

# Forensic Accounting and Money laundering<sup>GOED</sup>

International Seminar on  
Forensic Documents in Combating White Collar Crime  
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## This lecture

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- Presents aspects of Forensic accounting
- The differentiation between regular and investigative accounting techniques
- The crimes Forensic accounting typically detects, investigates and reports
- More particularly, aspects of the crime of Money laundering



# Money Laundering

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- Discusses typical methods of money laundering
- Introduces the measures taken worldwide to prevent money laundering
- Introduces forensic tools to detect money laundering



# Chronology of the forensic accountant

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- **1840s**
  - The first recorded instance of hiring an accountant as expert witness in Meyer vs Sefton
- **1960s**
  - Accountant learns to support police in their investigation
  - Give independent testimony in court
- **1980s**
  - Police priorities shift away from corporate victims
  - Forensic accountants shift to corporates  
& to their surprise discover the extent and innovation in Financial (white Collar) crime



# The Demand of the Forensic Accountant in White collar Crime

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- 1996
  - The Barings Bank Scandal in Singapore brought the need for forensic accountants closer home
- 2000
  - The Enron scandal brought to the fore the role of the Forensic Accountant .. More than 10000 computer tapes, 20 million sheets of paper, 500 back up discs and enough data about 10 times the size of the library of Congress will keep more than 300 Forensic accountants busy in the next 5 years



## The Financial Statement Frauds

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- 2000 onwards
  - WorldCom, Xerox, Arthur Andersen

The Financial Statement Frauds and the white collar crime goes unabated!! Can cause great damage to the credibility of the Financial structures of organised society.. Enron and WorldCom were close

- Investment decisions can be skewed and can affect growth of global capital markets



Paper shredder: **\$100**

Debt hidden in off-balance-sheet subsidiaries:  
**\$500 MILLION**

Stock cashed in by executives while encouraging  
employees to keep buying: **\$1.3 BILLION**

Sitting it front of a congressional committee and  
claiming ignorance of any wrongdoing with a  
completely straight face: **PRICELESS**

*There are some things money can't buy.  
Integrity is one of them.*

<http://politicalhumor.about.com>

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## Professional Expertise in Organized Crime

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Accounting expertise is needed to set up complex illicit transactions

Similarly, accounting expertise is required to unravel these transactions, especially where organized crime is involved



“Truth is stranger than fiction because, truth, unlike fiction, is not limited by your imagination”

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- Fraud and money laundering are after all carried out by people who know more about the accounting systems and other practices than auditors or police investigators



# Who hires forensic accountants?

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- ▶ Government
  - ▶ Enron Worldcom Scandals
- ▶ Banks & Financial Institutions
  - ▶ GTB, UTI
- ▶ Judicial System
  - ▶ MACE
- ▶ Regulators
  - ▶ Ketan Parekh, Harshad Mehta
- ▶ Corporates
  - ▶ Personal expenses charged to revenue & diversion of funds
- ▶ Individuals
  - ▶ Estimation of networth in bankruptcy and personal guarantees



# The Audit process

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- The Audit process concentrates on expression of an opinion on the truth and fairness of the financial statements and NOT on gathering evidence to be possibly produced before a court of Law.

# Auditing and Forensic Accounting distinguished



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- ❖ Auditing is a truth and fairness statement on the reliability of the financial statements
- ❖ Auditors report assures the stakeholders that the management has set up a system which reasonably captures all transactions of the company and reports the same as per the accounting principles and standards
- ❖ The audit process is not designed to look for frauds and crimes
- ❖ In summary, audit assumes that the transactions reported are genuine unless there are pointers to believe that such transactions cannot be relied upon



# Features of Forensic accounting

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- ❖ Forensic accounting proposes to “investigate” the possibilities of criminal intent in the conduct of the transaction
- ❖ Uses techniques which are not ordinarily used by auditors and sometimes based on suspicion and surmises
- ❖ Gathers evidence which can be produced in a court of law in a trial
- ❖ Does not assume the truth or legality of a transaction unless the same has been independently confirmed

# What are the skill sets of the forensic accountants?

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- Expert knowledge of accounting & control systems
- Deep domain knowledge of business
- Expert knowledge of business arrangements & Contracts
- Deep Understanding of Banking practices and requirements
- Expert knowledge in commercial laws
- Reasonable knowledge of differences in business practices in various countries
- High degree of creativity and innovation
- All this, to get to the mind of the criminal!!

