disclosures due to the nature of the entity where disclosure of acts of non-compliance are important to users of the financial statements.

Laws and Regulations Generally Recognized to Have a Direct Effect on the Determination of Material Amounts and Disclosures in the Financial Statements (Ref: Para. 6, 14)

A12. Certain laws and regulations are well-established, known to the entity and within the entity's industry or sector, and relevant to the entity's financial statements (as described in paragraph 6(a)). They could include those that relate to, for example:

- The form and content of financial statements;
- Industry-specific financial reporting issues;
- Accounting for transactions under government contracts; or
- The accrual or recognition of expenses for income tax or pension costs.

In the UK, these laws and regulations include those which:

- Determine the circumstances under which a company is prohibited from making a distribution except out of profits available for the purpose.^{11a}
- Require auditors expressly to report non-compliance, such as the requirements relating to the maintenance of adequate accounting records^{11b} or the disclosure of particulars of directors' remuneration in a company's financial statements.^{11c}

Some provisions in those laws and regulations may be directly relevant to specific assertions in the financial statements (e.g., the completeness of income tax provisions), while others may be directly relevant to the financial statements as a whole (e.g., the required statements constituting a complete set of financial statements). The aim of the requirement in paragraph 14 is for the auditor to obtain sufficient appropriate audit evidence regarding the determination of amounts and disclosures in the financial statements in compliance with the relevant provisions of those laws and regulations.

Non-compliance with other provisions of such laws and regulations and other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements, but are not considered to have a direct effect on the financial statements as described in paragraph 6(a). However, where the auditor identifies or suspects non-compliance with laws and regulations, the auditor takes into account potential fines, litigation or other consequences for the entity when evaluating the possible effect on the financial statements in accordance with paragraph 19(b).

^{11a} In the UK, under Section 830 of the Companies Act 2006.

^{11b} In the UK, under Section 498 of the Companies Act 2006.

^{11c} In the UK, under Section 497 of the Companies Act 2006.

A12-1. In the UK, the auditor's responsibility to express an opinion on an entity's financial statements does not extend to determining whether the entity has complied in every respect with applicable tax legislation. The auditor needs to obtain sufficient appropriate evidence to give reasonable assurance that the amounts included in the financial statements in respect of taxation are not materially misstated. This will usually include making appropriate enquiries of those advising the entity on taxation matters (whether within the firm or elsewhere). If the auditor becomes aware that the entity has failed to comply with the requirements of tax legislation, the auditor considers whether to report the matter to an appropriate authority outside the entity.

Procedures to Identify Instances of Non-Compliance – Other Laws and Regulations

(Ref: Para. 6, 15)

A13. Certain other laws and regulations may need particular attention by the auditor because they have a fundamental effect on the operations of the entity (as described in paragraph 6(b)). Non-compliance with laws and regulations that have a fundamental effect on the operations of the entity may cause the entity to cease operations, or call into question the entity's continuance as a going concern.¹² For example, non-compliance with the requirements of the entity's license or other entitlement to perform its operations could have such an impact (e.g., for a bank, non-compliance with capital or investment requirements).^{12a} There are also many laws and regulations relating principally to the operating aspects of the entity that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.

A14. As the financial reporting consequences of other laws and regulations can vary depending on the entity's operations, the audit procedures required by paragraph 15 are directed to bringing to the auditor's attention instances of non-compliance with laws and regulations that may have a material effect on the financial statements.

A14-1. When determining the nature and extent of the procedures necessary in a particular instance the auditor takes account of the particular entity concerned and the complexity of the law and regulations with which it is required to comply. In general, a small entity which does not operate in a regulated area will require few specific procedures compared with a large multinational corporation carrying on complex, regulated business.

A14-2. When performing the audit procedures required by paragraph 15(a), the auditor may consider whether the audit evidence obtained through inquiries of management and, where appropriate, those charged with governance, is consistent with the auditor's understanding obtained in accordance with paragraph 13.

Non-Compliance Brought to the Auditor's Attention by Other Audit Procedures (Ref: Para. 16)

A15. Audit procedures applied to form an opinion on the financial statements may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention. For example, such audit procedures may include:

- Reading minutes;

¹² See ISA (UK) 570 (Revised September 2019), *Going Concern*.

^{12a} Such requirements exist in the UK under the Financial Services and Markets Act 2000.

- Inquiring of the entity's management and in-house legal counsel or external legal counsel concerning litigation, claims and assessments; and
- Performing substantive tests of details of classes of transactions, account balances or disclosures.

Written Representations (Ref: Para. 17)

A16. Because the effect on financial statements of laws and regulations can vary considerably, written representations provide necessary audit evidence about management's knowledge of identified or suspected non-compliance with laws and regulations, whose effects may have a material effect on the financial statements. However, written representations do not provide sufficient appropriate audit evidence on their own and, accordingly, do not affect the nature and extent of other audit evidence that is to be obtained by the auditor.¹³

A16-1. Where management or those charged with governance have informed the auditor of an instance of actual or suspected non-compliance with laws and regulations (e.g., in response to the inquiries made in paragraph 15(a), through written representations in accordance with paragraph 17 or some other means), the requirements in paragraphs 19–22 apply.

