



Case Studies on fighting Money Laundering, Terrorist Financing and Economic Crime

May 2018

Purpose

This case studies pack has been prepared by ICPAC's Compliance Committee and Economic Crime and Forensic Accounting Committee and it endeavors to provide some practical guidance to ICPAC members and students. ICPAC has identified the need to raise awareness amongst its members and students, including awareness surrounding the risks arising from the nature of activities of their client base, the nature of transactions undertaken on behalf of their clients and the business activity in general associated with an international financial service center.

As there are no hard and brisk rules for recognizing money laundering, terrorist financing and economic crime, it is crucial for members and students of ICPAC to remain alert and vigilant to the Money Laundering ("ML"), Terrorist Financing ("TF") and fraud risks by applying their professional judgement, experience and professional skepticism.

The case studies demonstrate how following the money trail, identifying red flags and understanding clients' business is an effective way of detecting the activities of fraudsters, money launderers and other organized crime networks.

The case studies within this guidance paper, through analysis of the lessons that can be learned, also highlight the value and need of reporting suspicious financial transactions and suspicious activity to MOKAS.

Please note that all data and scenarios provided are fictitious and have been utilized only for the purpose of illustrating, sometimes in an extreme manner, red flags which ICPAC members and student should pick up to identify suspicious activity.

Case study 1

Deposits and Movement of funds between bank accounts with no business rationale

Facts of the Case

Company A received €2.250.000 from Company B in the form of a loan.

By the next day Company A instructed the Bank to transfer the funds as follows:

- a) €1.180.000 in another account of Company A with another bank.
- b) €1.000.000 issue of a banker's draft in favor of Company C – based on loan agreement
- c) €70.000 Cash withdrawal – no business explanation

Following the above transactions, Company A instructed for the account to close (after 8 months from opening).

Company C received €2.250.000 from Company B in the form of a loan.

A month later in the accounts of Company C a banker's draft amounting to €1.000.000 was also deposited (from Company A above)

Funds were used as follows:

- a) cash withdrawal €1.038.000 – no business explanation
- b) €1.656.000 issue of a banker's draft in favor of Company D – based on loan agreement
- c) €95.000 issue of a banker's draft in favor of Company E – based on loan agreement
- d) €350.000 transfer to Company F – based on loan agreement
- e) €100.000 turned into a Fixed Deposit upon maturity of which the funds have been withdrawn in cash.

Following the above transactions, Company C instructed for the account to close (after 8 months from opening).

Company D received €1.656.000 from Company C in the form of a loan.

No further transactions.

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- Common ordering party for the incoming funds of Companies A and C without an obvious link (transactions were effected on the same date).
- Cash withdrawals without business need or logic
- Continuous movement of funds from one company to another, possible to hide trace
- Accounts were opened and closed within a short period of time (8 months)
- Funds were effected based on loan agreements without obvious link between the companies

Case study 1 (continued)

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- Bad reputation
- Administrative fines for not performing adequate due diligence

3. What KYC/Due Diligence work could the accounting firm have carried out and when?

The Accounting firm should have received information at the initial stage of the business relationship regarding the group companies, the type of activities of all group companies and their interaction in the group.

In the case where the above information did not match the transactional behavior of the companies involved, the Accounting firm should challenge the purpose of the loan agreements, the relationship between the companies and the business logic behind the transactions.

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

Following the above enquiries with the companies involved, if the Accounting firm was not satisfied with the explanations given it should file a Suspicious Transaction Report and consider terminating the relationship.

Case study 2

Money Laundering

Facts of the Case

Mr. Andreou is an accountant and an administration service provider regulated by ICPAC, working in Cyprus. Mr. Andreou had employed one Compliance Officer (CO) who is a recently qualified accountant with no AML experience and limited work experience. Mr. Smith from the UK, who owns a used car dealership in the UK, approached Mr. Andreou and requested for bank administration and accounting services. Mr. Andreou sets up a company with the assistance of a registered licensed lawyer that purchased used cars from Mr. Smith's UK Company and resold them in the local market. Mr. Andreou approved and processed the payments of the purchases and members of his staff issued the sales invoices and deposited the receipts from the sale of the new cars and maintained proper accounting records. The business was very profitable and cash rich, as the used cars were bought at a very low price and resold at a significantly higher price in cash.

One employee of Mr. Andreou expressed her concerns to the CO as she was worried that the majority of sales were made in cash (below the €10,000 threshold¹) and, in addition to this, in many instances the cars were registered to a different customer than the one paying for the sale. The CO dismissed her worries and explained that this is how business is done in Cyprus, and that many people still have cash at home after the deposit haircut in 2013.

Not long after, Mr. Smith was convicted and imprisoned, since it emerged that he is a drug dealer who has set up used car sale businesses in a number of countries to launder the proceeds from drug sales. As a result, all used cars and cash were viewed by the Republic of Cyprus as criminal proceeds and were now the subject of confiscation proceedings.

Mr. Andreou was arrested and put on trial alongside the Compliance Officer. According to the prosecution, the set up and management of the company was intended to eliminate the trail that led back to Mr. Smith and his illegitimate funds and they should have been suspicious of the transactions as the cars sold were almost obsolete but generated high income in cash.

The CO and Mr. Andreou claimed they had no knowledge that the cars were in such a poor state and did not have grounds to suspect Cypriot buyers using cash to settle their purchases.

The CO was convicted of failure to report, contrary to Article 27 of the Prevention and Suppression of Money Laundering and Terrorist Financial (Amending) Law of 2018 (the "Law") and sentenced to 12 months' imprisonment.

¹ Article 5A of the Prevention and Suppression of Money Laundering and Terrorist Financial (Amending) Law of 2018

Case study 2 (continued)

1. Where are the red flags?

- The sale of the used cars at a premium price
- The volume of cash receipts
- The registration of the car under a different name from the buyer's name

2. What actions should have been taken?

Before accepting the client, proper KYC should have been performed followed by the risk assessment that would have enabled the CO to ascertain what sources and quality of evidence is required during the due diligence.

If proper source of fund/wealth was established and the economic profile of the client had been properly constructed prior to the execution of the transaction, the origin of the funds might have been exposed as resulting from illegitimate activity.

It would also have been expected that if an appropriate senior executive with skills, knowledge and experience was appointed as the CO of the company (as required by the AML Law, article 69(1)), he would have become suspicious when the accountant had alerted him of such transactions and been able to question the rationale of the transactions and picked up the red flag.

The firm should also have had policies in place to guide the staff on how to report suspicion internally to the CO and any considerations/explanations should have been documented.

Finally, the CO should have filed a Suspicious Activity Report (SAR) with MOKAS.

Case study 3

Insufficient and unsatisfactory KYC documents

Facts of the Case

Maria is the Compliance Officer of the Best Audit Firm Ltd. She is in charge of meeting with all new prospective clients and obtaining all necessary information before the commencement of the business relationship.

A new client, Mr. Shamir, introduced by a long standing existing client, has come in the office for a meeting. Mr. Shamir is an Israeli resident, a Cyprus home owner with a company that trades in furniture. Maria went through all the KYC documents required for the onboarding, explained the company's policies and procedures to be followed and left the meeting with a promise that the prospective client will provide all documents within the end of the week, so the firm can proceed with its acceptance procedures.

