August 2004

Practice Note 12

MONEY LAUNDERING – INTERIM GUIDANCE FOR AUDITORS IN THE UNITED KINGDOM

(Revised)

The Auditing Practices Board

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This Practice Note replaces Practice Note 12, 'Money Laundering', published in May 1997. (Practice Note 12 was withdrawn on 15 March 2004 following the publication of the exposure draft of Practice Note 12 (Revised).)

ISBN 1-84140-561-2

PRACTICE NOTE 12 (REVISED)

MONEY LAUNDERING – INTERIM GUIDANCE FOR AUDITORS IN THE UNITED KINGDOM

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INTRODUCTION

1. Practice Note 12, 'Money Laundering', which was originally issued in May 1997, has been revised to take account of the requirements of the United Kingdom anti-money laundering legislation which has a major impact on auditors' responsibilities to report money laundering suspicions.

2. Practice Note 12 (Revised) is being issued as interim guidance taking account of comments received during the consultation process and has been submitted to HM Treasury for approval in accordance with sections 330 and 331 of the Proceeds of Crime Act 2002 ('POCA'). When approval has been received Practice Note 12 (Revised) will be issued in final form.

3. Practice Note 12 (Revised) focuses on the impact of the anti-money laundering legislation on auditors' responsibilities when auditing and reporting on financial statements. It does not provide general guidance on the legislation. The Consultative Committee of Accountancy Bodies has issued anti-money laundering guidance for accountants ('CCAB Guidance') (http://www.icaew.co.uk/ccab/documents.html) which provides general guidance on the legislation[1].

4. The National Criminal Intelligence Service ('NCIS') has issued reporting guidance and disclosure forms (http://www.ncis.co.uk/disclosure.asp). These may change over time as the legislation is implemented.

5. The anti-money laundering legislation is complex and uncertainty inevitably exists as to how the courts will interpret it in practice. Notwithstanding this it is expected that the courts will take into account guidance issued by authoritative bodies. To obtain a full understanding of the legal requirements in the United Kingdom, auditors also have regard to the relevant provisions of the legislation and, if necessary, obtain legal advice.

Key changes

6. The key changes introduced by POCA and the Money Laundering Regulations 2003 (the 'Regulations') are as follows:

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1 The cross references in the Practice Note to 'CCAB Guidance' are to the second interim guidance published by the CCAB on the 16 February 2004 and subsequently updated on 9 March 2004. If, subsequent to the publication of this Practice Note, the CCAB updates the second interim guidance the cross references should be taken as referring to the latest CCAB Guidance.

- The definition of money laundering has been extended to comprise three new principal money laundering offences[2] (behaviour that directly constitutes money laundering) these include possessing, or in any way dealing with, or concealing, the proceeds of any crime. This includes crime committed by the entity or an individual. POCA does not contain de minimis concessions. Under the previous anti-money laundering legislation money laundering reporting duties for auditors extended only to the suspected proceeds of drug trafficking or terrorist funds unless as a result of their work the auditors would themselves have committed a money laundering offence.
- Whilst POCA does not extend the scope of the audit, auditors are required to report where they know or suspect, or have reasonable grounds[3] to know or suspect, that money laundering is taking place where the information has come to the auditors in the normal course of their business.
- Failure by an auditor to report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering in relation to the proceeds of any crime is now a criminal offence. Auditors (partners and staff) will face criminal penalties[4] if they breach the new requirements.
- The requirement to report is not just related to matters that might be considered material to the financial statements; auditors have to report knowledge or suspicion, or reasonable grounds for knowledge or suspicion, of crimes that potentially have no material financial statement impact.
- Auditors are required to report offences committed in the United Kingdom and conduct occurring overseas which would constitute an offence in any part of the United Kingdom if it occurred there.

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

3 More detailed guidance on what is meant by 'reasonable grounds' is given in section 6 of the CCAB Guidance.

4 The maximum penalty on conviction on indictment is five years imprisonment for the following offences:
- a person in the regulated sector failing to disclose (sections 330 and 331),
- the giving of consent by a nominated officer inappropriately to prohibited acts (section 336(5)), and
- the tipping off offence (section 333).

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

On summary conviction, the maximum penalty for all the above offences is six months imprisonment and/or a fine not exceeding the statutory maximum.

- Firms must take appropriate measures so that partners and staff are made aware of the provisions of POCA, the Regulations and the Terrorism Act 2000 ('TA 2000') and are given training in how to recognise and deal with transactions which may be related to money laundering.
- Auditors are required to adopt more rigorous client identification procedures and appropriate anti-money laundering procedures.

7. In the United Kingdom, the Regulations came into force for auditors on 1 March 2004. There are transitional provisions in respect of information which comes to the auditors' attention prior to 1 March 2004 (see section 25 of the CCAB Guidance). The CCAB Guidance explains that auditors, who were not within the regulated sector[5] before 1 March 2004, will only need to report knowledge or suspicions of money laundering if part or all of the information that gave rise to that knowledge or suspicion came to the attention of the auditor on or after that date (or if a report is necessary for another reason, such as because the auditors would otherwise commit one of the principal money laundering offences).

