THE IMPORTANCE OF MONEY LAUNDERING RISK ASSESSMENT AS PART OF ACCOUNTING OPERATIONS

Alina - Gabriela Mareș[1]
Raluca - Andreea Stoica[2]

Abstract

The purpose of this paper is to present the importance of having an international Anti-Money Laundering (AML) policy in place inside the business offering financial services.

Money laundering represent an easy way used by criminals and terrorists to keep themselves away from the authorities attention and in the same time, have control of their assets. So, the first part of this paper, will outline the threats that can be encountered by businesses operating into the 'regulated sector'. These firms are always at risk of providing services without knowing what is behind of a certain company's activities and that's why suitable procedures are required.

The second part of the paper will concentrate on elements of money laundering prevention and international Anti-Money Laundering programs. It is very important for the firms and individuals to understand the Anti-Money Laundering legislation, as this will help to identify, report and prevent money laundering activities.

The multi-faceted process of globalization has created new opportunities for international economic crimes. Criminals use a wide variety of methods to control and conceal the proceeds of their crimes, so anyone involved in these types of operations is committing a money laundering offence. So, the employees in high-risks industries need to identify unusual activities that can be associate with laundered money.

Keywords: *money laundering, risk, prevention, regulated sector, fraud*

JEL Classification: M40, M41, M48

Introduction

Money laundering is a way to give a legal appearance to funds obtained illegally, with the main purpose of generating profit for the person or group involved. It is the process of making 'dirty money' appear 'clean' and is used by criminals to hide the origin and real possession of income generated by their criminal activities. Also, we must take into consideration that money laundering has a negative impact on the worldwide economy, encouraging crimes such as drug trafficking and terrorism.

Criminals use a wide range of methods to control and conceal the proceeds of their crimes. Their goal is to be able to spend their money safe in the knowledge that it cannot be linked back to the original offences.

The phenomenon of 'money laundering' appeared a long time ago, being linked to the history of trade and the emergence of the banking system, being 'established' during the US Prohibition when the sale of alcoholic beverages and gambling led to the unprecedented enrichment of to those who were involved into these activities.

Firms operating in the 'regulated sector' – which includes accountants, auditors, insolvency practitioners, lawyers, and tax advisers – are required to assess the risk that their clients could be trying to launder criminal or terrorist funds and to put appropriate procedures in place to mitigate the risks.

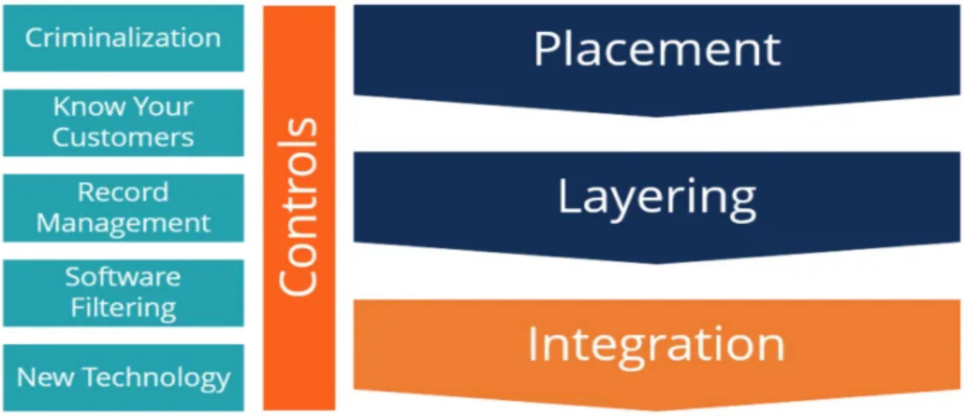
Money Laundering – How it works?

Money laundering refers to the methods criminals and terrorists use to keep control of their assets without them coming to the attention of the authorities. Businesses offering types of financial services that are potentially useful to money launderers are subject to a range of regulatory measures designed to prevent their facilities from being exploited for these purposes.

