



**Financial Services
Commission**

Supplementary Guidance

For the Audit Profession on Systems of control to prevent the financial system from being used for money laundering or terrorist financing activities.

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Table of Contents

CHAPTER I.....	5
1 Scope and Purpose.....	5
CHAPTER II.....	6
2 Client Identification and on-going monitoring of business relationships.....	6
CHAPTER III.....	8
3 Identification and reporting of knowledge or suspicions	8
3.1 Further enquiry	9
3.2 Reporting to the MLRO and to GFIU.....	10
3.3 Legal privilege.....	11
3.4 Reporting to regulators.....	11
CHAPTER IV	13
4 The auditor's report on financial statements	13
CHAPTER V	14
5 Resignation and communication with successor auditors.....	14
CHAPTER VI	15
6 The Privilege Reporting Exemption.....	15

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Supplementary Guidance Notes on Systems of Control & Requirements for the Audit
Profession

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CHAPTER I

1 Scope and Purpose

This Supplementary Guidance is provided for Audit Firms and Statutory Auditors registered under the Financial Services (Auditors) Act and is provided as additional guidance to those professionals only when conducting audit work on behalf of clients.

This Supplementary Guidance is “supervisory or regulatory guidance” for the purposes of Section 20A of the Crime (Money Laundering and Proceeds) Act 2007 (the “Act”). Chapter II of the “Systems of control to prevent the financial system from being used for money laundering or terrorist financing activities” (the “Guidance Notes”) provides further information on the legal basis of these Notes.

In this Supplementary Guidance, reference to International Standards on Auditing (“ISA”) are to the Auditing Standards published by International Auditing and Assurance Standards Board (<http://www.ifac.org/IAASB/>).

CHAPTER II

2 Client Identification and on-going monitoring of business relationships

Appropriate identification procedures, as required by the Act and Guidance Notes, are mandatory when accepting appointment as auditor. The extent of information collected about the client and verification of identity undertaken will depend on the client risk assessment. Guidance on identification procedures, including references to financial restrictions regimes (i.e. sanctions), is given in Chapters VI and VII of the Guidance Notes.

Auditing standards on quality control require the audit firm to consider the integrity of the client. This involves the auditor 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 Act and Guidance Notes.

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. The following is an illustrative paragraph that could be included for this purpose:

Client identification

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

It may also be helpful to inform clients of the auditor's responsibilities under the Act to report knowledge or suspicion, or reasonable grounds to know or suspect, that a money laundering or terrorist financing offence has been committed and the restrictions created by the 'tipping off' rules on the auditor's ability to discuss such matters with their clients. The following is an illustrative paragraph that could be included in the audit engagement letter for this purpose:

Money laundering disclosures

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

Whether or not to include these illustrative paragraphs in the audit engagement letter is a policy decision to be taken by individual firms.

The activities of and the relationship with the audit client will be monitored on an on-going basis. For example, if there has been a change in the client's circumstances, such as changes in beneficial ownership, control or directors, and this information was relied upon originally as part of the client identification

Supplementary Guidance Notes on Systems of Control & Requirements for the Audit Profession

procedures then, depending on the auditor's assessment of risk, the procedures may need to be re-performed and documented. However, annual reappointment as auditor does not, in itself, require the client identification procedures to be re-performed.

CHAPTER III

3 Identification and reporting of knowledge or suspicions

ISA 250 establishes standards and provides guidance on the auditor's responsibility to consider law and regulations in an audit of financial statements.

The anti-money laundering requirements do not require the auditor to extend the scope of the audit, save as referred to 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.

Auditing standards on law and regulations require 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 (paragraph 12 of ISA 250);

and

- sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements (paragraph 13 of ISA 250).

Paragraph 14 of ISA 250 also requires the auditor to perform procedures to help identify instances of non-compliance with other laws and regulations which may have a material effect on the financial statements. These procedures consist of:

- enquiring of those charged with governance as to whether the entity is in compliance with such laws and regulations; and
- inspecting correspondence with the relevant licensing or regulatory authorities;

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

For businesses within the regulated sector¹, other laws and regulations that may have a material effect on the financial statements will include the Act and the Guidance Notes.

When auditing the financial statements of businesses within the regulated sector the auditor reviews the steps taken by the entity to comply with the Act and Guidance Notes, assesses their effectiveness and obtains management representations concerning compliance. If the client's systems are thought to be ineffective the auditor considers whether there is a responsibility to report 'a matter of material significance' to the regulator in accordance with ISA 250, and considers the possible impact of fines (which might be imposed if non-compliance with the Act or Guidance is proven). Where the entity's business is outside the regulated sector, although the auditor's reporting responsibilities under the money laundering legislation are unchanged, the entity's

¹ Firms authorised under any of the Supervisory Acts (<http://www.gibraltarlaws.gov.gi/articles/2010s110.pdf>).

management is not required to implement the requirements of the Act or Guidance Notes.