The Proceeds of Crime Act 2002

8. For a number of years auditors in the United Kingdom have been required to report to an appropriate authority where they suspect the laundering of money which either derives from drug trafficking or is related to terrorist offences. Partners and staff in audit firms must continue to report non-compliance with certain laws related to terrorism[6] (see Appendix Two of the CCAB Guidance) but new anti-money laundering legislation extends both the definition of what money laundering comprises and the auditors' reporting responsibilities. The new anti-money laundering legislation imposes a duty to report money laundering in respect of the proceeds of all crime.

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5 For the purposes of this Practice Note this includes both the 'regulated sector' as defined in the Proceeds of Crime Act 2002 Schedule 9 Part 1 (as amended in November 2003) and also 'relevant business' as defined in paragraph 2(2) of the Money Laundering Regulations 2003.
The regulated sector includes businesses engaged in the following activities in the United Kingdom:
- banking, investment business and other FSMA 2000 regulated activities
- accountancy or audit services
- money service operators
- estate agency work
- operating a casino
- insolvency practitioners
- tax services
- legal services involving participation in financial or real property transactions
- formation, operation or management of a company or a trust
- dealing in goods of any description which involves accepting a total cash payment of 15,000 euro or more.

6 The Terrorism Act 2000 (as amended by the Anti-terrorism, Crime and Security Act 2001) and associated regulations.

9. POCA[7] establishes three new principal money laundering offences[2] which extend the definition of money laundering to encompass offences relating to the possession, acquisition, concealment or conversion of criminal property and involvement in arrangements relating to criminal property.

10. Those 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 (usually known as a Money Laundering Reporting Officer ('MLRO') and referred to as such in this Practice Note)[8]. If as a result of that report the MLRO has knowledge or suspicion, or reasonable grounds to know or suspect, money laundering the MLRO then has a responsibility to report to NCIS. Features of the anti-money laundering legislation include:

    - Money laundering now comprises three principal money laundering offences[2] which are defined in sections 328, 329 and 330 of POCA. The principal money laundering offences include concealing, disguising, converting, transferring, removing, using, acquiring or possessing property which constitutes or represents a benefit from criminal conduct. POCA does not contain de minimis concessions.
    - Partners and staff in audit firms are required to report all knowledge or suspicion, or reasonable grounds to know or suspect, that a criminal offence giving rise to any direct or indirect benefit (including cost savings) has been committed, regardless of whether that offence has been committed by a client or by a third party.
    - Partners and staff in audit firms need to be alert to the dangers of making disclosures that are likely to tip off a money launderer or prejudice an investigation ('tipping off')[9] as this may constitute a criminal offence under the anti-money laundering legislation.

11. 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 generally required to obtain prior consent to those actions from their MLRO and the MLRO is required to seek prior appropriate consent from NCIS (see paragraph 45 below).

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7 Although POCA came into force on 24 February 2003 the failure to report offences under POCA sections 330 to 332 did not generally apply to auditors until the Regulations came into force on 1 March 2004. The principal money laundering offences, consent provisions and tipping off offences have applied to auditors (and the UK population at large) from 24 February 2003.

8 There is no obligation on a sole practitioner to appoint an MLRO where the sole practitioner does not employ any staff, or act in association with any other person. Where no MLRO is appointed and a sole practitioner has knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering the sole practitioner has a responsibility to report to NCIS.

9 See guidance on 'tipping off' in paragraph 34.

The Money Laundering Regulations 2003

12. The Money Laundering Regulations 2003 replace the Money Laundering Regulations 1993 and 2001 and most of the relevant provisions came into force on 1 March 2004. The Regulations extend the ‘regulated sector’ to which POCA applies to include the provision by way of business of audit services by a person who is eligible for appointment as a company auditor under Section 25 of the Companies Act 1989 or Article 28 of the Companies (Northern Ireland) Order 1990[10]. For the purposes of this Practice Note ‘person’ is interpreted as referring to a UK audit firm that is designated as a ‘Registered Auditor’[11] and the Regulations are interpreted as applying to all partners and staff within that UK audit firm who are involved in providing audit services in the UK.

13. Where a Registered Auditor is not providing audit services the Regulations will nevertheless often apply as they also cover ‘the provision by way of business of accountancy services by a body corporate or unincorporate or, in the case of a sole practitioner, by an individual’[12].

14. The Regulations impose requirements on businesses in the regulated sector relating to systems and training to prevent money laundering, identification procedures for clients, record keeping procedures and internal reporting procedures.

FIRM-WIDE PRACTICES

Money Laundering Reporting Officer

15. The Regulations require relevant businesses to appoint a Money Laundering Reporting Officer. There is no obligation for a sole practitioner who does not employ any staff, or act in association with any other person, to appoint an MLRO. Auditors are required to report where they know or suspect, or have reasonable grounds to know or suspect, that another person is engaged in money laundering. Partners and staff in audit firms discharge this responsibility by reporting to their MLRO or, in the case of sole practitioners, to NCIS. The MLRO is responsible for deciding, on the basis of the information provided by the partners and staff, whether further investigation is required, whether the matter should be reported to NCIS and for making the report to NCIS. Auditors seek advice from the MLRO who acts as the main source of guidance and if necessary is the liaison point for communication with lawyers, NCIS and the relevant law enforcement agency. More detailed guidance on the role of the MLRO is given in section 15 of the CCAB Guidance.

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10 Section 2(k) of the Money Laundering Regulations 2003.