There are numerous ways to launder money, from the straightforward to complex ones, but one of the most common methods is to use a legitimate, cash-based business owned by a criminal organization. We can take as an example, if the organisation owns a coffee shop or a restaurant, it might inflate the daily cash receipts in order to channel illegal cash using that business and its bank account.

Even if you have managed to get your illicit cash into an account, this is not the final step, as you will need to explain all those cash deposits. So, to disguise your money's criminal origin, you can move it around using any number of methods. For example, you can move money through many accounts, buy investments and sell immediately or use corporate bodies of unclear ownership. As a criminal, if you are careful about covering your tracks, you will only consider the process complete when you are confident that the link between your money and its criminal origin can no longer be traced.

Basically, the process involves three major steps - **placement**, **layering** and **integration** and different controls are put in place to screen suspicious movement that could involve money laundering. The following figure shows these three steps and controls that are used to prevent it.



Source: https://corporatefinanceinstitute.com/resources/knowledge/finance/anti-money-laundering/

1. **Placement** – getting the cash into the financial system. For example, deposit cash into bank accounts or buy tradable assets for cash.
2. **Layering** – covering the trail. So, to disguise your money's criminal origin, you can move it around using any number of methods as moving money through many accounts, buying investments, and selling them quickly or using corporate bodies of unclear ownership.
3. **Integration** – establishing a legitimate source of wealth. The best way to establish an apparently respectable explanation for your wealth is to get your money into legitimate investments, property, established businesses or other income-earning assets. Once this step is complete, you can pass yourself off as a wealthy private investor or a successful entrepreneur.

The crimes themselves can range from obvious things, like robbery and drug dealing, to more sophisticated activities like embezzlement, tax fraud and cybercrime. Organised criminals tend to use deliberately complex methods to launder their profits – often employing intermediaries to set up front companies and trusts in different jurisdictions, concealing their wealth behind corporate structures that resemble those of the legitimate economy. Anyone becoming involved in these types of operations is committing a money laundering offence.

Money Laundering - Grounds of suspicion

Sometimes you may know for certain that a client's actions amount to money laundering. For example, they might tell you quite openly about a tax or accounting fraud – perhaps because they do not really consider it to be a crime. More likely though, you will come across things that cause you to question whether the origin of funds or the purpose or the purpose of arrangements could be suspicious.

Suspicion is a matter of judgment, and you must decide when curiosity leads to doubt, and when doubt becomes suspicion. In some firms, every day can bring a client or transaction that needs a decision. In some firms, every day can bring a client or transaction that needs a decision on possible grounds of suspicion. In others, this could be a rare occurrence.

The companies within the 'regulated sector' need to monitor customers deposits and other transactions and must verify the origin of large sums, monitor and report suspicious activities.

To recognise the grounds of suspicion, you must maintain high standards of due diligence, proportionate to the assessed level of money laundering risk. Anyway, there are also limits and you are not expected to know more about a client than is appropriate for the service you are providing or for your own job function. For example, if your role inside the company is purely administrative, you are not expected to have the same knowledge of your clients' affairs as someone who is directly involved and gives professional advice. Also, you are not expected to be an investigator – conducting surveillance, questioning suspects, or seeking out evidence – nothing beyond carrying out your normal work in n alert and professional manner.

To picture a situation that can be encountered by an employee in real life on their day-to-day activity, we will be presenting the following simplified case:

Imagine you are currently working in an accountancy firm and a senior member of your firm has recently retired and you have taken over the responsibility for several of his clients and one of this is XYZ S.A., a company that your firm has been preparing annual accounts for a couple of years. Your attention is first drawn to this client when a call is put through to you from the Managing Director asking you to carry out a simple corporate re-structuring, transferring al the shares in XYZ S.A. to a holding company XYZ LLC registered in Dubai and they want for your firm to continue working for them. As you did not manage to look into the accounts of the company you have responded with the most obvious question, asking why the company has to be registered in Dubai, but the manager is avoiding responding to your question and leaves the call unexpectedly saying that has to join another meeting.

