COMBATING MONEY LAUNDERING

CFOs are in the financial front line of the war against terrorism and the war on drugs. The international organization co-ordinating work to stop money-laundering has published a revised set of guidelines to assist in combating money-laundering.

Australia has been a pioneer in curbing money laundering. First, it has introduced one of the world's most ambitious forms of legislation and set of administrative arrangements. Second, it has been involved in the international effort to create counter-measures against money laundering. However, there is still work to be done, including creating a mentoring scheme to assist CFOs deal with difficult issues.

Financial Action Task Force

The Paris-based Financial Action Task Force (FATF) has a total membership of 33: 31 countries (including Australia) and two international organizations (World Bank and International Monetary Fund). It was created in 1989, at a time when there was increasing concern about the laundering of drug money. It has been given additional impetus since September 11 2001, with the concern over the movement of funds to finance terrorist operations.

There are no accurate figures for the extent of the money laundering problem. The International Monetary Fund (IMF) has estimated that the amount could be between two and five per cent of the world's gross domestic product. This suggests that it could be between US$590 billion (the equivalent of the GNP of Spain) up to US$ 1.5 trillion.

An example of the extent of the underground Australian economy is the demand for high denomination bank notes to move money around in cash transactions. As at June 30 2002, the values of notes in circulation were:
$100: $13.6 billion
$50: 14.7 billion
$20: 2.8 billion
In other words, there were almost seven $100 notes in circulation for every man, woman and child in Australia (19.6 million people) Do you have seven on you right now? The chances are, you do not. The favourite denomination for automatic cash machines are $50 notes. Of course, not all the $100 notes are used for organized crime purposes but they do provide some evidence of the extent of the problem.

$100 notes are popular for the transfer of cash in large amounts. A pile of such notes is half the height of a pile of $50. A large package of notes would be noticeable and could be stolen by an unscrupulous person. No doubt the criminals moving cash would like to use even higher denominations but the Reserve Bank would be worried about the inflationary implications of producing (say) $500 denominations .

Illegal arms sales, smuggling and the activities of organized crime (such as drug trafficking and prostitution rings) can generate huge sums of money. Additional proceeds can come from embezzlement, insider trading, bribery, and computer fraud schemes.

The criminals need to “clean” the funds through money laundering. Thus, the money is sent to other locations for other purposes, so that when the money eventually appears in the criminal’s bank account back home the money seems “clean”. For example, a drug dealer in Australia may buy a painting in England with the proceeds, sell it in France, use the proceeds to buy real estate in Greece and then sell the property, with the money being sent to an Australian bank account. If questioned by Australian police about how the money was obtained, the criminal can say he sold a property in Greece: a respectable transaction.

Crime can be global but police forces are only local. Their investigations often have to stop at the state or national boundary.

AUSTRAC

Australia has been described by the FATF as a ‘learning laboratory” because of its innovative approach to curbing money laundering. It was one of the world’s first financial centres requiring reporting of financial data to a central agency and it was the first government to adopt a national system for monitoring wire transfers.

The basic legislation is the 1988 Financial Transaction Reports Act, which provides for the reporting of certain transactions and transfers. It also established the Australian Transaction Reports and Analysis Centre (AUSTRAC).

“Cash dealers” are defined as banks, building societies and credit unions referred to as financial institutions; financial corporations; insurance companies and insurance intermediaries; securities dealers and futures brokers; cash carriers; managers and trustees of unit trusts; firms that deal in travellers cheques, money orders and the like; persons who collect, hold exchange or remit currency on behalf of other persons; currency and bullion dealers; casinos and gambling houses; and Totalisator.

There are requirements to report cash transfers into and out of Australia of A$10,000 or more or the foreign currency equivalent. The legislation provides penalties for avoiding the reporting requirements and in respect of false or incomplete information. It also has penalties for persons who facilitate or assist in these activities.

The 40 Recommendations

The original FATF Forty Recommendations were drawn up in 1990, as an initiative to combat the misuse of financial systems by persons laundering drug money. In 1996, the Recommendations were revised to reflect the types of evolving money laundering techniques. Those Recommendations were endorsed by over 130 countries.