# The Future of the Forensic Accounting profession



- High degree of specialization .. Sector specific
- High usage of Technology in detection of crime, especially pattern recognition
- Greater use in detection of financial crime by the Police
- Greater demand from Courts for hiring forensic accountants as expert witnesses
- Greater demand from Regulators in detecting Financial Statement Fraud



## The downside

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- Reactive.. Compliant driven
- Backwards Looking
- “Examination of the corpse”
- The burden of proof is on the accountant.. High degree of exactitude



## Some financial crimes that are detected by the Forensic Accountants

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- Stock Manipulation
- Bank Frauds
- Bankruptcy
- Skimming & Embezzlement
- Corporate Frauds
- Tax Evasion and of course,
- Money Laundering



# Money Laundering

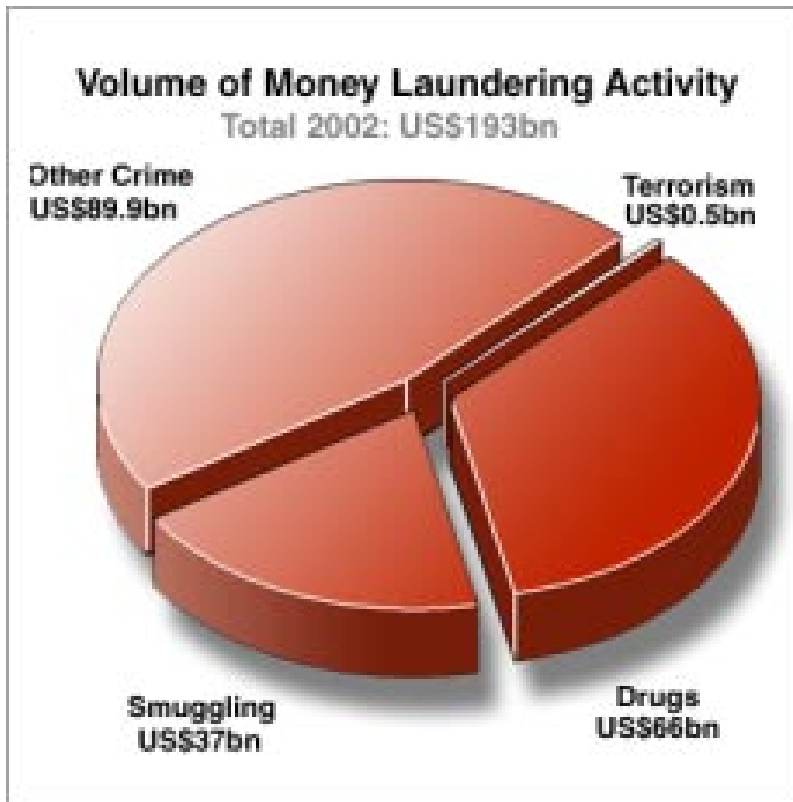


Money laundering is a criminal practice of filtering ill-gotten gains (dirty money) through a series of transactions so that the funds are *cleaned* to look like the proceeds from legal activities

“Whoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the *proceeds of crime* and *projecting it as untainted property* shall be guilty of offence of money-laundering”

Section 3 of the Prevention of Money Laundering Act, 2002

# Volume of money laundering



Money Laundering is one of the three largest trades in the world including the international trade in oil and the currency markets!!



# Financial Crimes

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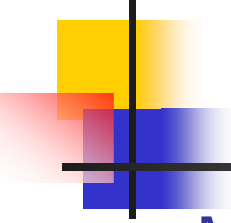
- Large criminal organisations do not restrict their activity to drugs
- The traditional organised crime groups are deeply involved in large scale commercial fraud
- White-collar criminals are quickly involved in other types of crimes, frequently by engaging others to ensure successful operations
- International connections will be necessary to secure the supply of illicit goods, drugs and arms etc.
- In most cases offshore laundering facilities will be used, frequently involving tax-haven countries with bank secrecy laws and efficient money transfer facilities.