The abrupt termination of the call leaves you feeling rather uneasy, as you also recall Dubai featuring in a newspaper article you read recently about money laundering and the heroin trade in Afghanistan, so you decide it would be appropriate to investigate this. This way you find information about this subject on the authorized websites indicating the same thing and this flags the fact that you may have three indicators of money laundering here: a sudden change in a client's business arrangements, the involvement of financial centre reportedly linked with the drugs trade and a client's reluctance to answer routine questions. At this point, you have no actual grounds for suspicion, but you should centrality take steps to find out more bot the reasons for this move.

Looking into the last annual accounts, you see that they are a software company specializing in website development. So, it occurs to you that software is one of those commodities where the value may be hard to determine, making it an ideal cover for moving dirty money by invoicing for inflated sums. Deciding it would be good to find out more about the company's business, you do an online search and find the website, where you see a lot of bold statements about how the company work and links to a umber of client companies for whom they claim to have developed websites. Further online searches confirm that these sites do indeed exist, and you find that some belong to UK companies and some to companies in North Africa and the Middle East. You are reassured to see that the companies clints appear to be genuine, but you still feel that you must have a better understating of their business, so you arrange a meeting with them to ask for further explanation on their basic business model. You also get in touch with your colleague that was previously working for this client and after getting a better understating of your client's business, you realise that you need to be alert for signs of possible money laundering, but this does not mean that you should start assuming that your clients are criminals. There is no reason of being worried if you have obtained credible and consistent answers to your enquiries.

So, whenever you come across something that gives you cause to question arrangements, it is important to obtain the relevant information to which you have routine access and consider whether you have satisfactory explanation that's consistent with what you know.

AML (Anti-Money Laundering)

AML is an acronym for the term Anti-Money Laundering. It is mainly used in the financial, legal and compliance sectors to develop the standard controls that companies, and organizations must carry out to avoid, identify and report suspicious behaviours of money laundering that can happen while carrying out their activity.

Anti-Money Laundering, AML compliance practices focus on performing procedures that discourage and prevent potential violators from engaging in money laundering fraud or crime. In this way, criminals cannot hide the illicit origin of money in any type of transaction.

In the fight against money laundering the government is responsible for enacting legislation to combat money laundering. Risks of money laundering and terrorist financing is a major concern for the EU financial system and for the security of its citizens. EU strengthens its permanent efforts to combat money laundering and terrorist financing.

Accountants can be involved at any stage of the process, for example:

- While preparing the accounts of a small business, you may notice an unusually high proportion of cash transactions, as compared with online or card payments, indicating a possible placement operation.
- While doing an audit you may spot suspiciously large payments for intangible services like consultancy which could be a cover for layering transactions.
- You could be engaged by a company that conducts entirely legitimate business, but which as acquired using laundered money, thus providing an apparently respectable income for the owners – a successful integration operation.

Criminals tend to use deliberately complex arrangements, so it is very unlikely that you will be able clearly identify all the different stages of a money laundering operation.

The European Union issues Directives compelling member states to implement AML measures in their own legislation. Regulatory bodies ensure that firms they supervise operate policies and procedures in compliance with the national legislation.

Your firm has anti-money laundering policies and procedures that must be followed by all relevant staff. All regulated businesses are required to assess the level of money laundering risk presented by their clients and the services they are providing to them, and to apply AML measures proportionate to the risks identified – a process that is formally known as the 'risk-based approach'.

There are money laundering offences that you are at risk of committing – even inadvertently - in the normal course of your work. These offences – which also carry criminal sanctions – fall under three headings:

1. **Assisting** – it is an offence to become concerned in an arrangement that you know or suspect assists someone to a launder money.
2. **Tipping off** – you must not inform a client or any outside party about suspicion of money laundering.