Audit Procedures When Non-Compliance Is Identified or Suspected

A17. The auditor may become aware of information concerning an instance of non-compliance with laws and regulations other than as a result of performing the procedures in paragraphs 13–17 (e.g., when the auditor is alerted to non-compliance by a whistle blower).

Matters Relevant to the Auditor's Understanding of the Nature of the Act and Circumstances in Which It Has Occurred (Ref: Para. 19(a))

A18-1. Where the auditor determines that the identified or suspected non-compliance with laws and regulations is intentional, the requirements in ISA (UK) 240 (Revised May 2021) apply.^{13a}

Matters Relevant to the Auditor's Evaluation (Ref: Para. 19(b))

A19. Matters relevant to the auditor's evaluation^{13b} of the possible effect on the financial statements include:

- The potential financial consequences of identified or suspected non-compliance with laws and regulations on the financial statements including, for example, the imposition of fines, penalties, damages, threat of expropriation of assets,^{13c} enforced discontinuation of operations, and litigation.

¹³ ISA (UK) 580, *Written Representations*, paragraph 4.

^{13a} ISA (UK) 240 (Revised May 2021), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

^{13b} ISA (UK) 620 (Revised November 2019), *Using the Work of an Auditor's Expert* applies if the auditor judges it necessary to obtain appropriate expert advice in connection with the evaluation of the possible effect of legal matters on the financial statements.

^{13c} In the UK, the Proceeds of Crime Act 2002 provides procedures to enable the authorities to confiscate in criminal proceedings or bring an action for civil recovery of assets which represent the benefits of criminal conduct.

- Whether the potential financial consequences require disclosure.
- Whether the potential financial consequences are so serious as to call into question the fair presentation of the financial statements, or otherwise make the financial statements misleading.

Audit Procedures and Communicating Identified or Suspected Non-Compliance with Management and Those Charged with Governance (Ref: Para. 20)

- A20. The auditor is required to discuss the suspected non-compliance with the appropriate level of management and, where appropriate, with those charged with governance, as they may be able to provide additional audit evidence. For example, the auditor may confirm that management and, where appropriate, those charged with governance have the same understanding of the facts and circumstances relevant to transactions or events that have led to the suspected non-compliance with laws and regulations.
- A21. However, in some jurisdictions, law or regulation may restrict the auditor's communication of certain matters with management and those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the auditor is required to report the identified or suspected non-compliance to an appropriate authority pursuant to anti-money laundering legislation. In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice.

A21-1. In the UK, the auditor is subject to compliance with legislation relating to 'tipping off'. 'Tipping off' is an offence under Section 333A of the Proceeds of Crime Act 2002 (POCA). It arises when an individual discloses that:

- (a) A report (internal or external) has already been made where the disclosure by the individual is likely to prejudice an investigation which might be conducted following the internal or external report that has been made; or
- (b) 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.

Whilst 'tipping off' requires a person to have knowledge or suspicion that a report has been or will be made, a further offence of prejudicing an investigation is included in Section 342 of the POCA. Under this provision, it is an offence to make any disclosure which may 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.

The disclosure offences under Sections 333A and 342 of the POCA are not committed if the person disclosing does not know or suspect that it is likely to prejudice an investigation.

- A22. If management or, as appropriate, those charged with governance do not provide sufficient information to the auditor that the entity is in fact in compliance with laws and regulations, the auditor may consider it appropriate to consult with the entity's in-house or external legal counsel about the application of the laws and regulations to the circumstances, including the possibility of fraud, and the possible effects on the

financial statements. If it is not considered appropriate to consult with the entity's legal counsel or if the auditor is not satisfied with the legal counsel's opinion, the auditor may consider it appropriate to consult on a confidential basis with others within the firm, a network firm, a professional body, or with the auditor's legal counsel as to whether a contravention of a law or regulation is involved, including the possibility of fraud, the possible legal consequences, and what further action, if any, the auditor would take.

Evaluating the Implications of Identified or Suspected Non-Compliance (Ref: Para. 22)

A23. As required by paragraph 22, the auditor evaluates the implications of identified or suspected non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations. The implications of particular identified or suspected non-compliance will depend on the relationship of the perpetration and concealment, if any, of the act to specific controls and the level of management or individuals working for, or under the direction of, the entity involved, especially implications arising from the involvement of the highest authority within the entity. As noted in paragraph 9, the auditor's compliance with law, regulation or relevant ethical requirements may provide further information that is relevant to the auditor's responsibilities in accordance with paragraph 22.

A23-1. Where the auditor identifies or suspects non-compliance with laws and regulations, the auditor may determine that a significant deficiency in internal control exists. In such circumstances, the requirements in ISA (UK) 265 apply.^{13d}

A24. Examples of circumstances that may cause the auditor to evaluate the implications of identified or suspected non-compliance on the reliability of written representations received from management and, where applicable, those charged with governance include when:

- The auditor suspects or has evidence of the involvement or intended involvement of management and, where applicable, those charged with governance in any identified or suspected non-compliance.
- The auditor is aware that management and, where applicable, those charged with governance have knowledge of such non-compliance and, contrary to legal or regulatory requirements, have not reported, or authorized reporting of, the matter to an appropriate authority within a reasonable period.