# The structure of Money laundering

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- Conceal ownership of funds
- Source of funds
- Movement of Funds
- Use of funds

to enable funding criminal activities



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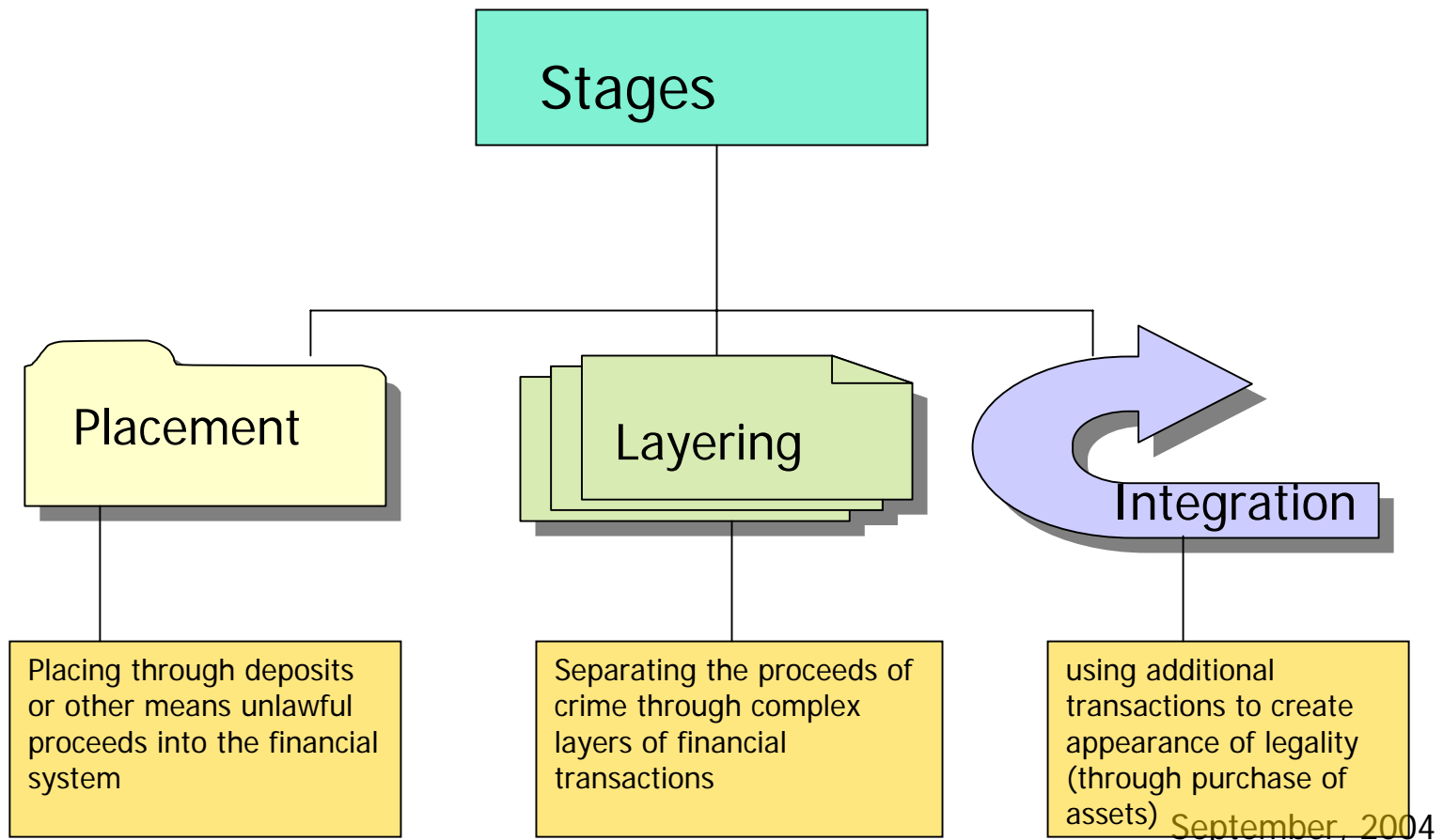
Money laundering is organized crime's way of trying to disprove the adage "Crime does not Pay".