3. **Failing to report suspicions -** if in the course of business, you know or suspect, or have reasonable grounds for knowing or suspecting, that another person is engaged in money laundering, you commit an offence if you fail to make a suspicion as soon as is practicable.

Practices and requirements established by the AML compliance regulations on Money Laundering Prevention not only help businesses not to get involved in possible frauds and crimes but also their assessment improves, optimizes, and automates their usual processes.

Conclusion

Money laundering is the illegal process of making large amounts of money generated by a criminal activity, such as drug trafficking or terrorist funding, appear to have come from a legitimate source. The money from the criminal activity is considered dirty, and the process "launders" it to make it look clean.

It is important to understand the magnitude of the risks associated with money laundering. These criminal practices are a considerable offence for society, companies, and individuals, and therefore compliance with the practices of prevention of money laundering is mandatory for all kinds of business and organizations and is strictly regulated in every state, country, and region.

The legislation is responsible for guiding the regulated sectors on how to operate and proceed. Compliance and legal departments are responsible for ensuring that all company processes meet the requirements requested by the AML regulations of each state and country.

References

Electronic Identification, https://www.electronicid.eu/en/blog/post/aml-anti-money-laundering-compliance-kyc/en

Investopedia, Investopedia software, https://www.investopedia.com/terms/m/moneylaundering.asp#citation-6

Comply Advantage, https://complyadvantage.com/knowledgebase/anti-money-laundering/money-laundering-reporting-officer/

CFI, https://corporatefinanceinstitute.com/resources/knowledge/finance/anti-money-laundering/

BCE, https://www.bankingsupervision.europa.eu/ecb/pub/ra/html/ssm.ra2020~a9164196cc.ro.html#toc1

Avocat.net, https://www.avocatnet.ro/articol_55364/Sp%C4%83larea-banilor-Tranzac%C8%9Biile-suspecte-ajung-mai-u%C8%99or-in-aten%C8%9Bia-autorit%C4%83%C8%9Bilor-Ce-trebuie-s%C4%83-%C8%99tii-despre-raportarea-lor.html

Concilium.Europa.eu, https://www.consilium.europa.eu/ro/policies/fight-against-terrorism/fight-against-terrorist-financing/

Deloitte, https://www2.deloitte.com/ro/ro/pages/finance/solutions/aml.html

Institute of International Banking Law & Practice, https://iiblp.org/trade-based-money-laundering-primer/

Financial Crimes Enforcement Network, https://www.fincen.gov/history-anti-money-laundering-laws

FINRA, https://www.finra.org/rules-guidance/key-topics/aml

Association of Certified Anti-Money Laundering Specialists, https://www.acams.org/en/certifications/cams-certification#get-certified-4be80541

United Nations Office on Drugs and Crime. "Money-Laundering and Globalization, https://www.unodc.org/unodc/en/money-laundering/globalization.html

Financial Action Task Force, https://www.fatf-gafi.org/about/whatwedo/

International Monetary Fund. "IMF and the Fight Against Money Laundering and the Financing of Terrorism, https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/31/Fight-Against-Money-Laundering-the-Financing-of-Terrorism

Reuter, P. and Truman, E.M. (2004), Chasing Dirty Money: *The Fight against Money Laundering, Institute for International Economics*, Washington, DC.

Clark, A. and Burrel, P. (Eds) (2003), *A Practitioner's Guide to International Money Laundering Law and Regulation*, City & Financial, Surrey.

Johnston, R.B. and Abbott, J. (2005), *"Deterring the abuse of the financial system: elements of an emerging financial integrity standard",* IMF Policy Discussion Paper 05/3, IMF, Washington, DC.

Schneider, F. (2008), *"Money laundering and financial means of organized crime: some preliminary empirical findings",* Paolo Baffi Centre Research Paper No. 2008-17, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id¼1136149

Shams, H. (2004), *Legal Globalization: Money Laundering Law and Other Case*, British Institute of International and Comparative Law, London.