Mr. Shamir, as promised, dropped off at the reception an envelope with some documents, but upon review, Maria realized that he had only provided a few documents. She emailed him a list of missing documents and a new deadline to provide her with everything. Mr. Shamir responded that he was in a hurry to obtain a Tax Identification Number and requested the firm to proceed with the application to the Inland Revenue until he comes back next week with the necessary documents.

The firm prepared the forms to be submitted to the Inland Revenue and asked him to come in the office and sign the forms and bring the remaining documents. Mr. Shamir signs the documents and leaves a substantial cash amount to the firm for future services but omits to bring in the pending documents required to complete the KYC and Due Diligence procedures. He explained that the documents are held by his lawyer and he has not passed by his office to collect them.

Maria contacts the client who referred Mr. Shamir to the firm and finds out that he does not know him that well and that he arrived from the illegitimate airport of the occupied area of Cyprus. Maria contacts Mr. Shamir immediately and asks him for a meeting. Mr. Shamir fails again to provide the firm with the missing documents, he explained that he does not have a utility bill for his Cyprus residence which had been marked as his main residence and that his yellow slip (residence permit issued from the immigration office) is held by the lawyer. As a result, Maria informed him that Best Audit Firm Ltd cannot provide any services to him and returned the cash to him. No further services were provided to Mr. Shamir.

Case study 3 (continued)

1. What are the red flags which might indicate money laundering activity and/or terrorist financing in this case?

- Mr. Shamir would not provide the documents requested by the compliance officer
- The urgency of Mr. Shamir to proceed with the registration to the Inland Revenue
- The substantial cash paid to the firm for future work
- The entrance into the country through the occupied area of Cyprus

2. What are the risks and potential threats that the accounting firm may be faced with in this situation?

- The firm could have unknowingly been assisting in a money laundering/terrorist financing scheme through the inability to verify the client
- Reputational risk
- Administrative fines for not performing adequate due diligence

3. What actions should the Compliance Officer have taken?

- The Compliance Officer should have assessed whether the prospective client's unwillingness to provide the necessary documents was suspicious and report the case to MOKAS
- The firm should not have proceeded in offering any services to, or accepting any cash payment from the prospective client before the completion of the Due Diligence ("DD") / Know Your Customer ("KYC") process.

Case Study 4

Watch for the Middleman and not for the Politically Exposed Person (PEP)

Facts of the Case

XYZ Audit Ltd is a middle size Audit Firm in Cyprus, specializing in the provision of a range of professional services, ranging from accounting, tax, fiduciary and audit services.

Mr Donald, a prominent American businessman and lawyer by profession, has approached the Firm requesting the incorporation of 6 companies with €1.000 issued share capital for each company (i.e. total of €6.000) with the principal activities to invest, on the behalf of prominent investors, in the real estate property of Eastern Europe.

The Audit Firm performs full Know your Client (KYC) verification of Mr Donald, by obtaining all the required identification and economic profile data and also performing a full background check for the said individual as to identify any PEP, sanctions and adverse media positive matches. All the procedures performed do not identify anything suspicious or negative which would prevent the acceptance of Mr Donald as client.

The Audit Firm incorporates the 6 companies with the assistance of a registered licensed lawyer requested by the client, with Mr Donald as the sole Beneficial Shareholder (BO) and immediately there are funds deposited in the bank accounts of each of the 6 companies for €10.000.000 (i.e. total of €60.000.000). Each of the funds is shown as loans payable, for 1% interest, to a common investor Mr Vladimir from Russia. The funds are then immediately invested in commercial property in Easter Europe.

During a Regulatory monitoring inspection from ICPAC, it is identified that Mr Vladimir (the sole investor) is a PEP (ex-mayor of a Russian city) and has a criminal history and sentences by Russian courts for embezzlement, money laundering, and being involved in a criminal organisation.

The Audit Firm is reported in the Disciplinary Committee of ICPAC for not performing adequate KYC procedures and also the specific BO (Mr Donald) and the sole investor (Mr Vladimir) are reported by ICPAC to MOKAS.

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- No economic substance in the business setting of the 6 companies of having only 1 sole investor (Mr Vladimir) for all 6 companies and the only return sought, for a total of €60.000.000 investment, to be 1%.
- BO (Mr Donald) is a prominent lawyer and the principal activities sought for the 6 companies as to invest in real estate, do not tie directly to his primary profession of being a lawyer.
- BO only invested €6.000 in total to all 6 companies and the sole investor invested €60.000.000 in total to all 6 companies, so a question arises on who the real BO is in all 6 companies.

Case Study 4 (continued)

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- The Audit Firm has been reported to the ICPAC Disciplinary Committee, on the grounds of aiding money laundering due to the insufficient performance of KYC for this specific client, and with the risk of severe disciplinary measures to be decided against the Firm.
- The Audit Firm has been reported to MOKAS, and will be part of an investigation and the possibility of criminal proceedings against them, on the grounds of aiding money laundering due to the insufficient performance of KYC for this specific client.

3. What KYC/Due Diligence work could the accounting firm have carried out and when?

- The Audit Firm should have recognised and implement appropriate KYC procedures as to mitigate the risk that corrupt PEPs are firstly concerned about hiding their identity and secondly about hiding their assets. The real risky PEPs are the suits, the middlemen, the associates who stand in the shadows and are almost always the ones involved in the account openings. These people are the PEPs you really need to look out for. In fact, the political figure is arguably the last person you need to watch out for. As such, an effective PEP risk mitigation solution should not merely provide a long list of officeholders' names and positions but in order to identify risk critically and methodically, it must also provide the identities of all those 'exposed persons' that surround the PEP.
- The Audit Firm should have assessed the economic substance of the transactions and the reasoning of why the identified BO (Mr Donald) has only invested a total of €6.000 and the Sole Investor (Mr Vladimir) has invested a total of €60.000.000 (with only 1% return), as such critically assessing on who the real BO is.
- A full KYC procedure should have been performed, not only on the BO but also on the Sole Investor.
- Source of Funds and Source of Wealth, for the Sole Investor (Mr Vladimir), should have been identified and thoroughly examined in terms of legitimacy of source.
- The Audit Firm, should have established monitoring procedures on the following:
 - i. ensure clients due diligence information is up to date as existing clients sometimes become PEPs after they enter a business relationship;
 - ii. ensure internal procedures include employee ongoing training programmes, addressing effective ways of determining whether clients are PEPs;
 - iii. use of the internet and media as sources of information for the determination, monitoring and verification of information in relation to PEPs;
 - iv. use of available commercial databases, but do not fall into the trap of wrongly assuming that if a name is (not) in such a database then the client is (not) a PEP;
 - v. use of countries' published lists of domestic PEPs;
 - vi. use in-house developed databases as a tool to assist in the determination of who is a PEP;
 - vii. use countries' asset disclosure systems applying to those individuals who hold prominent public functions;

Case Study 4 (continued)

3. What KYC/Due Diligence work could the accounting firm have carried out and when?
(continued)

- viii. use of self-declarations by a client of their PEP status, while noting that such procedure would shift the financial organisation's obligation to their client, which is not an acceptable practice; and
- ix. use general information publicised by competent authorities (e.g. the level of corruption in the country, the level of income for certain types of positions).