It is an attempt to assure drug dealers , illegal arms dealers, corrupt public officials and other criminals that they can hide their profits and to provide them the fuel to operate and expand their criminal enterprises

(International Narcotics Strategy Report, 2001)

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# Stages of Money laundering



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# Typical Routes to place funds

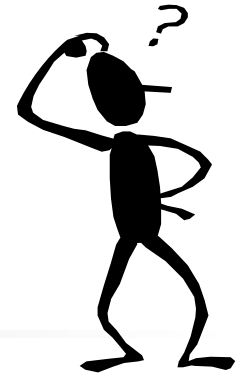
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- \* "Traditional"
  - \* Small deposits (smurfing)
  - \* Lottery tickets
  - \* Casinos
  - \* Travel Agencies
  - \* Import- Export
  - \* Hawala
- \* "Modern"
  - \* Prepaid cards
  - \* Correspondent banking
  - \* Insurance policy

# Hawala..The ancient form of Money laundering

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- > Hawala is an ancient system originating in South Asia and used around the world to conduct legitimate remittances
- > It is an alternative or parallel remittance system which works on **Trust & Honour**
- > This is what makes it difficult to detect!



# Why does hawala work ?

- Cost effective
  - Price Differences are as high as 20% in some markets
- Efficient
  - Delivery is assured in one or two days
- Reliable
  - Rarely is a remittance "lost" in transit
- Lack of bureaucracy
  - No need to prove identity or status or origin of money
- Lack of paper trail
  - Transaction is assured "anonymity"
- Tax Evasion
  - Scrutiny free remittance channel and tax elusive



# Indicators of Hawala

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- Significant deposit activity in bank accounts from one or more ethnic communities (Afghan, Bangladesh, Somalia, India, Pakistan) and outgoing transfers to major financial centres (Great Britain, Switzerland and Dubai etc)
- Certain businesses more likely to involve in hawala -
  - import/export
  - travel and related services
  - jewelry (gold, precious stones)
  - foreign exchange
  - rugs/carpets
  - used cars
  - car rentals (usually non-chain or franchise)
  - telephone/pagers

# How does one “soften” the Hawala Networks

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“Perhaps, if Asian Banking systems had

- reasonably expedient,
- reasonably priced,
- reasonably regulated,
- user friendly banks

-Osama Bin Laden would have found it impossible to finance his mischief so invisibly”



# Placement and detection

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- Placement is usually through a series of small cash deposits with legitimate business fronts..
- Need to know
  - price & business patterns
  - size of business and size of cash deposits
  - need to transfer cash and its underlying patterns
  - arrangements of the customer through KYC data



# Layering and Detection

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- At the layering stage, the placed funds are layered through a series of legitimate sources maybe, in different countries making the original source tough to detect
- This is tough to detect since it happens through a series of apparently unrelated transactions, with funds being moved electronically.. Can be detected only through active international police cooperation and regulatory networks
- Mutual legal Assistance Treaties are a solution and need to be pursued actively
- The FATF initiative is an excellent base for exchanging typologies to exchange information on current money laundering techniques and maybe, suspect rogue organisations.



# Integration and Detection

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- Laws exist to question “sources” of funds.. Sec 69 of the Income Tax Act
- The Integration process should
  - question the source of funds
  - understand the need to infuse cash
  - understand KYC norms of the customers
  - price and trade patterns

# The Initiatives to Combat Money Laundering

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- The Institutional Initiative
- The Legal initiative
- The Forensic initiative



# Institutional initiatives

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- FATF
- FinCEN
- BIS
- IMOLIN
- Financial intelligence unit (FIU)



# Legal initiative

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- PATRIOT Act-in USA
- Bank Secrecy Act – in USA
- Prevention of Money Laundering Act 2003-in India
- And various legislations in many countries round the globe



# Forensic initiative

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- To instal Anti-Money Laundering software and procedures in Banks
- To investigate “nature” and “pattern” of crime by agencies involved in the detection of Money Laundering
- To prepare the Evidence which is admissible in a court of Law
- To prepare a Team of AML specialists by training them in qualifying exams >>

# KYC NORMS



- The “Know your Customer” norms issued by the banks under the guidance of the Supervisor typically includes
  - Strict proof of Identity
  - Detailed relationship analysis
  - Detailed Business information & connections
  - This should help the Bank to monitor Suspicious Transactions..