As a result of September 11 2001, the FATF expanded its mandate to deal with the issue of the financing of terrorism. It created the Eight Special Recommendations on Terrorist Funding in October 2001. These cover: the need for governments to ratify and implement United Nations treaties on terrorism; governments to criminalise the financing of terrorism and associated money laundering; governments to freeze and confiscate terrorist assets; suspicious transactions related to terrorism to be reported to governments; the need for international co-operation in combating the financing of terrorism; the regulation of informal financial transfers done outside the usual banking system; the monitoring of wire transfers; and the scrutiny of non-profit organizations (see box).

The Forty Recommendations have now been updated (June 2003). Among some of the basic obligations are: the criminalization of the laundering of the proceeds of serious crimes; enactment of laws to seize the proceeds of crime; obligations for financial institutions to identify all clients; a requirement for financial institutions to report suspicious transactions to the competent national authority; adequate systems for the control and supervision of financial institutions; and the need to accept international agreements aimed at stopping money laundering.

Australia's financial arrangements are in line with the Recommendations. Given the increasing risk of terrorism and the growing use of drugs, the risks of money laundering will be around for a long time.

A Mentoring System?

At first sight, then, it seems that Australians CFOs are well placed to cope with the new era of combating money laundering. But recent financial scandals – not related to money laundering - have shown that there is no need for complacency. If money laundering is looked at the wider context of financial irregularities, then there is always a risk of unethical behaviour.

John Horder of MSM Loss Management, Sydney is advocating the creation of a mentoring scheme to enhance ethical behaviour within the accounting profession. “Law are made for honest people”, he says. “Honest people follow them. Others look for gaps. Laws are blunt. Some of the recent problems have shown the need for better ethical behaviour”.

Horder has suggested that there should be a mentoring system for accountants to help them think through any ethical dilemmas they encounter in their daily work. “There is the risk that CFOs will get prevailed upon to bend the rules. They fear losing their jobs, especially with the younger members of the profession, with partners, children and mortgages to worry about. They could be vulnerable to pressure. There is no place to turn to get advice on ethical dilemmas”

Therefore, Horder has suggested that the accounting profession create a mentoring system, where more senior and experienced members of the profession can give advice to other members who have ethical dilemmas. They may also be in a position to have a word with board members to mediate on behalf of the CFO.

September 11 and international finance

American investigations into how the September 11 terrorists were financed have shown two problems for the international community.

First, some Arabs use the “hawala” banking system. It is based on trust between hawala agents, who move memoranda – rather than money – between themselves. The system originated in China as a way of enabling money to go from one location to another without risking robbery on the road or river.

For example, a person in Australia of Iraqi origin sells a property in Iraq to person in Iraq. The cash could not move out of the country owing to restrictions placed on it by both Saddam Hussein and the United Nations. The person buying the property gives the money to an Iraqi hawala agent. That agent contacts an hawala agent in Australia for him to pay the Australian resident the equivalent sum. Money moves back and forth between customers and agents and so eventually all the transactions balance out. All of these transactions are very difficult to monitor by standard government reporting requirements because they do not go through official channels.

Second, a pillar of Islam is giving money to charity. Moslems are required to give to people in need. It is suspected that some of the finance for the September 11 terrorist attack came from Moslems who thought that they were giving money to respectable charities in Saudi Arabia and elsewhere.

In October 2002, the FATF published the "international best practices" for "Combating the Abuse of Non-Profit Organizations". The document does not contain recommendations but instead seeks to alert governments to the problems involved in non-profit organizations being used as front organizations for terrorist groups, such as an organization claiming to be raising funds for the relief of orphans and widows when in fact the funds went to al-Qaida operatives.

FATF documents are careful not to highlight in particular the problems associated with Islamic banking or charities. Australian officials have been equally careful not to inflame anti-Islamic feelings. But it is worth noting that Islam is now the country's second most important religion and Australia is expanding its ties with countries that have Moslem populations.

Therefore, it is necessary for Australian financial officials to be aware of the specifics of Islamic financial life (including the Islamic ban on lending money at interest and the creation of alternative banking arrangements)

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