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

- The Audit Firm should re-visit its KYC procedure based on the recommendation in Part 3 above.
- The Audit Firm should fully and openly cooperate, both with ICPAC and MOKAS accordingly, for the investigation currently in place for Mr Donald and Mr Vladimir.

Case Study 5

European Commission Funding Fraud

Facts of the Case

ABC Audit Ltd is a small size Audit Firm in Cyprus, specializing in the provision of a range of professional services, ranging from accounting, tax, fiduciary and audit services.

Ms Angela, a German national, approaches the Audit Firm requesting the incorporation of a company (“the Company”) that will be involved in the construction of a Food Packaging Factory for a related Company in Bulgaria. The construction project will be subsidised by 50% from funds from the European Commission under the European Union (EU) Plan of aiding the employment in poor regions of Europe. Ms Angela informs the Audit Firm, that one of the conditions set by European Commission, in approving the 50% subsidy, are that the costs of construction of the Food Packaging Factory be audited by an EU Audit Firm.

The Audit Firm performs full Know your Client (KYC) verification of Ms Angela, by obtaining all the required identification and economic profile data and also performing a full background check for the said individual as to identify any PEP, sanctions and adverse media positive matches. All the procedures performed do not identify anything suspicious or negative which would prevent the acceptance of Ms Angela as client.

The Audit Firm sets up the Company with the assistance of a registered licensed lawyer requested by the client, with Ms Angela as the sole Beneficial Shareholder (BO) and with share capital issued and paid in a Cyprus Bank for €5.000000. Both Source of Funds and Source of Wealth have been adequately identified and established and have been considered acceptable by the Audit Firm.

The Company, very soon signs a number of contracts with a number of Asian suppliers for the provision of materials required for the construction of the Food Packaging Factory for the related company in Bulgaria. The total invoices value for the purchase of all the material is for €5.000.000. The Company then sells all the material to the related company in Bulgaria for a total price of €10.000.000.

The Audit Firm performs the first year-end audit of the Company and issues a “Clean Audit Opinion”. Soon after, Ms Angela requests the Audit Firm to liquidate the Company and close all the bank accounts. The Audit Firm, proceeds with her request and liquidates the Company. In the same year, the European Anti-Fraud Office (OLAF) informs ICPAC, that it is currently investigating ABC Audit Ltd and their client, Ms Angela, with the charges that they have colluded to defraud the European Commission and fraudulently applying and receiving a subsidy of €5.000.000 (i.e. 50% of total cost of €10.000.000 invoiced by the Company to the Bulgarian Company) instead of only entitled for subsidy of €2.500.000 (i.e. 50% of the actual cost of €5.000.000 initially invoiced by the Asian Supplies to the Company).

Case Study 5 (continued)

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- No economic substance in the business setting of the Company as to act as the middle-man between the Asian Suppliers and the Bulgarian Company and under a 100% mark-up pricing.
- Significant EU funding involved in the business transactions between all the parties involved.
- Immediate liquidation request of the Company and closure of its bank accounts, in the second year of its operation and by only performing 1 single business transaction.

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- The Audit Firm has been reported by The European Anti-Fraud Office (OLAF) to the ICPAC Disciplinary Committee, on the grounds of aiding a funding fraud scheme against the EU, and with the risk of severe disciplinary measures to be brought against the Firm.
- The Audit Firm has been reported by OLAF to the Cyprus Police, on the grounds of aiding a funding fraud scheme against the EU, and with the risk of severe criminal measures to be brought against the Audit Firm.

3. What KYC/Due Diligence work could the accounting firm have carried out and when?

- The Audit Firm should have assessed the economic substance in the business setting of the Cyprus Company as to act as the middle-man between the Asian Suppliers and the Bulgarian Company and under a 100% mark-up pricing (i.e. from a €5.000.000 purchase cost to a €10.000.000 revenue income).
- The Audit Firm, should have identified as a significant fraud audit risk that there is EU funding involved and that the European Commission will be placing reliance on its Audit Report as to approve and pay the 50% subsidy to Ms Angela.
- The request for the immediate liquidation of the Company and closure of its bank accounts, in the second year of its operation and by only performing 1 single business transaction, should have been identified as suspicious by the Audit Firm and both an Internal Suspicious Report should have been filed with the Compliance Officer and an external report should have been submitted to MOKAS.

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

- The Audit Firm should re-visit its Audit Methodology and KYC procedure based on the recommendations in Part 3 above.
- The Audit Firm should fully and openly cooperate, both with ICPAC, MOKAS, Cyprus Police and OLAF as relevant, for the investigation currently in place for Ms Angela.

Case study 6

Investment fraud

Facts of the Case

An investment company is offering brokerage service to clients. It collects clients' funds and places them into the bank account denominated as "Clients Bank Account" with ABC Bank plc, for further clearing and settlement transactions for clients' orders, which require 2 signatures of both executive directors.

Clients' agreement indicates that the Company does not use clients' funds for own purposes, separates and segregates clients' funds in an EU bank.

The Company has a process to daily reconcile the records of accounting, back office and bank, to ensure that the Clients' Funds are kept in the separate accounts with the licensed bank and not used for 'own' Company needs at any circumstances.

Due to shortage of staff, the in-house accountant is responsible to prepare accounting records, which include obligations to clients, and to reconcile these records to third party records and to back-office records.

Due to non-compliance with the risk management policies, and resulting liquidity and capital shortage, executive directors decide to use clients' funds to hedge own trading positions.

Trading, unfortunately, is not profitable and the clients' funds are paid to the counterparties to settle own loss-making trading deals.

The in-house accountant, due to heavy workload, prepares the accounting records based on the accounting statements, however, does not perform regular reconciliations with the back-office records, to ensure that the Clients' funds held with the ABC Bank and reflected in the accounting records, correspond to the amounts reflected on clients' statements (i.e. what Company shows in external reports to clients as due to clients).

At some point, the clients start to experience difficulties in withdrawing the funds and complain to the Competent Authority.

The Competent Authority during its investigation revealed that the company:

- committed a theft of clients' funds and used them for own purposes,
- operates a scheme where the clients' withdrawals were paid from other's clients funds generated by aggressive marketing techniques,
- did not employ the procedures to safeguard clients' funds,
- internal 2nd and 3rd line of controls failed to report this to the Board and to the Competent Authority.

Case study 6 (continued)

Facts of the Case (continued)

As a result, the Company's license is withdrawn due to non-compliance with Article 28(1) of the Law, in relation to the authorization and operating conditions laid down in Article 18(2)(j) of the Law, was due to their fault, willful omission and negligence.

1. Economic crimes committed

- Theft (of clients' money)
- Fraud (pyramid-style payments)
- Conspiracy to commit fraud (executive directors acted in concert for bank signature purposes)
- Furnishing false information to clients
- Money laundering

2. Actions made by the professionals to enable these crimes?

- The executive directors forced the Company to commit theft by transferring clients' funds to own accounts and giving instructions to settle own obligations with clients' funds.
- The in-house accountant assisted in fraud and theft, by being negligent for non-performing the required tasks.
- Internal Audit, AML and Compliance functions failed to recognize, and report risks due to negligence.