“By being careful that the procedure does not result in the denial of access to the general public services” circular of RBI



## The Alerting Structure in Banks in India

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- Prohibition of Issue of DDs/TTs in excess of Rs.50,000 by cash deposits
- Close watch of Cash withdrawals and deposits for Rs.10 lakhs and above, especially of a suspicious nature
- Increasing networking/computerization of branches permits data integration and analysis
  - Source: RBI Circular on KYC Norms



# The “indicators” of money laundering in Banks

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- High Risk products & services
- High Risk Geographic Locations
- High risk customers

Office of the Comptroller of Currency,  
Washington DC

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# High-risk Products And Services



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- Wire Transfer/International Correspondent Banking
- Private Banking Relationships
- Politically exposed Persons
- Electronic Banking



## Electronic banking and Cyber Launderer

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- E-banking encourages cyber-launderer
  - Anonymity
  - Lack of Audit trails
  - Lack of Records
  - Absence of Bureaucracy
  - Border-less

(Almost like Hawala!!)
- Encryption makes it difficult for the forensic accountant to crack the trail



# High-risk Customers

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- NBFCs including Money Service Businesses
- NGOs
- Offshore Corporations, bearer share corporations, and banks located in tax and/or secrecy heavens and jurisdictions designated as non-cooperative in the fight against money laundering
- Cash intensive businesses.



## High-risk Geographic Locations

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- Jurisdictions identified by intergovernmental organisation as non-cooperative (NCCT)
- Countries/jurisdictions of “primary concern”.
- Geographies identified as by OFAC
- Jurisdictions identified as areas of primary money laundering concern by USA PATROT Act
- Jurisdictions identified by bank management



## What could trigger a Suspicious Transaction report

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- Customers who provide insufficient or suspicious information
- Efforts to avoid reporting or record keeping requirement
- Certain fund transfer activities
- Activity inconsistent with the customer's business
- Other suspicious customer activity
- Changes in bank-to-bank transactions
- Bank employees

# Money laundering and Terrorist Financing



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# Terrorist Financing Red Flags

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- ✦ Smaller dollar amounts entering the country and used in typical retail consumer activity
- ✦ Funds generated by a business owned by nationals of countries associated with terrorist activity
- ✦ Charity/relief organisation-linked transactions
- ✦ Currency exchange buying/selling foreign currencies from various countries in the Middle East
- ✦ Business account activity conducted by nationals of foreign countries associated with terrorist activity with no obvious connection to the business



# Reports That Can Help Bankers Identify Suspicious Transactions

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- Cash Transaction Reports
- Wire Transfer Records/Logs
- Monetary Instrument Record
- Velocity of Funds Report

# Implementation Challenges Faced



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- ID/Address evidence of Overseas Corporate Stakeholders
- Certified documentation for customers residing in High Risk Countries
- PO Box addresses in Middle East and African countries for NRIs
- Customer Awareness
- Reluctance to share information



# Monitoring & Reporting of accounts and transactions

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- Ongoing monitoring of accounts on a risk sensitive basis
- Systems in place to detect suspicious or unusual pattern of activity
- Limits may be fixed for particular class or category of accounts
- Transactions that do not make economic or commercial sense



## Monitoring of accounts

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- Large cash deposits inconsistent with normal or expected transactions of the customer
- Very high account turnover inconsistent with the average balance maintained
- Sudden spurt of activity in inadequately operated accounts
- Intensified monitoring for higher risk accounts-PEPS-country of origin, sources of funds, nature of transaction

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# Thank You

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