11 A Registered Auditor is defined as ‘A firm entered on the register as eligible for appointment as company auditor under section 25 of the 1989 Act, article 28 of the NI Order 1990, or section 185 of the RI 1990 Act.’

12 Section 2(j) of the Money Laundering Regulations 2003.

Training

16. Firms are required to take appropriate measures so that partners and staff are made aware of the provisions of POCA, the Regulations and the TA 2000 and are given training in how to recognise and deal with transactions which may be related to money laundering. Guidance on training is given in section 16 of the CCAB Guidance. The level of training provided to individuals needs to be appropriate to their role and seniority within the firm.

17. Apart from the training referred to in paragraph 16 above, additional training or expertise in criminal law is not required under POCA. However, auditing standards on law and regulations require an auditor to obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry to help identify possible or actual instances of non-compliance with those laws and regulations which provide a legal framework within which the entity conducts its business and which are central to the entity's ability to conduct its business and hence to its financial statements.

Client identification procedures

18. The identification procedures required by the Regulations are now mandatory when accepting appointment as auditor. Guidance on identification procedures is given in section 18 of the CCAB Guidance.

19. Auditing standards on quality control for audits state that acceptance of client relationships and specific audit engagements includes considering the integrity of the principal owners, key management and those charged with governance of the entity. This involves auditors 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 will need to be extended to comply with the Regulations[13].

20. Annual reappointment as auditor does not, in itself, require the client identification procedures to be re-performed. However, 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 auditors' assessment of risk, the procedures may need to be re-performed and documented, to provide evidence of the decision.

Engagement letters

21. For new audit engagements where client identification procedures may start before the engagement letter is drafted it might be helpful for the auditors to include an additional paragraph where there are pre-engagement letter communications with the potential client. For existing audit engagements where a firm is unable or does not wish to rely on

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13 The Regulations do not require firms who were not subject to the Money Laundering Regulations 1993 to obtain identification evidence in respect of business relationships formed prior to 1 March 2004.

the transitional provisions in the Regulations (which do not require identification evidence to be obtained in respect of audit relationships existing as at 1 March 2004), it may be helpful for the auditors to explain to their client the reason for requiring evidence of identity and this can be achieved by including an additional paragraph in the audit engagement letter. The following is an illustrative paragraph that could be included for this purpose:

'Client identification

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

22. It may also be helpful to inform clients of the auditors' responsibilities under POCA to report knowledge or suspicion, or reasonable grounds to know or suspect, that a money laundering offence has been committed and the restrictions created by the tipping off rules on the auditors' ability to discuss such matters with their clients, although it is not necessary to do so. The following is an illustrative paragraph that could be included in the audit engagement letter for this purpose:

'Money laundering reporting

The provision of audit services is a business in the regulated sector under the Proceeds of Crime Act 2002 and, as such, partners and staff in audit firms are required to report all knowledge or suspicion, or reasonable grounds to know or suspect, that a criminal offence giving rise to any direct or indirect benefit from criminal conduct has been committed, regardless of whether that offence has been committed by their client or by a third party. If as part of our normal audit work we have knowledge or suspicion, or have reasonable grounds to know or suspect, that such offences have been committed we are required to make a report to the National Criminal Intelligence Service. It is not our practice to discuss such reports with you because of the restrictions imposed by the tipping off provisions of the UK anti-money laundering legislation.'

23. Whether or not to include these illustrative paragraphs in the audit engagement letter is a policy decision to be taken by individual firms to be applied on all audit engagements, irrespective of particular client situations. Unless the policy is applied in a consistent manner inclusion of these paragraphs might be interpreted by law enforcement as 'tipping off'.

IMPACT OF NEW LEGISLATION ON AUDIT PROCEDURES

Identification of knowledge or suspicions

24. Auditing standards on law and regulations establish standards and provide guidance on the auditors' responsibility to consider law and regulations in an audit of financial statements. The anti-money laundering legislation does not require auditors to extend the scope of their audit, save as referred to in paragraph 31 below, but the normal audit work could give rise to knowledge or suspicion, or reasonable grounds for knowledge or suspicion, that will need to be reported. Such knowledge or suspicion may arise in relation to:

    - law and regulations relating directly to the preparation of the financial statements;
    - law and regulations which provide a legal framework within which the entity conducts its business; and
    - other law and regulations.

25. Auditing standards on law and regulations require auditors to obtain sufficient appropriate audit evidence about compliance with those laws and regulations that have an effect on the determination of material amounts and disclosures in the financial statements. This may cause auditors to be suspicious that, for example, breaches of the Companies Act or tax offences have taken place, which may be criminal offences resulting in the acquisition of criminal proceeds.

26. Auditing standards on law and regulations also require auditors to perform procedures to help identify possible or actual instances of non-compliance with those laws and regulations which provide a legal framework within which the entity conducts its business and which are central[14] to the entity's ability to conduct its business and hence to its financial statements. These procedures consist of:

    - obtaining a general understanding of the legal and regulatory framework applicable to the entity and the industry and of the procedures followed to ensure compliance with that framework;
    - inspecting correspondence with the relevant licensing or regulatory authorities;
    - enquiring of those charged with governance as to whether they are on notice of any such possible instances of non-compliance with law or regulations; and
    - obtaining written representation that those charged with governance have disclosed to the auditors all known actual or possible non-compliance with laws and regulations

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

whose effects should be considered when preparing financial statements, together with, where applicable, the actual or contingent consequences which may arise from the non-compliance.