A25. In certain circumstances, the auditor may consider withdrawing from the engagement, where permitted by law or regulation, for example when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances or the identified or suspected non-compliance raises questions regarding the integrity of management or those charged with governance, even when the non-compliance is not material to the financial statements. The auditor may consider it appropriate to obtain legal advice to determine whether withdrawal from the engagement is appropriate. When the auditor determines that withdrawing from the engagement would be appropriate, doing so would not be a substitute for complying with other responsibilities under law, regulation or relevant ethical requirements to respond to identified or suspected non-compliance. Furthermore, paragraph A8a of

^{13d} ISA (UK) 265, *Communicating Deficiencies in Internal Control to Those Charged With Governance and Management*, paragraph 8.

ISA (UK) 220 (Revised November 2019)¹⁴ indicates that some ethical requirements may require the predecessor auditor, upon request by the proposed successor auditor, to provide information regarding non-compliance with laws and regulations to the successor auditor.

A25-1. Withdrawal from the engagement by the auditor is a step of last resort. It is normally preferable for the auditor to remain in office to fulfil the auditor's statutory duties, particularly where minority interests are involved. However, there are circumstances where there may be no alternative to withdrawal, for example, where the directors of a company refuse to issue its financial statements or the auditor wishes to inform the shareholders or creditors of the company of the auditor's concerns and there is no immediate occasion to do so.

A25-2. If the auditor determines that continued holding of office is untenable or the auditor is removed from office by the entity, the auditor will be mindful of the auditor's reporting duties.^{14a}

Communicating and Reporting Identified or Suspected Non-Compliance

Communicating Identified or Suspected Non-Compliance with Those Charged with Governance (Ref: Para. 23-1–24)

A25-3. For audits of financial statements of public interest entities, ISA (UK) 260 (Revised November 2019)^{14b} requires the auditor to communicate in the additional report to the audit committee any significant matters involving actual or suspected non-compliance with laws and regulations or articles of association which were identified in the course of the audit.

A25-4. In the UK, laws or regulations may prohibit alerting ('tipping off') the entity when, for example, the auditor is required to report the identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity pursuant to anti-money laundering legislation.

A25-5. If non-compliance with laws and regulations is intentional but not material the auditor considers whether the nature and circumstances make it appropriate to communicate the matter with those charged with governance as soon as practicable.

Suspicion that Management or Those Charged with Governance are Involved in Non-Compliance (Ref: Para. 25)

A25-6. In the case of suspected money laundering it may be appropriate to report the matter direct to an appropriate authority outside the entity (see paragraph A28).

Potential Implications of Identified or Suspected Non-Compliance for the Auditor's Report (Ref: Para. 26–28)

A26. Identified or suspected non-compliance with laws and regulation is communicated in the auditor's report when the auditor modifies the opinion in accordance with paragraphs 26–28. In certain other circumstances, the auditor may communicate identified or suspected non-compliance in the auditor's report, for example:

¹⁴ ISA (UK) 220 (Revised November 2019), *Quality Control for an Audit of Financial Statements*.

^{14a} In the UK, under Part 16 of the Companies Act 2006.

^{14b} ISA (UK) 260 (Revised November 2019), paragraph 16-2(k).

- When the auditor has other reporting responsibilities, in addition to the auditor's responsibilities under the ISAs (UK), as contemplated by paragraph 43 of ISA (UK) 700 (Revised November 2019);
- When the auditor determines that the identified or suspected non-compliance is a key audit matter and accordingly communicates the matter in accordance with ISA (UK) 701 (Revised November 2019),¹⁵ unless paragraph 14 of that ISA (UK) applies; or
- In exceptional cases when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances and withdrawal from the engagement is not possible (see paragraph A25), the auditor may consider describing the identified or suspected non-compliance in an Other Matter paragraph in accordance with ISA (UK) 706 (Revised June 2016).¹⁶

A26-1. In the UK, if the auditor concludes that the view given by the financial statements could be affected by a level of uncertainty concerning the consequences of identified or suspected non-compliance with laws and regulations which, in the auditor's professional judgment, is significant, the auditor, subject to a consideration of 'tipping off' (see paragraph A21-1), includes an explanatory paragraph referring to the matter in the auditor's report.

A27. Law or regulation may preclude public disclosure by either management, those charged with governance or the auditor about a specific matter. For example, law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including a prohibition on alerting the entity. When the auditor intends to communicate identified or suspected non-compliance in the auditor's report under the circumstances set out in paragraph A26 or otherwise, such law or regulation may have implications for the auditor's ability to describe the matter in the auditor's report, or in some circumstances to issue the auditor's report. In such cases, the auditor may consider obtaining legal advice to determine the appropriate course of action.

A27-1. In the UK, when considering whether the financial statements reflect the possible consequences of any identified or suspected non-compliance with laws and regulations, the auditor has regard to the requirements of the applicable financial reporting framework. Identified or suspected non-compliance with laws and regulations may require disclosure in the financial statements because, although the immediate financial effect on the entity may not be material,^{16a} there could be future material consequences such as fines, litigation or other consequences for the entity, or the non-compliance may be qualitatively material. For example, an illegal payment may not itself be material but may result in criminal proceedings against the entity or loss of business which could have a material effect on the true and fair view given by the

¹⁵ ISA (UK) 701 (Revised November 2019), *Communicating Key Audit Matters in the Independent Auditor's Report*.