3. What actions might the in-house accountant have taken?

Firstly, the accountant should ensure adherence to the procedures set and should perform regular reconciliations in the prescribed format.

If the task could not have been performed due to the workload, this should have been escalated to management and control functions. By elevating the issue to senior management further resources would possibly have been devoted to the accounting function. In case management was reluctant to do so then the accountant:

- should resign due to inadequate resources to properly performance his duties (*per section 330.2 of IFAC Code of Ethics for Professional Accountants*)
- based on his judgement and professional skepticism, he should seriously consider reporting the suspicion by submitting a Suspicious Transaction Report to the Anti-Money Laundering Officer appointed in accordance with the Regulators Directives for the prevention of money laundering, as per the firm's standard AML procedure.

Case study 6 (continued)

3. What actions might the in-house accountant have taken? (continued)

By performing proper and accurate reconciliations on a regular basis, the accountant could have realized that the Company's management uses clients' funds for own purposes and that Clients' funds are stolen.

In this case, if the accountant believed that others are behaving or acting unethically, he should first consider raising the matter internally, through the organization's own whistle-blowing procedure, by submitting the Suspicious Transaction Report to the Anti-Money Laundering Officer appointed in accordance with the AML Law.

Alternatively, he may wish to seek the advice of his professional body and/or a lawyer or the regulator.

If all the available options for reporting and escalation have been exhausted, the in-house accountant might finally conclude that it is appropriate to resign.

4. Role of Professional accountants in such cases.

The professional accountants can help prevent fraud and theft using their expertise, professional skepticism and their professionalism to act with integrity and by refusing to become associated with practices they know to be unethical or contrary to the law and regulations.

Their role goes beyond this as they are expected to educate staff, peers and management within the organization for the proper adherence of firm's policies and procedures in respect of the accounting function and of any exceptions they may identify during the conduct of their work (reconciliations of clients' accounts, recording and reviewing of transactions and balances). Accountants have the necessary skills and position to explain the risks and potential consequences of unauthorized use of clients' assets.

Established compliance processes should, in all likelihood, be in place and work as prescribed.

Case Study 7

Source of Funds and Source of Wealth

Facts of the Case

TBC Audit Ltd is a large size Audit Firm in Cyprus, specializing in the provision of a range of professional services, ranging from accounting, tax, fiduciary and audit services.

Mr Emmanuel, a French national, approaches the Audit Firm requesting for the incorporation of a company (“the Company”) that will be involved in the financing of other Group Companies involved in the investment of real estate in France.

The Audit Firm performs full Know your Client (KYC) verification of Mr Emmanuel, by obtaining all the required identification and economic profile data and also performing a full background check for the said individual as to identify any Politically Exposed Persons (PEP), sanctions and adverse media positive matches. All the procedures performed do not identify anything suspicious or negative as not to accept Mr Emmanuel as client. However, it has been identified, during the background check, that Mr Emmanuel is a Senior Government Official in the Ministry of Interior in France. In this respect, the client is categorised as High Risk for AML purposes, due to his PEP status, and also enhanced due diligence procedures are performed as to ensure compliance with the AML relevant requirements for PEP clients. More specifically, his source of funds and source of wealth are identified and established through obtaining his recent Tax Return and Capital Statement, submitted in the French Tax Authorities, declaring an annual income from sources of employment and investment returns of €1.000.000 and total wealth of around €10.000.000.

The Audit Firm sets up the Company requested by the client, with Mr Emmanuel as the sole Beneficial Shareholder (BO) and with share capital issued and paid in a Cyprus Bank for €2.000.000 through a direct bank wire transfer from French Bank.

The Company, then immediately provides financing of €2.000.000 to a number of Group Companies in France, with a total interest charge of 5%.

The Audit Firm performs the first year-end audit of the Company and issues a “Clean Audit Opinion”.

In the second year of operations of the Company, there is an increase in the share capital of the Company of €20.000.000, paid as a bank wire from a Marshal Islands Company’s bank account to the Company’s bank account in Cyprus; the Marshal Island’s Company is identified as 100% owned by Mr Emmanuel. Immediately after, the whole €20.000.000 are provided as financing to a number of Group Companies in France, with a total interest charge of 5%.

Case study 7 (continued)

Facts of the Case (continued)

The Audit Firm identifies the economic profile discrepancy of the €22.000.000 total share capital issued and paid in the Company, versus the identified and established total wealth of Mr Emmanuel of €10.000.000. The Audit Firm, contacts Mr Emmanuel for explanations on the discrepancy and also for the provision of additional support of the total additional capital funding of €20.000.000. Mr Emmanuel provides the Audit Firm with a confirmation signed by the Directors of his 100% owned company in the Marshal Islands. The Audit Firm accepts the evidence provided and files the confirmation in the KYC file of Mr Emmanuel.

A week after, a Senior Partner of the Audit Firm, watches in the news that Mr Emmanuel, a Senior Government Official in the Ministry of Interior in France, has been arrested by the French Authorities on the criminal accusations of obtaining €20.000.000 bribes from a Construction Company in France in order to approve them as successful contractors for a €200.000.000 construction project of a number of new government buildings in France.

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- The PEP status has not been initially declared to the Audit Firm by the client and only identified thereafter when the Audit Firm performed its own background check.
- There was a significant discrepancy in the Economic Profile of the client, following the establishment of the business relationship (i.e. €22.000.000 total investment in the Cyprus Company versus a €10.000.000 declared wealth in the French Tax Authorities).
- The €20.000.000 additional capital has been bank wired from an offshore company and bank account in the Marshal Islands and thereafter transferred to a French company and bank account through the Company and bank account in Cyprus.
- The only evidence forwarded, for the support of the additional €20.000.000 funding, was an internal confirmation signed by the Directors of a related Group Company of the client.

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- The Audit Firm may face disciplinary procedures from ICPAC, on the grounds of failing to adopt appropriate KYC procedures for its audit clients.
- The Audit Firm may face criminal procedures from the French Authorities, on the grounds of aiding or not identifying the money laundering performed by his audit client.

Case study 7 (continued)

3. What KYC/Due Diligence work could the accounting firm have carried out and when?

- The Audit Firm should have requested for adequate explanations from their client, after they have identified his PEP status through their own background checks, on the reasoning of why his PEP status has not been initially communicate to the Audit Firm by the client directly.
- The Audit Firm should have obtained independent evidence of justifying the legitimacy of the additional €20.000.000 funding from the client and not accept the signed confirmation coming from the client's Marshal Islands Company's Directors.
- The Audit Firm should have identified as suspicious the additional €20.000.000 funding from the Marshal Island's Company and the insufficient explanation/evidence provided by the client and should have raised and submit both an Internal Suspicious Report and MOKAS Report for this specific client.

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

- The Audit Firm should re-visit its KYC procedure based on the recommendations in Part 3 above.
- The Audit Firm should immediately raise and submit an Internal Suspicious Report and MOKAS report for Mr Emmanuel.
- The Audit Firm should fully and openly cooperate, both with ICPAC, MOKAS, and the French Authorities, for the investigation currently in place for Mr Emmanuel.