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

27. Laws relating to money laundering will be central to an entity's business, if that business is within the regulated sector as defined by POCA and the Regulations (see footnote 5). When auditing the financial statements of businesses within the regulated sector auditors review the steps taken by the entity to comply with the Regulations and obtain management representations concerning compliance with the Regulations. In addition auditors enquire as to whether the entity has made appropriate disclosures of money laundering offences to NCIS or a nominated officer and consider the impact of for example possible fines, asset recovery or other consequences of regulatory or legal action, following non-compliance with the Regulations or POCA.

    Where the business is outside the regulated sector management is not required to implement the Regulations. For these entities, POCA is therefore unlikely to be considered by auditors to be central to an entity's business for the purposes of auditing standards.

28. In relation to other laws and regulations, auditing standards on laws and regulations require auditors to be alert to the fact that audit procedures applied for the purpose of forming an opinion on the financial statements may bring instances of possible non-compliance with laws and regulations to the auditors' attention and to be alert for those instances that might incur obligations for partners and staff in audit firms to report money laundering offences. There are a number of offences under the TA 2000, which trigger an obligation to make a report. For example, someone is engaged in money laundering under section 18 of the TA 2000 if they enter into or become concerned in an arrangement which facilitates the retention or control of terrorist property[15]. More detailed guidance on offences under the TA 2000 is given in Appendix Two of the CCAB Guidance.

29. In some situations the audit client may have obtained legal advice to the effect that certain actions or circumstances do not give rise to criminal conduct and therefore cannot give rise to criminal property. As explained in auditing standards on law and regulations, whether an act constitutes non-compliance with law or regulations may involve consideration of matters which do not lie within the competence and experience of individuals trained in the audit of financial information. Provided that the auditors consider that the advice has been obtained from a suitably qualified and independent lawyer and that the lawyer was made aware of all relevant circumstances known to the auditors, the

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15 Terrorist property includes 'money or other property which is likely to be used for the purposes of terrorism' irrespective of whether those funds come from a legitimate source or not.

auditors are able to rely on such advice provided they have complied with auditing standards on using the work of an expert.

30. The new anti-money laundering legislation requires United Kingdom auditors to report conduct which takes place overseas if that conduct would constitute an offence in any part of the United Kingdom. The new anti-money laundering legislation does not change the scope of the audit and does not therefore impose any requirement for UK parent company auditors to change or add to their normal instructions to auditors of overseas subsidiaries. However, when considering non-UK parts of the group audit the UK parent company auditor will need to consider whether information obtained as part of the group audit procedures (for example reports made by non-UK subsidiary auditors, discussions with non-UK subsidiary auditors or discussions with UK and non-UK directors) gives rise to knowledge or suspicion, or reasonable grounds for knowledge or suspicion, such that there is a requirement for the UK parent company auditor to report to NCIS.

Further investigation

31. Once auditors suspect a possible breach of law or regulations, they will need to investigate further to assess the implications of this for their audit of the financial statements. Auditing standards on laws and regulations require that when auditors become aware of information concerning a possible instance of non-compliance, the auditors 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. Providing that auditors are satisfied that they know or suspect, or have reasonable grounds to know or suspect, that a criminal offence has been committed anti-money laundering legislation does not require the auditors to undertake any additional investigation to determine whether a criminal offence has been committed or to obtain further details of the suspected crime. If the auditors are genuinely uncertain as to whether or not there are reasonable grounds to suspect that an offence has been committed, the auditors may wish to seek advice from their MLRO.

32. Auditors may have knowledge or suspicion that criminal offences have occurred where an audit client is the victim of the crime; for example a company involved in the retail business is likely to have been the victim of shoplifting offences. Auditors are required to report knowledge or suspicion of money laundering arising from such crimes because they constitute money laundering under the new anti-money laundering legislation, even where the identity of the criminal is unknown. Such situations are likely to be reported using limited intelligence value reports (see paragraph 38).

33. Where the auditors have made a report to the MLRO and the MLRO has decided that further investigation is necessary the auditors will need to be made aware of the outcome of the investigation to determine whether there are any implications for their audit report or their decision to accept reappointment as auditors.

Tipping off

34. In the United Kingdom, 'tipping off' is an offence under section 333 of the Proceeds of Crime Act 2002. It arises when an individual discloses matters where:

    (a) There is knowledge or suspicion that a report (internal or external) has already been made; and

    (b) That disclosure is likely to prejudice any investigation which might be conducted following the report.

    Whilst 'tipping off' requires a person to have knowledge or suspicion that a report has been made, a further offence of prejudicing an investigation is included in section 342 of POCA. Under this provision, it is an offence to make any disclosure which is likely to prejudice an investigation of which a person has knowledge or suspicion, or to falsify, conceal, destroy or otherwise dispose of, or cause or permit the falsification, concealment, destruction or disposal of, documents relevant to such an investigation.