¹⁶ ISA (UK) 706 (Revised June 2016), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

^{16a} As discussed in ISA (UK) 320 (Revised June 2016), *Materiality in Planning and Performing an Audit*, judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a matter or a combination of both.

financial statements.

Reporting Identified or Suspected Non-Compliance to an Appropriate Authority Outside the Entity (Ref: Para. 29)

- A28. Reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be required or appropriate in the circumstances because:
- (a) Law, regulation or relevant ethical requirements require the auditor to report (see paragraphs A29–A29-3);
 - (b) The auditor has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements (see paragraph A30);
 - (c) Law, regulation or relevant ethical requirements provide the auditor with the right to do so (see paragraph A31); or
 - (d) The matter may be one that ought to be reported in the public interest (see paragraphs A33-1–A33-8).
- A29. In some jurisdictions, the auditor may be required by law, regulation or relevant ethical requirements to report identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity. For example, in some jurisdictions, statutory requirements exist for the auditor of a financial institution to report the occurrence, or suspected occurrence, of non-compliance with laws and regulations to a supervisory authority. Also, misstatements may arise from non-compliance with laws or regulations and, in some jurisdictions, the auditor may be required to report misstatements to an appropriate authority in cases where management or those charged with governance fail to take corrective action.
- A29-1. Anti-money laundering legislation in the UK imposes a duty on the auditor to report suspected money laundering activity. There are similar laws and regulations relating to financing terrorist offences.^{16b} The impact on the auditor of this legislation can broadly be summarized as follows:
- Partners and staff in the firm are required to report suspicions of conduct which would constitute a criminal offence which gives rise to direct or indirect benefit; and
 - Partners and staff in the firm need to be alert to the dangers of 'tipping off' as this will constitute a criminal offence under the anti-money laundering legislation.
- The Appendix contains further guidance on the auditor's responsibilities in respect of money laundering, terrorist financing and proceeds of crime legislation in the UK.
- A29-2. For auditors of certain entities subject to statutory regulation,^{16c} laws and regulations establish separate responsibilities for the auditor to report certain information direct to an appropriate authority outside the entity. Standards and guidance on these

^{16b} In the UK, the Terrorism Act 2000 contains reporting requirements for the laundering of terrorist funds which include any funds that are likely to be used for the financing of terrorism.

^{16c} Auditors of public interest entities and other entities in the financial sector, pension schemes and charities have a statutory responsibility, subject to compliance with legislation relating to 'tipping off' (see paragraph A21-1), to report matters that are likely to be of material significance to the regulator.

responsibilities is given in Section B of this ISA (UK)^{1a} and relevant FRC Practice Notes.

A29-3. The procedures and guidance in Section B of this ISA (UK)^{1a} can be adapted to circumstances in which the auditor of other types of entity identifies or suspects non-compliance with laws and regulations which the auditor is under a statutory duty to report.

A30. In other cases, the relevant ethical requirements may require the auditor to determine whether reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity is an appropriate action in the circumstances. For example, the IESBA Code requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed, which may include reporting to an appropriate authority outside the entity.¹⁷ The IESBA Code explains that such reporting would not be considered a breach of the duty of confidentiality under the IESBA Code.¹⁸

A31. Even if law, regulation or relevant ethical requirements do not include requirements that address reporting identified or suspected non-compliance, they may provide the auditor with the right to report identified or suspected non-compliance to an appropriate authority outside the entity. For example, when auditing the financial statements of financial institutions, the auditor may have the right under law or regulation to discuss matters such as identified or suspected non-compliance with laws and regulations with a supervisory authority.

A32. In other circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the auditor's duty of confidentiality under law, regulation or relevant ethical requirements.

A33. The determination required by paragraph 29 may involve complex considerations and professional judgments. Accordingly the auditor may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The auditor may also consider obtaining legal advice to understand the auditor's options and the professional or legal implications of taking any particular course of action.

Reporting in the Public Interest

A33-1. Where the auditor has identified or suspects non-compliance with laws and regulations which does not give rise to a responsibility under law, regulation or relevant ethical requirements to report to an appropriate authority outside the entity, the auditor considers whether the matter may be one that ought to be reported in the public interest to an appropriate authority outside the entity and, where this is the case, except in the

¹⁷ See, for example, paragraphs 360.21 A1 and 360.25 A1–R360.27 of the IESBA Code.

In the UK, the auditor has regard to paragraphs A33-1–A33-8 of this ISA (UK) and any specific requirements of the auditor's relevant professional body.

¹⁸ See, for example, paragraphs R114.1–114.1 A1 and R360.26 of the IESBA Code.

In the UK, the auditor has regard to any specific requirements of the auditor's relevant professional body.

circumstances covered in paragraph A33-3, discusses the matter with those charged with governance, including any audit committee.^{18a}

A33-2. If, having considered any views expressed on behalf of the entity and in the light of any legal advice obtained, the auditor concludes that the matter ought to be reported in the public interest to an appropriate authority outside the entity, the auditor notifies those charged with governance in writing of the auditor's conclusion and, if the entity does not voluntarily do so itself or is unable to provide evidence that the matter has been reported, the auditor reports the matter direct to an appropriate authority outside the entity.