Case study 8

Money Laundering

Facts of the Case

Yiannis is an in-house accountant of a Cyprus incorporated company (“the Company”) which is a subsidiary of a large group of companies incorporated in Russia. He is a professional accountant and an expert in financial instruments. Further to the company working hours, Yiannis is working until late regularly during which time he processes the major part of the company’s transactions.

More specifically, he is using a few bank accounts, which were opened in the name of the Company, to carry out transfers in foreign currencies. In most of the cases these activities are not linked to the business activities of the Company. In addition, the balance of the accounts is usually nearly zero; however the total amount of the transfers and volume of transactions is often considerable.

The transactions posted in the general ledger are split in small amounts and in addition, many of the transactions are rounded amounts and less than €1.000. The internal policy of the company is to supervise transactions which are above €1.000. The proceeds from the transactions are deposited at different branches of the same bank.

Also, he makes short-term investments, mainly using electronic means to transfer, in marketable securities and derivatives, which are quickly liquidated so that the proceeds can be reinvested. The investments are spread in Bermuda, Seychelles and Mauritius and other locations around the world.

Yiannis behavior has been identified by some other employees of the Company, but without taking any further steps or informing any person of the Company high on the hierarchy. The company recently hired a new accountant supervisor to assist the financial controller of the Company and he suspects that Yianni’s transactions are outside the corporate goals of the Company and its activities and seems not to be legitimate transactions.

1. What red flags can we observe in the above scenario?

There are numerous red flags in the scenario but the obvious one that is often over looked is the employee working until late regularly and possibly does not take vacation. Yiannis is working until late regularly, where a large volume of transactions is being processed. The absence of any obvious explanation for the late working hours environment could be a sign that they are being deliberately set up to confuse and obscure. The use of several bank accounts for transfers which in most cases are not linked to the main activities of the Company maybe another indication of money laundering.

Case study 8 (continued)

1. What red flags can we observe in the above scenario? (continued)

Additionally, the bank accounts closing balance on each day is close to zero even though the total amount and volume of transactions is considerable. Moreover, the posted transactions are below the threshold of €1.000 which is the Company's threshold for requiring supervision on transactions executed and entered into the system.

Finally, complex financial instruments, derivatives in this case, being used by a business with no obvious business rationale is a sign of the layering and integration stages of money laundering.

2. What can professionals do to combat criminals and fraudulent activity? What tools do they have at their disposal?

Professional accountants are usually in a position to assist the financial intelligence units and the economic crime department of the police to identify and eliminate criminals and fraudulent activity. Very often, processing any single or number of transactions requires the involvement of several advisors. These could include but are not limited to corporate service providers, brokers, forensic accountants and fraud auditors;

Professional accountants have a duty under the AML legislation to file a Suspicious Activity Report (SAR) or Suspicious Transaction Report (STR) to The Unit for Combating Money Laundering ("MOKAS"), whenever they suspect a crime under the AML Law. SARs and STRs include details of all parties, the suspicious transactions, the history and the trail.

MOKAS has implemented the goAML software for easier and more efficient reporting. The Institute of Certified Public Accountants ("ICPAC") Prevention and Suppression of Money Laundering Activities Directive (the "Directive") Par. 2.09 requires their members to report to MOKAS acquired knowledge or reasonable suspicion that another person is engaged in money laundering or terrorist financing. No offence of tipping-off is committed when the disclosure is made in this way to MOKAS or to competent Supervisory Authorities under Article 69 of The Prevention and Suppression of Money Laundering Activities (Amending) Law of 2018 and Par. 2.10 of the Directive.

Case study 8 (continued)

3. What are the obligations of an 'in-house accountant'?

Any direct involvement of the accountants in the money laundering process means that they are themselves breaking the Law.

Additionally, any person, including an auditor, external accountant, tax advisor or trust and company service provider, in practice or elsewhere, who, in the course of his trade, profession, business or employment, acquires knowledge or reasonable suspicion that another person is engaged in money laundering or terrorist financing, commits an offence if he/she does not report his/her knowledge or suspicion to MOKAS, as soon as it is reasonably practical after the information came to his/her attention. This duty to report arises under Article 27 of the Law and Par. 2.09 of the Directive.

Adherence to the Code of Ethics for Professional Accountants is fundamental in the obligations of an in-house accountant. This promotes professional integrity, which provides the means to protect against complicity in economic crime and acts as a barrier against (un)professional enablers and even protects against unintentional participation in an economic crime.

In this case, the accountant is in clear breach of the Law as well as the Directive and the Code of Ethics for Professional Accountants. He did not demonstrate any professional skepticism and integrity and disrespected the company policies and the principles of the law and the Code.

Case study 9

Insufficient and inadequate processes and procedures

Facts of the Case

A firm of accountants adopted an aggressive foreign expansion strategy in order to increase its profitability and market share especially in the international market. Based on the new strategy, the firm established alliances and cooperation associations with a number of small to medium sized fast-growing law firms, primarily in Eastern European countries and to a lesser extent, in other EU member states. These law firms are not part of any international network of lawyers, but they share the same eagerness to expand their business.

The firm has appointed a Compliance Officer with limited anti-money laundering and compliance experience. The assistance to the Compliance Officer is a junior employee without any experiences in compliance.

The firm's acceptance policy operates on a risk point's basis. The riskiness of clients is determined based on just two factors:

- whether the client is a PEP (this criterion carries most of the risk points). PEP's are identified using a reputable web check platform; and
- what the client discloses as being his business activity.

All clients that are not PEPs are usually classified as normal risk clients. Work referred to the firm by the foreign law firms is assessed as normal because the company has a policy of relying on their client due diligence (CDD) policies and procedures for its clientele because they are regulated firms and it considers the referrers as trusted associates.

The firm's management requested from the compliance team to ensure that their work contributes towards the firm's strategic decision for growth and expansion in foreign markets. It now transpires that one of the accounting firm's international clients, referred to by a law firm in Eastern Europe, is on that country's Ministry of Internal Affairs List for Embezzlement and Corruption and the accounting firm is considering its options.

1. What actions should the Compliance Officer and his assistant have taken? Identify the critical issues and potential risks that this accounting firm may be faced with.

The strategic decision for aggressive foreign expansion is by itself a risk area which the accounting firm should have addressed. The accounting firm should have incorporated into its decision-making process the fact that dealing with foreign jurisdictions and individuals entails increased risks and needs to be better managed.

Case study 9 (continued)

1. What actions should the Compliance Officer and his assistant have taken? Identify the critical issues and potential risks that this accounting firm may be faced with. (continued)

The accounting firm's decision to create alliances and cooperation with small to medium size firms which themselves also aim for rapid expansion is also another critical area which increases the risk of the accounting firm. Such law firms would also put growth before compliance hence the risk increases.

The firm should also have been alerted to the fact that none of these law firms belonged to any of the big international networks of law firms, which would have given some level of assurance. Furthermore, the location of these firms in jurisdictions that may not follow the same or equivalent anti-money laundering laws and procedures should have also been a factor, which the accounting firm should have considered.