35. In performing any further investigation in the context of their audit of the financial statements the auditors need to be aware that they are under an obligation under the money laundering legislation not to disclose information to any person if doing so is likely to tip off or prejudice an investigation (referred to in this Practice Note as 'tipping off'). The risk of committing an offence of tipping off is greatest if management and/or the directors are themselves involved in the suspected criminal activity. To minimise any risk of tipping off it is important that any further investigation consists only of steps that the auditors would have performed as part of their normal audit work (although even these steps may in some circumstances amount to tipping off) and that the MLRO is consulted before any further investigation work is performed. There is potentially a risk of tipping off if the auditors do not act on their suspicions when management and/or the directors might have expected them to take some action. In these circumstances, auditors seek advice from the MLRO. Guidance on 'tipping off' is provided in Section 9 of the CCAB Guidance.

36. Auditors will also need to consider whether continuing to act for the company could itself constitute money laundering, for example if it amounted to aiding or abetting the commission of one of the principal money laundering offences in sections 327, 328 or 329 of POCA, or if it amounted to one of the principal money laundering offences itself, in particular the offence of becoming involved in an arrangement under section 328 of POCA. In those circumstances the auditor may need to seek appropriate consent from NCIS through their MLRO to continue to act (see paragraph 45 below).

Reporting to the MLRO

37. In the United Kingdom, auditors are required to report to their MLRO or, in the case of sole practitioners, to NCIS where they know or suspect, or have reasonable grounds to know or suspect, that another person is engaged in money laundering. Money Laundering reports need to be made irrespective of the quantum of the benefits derived from, or the

seriousness of, the offence. There are no de-minimis concessions contained in POCA, the Regulations or the TA 2000. There is no provision for auditors not to make a report even where they consider that the matter has already been reported or their report would provide NCIS with no additional information. Such situations are likely to be reported using limited intelligence value reports (see paragraph 38).

38. The format of the internal report made to the MLRO is not specified by the Regulations. MLROs determine the form in which partners and staff in audit firms report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering offences internally to their MLRO. Reporting to the MLRO is the individual responsibility of the partner or audit staff member and although suspicions would normally be discussed within the engagement team before deciding whether or not to make an internal report to the MLRO an individual should not be dissuaded from reporting to the MLRO if the individual still considers that it is necessary. The form of the internal report to the MLRO is likely to reflect the guidance provided by NCIS in relation to standard disclosure reports and reports of limited intelligence value. In the case of a sole practitioner, who is not required to appoint an MLRO, the sole practitioner reports directly to NCIS and may wish to use the NCIS forms of report (http://www.ncis.co.uk/disclosure.asp). The NCIS reporting guidance permits aggregated reporting of suspicious activity that meets the NCIS criteria for ‘limited intelligence value’ reporting. These criteria are defined in NCIS guidance notes for completing the limited intelligence value report form available on the NCIS website.

39. Guidance on the reporting of suspicions by the MLRO to NCIS is given in section 20 of the CCAB Guidance.

40. During the course of their audit work auditors might obtain knowledge or form a suspicion about a prohibited act that would be a criminal offence under POCA sections 327, 328 or 329 but has yet to occur. Because attempting or conspiring to commit a money laundering offence is in itself a money laundering offence, even if the underlying offence has not yet occurred it is possible that in some circumstances a report might need to be made.

41. When reporting to the MLRO partners and staff in audit firms follow their firm’s internal reporting procedures. The timing of reporting by the MLRO to NCIS, or in the case of a sole practitioner their report to NCIS, is governed by section 331(4) of POCA which requires the disclosure to be made ‘as soon as is practicable’ after the information or other matter comes to the attention of the MLRO.

42. Both standard and limited intelligence value reports are made as soon as is practicable.NCIS accepts that this will not always mean ‘immediately’ and states that it is content to receive aggregate limited intelligence value reports within one month of the completion of an audit, provided that during the engagement no time sensitive information is discovered (that may, for example, allow the recovery of proceeds of crime if communicated immediately). For the purposes of this Practice Note ‘completion of the

audit' is interpreted as being no later than the date the auditors' report is signed, although if there is likely to be a significant gap between the date the audit work is completed and the date the auditors' report is signed the auditors consider submitting the limited intelligence value report earlier.

43. Partners and staff in audit firms follow their firm's internal documentation procedures when considering whether to include documentation relating to money laundering reporting in the audit working papers.

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. It will not be available to non-legally qualified auditors giving advice to their clients on legal issues, for example advice on company or tax law. If auditors are given access to client information over which legal professional privilege may be asserted (for example, correspondence between clients and solicitors in relation to legal advice or litigation) and that information gives grounds to suspect money laundering, the auditors consider whether they are nevertheless obliged to report to their 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 auditors but where the auditors are in possession of client information which is clearly privileged (for example, a solicitor's advice to an audit client), the auditors seek legal advice. Guidance on legal privilege is given in section 12 of the CCAB Guidance.

Reporting to obtain appropriate consent

45. In addition to the auditors' duty to report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering under POCA sections 330 and 331, auditors may need to obtain appropriate consent to perform an act which could otherwise constitute a principal money laundering offence by the auditor under POCA sections 327 to 329 (a 'prohibited act'). For example, if auditors suspected that their audit report was necessary in order for financial statements to be issued in connection with a transaction involving the proceeds of crime, or if the auditors were to sign off an auditors' report on financial statements for a company that was a front for illegal activity, the auditor might be involved in an arrangement which facilitated the acquisition, retention, use or control of criminal property under section 328 of POCA. In these circumstances, in addition to their normal procedures, auditors would generally need to obtain appropriate consent from NCIS via their MLRO as soon as is practicable. Further guidance on seeking appropriate consent is given in section 20 of the CCAB Guidance.