A33-3. The auditor reports in the public interest a matter direct to an appropriate authority outside the entity and without discussing the matter with the entity if the auditor concludes that the identified or suspected non-compliance with laws and regulations has caused the auditor no longer to have confidence in the integrity of those charged with governance. Such a conclusion may arise in the circumstances identified in paragraph A24 or as a result of other audit procedures.

A33-4. Determination of where the balance of public interest lies requires careful consideration. An auditor whose suspicions have been aroused uses professional judgment to determine whether the auditor's misgivings justify the auditor in carrying the matter further or are too insubstantial to deserve reporting. The auditor is protected from the risk of liability for breach of confidence or defamation provided that:

- In the case of breach of confidence, disclosure is made in the public interest, and such disclosure is made to an appropriate body or person,^{18b} and there is no malice motivating the disclosure; and
- In the case of defamation, disclosure is made in the auditor's capacity as auditor of the entity concerned, and there is no malice motivating the disclosure.

In addition, the auditor is protected from such risks where the auditor is expressly permitted or required by legislation to disclose information.^{18c}

^{18a} In rare circumstances, according to common law, disclosure might also be justified in the public interest where there is no instance of non-compliance with laws and regulations, e.g. where the public is being misled or their financial interests are being damaged; where a miscarriage of justice has occurred; where the health and safety of members of the public or the environment is being endangered – although such events may well constitute breaches of laws and regulations.

^{18b} In the UK, appropriate authorities outside the entity could include the Serious Fraud Office, the Crown Prosecution Service, police forces, the Financial Conduct Authority, the Prudential Regulation Authority, the Panel on Takeovers and Mergers, the Society of Lloyd's, local authorities, the Charity Commission for England and Wales, the Office of the Scottish Charity Regulator, the Charity Commission for Northern Ireland, HM Revenue and Customs, the Department of Business, Energy and Industrial Strategy and the Health and Safety Executive.

^{18c} In the UK, the Employments Rights Act 1996 would give similar protection to an individual member of the engagement team who made an appropriate report in the public interest. However, ordinarily a member of the engagement team who believed there was a reportable matter would follow the firm's policies and procedures to address such matters. ISA (UK) 220 (Revised November 2019) paragraph 18(a) requires that the engagement partner shall take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters. If differences of opinion arise within the engagement team, ISA (UK) 220 (Revised November 2019) paragraph 22 requires that the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

A33-5. 'Public interest' is a concept that is not capable of general definition. Each situation must be considered individually. In the UK, legal precedent indicates that matters to be taken into account when considering whether disclosure is justified in the public interest may include:

- The extent to which the identified or suspected non-compliance with laws and regulations is likely to affect members of the public.
- Whether those charged with governance have rectified the matter or are taking, or are likely to take, effective corrective action.
- The extent to which non-disclosure is likely to enable the identified or suspected non-compliance with laws and regulations to recur with impunity.
- The gravity of the matter.
- Whether there is a general ethos within the entity of disregarding laws and regulations.
- The weight of evidence and the degree of the auditor's suspicion that there has been non-compliance with laws and regulations.

A33-6. An auditor who can demonstrate having acted reasonably and in good faith in informing an appropriate authority of non-compliance with laws and regulations which the auditor suspects has been committed would not be held by the court to be in breach of duty to the client even if, an investigation or prosecution having occurred, it were found that there had been no offence.

A33-7. The auditor needs to remember that the auditor's decision as to whether to report, and if so to whom, may be called into question at a future date, for example on the basis of:

- What the auditor knew at the time;
- What the auditor ought to have known in the course of the audit;
- What the auditor ought to have concluded; and
- What the auditor ought to have done.

The auditor may also wish to consider the possible consequences if financial loss is occasioned by non-compliance with laws and regulations which the auditor suspects (or ought to suspect) has occurred but decided not to report.

A33-8. The auditor may need to take legal advice before making a decision on whether identified or suspected non-compliance with laws and regulations needs to be reported to an appropriate authority in the public interest.

Considerations Specific to Public Sector Entities

A34. A public sector auditor may be obliged to report on identified or suspected non-compliance to the legislature or other governing body or to report them in the auditor's report.

Timing of Reports

A34-1. Laws and regulations may stipulate a period within which reports are to be made. If the auditor becomes aware of a suspected or actual non-compliance with laws and regulations which gives rise to a statutory duty to report, the auditor complies with any

such stipulated periods for reporting. Ordinarily the auditor makes a report to an appropriate authority outside the entity as soon as practicable.

Reporting to Authorities of Public Interest Entities (Ref: Para. 29-1)

A34-2. The disclosure in good faith to the authorities responsible for investigating such irregularities, by the auditor, of any irregularities referred to in paragraph 29-1 shall not constitute a breach of any contractual or legal restriction on disclosure of information in accordance with the Audit Regulation.^{18d}

A34-3. The auditor considers whether to take further action when the entity investigates the matter referred to in paragraph 23-1 but where the measures taken by management or those charged with governance, in the auditor's professional judgement, were not appropriate to deal with the irregularities identified or would fail to prevent future occurrences.