The firm assumed that all clients referred to by the associated law firms were classified as normal risk which increased the risk undertaken as they relied on their procedures without assessing and evaluating them. Furthermore, the firm appeared to have a weak policy of relatively simplified KYC/Due Diligence procedures in line with the firm's management priority of expansion rather than proper compliance.

2. What KYC/Due Diligence procedures and processes should the accounting firm have implemented?

The accounting firm should have ensured that the appointed Compliance Officer is an experienced person with sufficient in-depth knowledge of anti-money laundering and compliance issues. The employment of an experienced Compliance Officer would have ensured that the necessary processes would have been put in place to better manage the risks associated with the expansion.

Furthermore, the accounting firm should have introduced a detailed policy and guidance to enable it to better address the risks it will be facing following the strategic decision to expand abroad. It seems that the measures introduced to classify the clients into high and low risks were insufficient and too simplistic hence leading to risky issues etc. slipping through the system.

Finally, enhanced due diligence measures should have been applied for clients introduced by the law firms.

Case study 9 (continued)

3. What actions should the accounting firm have taken to minimize its exposure.

- Adopt more rigorous procedures for clients introduced from the law firms. Agree with the law firms these rigorous procedure as it would be also for their benefit.
- Avoid imposing pressure on the compliance team to facilitate the expansion.
- Adopt a more comprehensive risk scoring model, which takes into account various risks factors (customer, industry, geography, distribution, legal risk)

4. What actions should the Compliance Officer and his assistant have taken?

- Should not have accepted appointment due to lack of experience.
- Should not have accepted the pressure from the management to facilitate growth.
- Should have insisted on full and proper compliance procedures.
- Should have resigned.

Case study 10

Fraudulent Investment Company

Facts of the Case

A newly established Investment Company (“the Company”) requires your accounting services. The Company is managed by a group of highly paid professional advisors. They provided you with the due diligence documents as follows:

- Company legal documents
- Passport copies of the management team
- Pictures of the professional team
- Picture of their offices
- Web page link

During your review process, you found out that the Managing Director run a similar company which collapsed recently after failing to file accounts. What was more worrying however, was the fraud warning found on the internet on a company with a similar name to the client.

In your efforts to complete all the work, you contact the professional advisors representing the client, requesting a CV of the Managing Director which they could not find (you could not find any reference for him anywhere). Finally, the previous accountants were not available to provide you with any feedback on the client company.

On a final attempt to confirm any information, you cross check the picture of the offices provided with the google maps, only to reveal another host in that location.

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- The Managing Director has a history of poor compliance with failed disclosure requirements.
- The professional advisors representing the Company could not provide a CV of the Managing Director.
- The previous accountants were not available to provide a reference on the company.
- Adverse publicity of a similarly named company.
- Inconsistency in information provided for the location of the offices.

The above indicators which came up during the initial risk assessment will clearly need to be investigated further, before engaging with this Investment Company.

Case study 10 (continued)

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- Bad reputation
- Administrative fines for not performing adequate due diligence
- Possible law suits from defrauded investors
- Facilitating the Company to process funds from possible illegal activities (investment fraud)

3. What KYC/Due Diligence work could the accounting firm have carried out and when?

The initial due diligence was properly performed. Following the findings however, enhanced due diligence should be carried out as follows:

- Request reference letters to be directly posted to your office by a European bank on the Members of the management team and/or UBOs.
- Request license to operate from an acceptable regulator.
- Request analytical explanation of the way business is carried out such as (i) how the investors place their money and (ii) the type of due diligence the Company is performing for their clients.
- Request proof of head office address.

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

If from the additional information received, the Red Flags still exist or are not fully mitigated, then the accounting firm should consider rejecting the business relationship and possibly filing a SAR with MOKAS.

Case study 11

Supplier Fraud

Facts of the Case

Mr. Yiannis, who imports fruits from Romania, received an email from a supplier (Wholesale Productions Ltd) to make the payment for settlement of goods purchased to a bank account in the name of the supplier other than the one usually utilized for this purpose.

Dear Yianni,

Good morning.

With regards to today's payment, please pay attention and take note that we would appreciate to receive this specific amount with our corresponding/alternative XYZ Bank, IBAN Number stated below. All details remain the same respectively, as stated below and attached herein only the IBAN No. differs, which you should take note on. Thank you.

Kindly arrange T.T transfer in amount €50.000 as advised and instructed to our below corresponding IBAN number. Please acknowledge as informed.

EUR ACCOUNT:

BENEFICIARY NAME: Wholesale Productions Romania Ltd

BANK NAME: XYZ Bank

IBAN/ACCOUNT NO:

BIC/SWIFT CODE:.....

Waiting for your prompt acknowledgment and confirmation by return.

J.E. Foster

Wholesale Productions

Managing Director

After the receipt of the above email, Yiannis instructed his bank to make the payment to the alternative IBAN instead of the IBAN usually used for the payments, which was also stated on the supplier's invoice.

Soon, after he realized that the payment was fraudulent, he instructed the bank to stop the payment. Unfortunately, the payment was completed, and the beneficiary account was credited. Yiannis reported the case to the police and he is requesting from his bank to make the necessary actions to receive a refund from the hacker's account.

Case study 11 (continued)

1. What could have been done to prevent this fraud?

Companies communicating with their suppliers or other counterparties from abroad should be very cautious in providing or accepting payment information through email (e.g. such as bank account numbers). Any order for payment to a new supplier abroad or to an alternative bank account of an existing supplier should be double checked and confirmed, using other means, such as fax and call back procedures, in addition to the email communication. Also, any change in payment details, such IBAN number should be verified with the counterparty.

An internal mechanism should be put in place to make sure that the finance team is kept aware of these types of scams. Any suspected incidents should be reported to the internal fraud prevention department or, if no such department exists, to the senior management of the procurement department who have long experience dealing with the suppliers, or to the Police.

It is essential to understand and implement segregation of duties and follow the four eyes principle. The handling of payments should involve more than one person for the preparation, approving and execution of payments.

Case study 12

Complex structures

Facts of the Case

An accounting firm is offering administration, bookkeeping and corporate services to a large Group with a corporate structure consisting of a number of companies whose main activities are the holding of investments in various industries and the provision of consulting and management services.

The fees generated by the accounting firm from this Group amount to 5% of the firm's annual turnover.

The companies belong to a large Group consisting of companies registered in various low tax jurisdictions. Although different shareholding percentages apply to the various layers of the structure, the Group seems to belong to a number of trusts which are set up, again, in various jurisdictions.

The accounting firm suspects that there may be other companies belonging to the same Group which may be administered by other service providers in Cyprus, but this information could not be verified with certainty.

Overall, there seems to be a tendency for secrecy when the employees of the accounting firm seek to obtain information and documentation from the people acting as the representatives of the Group. Furthermore, information on the beneficial ownership and control of the structure is somewhat obscured, although, the accounting firm suspects that the whole structure belongs to a Ukrainian multimillionaire and his family who has interests in a number of different industries and holds key positions in the Board of Directors of major Ukrainian companies and is also known to have close links with the government.