Whilst the principal money laundering offences apply to these entities, the laws relating to money laundering or terrorist financing 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 250.

Auditing standards on laws and regulations require the auditor to be alert to the possibility that audit procedures applied for the purpose of forming an opinion on the financial statements may bring instances of possible non-compliance with other laws and regulations to the auditor's attention. This includes of non-compliance that might incur obligations for partners and staff in audit firms to report to a regulatory or other enforcement authority.

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. Even where no offence under the Act has been committed, civil recovery actions or other civil claims may give rise to contingent liabilities. The auditor will remain alert to the fact that discussions with the client on such matters may give rise to a risk of 'tipping off'.

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

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

3.1 Further enquiry

Once the auditor suspects a possible breach of law or regulations, the auditor will need to make further enquiries to assess the implications of this for the audit of the financial statements. Auditing standards on laws and regulations require that when the auditor becomes aware of information concerning a possible instance of non-compliance, the auditor should obtain an understanding of the nature of the act and the circumstances in which it has occurred, and sufficient other information to evaluate the possible effect on the financial statements. Where the auditor knows or suspects, or has reasonable grounds to know or suspect, that another person is engaged in money laundering or terrorist financing, a disclosure must be made to the firm's MLRO or, for sole practitioners, to GFU. The legislation does not require

the auditor to undertake any additional enquiries to determine further details of the predicate criminal offence. If the auditor is genuinely uncertain as to whether or not there are grounds to make a disclosure, the auditor will bring the matter to the attention of the audit engagement partner who may wish to seek advice from the MLRO.

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 or terrorist financier to the possibility that a report will be or has been made, especially if management and/or the directors are themselves involved in the suspected criminal activity.

3.2 Reporting to the MLRO and to GFU

In Gibraltar, auditors report to their MLRO or, in the case of sole practitioners, to GFU where they know or suspect, or have reasonable grounds to know or suspect, that another person is engaged in money laundering or terrorist financing. Reports need to be made irrespective of the quantum of the benefits derived from, or the seriousness of, the offence. There are no de minimis concessions applicable to the auditor contained in the legislation or Guidance Notes. There is no provision for the auditor not to make a report even where the auditor considers that the matter has already been reported.

However, the auditor is not required to report where:

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

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

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

- where the client or third party's money laundering is occurring wholly overseas: is the money laundering lawful there? If it is, a report is not required. However, auditors need to be careful to ensure that no consequences of the criminal conduct are, in fact, occurring in Gibraltar;
- where the client or third party's money laundering is occurring in the Gibraltar in relation to underlying conduct which occurred overseas and was lawful there: would the conduct amount to a 'serious offence' if it had occurred here? If it would have amounted to such an offence, a report is required.

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

During the course of the audit work the auditor might obtain knowledge or form a suspicion about a prohibited act that would be a criminal offence under but has yet to occur. Because attempting or conspiring to commit a money laundering offence or terrorist financing is in itself an offence, it is possible that in some circumstances a report might need to be made.

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

The format of the internal report made to the MLRO is not specified by the Guidance Notes. MLROs determine the form in which partners and staff in audit firms report knowledge or suspicion of, or reasonable grounds to know or suspect, money laundering offences internally to their MLRO, although this will need to provide the MLRO with sufficient information to enable a report to be made to GFIU if necessary. Reporting as soon as is practicable to the MLRO is the individual responsibility of the partner or audit staff member and although suspicions would normally be discussed within the engagement team before deciding whether or not to make an internal report to the MLRO this should not delay the report to the MLRO and, even where the rest of the engagement team disagrees, an individual should not be dissuaded from reporting to the MLRO if the individual still considers that it is necessary. In the case of a sole practitioner, who is not required to appoint an MLRO, the sole practitioner reports directly to GFIU.

The MLRO makes the decision as to whether a report is made by the audit firm to GFIU. Suspicious Activity Reports must be made using the disclosure form in Appendix 6 of the Guidance Notes.

Partners and staff in audit firms follow their firm's internal documentation procedures when considering whether to include documentation relating to money laundering reporting in the audit working papers. However, in order to prevent 'tipping off' where another auditor or professional advisor has access to the audit file, the auditor may wish to have all details of internal reports held by the MLRO and exclude these from client files.

3.3 Legal privilege

Legal privilege can provide a defence for a professional legal adviser to a charge of failing to report knowledge or suspicion of money laundering or terrorist financing and is generally available to the legal profession when giving legal advice to a client or acting in relation to litigation.