Documentation (Ref: Para. 30)

A35. The auditor's documentation of findings regarding identified or suspected non-compliance with laws and regulations may include, for example:

- Copies of records or documents.
- Minutes of discussions held with management, those charged with governance or parties outside the entity.

A36. Law, regulation or relevant ethical requirements may also set out additional documentation requirements regarding identified or suspected non-compliance with laws and regulations.¹⁹

^{18d} Article 7 of Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014.

¹⁹ See, for example, paragraph R360.28 of the IESBA Code.

In the UK, the auditor has regard to any specific requirements of the auditor's relevant professional body.

Appendix

(Ref: Para. A6-1, A29-1)

Money Laundering, Terrorist Financing and Proceeds of Crime Legislation in the United Kingdom¹

1. In the UK, 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).
 - Criminal Finances Act 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, and should be read in conjunction with the more detailed updated guidance, which includes a series of practical examples, issued by the Consultative Committee of Accountancy Bodies (CCAB).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 ('2017 Regulations') replace the Money Laundering Regulations 2007. The 2017 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

¹ The revised guidance in this Appendix has been shared with HM Treasury, HM Revenue and Customs and the National Crime Agency (NCA) 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 CCAB has issued revised 'Anti-Money Laundering Guidance for the Accountancy Sector' ('CCAB Guidance') which provides detailed 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> The CCAB Guidance is approved by HM Treasury.

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 2017 Regulations.

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 National Crime Agency (NCA). For the purposes of this Appendix, 'person' is interpreted as referring to a UK firm (or sole practitioner) that is designated as a 'Registered Auditor' to which the 2017 Regulations apply. The 2017 Regulations also set out a series of key changes in respect of:

- More prescriptive risk assessments.
 - Policies and procedures to mitigate money laundering and terrorist financing risks.
 - Enhanced transparency over beneficial owners.
 - Customer due diligence.
 - Changes to extend the definition of Politically Exposed Persons.
 - A person responsible for compliance at Board level.
 - Enhanced training requirements.
4. Where a Registered Auditor is not carrying out statutory audit work, the 2017 Regulations will nevertheless often apply as they also cover a firm or sole practitioner who provides accountancy 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, maintaining records, and internal reporting.

To Whom Does the Anti-Money Laundering Legislation Apply?

5. The requirement to make a report under Sections 330 and 331 of POCA applies to information which comes to a person in the course of a business, or a Money Laundering Reporting Officer ('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.
6. Sections 45 and 46 of the Criminal Finances Act 2017 create criminal offences for failing to prevent the facilitation of tax evasion. These offences apply to Companies, Partnerships and Limited Liability Partnerships (LLPs) where:
- Criminal tax evasion takes place under UK or foreign law;
 - It is facilitated by the business' employee, agent or those performing services for the business; and
 - The business, by virtue of failing to put in place reasonable prevention methods, has failed to prevent that person from enabling the crime.

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

When is an Auditor in the UK Regulated Sector?

7. The regulated sector includes any firm or individual who acts in the course of a business carried on in the UK as an auditor. This is set out in more detail in paragraphs 8 - 10 of this Appendix.
8. A person is eligible for appointment as an auditor if the person is a member of a Recognized Supervisory Body⁷ 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, LLPs, 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.
9. The Anti-Money Laundering Legislation applies to all partners and staff within a UK 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 firm and employees (both audit partners and staff and experts from other disciplines) of non-UK firms, including contractors.
10. 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 Recognized Supervisory Body.
11. It is unlikely that it will be practicable or desirable for a UK 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 firms may choose to impose procedures across the firm requiring all partners and staff to report to the firm's MLRO.⁸
12. 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 November 2019).⁹ 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.

⁷ A Recognized Supervisory Body 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 recognized by the Secretary of State by Order.

⁸ Persons outside the regulated sector are not obliged to report to their MLRO under Sections 330 and Section 331 of POCA (the 'failure to report' offence), but can make voluntary reports under Section 337.

⁹ ISA (UK) 220 (Revised November 2019), *Quality Control for an Audit of Financial Statements*, paragraph 7(d).

Key Legal Requirements

13. 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:
 - o The auditor knows or suspects, or has reasonable grounds to know or suspect, that another person is engaged in money laundering; and
 - o 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
 - o 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.¹⁰
 - 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.¹¹ Auditors (partners and staff) will face criminal penalties¹² 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

¹⁰ 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.

¹¹ Subject to the provisions of Section 330(6) of POCA relating to information coming to a legal adviser or relevant professional adviser in 'privileged circumstances' and Section 330(7A) relating to offences committed overseas.

¹² 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.

training in how to recognize 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

14. There are three principal money laundering offences in POCA which define money laundering to encompass offences relating to:

- The concealment (Section 327);
- Becoming involved in arrangements which facilitate the creation (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.

15. 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 a firm, the nominated officer is usually known as a Money Laundering Reporting Officer¹³ ('MLRO') and is referred to as such in this Appendix (see paragraphs 22–24 of this Appendix).¹⁴ 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 NCA.