The accounting firm, despite numerous efforts, only now managed to receive the necessary documentation in order to carry out the bookkeeping of these companies for the last three consecutive years and this documentation revealed the following:

- The investments in various companies, especially start-ups, are acquired and are disposed of within a short period of time always at a profit.
- The companies of the Group have numerous bank accounts both in Cyprus and abroad and funds are being transferred between these bank accounts immediately upon deposit.
- The invoices for consulting and management services are predominantly issued to Ukrainian companies. The accounting firm accidentally found out that the Ukrainian multimillionaire is a member of their Board of Directors.

Case study 12 (continued)

1. What are the red flags which might indicate money laundering activity and/or terrorist financing in this case?

- Rapid disposal of investments.
- Swift transfers of funds between bank accounts of the various companies and other entities of the Group.
- Complex structure! Why? What is the purpose?
- The fact that the ownership structure is not clear should raise concerns. Does the accounting firm have access to all records of all entities in the structure especially the documents relating to the trusts? And more specifically who is the settlor (his Source of Wealth and Source of Funds) and the beneficiaries?
- The fact that the companies administered by the accounting firm in Cyprus receive consultancy fees from Ukrainian companies, for which the purported UBO acts as a Board Member, should raise concerns as to whether the transactions are done at arm's length, or whether there are suspicions for tax evasion, bribes or any other type of money laundering.

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- Significant fees earned from this structure. Therefore, fee dependency which could lead to discounts in various compliance processes.
- The Group invests in various industries. The accounting firm may not have the necessary expertise and knowledge to be able to better understand and handle these activities.
- The wide dispersion of the Group in various low tax jurisdictions. The accounting firm may be unaware of the reasons for such dispersion and hence the hidden reasons as to the complexity of the structure.
- The fact that the accounting firm suspects that another part of the same Group is being serviced by another firm in Cyprus. Why would this be necessary or undisclosed?
- The tendency for secrecy by the client's representatives. Are there issues which are not disclosed to the accounting firm and hence pose a threat?
- The risk of not properly establishing who the real UBO is and his/her source of funds.
- The unverified information that the Group may be owned by a Ukrainian multimillionaire having links with the Ukrainian government. If the real owner is indeed to Ukrainian multimillionaire with ties to the government, the Group should be treated as PEP related, due diligence should be performed as to the reason of setting up the complex structure and the economic reason of the transactions performed.
- Delay in receiving the necessary information to prepare the financial statements despite numerous follow-ups. There is a possibility that the documents are manipulated.

Case study 12 (continued)

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation? (continued)

- The accounting firm may find itself unwittingly being assisting in a money laundering/terrorist financing scheme. Indicators:
 - Investments are being made in various companies and being disposed within a short period of time.
 - Many investments are being made in start-ups, whose value cannot be easily measured.
 - Money is transferred in numerous accounts in Cyprus and abroad, immediately after deposit.
- May be exposed to investigation as a result of possible wrong doing by its client.
- May be subject to disciplinary action by the regulator and the court.

3. What KYC/Due Diligence work should the accounting firm have carried out and when?

- Clear establishment of the actual UBO. In this respect the Group structure should be obtained and relevant corporate documents reviewed (including trust agreements).
- Once the UBO is identified the firm should perform full KYC/DD on the individual UBO (i.e. identification, utility bill). Searches should also be carried out on the Group and the UBO against sanctions / PEPs lists, and in various internet sites to establish the background, Source of Funds and Source of Wealth of the UBO and the Group. References should also be obtained from independent reliable sources.
- Establish whether there is a valid economic purpose for setting up such a complicated structure.
- Establish the expertise possessed by the UBO and/or directors of the Group to be able to operate in the industry within which the company is operating.
- Obtain detailed information as required by the Law and the Directive on any of the Trusts that appear in the Group structure.

4. What steps could the accounting firm undertake to mitigate its risks and possible exposure?

- Immediately re-perform KYC/DD on the Group, establish who the UBO is and perform KYC/DD on the UBO.
- Immediately perform KYC/DD on the company's counterparties especially in relation to the loans granted and the services provided.
- Carry out detailed search in relation to the company's investments.
- Scrutinize all agreements entered into by the Group.
- Address these queries to the representatives of the Group, in order to obtain the necessary answers.
- Consider filing a report to MOKAS, if suspicions for ML/TF arise.

Case study 13

Bank administration services to client with fraudulent activity

Facts of the Case

A German client with IT background, approached Merry Accountants Ltd (administration service providers regulated by ICPAC) requesting to become their client in order to offer him administration services for his banking transactions. Merry Accountants Ltd set up a registered company for the purpose of receiving income from a gaming application he had developed.

During on-boarding, the client declared that he will be receiving income from the gaming application he had developed through social platforms (Apple Store, Google, Facebook).

Merry Accountants Ltd checked on the Apple Store that the gaming application was operational and proceeded to fill in all the relevant documents to open a bank account for their client with Money Bank.

During the first 6 months the client's bank account received 50 inward payments. Only 3 out of the 50 payments were from social platforms; the rest were from individuals and legal entities with payment details "Investment".

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- Most of the client's transactions were not in line with the declared activities.
- The payment details which refer to "investments" lead to the suspicion that the client may be committing investment fraud.

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- Processing transactions for the client which seem suspicious.
- Bad reputation with Money Bank, who is obliged to assess Merry Accountants Ltd on a regular basis for the quality of clientele they introduce to the Bank.

3. What KYC / Due Diligence work could the accounting firm have carried out and when?

- During the on-boarding of the client Merry Accountants Ltd should have carried out a more thorough due diligence of the client and his business.
- Merry Accountants Ltd should have been able to compile a comprehensive economic profile for the client, which, in addition to the business activities, should have included information such as his main counterparties. The business of the major counterparties should have been independently checked to ensure that they exist, and they are in the same line of business.

Case study 13 (continued)

3. What KYC / Due Diligence work could the accounting firm have carried out and when?
(continued)

- The client should have been asked what the expected turnover in the bank accounts will be, which should have been backed up by a thorough business plan.
- The client's actual transactions should have been monitored against his declared economic profile, and once undeclared counterparties were identified, or unrelated transactions, the client should have been asked.

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

Since the client's bank account is not operating satisfactorily, Merry Accountants should stop servicing the client and file a suspicion report with MOKAS. Money Bank should also be notified that Merry Accountants Ltd stopped servicing the client.

Case study 14

Property fraud

Facts of the Case

Entities involved

- Individual 'A', nominee Shareholder & Director of Company B
 - Company 'B', a legal entity which was registered to invest in real estate – the “audit client”
 - Individual 'C', buyer and the son of E
 - Individual 'E', buyer and the UBO of Company B
 - Company 'H', real estate agent/developer - seller
-
- Individual C paid the amount of €500.000 to the Company B's bank account as down payment for the acquisition of property from Company 'H'.
 - Upon enquiry by the bank, Individual A and Company B claimed that the money from Individual C was received as down payment for the acquisition of property from Company H for which Individual A was negotiating on behalf of Individual C and Individual E.
 - No contract of sale was submitted to the bank.
 - Company B from thereon remained dormant.
 - The deal for the acquisition of property fell through nearly two years after the down payment and the €500.000 was to remain in the books of Company B as an interest free loan.
 - When the audit firm requested the lawyer's letter as part of their audit work on the accounts of Company B, it was included in the reply that the District Attorney had ordered the freezing of Company B's bank account on the grounds that the amount of €500.000 remitted to the bank account was a result of money laundering.
-
- 1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?**
- No contract of sale for the property.
 - Receipts not sent to the bank initially, but only after queries on the total amount transferred.
 - No other business transactions by Company B.
 - Although the funds were initially intended for property acquisition, the agreement fell through and the money received turned into an interest free loan in B's books.