46. Appropriate consent from NCIS will protect the auditors from committing a principal money laundering offence but will not relieve them from any civil liability or other professional, legal or ethical obligations. As an alternative to seeking appropriate consent, auditors may wish to consider resignation from the audit but, in such circumstances, are still required to disclose suspicions to their MLRO and will wish to consider the possibility

of tipping off. Further guidance on resignation is given in paragraphs 53 to 55 below and on communication with relevant law enforcement agencies in relation to tipping off is given in paragraph 51.

Reporting to regulators

47. Reporting to NCIS does not relieve the auditors from other statutory duties. Examples of statutory reporting responsibilities include:

- *Audits of entities in the financial sector*: auditors have a statutory duty to report matters of 'material significance' to the FSA which come to their attention in the course of their work;
- *Audits of entities in the public sector*: auditors of some public sector entities may be required to report on its compliance with requirements to ensure the regularity and propriety of financial transactions. Activity connected with money laundering may be a breach of those requirements; and
- *Audits of other types of entity*: auditors of some other entities are also required to report matters of 'material significance' to regulators (for example, charities and occupational pension schemes).

48. Knowledge or suspicion, or reasonable grounds for knowledge or suspicion, of involvement of the entity's directors in money laundering, or of a failure of a regulated business to comply with the Regulations would normally be regarded as being of material significance to a regulator and so give rise to a statutory duty to report to the regulator in addition to the requirement to report to NCIS. In determining whether such a duty arises, auditors follow the requirements of auditing standards on reporting to regulators in the financial sector and consider the specific guidance dealing with each area set out in related Practice Notes subject to compliance with legislation relating to 'tipping off'.

49. Auditing standards on law and regulations require that when auditors become aware of suspected or actual non-compliance with law and regulations which gives rise to a statutory duty to report, they should, subject to compliance with legislation relating to tipping off, make a report to the appropriate authority without undue delay. There is a potential conflict between the auditors' statutory duty to report to the regulator and the offence of tipping off. Further guidance is set out in section 22 of the CCAB Guidance.

The auditors' report on financial statements

50. Where it is suspected that money laundering has occurred the auditors will need to apply the concept of materiality when considering whether their report on the financial statements needs to be qualified or modified, taking into account whether:

- The crime itself has a material effect on the financial statements;
- The consequences of the crime have a material effect on the financial statements; or

- The outcome of any subsequent investigation by the police or other investigatory body may have a material effect on the financial statements.

51. If it is known that money laundering has occurred and that directors or senior staff of the company were knowingly involved, the auditors will need to consider whether the auditors' report is likely to include a qualified opinion on the financial statements. Any disclosure in the auditors' report is subject to compliance with legislation relating to 'tipping off'. It might be necessary for the auditors through their MLRO to discuss with the relevant law enforcement agency (notified to them by NCIS) whether disclosure in the report on the financial statements, either through qualifying the opinion or referring to fundamental uncertainty, could constitute tipping off. If so, the auditors through their MLRO will need to agree an acceptable form of words with the relevant law enforcement agency. Although appropriate consent can not be given to 'tipping off', it is unlikely that auditors who use a form of words agreed with the relevant law enforcement agency will commit a tipping off offence provided that they do not know or suspect that the disclosure will prejudice an investigation. Such knowledge or suspicion is an essential element of the tipping off offences under POCA sections 333 and 342.

52. Timing may be the crucial factor. Any delay in issuing the audit report pending the outcome of an investigation is likely to be impracticable and could in itself lead to issues of tipping off. Auditors also consider the potential dangers of tipping off by not issuing a qualified auditors' report in situations where management and/or the directors might expect them to qualify their report. Auditors seek advice from the MLRO who acts as the main source of guidance and if necessary is the liaison point for communication with lawyers, NCIS and the relevant law enforcement agency. If an audit report has to be issued, and agreement with the relevant law enforcement agency cannot be reached, firms may need to seek legal advice before issuing a qualified audit report. As a last resort it may be necessary to make an application to the court in respect of the content of the qualified audit report. See section 22 of CCAB Guidance for guidance on the interaction of different reporting duties.

Resignation and communication with successor auditors

53. Auditors may wish to resign from their position if they believe that their client or employer is engaged in money laundering or any other illegal act, particularly where a normal relationship of trust can no longer be maintained. Where auditors intend to cease to hold office there may be a conflict between the requirements under section 394 of the Companies Act 1985 for auditors to deposit a statement at a company's registered office of any circumstances that they believe need to be brought to the attention of members or creditors and the risk of tipping off. This may arise if the circumstances connected with the resignation of the auditors include knowledge or suspicion of money laundering. See section 24 of CCAB Guidance for guidance on cessation of work and resignation.

54. Where such disclosure of circumstances may amount to tipping off, auditors seek to agree the wording of the section 394 disclosure with the relevant law enforcement agency and,

failing that, seek legal advice. Auditors also consider the potential dangers of tipping off by not making a disclosure of circumstances connected with money laundering in situations where management and/or the directors might expect the section 394 disclosures to refer to the facts and circumstances that give rise to the auditors' suspicions of money laundering. Auditors seek advice from the MLRO who acts as the main source of guidance and if necessary is the liaison point for communication with lawyers, NCIS 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 394 statement.