16. 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 49–51 of this Appendix). Auditors could also commit a principal offence through acts of omission.

Firm-wide Practices

17. The Anti-Money Laundering Legislation requires the firm to establish risk-sensitive policies and procedures¹⁵ relating to:

- Customer identification and ongoing monitoring of business relationships.

¹³ The 2017 legislation creates a new role of 'officer responsible for compliance'; however, for the purposes of this guidance the term MLRO should be deemed to cover both roles. More detailed explanation is provided in Section 3 of the CCAB Guidance.

¹⁴ Requirements relating to internal reporting procedures do not apply to sole practitioners; however, a sole practitioner is still subject to external reporting obligations under POCA. 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 23 of this Appendix).

¹⁵ Detailed guidance on developing and applying a risk based approach is given in Section 4 of the CCAB Guidance.

- Reporting internally and to the NCA.¹⁶
- Record keeping.
- Internal control, risk assessment and management.
- Training for all relevant employees.
- Monitoring and management of compliance with a firm's policies and procedures.
- The internal communication of such policies and procedures throughout the firm.

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 coordinated with the responsibility for the firm's quality control systems under ISQC (UK) 1 (Revised November 2019).¹⁷

Client Identification and Ongoing Monitoring of Business Relationships

18. Appropriate identification procedures,¹⁸ 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.
19. 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.
20. 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 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 management and those charged with governance. Such wording could be included in the auditor's engagement letter.¹⁹
21. The activities of and the relationship with the client are monitored by the firm on an ongoing 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

¹⁶ Whilst a risk based approach is appropriate when devising policies and procedures, the auditor does not adopt a risk based approach to making reports either internally or to the NCA.

¹⁷ International Standard on Quality Control (UK) 1 (Revised November 2019), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance and Related Services Engagements*.

¹⁸ Guidance on identification procedures, including references to financial restrictions regimes (i.e., sanctions), is given in Section 5 of the CCAB Guidance.

¹⁹ ISA (UK) 210 (Revised June 2016), *Agreeing the Terms of Audit Engagements*.

client identification procedures to be re-performed.

Money Laundering Reporting Officer

22. The Anti-Money Laundering Legislation requires relevant entities to appoint a nominated officer (usually known as the MLRO¹³). The auditor is required to report to the MLRO 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.
23. A sole practitioner is not required to appoint a MLRO; however, the external reporting obligations under the Anti-Money Laundering Legislation remain, 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 Appendix to reporting matters to the MLRO should be read as making a report directly to the NCA in the case of a sole practitioner.
24. Partners and staff in a firm 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 inquiry 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

25. 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 recognize and deal with activities which may be related to money laundering and terrorist financing.²⁰ 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 and terrorist financing 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 November 2019)²¹ 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

²⁰ Guidance on training is given in Section 3 of the CCAB Guidance and in Regulation 24 of the 2017 Regulations.

²¹ ISA (UK) 250 (Revised November 2019), *Section A—Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 13.

framework.

Impact of Anti-Money Laundering Legislation on Audit Procedures

Identification of Knowledge or Suspicions

26. ISA (UK) 250 (Revised November 2019) 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 35 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.

27. ISA (UK) 250 (Revised November 2019) 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;²² and
- Sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.²³

This may cause the auditor to be suspicious that, for example, breaches of the Companies Act 2006 or tax offences have taken place, which may be criminal offences resulting in criminal property.

28. ISA (UK) 250 (Revised November 2019) 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.²⁴ 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.

29. For entities within the regulated sector²⁵ or public interest entities, other laws and regulations that may have a material effect on the financial statements will include Anti-

²² ISA (UK) 250 (Revised November 2019) Section A, paragraph 13.

²³ ISA (UK) 250 (Revised November 2019) Section A, paragraph 14.

²⁴ ISA (UK) 250 (Revised November 2019) Section A, paragraph 15.

²⁵ For the purposes of this Appendix this includes (but is not restricted to) the following persons acting in the course of business in the UK: 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 or more; and casinos. More detail is provided in Part 2 of the 2017 Regulations.

- 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 system of 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 November 2019).²⁶
30. 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 November 2019), unless there are other indicators that may lead to a risk of material misstatement of the financial statements.
 31. ISA (UK) 250 (Revised November 2019) 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.²⁷ This includes non-compliance that might incur obligations for the auditor to report to an appropriate authority outside the entity.
 32. 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 45–48 of this Appendix).
 33. In some situations the entity 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 beyond the auditor's professional competence to determine. Provided that the auditor considers that the advice has been obtained from a suitably qualified and independent solicitor and that the solicitor was made aware of all relevant circumstances known to the auditor, the auditor may rely on such advice, provided the auditor has complied with the requirements of ISA (UK) 500²⁸ and ISA (UK) 620 (Revised November 2019).²⁹
 34. 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

²⁶ ISA (UK) 250 (Revised November 2019), *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*.

²⁷ ISA (UK) 250 (Revised November 2019) Section A, paragraph 16.

²⁸ ISA (UK) 500, *Audit Evidence*.

²⁹ ISA (UK) 620 (Revised November 2019), *Using the Work of an Auditor's Expert*.