If the auditor is given access to client information over which legal professional privilege may be asserted (for example, correspondence between clients and solicitors in relation to legal advice or litigation) and that information gives grounds to suspect money laundering or terrorist financing, 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 (for example, a solicitor's advice to an audit client), the auditor should seek legal advice to determine whether that privilege can be extended to the auditor.

3.4 Reporting to regulators

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

Supplementary Guidance Notes on Systems of Control & Requirements for the Audit Profession

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

Knowledge or suspicion, or reasonable grounds for knowledge or suspicion, of involvement of the entity's directors in money laundering or terrorist financing, or of a failure of a regulated business to comply with the Guidance Notes 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 GFU. In determining whether such a duty arises, the auditor follows the requirements of auditing standards on reporting to regulators in the financial sector and considers the specific guidance dealing with each area set out in related Practice Notes. A tipping off offence is not committed when a report is made to that person's supervisory authority or in any other circumstances where a disclosure is not likely to prejudice an investigation.

CHAPTER IV

4 The auditor's report on financial statements

Where it is suspected that money laundering or terrorist financing has occurred the auditor will need to apply the concept of materiality when considering whether the auditor's report on the financial statements needs to be qualified or modified, taking into account whether:

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

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

Timing may be the crucial factor. Any delay in issuing the audit report pending the outcome of an investigation is likely to be impracticable and could in itself alert a money launderer. The auditor should seek advice from the MLRO who acts as the main source of guidance and if necessary is the liaison point for communication with lawyers, GFIU and the relevant law enforcement agency.

CHAPTER V

5 Resignation and communication with successor auditors

Auditors may wish to resign from their position as auditor if they believe that the client or an employee is engaged in money laundering, terrorist financing 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 are requirements under the Financial Services (Auditors) Act for the auditor to deposit a statement with the FSC with an adequate explanation of the reasons therefore. This may arise if, for example, the circumstances connected with the resignation of the auditor include knowledge or suspicion of money laundering or terrorist financing and an internal or external disclosure being made.

CHAPTER VI

6 The Privilege Reporting Exemption

A relevant professional adviser² who suspects or has reasonable grounds for knowing or suspecting that another person is engaged in money laundering or terrorist financing is exempted from making a money laundering report where his knowledge or suspicion comes to him in privileged circumstances (the privilege reporting exemption). In such circumstances, provided that the information is not given to him with the intention (by his client or another person) of furthering a criminal purpose ('the crime/fraud exception'), Section 2(2B) of the Act affords the adviser a complete defence against a charge of failure to disclose (ie, to make a SAR). By implication, the exemption also means that in these circumstances a business should not make a SAR, as they are expected to be bound by the same standards of behaviour as is the case for legal professional advisers subject to legal professional privilege.

Discussions with the MLRO to seek advice about making a report under the Act shall not be taken to be an internal report when it was not intended as such, e.g., if the person initiating the discussion believes the matter falls within the privilege reporting exemption and contacts the MLRO to confirm this. On receipt of such an approach, it is recommended the MLRO still collects the information which would otherwise be included in the required disclosure to enable careful consideration with the reporter of whether or not the matter falls within the privilege reporting exemption and, if it does, whether this is overridden by the crime/fraud exception. It is recommended that the MLRO documents the decision reached in this regard and the reasons for reaching that decision.

The information must ;

“have been obtained on or received from one of their clients-

- (i) in the course of ascertaining the legal position for their client; or
- (ii) whilst performing the task of defending or representing that client in, or concerning judicial proceedings, including advice on instituting or avoiding proceedings, whether such information is received or obtained before, during or after such proceedings.”

If a relevant professional adviser considers that the information or other matter on which his knowledge or suspicion is based came to him in privileged circumstances, he is obliged to apply the privilege reporting exemption in the Act (unless the crime/fraud exception applies) and so has no discretion to make a money laundering report. This means that the relevant professional adviser could find himself in a situation where he might wish to make a report but is prevented from doing so. In such circumstances, he should consider whether he may continue to act, but in carrying out his decision will need to bear in mind the provisions of the Act relating to prejudicing an investigation.

Whether or not the privilege reporting exemption applies needs to be considered carefully, including a consideration as to whether the relevant professional adviser was working in privileged circumstances when the particular information or other matter came to him. This is an important consideration, as a relevant professional adviser may be providing a variety of services to a client, not all of which may create privileged circumstances for this

² defined in the legislation as a “notary, independent legal professional, auditor, external accountant or tax advisor”

Supplementary Guidance Notes on Systems of Control & Requirements for the Audit
Profession

purpose. Accordingly, it is strongly recommended that a careful record is maintained of the provenance of information considered when a decision is made on the applicability or otherwise of the privilege reporting exemption.