55. The offence of tipping off may also cause a conflict with the need to communicate with the prospective successor auditors in accordance with ethical requirements relating to changes in professional appointment. Whilst the existing auditors might feel obliged to mention any knowledge or suspicion they have regarding suspected money laundering, to do so may run the risk of tipping off. Expressing such concerns orally rather than in writing does not alleviate the issue. The approach adopted when an auditor is contacted by a successor auditor follows that described in paragraph 53 and 54 in relation to the section 394 statement. The auditors seek to agree the wording of the disclosure to successor auditors with the relevant law enforcement agency and, failing that, may need to apply to the court for a declaration of what is included in the communication.

APPENDIX 1

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

These are examples of some of the situations that auditors may encounter during the course of the audit and some of the factors that auditors may wish to bear in mind when considering reporting suspicions of money laundering. They are intended to demonstrate the breadth of the money laundering legislation. This is not an exhaustive list of offences, nor a guide as to how such offences must be dealt with. The best way to deal with suspected money laundering will vary according to the particular facts of each case and should be dealt with in accordance with the firm's procedures. Firms will need to decide the extent to which they are prepared to follow NCIS guidance, particularly if NCIS states in its guidance that in a particular type of case no report at all is required.

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

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

The auditor is suspicious that the shoplifters have committed the offence of theft. The auditor realises that the goods stolen by the shoplifters are the proceeds of their crime, and knows that the possession of criminal proceeds is a money laundering offence. The information has come to the auditor in the course of the audit and therefore, even though the client is the victim of the shoplifting and the auditor does not know who the shoplifters are, the auditor has to make a report to the MLRO.

Once the auditor has reasonable grounds to suspect that money laundering has taken place, POCA does not require the auditor to undertake further investigation outside the auditor's normal audit work to determine whether an offence has occurred or to find out further details of the offence. Accordingly, the auditor does not need to review the files containing the details of the police being called, unless the auditor would otherwise have done so for the purposes of the audit. Following the firm's procedures, which take into account the NCIS guidance about offences where the perpetrators cannot be deduced from the information to hand and the proceeds have disappeared without trace, and about multiple suspicions of limited intelligence value which arise during the course of one audit, the auditor decides to make a report to his MLRO at the end of the audit, briefly describing the situation and any other matters of limited intelligence value.

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

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

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

NCIS guidance states that in the case of minor irregularities where there is nothing to suggest dishonest behaviour, the person making the report may be satisfied that no criminal property is involved and therefore a report is not required. Otherwise, where dishonest behaviour is suspected and a report is necessary, a limited intelligence value report may be appropriate.

The auditor considers whether there are any indications that the company has acted honestly, for example whether the client attempted to return the overpayments to its customers, or that the overpayments were mistakenly overlooked. If there are no such indications, the auditor concludes that the client may have acted dishonestly. Following the firm's procedures, which take into account the NCIS guidance about minor irregularities where dishonest behaviour is suspected, and about multiple suspicions of limited intelligence value which arise during the course of one audit, the auditor decides to make a report to the MLRO at the end of the audit, briefly describing the situation and any other matters of limited intelligence value.

3. Companies Act offences that are criminal offences (for example, loans to Directors)

The audit client is a public company with a number of subsidiaries. On one of the subsidiary audits, the auditor discovers that the subsidiary has guaranteed a £20,000 loan made by a bank to one of its directors.

The auditor knows that loans to directors and persons connected to them, and the giving of guarantees or security for loans to directors, are prohibited by section 330 of the Companies Act 1985. The auditor also knows that in the case of relevant companies only (which include public companies and subsidiaries of public companies), such loans can give rise to criminal offences under section 342(2) of the Companies Act 1985, and the director may also commit an offence. The auditor considers whether any of the exemptions apply (for example, short-term loans up to a certain value, certain inter-company loans, certain small loans, loans approved at general meetings to enable a director to perform the director's duties), and whether the company could claim that it did not know the relevant circumstances at the time of the loan.

The auditor concludes that there are reasonable grounds to suspect that an offence has been committed and that the director is in possession of the proceeds of the company's crime. The auditor decides to make a full report to his MLRO without waiting until the end of the audit.

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

During the course of the audit, the auditor discovers that the audit client has paid a dividend based on draft accounts. Audit adjustments subsequently reduce distributable reserves to the extent that the dividend is now illegal under the Companies Act 1985.

The auditor recognises that the payment of an illegal dividend is not per se a criminal offence because the Companies Act 1985 imposes only civil sanctions on companies making illegal distributions and decides not to report the matter to the MLRO.

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

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

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

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

The authorities are aware of the licensing issue, there is no indication that the relevant government agency is aware of the pollution of the nearby river. As the only benefit to the company is in the form of costs savings, the auditor decides to include this matter in the limited intelligence value report to the MLRO at the end of the audit.

6. Offences committed overseas that are criminal offences under UK law (for example bribery)

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

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

The auditor questions the client's Finance Director about the matter and the FD admits that the consultant has told him that some 'facilitation payments' will be necessary to move the project along and the FD agreed that some payments should be made to get the local officials to do the jobs that they should be doing anyway; for example, to get the traffic police to let the construction vehicles through nearby road blocks. The FD thought that such payments were acceptable in the country in question.