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 should consider whether information obtained as part of the group audit procedures (e.g., reports made by non-UK component auditors, discussions with non-UK component auditors or discussions with UK and non-UK management and those charged with governance) 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 also considers whether such conduct constitutes an offence under Section 6 of the Bribery Act 2010.

Further Inquiry

35. Once the auditor identifies or suspects non-compliance with laws and regulations, the auditor makes further enquiries to assess the implications of this for the audit of the financial statements. ISA (UK) 250 (Revised November 2019) 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.³⁰ 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 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.
36. 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.

Reporting to the MLRO and to the NCA

37. 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.
38. 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,

³⁰ ISA (UK) 250 (Revised November 2019) Section A, paragraph 19.

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 law³¹ 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 37 of this Appendix.

39. 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.
40. 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.³² 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 exclude from the audit file all details of internal reports held by the MLRO. 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.
41. The MLRO makes the decision as to whether a report is made by the firm to the NCA.

³¹ 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 an offence under:

- (a) The Gaming Act 1968;
- (b) The Lotteries and Amusements Act 1976; or
- (c) Section 23 or 25 of the Financial Services and Markets Act 2000.

³² <http://www.nationalcrimeagency.gov.uk/about-us/what-we-do/economic-crime/ukfiu/how-to-report-sars>

Suspicious Activity Reports may be made using one of the NCA's manual or on-line forms.³²

42. 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.³³ 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.
43. Where the auditor has made a report to the MLRO and the MLRO has decided that further inquiry is necessary, the auditor will need to be made aware of the outcome of the inquiry to determine whether there are any implications for the auditor's report or the decision to accept reappointment as auditor.

Legal Privilege

44. 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.³⁴ 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

45. 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 (either internal or external) 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.
46. There are a number of exceptions to this offence under the Anti-Money Laundering

³³ Guidance on the reporting of knowledge and suspicions by the MLRO to the NCA is given in Section 7 of the CCAB Guidance.

³⁴ The Proceeds of Crime Act 2002 and Money Laundering Regulations 2003 (Amendment) Order 2006 (SI 2006/308) 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.

Legislation, including where disclosures are made:

- To a fellow auditor employed by a firm that shares common ownership, management or control with the firm;³⁵
 - 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
 - In circumstances where the person making the disclosure does not know or suspect that the disclosure is likely to prejudice an investigation.
47. A further offence of prejudicing an investigation is included in the Anti-Money Laundering Legislation. Under this provision,³⁶ 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.
48. ISA (UK) 260 (Revised November 2019)³⁷ requires the auditor to communicate significant findings from the audit with those charged with governance of an entity. The auditor considers 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 should 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

49. 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

³⁵ Some network firms may not meet these criteria.

³⁶ Section 342 of POCA.

³⁷ ISA (UK) 260 (Revised November 2019), *Communication with Those Charged with Governance*, paragraph 16.

could otherwise constitute a principal money laundering offence.³⁸ 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 issue 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.³⁹

50. The auditor also needs 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 the engagement the auditor may need to seek NCA consent for such an action to be taken.
51. 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 58–62 of this Appendix.

Reporting to Regulators

52. Reporting to the NCA does not relieve the auditor from other statutory duties. Examples of statutory reporting responsibilities include:
- *Audits of financial statements 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 financial statements 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

³⁸ 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 31).

³⁹ 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>

requirements.

- *Audits of financial statements 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).

53. Knowledge or suspicion, or reasonable grounds for knowledge or suspicion, of involvement of the entity's management or those charged with governance 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

54. Where money laundering has been identified or is suspected, the auditor evaluates the possible effect, both in quantitative and qualitative terms, on the financial statements, 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.

55. If it is known that money laundering has occurred and that management or those charged with governance were knowingly involved, the auditor needs to consider whether the auditor's report should:

- Be modified in accordance with ISA (UK) 705 (Revised June 2016);⁴⁰ or
- Incorporate an Emphasis of Matter paragraph in accordance with ISA (UK) 706 (Revised June 2016).⁴¹

56. However, the auditor also 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,⁴² could alert a money launderer.

57. 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.

⁴⁰ ISA (UK) 705 (Revised June 2016), *Modifications to the Opinion in the Independent Auditor's Report*.

⁴¹ ISA (UK) 706 (Revised June 2016), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

⁴² Paragraph A24 of ISA (UK) 260 (Revised November 2019) 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).

Resignation and Communication With Successor Auditors⁴³

58. 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 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.
59. 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.
60. 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 successor auditor from committing a money laundering offence.
61. 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 2006,⁴⁴ the auditor considers whether the disclosure of that information would constitute a 'tipping off' offence under the Anti-Money Laundering Legislation as 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 successor auditor.
62. 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 successor auditor which detail circumstances which have lead the audit team to suspect

⁴³ Section 9 of the CCAB Guidance provides more general guidance on cessation of work and resignation.

⁴⁴ The Statutory Auditors and Third Country Auditors Regulations 2016 (SI 2016/649) came into force on 15 June 2016 and amended the Companies Act 2006 requiring auditors to make available all relevant information held in relation to holding the office as auditor to a successor auditor.

management of a fraud, this will not constitute a 'tipping off' offence.⁴⁵

- 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 58–59 of this Appendix in relation to the Section 519 statement.

⁴⁵ 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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