The auditor suspects that bribes have been paid and the auditor is aware that bribery, including the bribery of government officials, is a criminal offence under UK law. Accordingly, the auditor decides to make a full report to the MLRO.

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

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

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

Money laundering offences include conduct occurring overseas which would constitute an offence if it had occurred in the UK. Because the UK has no exchange control legislation and the preaching of any faith is allowed it is unlikely that either of the offences committed by the overseas subsidiary constitute offences under UK law. The auditor decides not to make a report to the MLRO in these circumstances.

APPENDIX 2

Guidance as to whom the anti-money laundering legislation applies

To whom does the reporting requirement apply?

The requirement to make a report under section 330 of POCA applies to information that comes to a person in the course of a business in 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 United Kingdom. For this reason there may be an obligation for auditors to report information arising from the audit of subsidiaries of UK companies or non-UK companies.

If conduct taking place overseas that would be an offence if it took place in the UK comes to the attention of an auditor whilst working in the UK regulated sector, the auditor makes a report to the MLRO.

When is an auditor working in the UK regulated sector?

The regulated sector includes the provision, in the UK, by way of business, of audit services by a person who is eligible for appointment as a company auditor under s.25 of the Companies Act 1989 or Article 28 of the Companies (Northern Ireland) Order 1990.[16]

A person is eligible for appointment as a company auditor if the person is a member of a recognised supervisory body, (which is a body established in the UK which maintains and enforces rules as to the eligibility of persons to seek appointment as company auditors and the conduct of company audit work, and which is recognised by the Secretary of State by Order) and is eligible for appointment under the rules of that body.

For the purposes of this Practice Note 'person' is interpreted as referring to a UK audit firm that is designated as a 'Registered Auditor' and the Regulations are interpreted as applying to all partners and staff within that UK audit firm who are involved in providing audit services in the UK.

Where they become involved in the provision of audit services in the UK by a UK audit firm which is subject to POCA and the Regulations, the obligation to make reports under section 330 of POCA may also extend to:

- Experts from other disciplines within the UK audit firm.
- Experts from outside the UK audit firm.
- Employees of non-UK audit firms, for example an auditor from an overseas office of an international firm.

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16 POCA Schedule 9, Part 1, paragraph 1(1)(k).

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

It is unlikely that it will be practicable or desirable for a UK audit firm which is within the regulated sector to distinguish for reporting purposes between partners and staff who are providing services in the regulated sector and those who are not. Accordingly, UK audit firms may choose to impose procedures across the firm requiring all partners and staff to report to the firm's MLRO (see section 13 of the CCAB Guidance)[17].

The following table illustrates how the reporting requirements might apply in a number of different scenarios. This table is intended as a guide. In case of any doubt, auditors should refer to the provisions of POCA and the Regulations, which take precedence over any guidance in this Appendix and may need to seek legal advice.

17 Persons outside the regulated sector are not obliged to report under POCA s.330 (the 'failure to report' offence), but can make voluntary reports under POCA s.337 of information they obtain in the course of their trade, profession, business or employment which causes them to know or suspect, or gives reasonable grounds for knowing or suspecting, that another person is engaged in money laundering. Such reports are protected from breach of client confidentiality in the same way as reports made under POCA s.330.

<table>
<tr><th></th><th colspan="2">Offence discovered as part of audit of:</th></tr>
<tr><th>Persons</th><th>UK companies (including UK subsidiaries of UK or non-UK companies)</th><th>Non-UK companies (including non-UK subsidiaries of UK or non-UK companies)</th></tr>
<tr><td>• working in UK for UK audit firm</td><td>Yes</td><td>Yes</td></tr>
<tr><td>• working in UK for non-UK audit firm</td><td colspan="2">Although the auditor or audit firm is unlikely to be eligible for appointment as a UK company auditor, in practice, it is likely that the auditor or audit firm would be providing accountancy services and therefore fall within the UK regulated sector.</td></tr>
<tr><td>• seconded to UK audit firm</td><td>Yes</td><td>Yes</td></tr>
<tr><td>• working temporarily outside UK or on foreign secondments, or working permanently outside UK but employed by a UK audit firm</td><td colspan="2">The position of auditors working temporarily outside the UK or on foreign secondments, or working permanently outside the UK but employed by a UK audit firm, is more difficult. For example the duty to report may be influenced by the terms of the secondment.

The following is a non-exhaustive list of issues to consider and firms may wish to take legal advice in relation to the need for their employees to comply with the UK's money laundering reporting regime as well as any local legal requirements.

Issues to consider include:

• Auditors working permanently or temporarily outside the UK consider the anti-money laundering legislation in their host country.

• If the auditors' work outside the UK is part of a UK audit then in some circumstances that information may have come to their attention in the course of engaging in regulated activities in the UK and therefore be reportable.

• In the case of auditors working permanently outside the UK for a UK firm, it may be appropriate to consider whether they are working at a separate firm or at a branch office of a UK firm.

• Auditors should be particularly cautious about any decision not to make a report on their return to the UK if the information relates to work that they are undertaking in the UK.

• Regardless of the strict legal position, firms may wish to consider putting in place a business-wide anti-money laundering strategy to protect their global reputation and UK regulated business (see Section 13 of the CCAB Guidance).</td></tr>
<tr><td>• working permanently outside UK for non-UK audit firm</td><td>No</td><td>No</td></tr>
</table>

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