Case study 14 (continued)

2. What are the risks and the potential threats that the auditing firm may be faced with this situation?

- Regulatory penalties for not performing adequate due diligence and/or issuing a clean audit report.
- Bad reputation.

3. What KYC/Due Diligence work could the accounting firm have carried out and when?

When the auditor realized that there was a mismatch in the transactional behavior of the Company involved against the Company's economic profile they have constructed, they should have challenged the purpose of the loan agreement, the relationship between the parties involved and the audit client as well as the business logic behind the transactions.

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

- The audit firm should seek explanations as to the freezing order.
- Consider filing SAR to MOKAS.
- Consider terminating the business relationship with the audit client.

Case study 15

Bank account opening in absence of setting up a solid economic profile

Facts of the Case

A recently incorporated company (“The Company”) requested to open an account with a Bank. It declared annual turnover of \$25 million for the following year. Its declared business is the provision of civil engineering services to companies involved in the construction of infrastructure in Siberia. The Bank requested financial information regarding the business activity of the Company. The directors of the Company stated that, due to the fact that the Company has recently been incorporated, no financial information is available. They claimed that the expected turnover will be generated from potential agreements with companies involved in the construction of infrastructure in Siberia. They presented the Bank with the CVs of two civil engineers / employees who were working as civil engineers in a construction company for 10 years. Moreover, they informed the Bank that they will be providing the Bank with a sample of agreements with their potential customers prior to any request of execution of transactions.

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- The fact that the company did not provide any information regarding its potential clients and reasons why a newly incorporated company is competent and will be able to offer civil engineering services of \$25 million in the next 12 months, is questionable.
- The fact that a company with operations in Siberia is banking in Cyprus should be questioned.

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

If the Bank opens an account and performs transactions on behalf of the Company, without building a solid economic profile, it will be involved in executing transactions that cannot be adequately substantiated. Therefore, the Bank and its officers may be exposed to fines and penalties according to the ML/TF laws and directives.

3. What KYC/Due Diligence work could the Bank have carried out and when?

The Bank should insist in obtaining sufficient information from the Company, regarding its ability to offer the declared services, as well as the declared turnover. Moreover, information should be obtained about its potential counterparties to ensure that the Company and its counterparties are not part of a group structure which is involved in money laundering. Moreover, more explanations should be sought as to why the clients want to bank through Cyprus.

Case study 15 (continued)

4. What steps may the Bank undertake to mitigate its risks and possible exposure?

The Bank should not proceed in opening the account and performing transactions, if it does not obtain and document sufficient information, to establish and verify the following:

- the business activities of the company,
- the counterparties of the company,
- the transactions to be executed (source and destination of funds) (i.e. to reasonably justify that they are not generated by ML / TF activities and that the funds are from legitimate sources)

Case study 16

Acquisition of a superyacht without proper evidence of source of funds

Facts of the Case

A young millionaire (€25 million net worth) requests from a Bank to open an account for one of his companies. The company owns a superyacht (value €200 million), which is rented out to wealthy individuals. According to the company's financial statements which were submitted to the Bank, the acquisition of the superyacht was financed by a company, which belongs to a large foreign media group. According to the terms of the loan, the loan will be repaid in 25 years and bears an interest rate of 1%. The declared turnover of the company was €40 million per annum.

What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

The value of the asset of the company (superyacht) is significantly larger than the net worth of the beneficial owner of the company. Moreover, the asset was financed by a group with non-related business activities and no relation to the BNO. The terms of the loan are not considered to be based on commercial terms.

What are the risks and the potential threats that the Bank may be faced with in this situation?

There is a risk that the actual ultimate beneficial owner was not disclosed to the Bank. The actual ultimate beneficial owner of the company might be a person wealthier than the disclosed beneficial owner. Moreover, a connection might exist between the media group and the company, as the loan for the acquisition of the yacht does not seem to be based on commercial terms.

What KYC/Due Diligence work could the bank have carried out and when?

The Bank should insist in obtaining sufficient information from the company, proving the financial soundness of the declared beneficial owner and his ability to obtain a loan approximately eight times his net worth. Moreover, enhanced due diligence should be performed in order to establish whether there is a connection between the company and the media group (lender).

Further to the above, sufficient explanations should have been obtained regarding the customers that will be renting the superyacht and the rental income through a proper business plan. Efforts should have been made to gather information about companies involved in the same business and their expected income from such operations, in order to assess whether the information provided by the client regarding the expected income, is reasonable.

Case study 16 (continued)

What steps may the Bank undertake to mitigate its risks and possible exposure?

The Bank should not proceed with opening the account and performing transactions, if the information mentioned above is not obtained. Moreover, it must consider reporting the case to MOKAS.

Case study 17

Transactions of vague nature and activities with no business substance

Facts of the Case

A German client with IT background, approached ABC Associated Ltd (administration service providers regulated by ICPAC), requesting to become their client in order to offer him administration services for his banking transactions. ABC Associates Ltd sets up a company for this purpose (WeBe Ltd).

During on-boarding, the client declared that he will operate in the business of “Distribution of gaming consoles, software and accessories”. ABC Associates Ltd proceeded to fill in all the relevant documents to open a bank account for their client with ABC Bank.

The client’s first transactions were to send funds from the beneficial owner’s account with a Swiss Bank, as a capital contribution and then pay the equivalent amount to a company in China (WeFu Ltd). ABC Bank asked for supporting documentation for the first outgoing transaction, in order to confirm the client’s declared activities. The client presented an invoice issued by WeFu for the purchase of silver grains. However, from a quick internet check, no information was found on the supplier (WeFu). When asked why this is not in line with the declared activities of the company, he replied that “he found a good opportunity to buy silver grains”.

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- The client’s first transaction is not in line with the declared activities and his background.
- The client did not maintain in the past any similar types of businesses, this was his first attempt to set up a company to trade goods.
- The counterparty in China, after a first review, did not maintain a website, in order to confirm that it was actually selling this product (silver grains).

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- Processing transactions for the client which seem suspicious.
- Bad reputation with ABC Bank, who is obliged to assess ABC Associates Ltd on a regular basis for the quality of clientele they introduce to the Bank.

Case study 17 (continued)

3. What KYC / Due Diligence work could the accounting firm have carried out and when?

- During the on-boarding of the client ABC Associates Ltd should have carried out a more thorough due diligence of the client and his business.
- ABC Associates Ltd should have been able to compile a comprehensive economic profile for the client, which, in addition to the business activities, should have included information such as his main suppliers and his main clients.
- The business of the major counterparties should have been independently checked to ensure that they exist, and they are in the same line of business.
- The client should have been asked what the expected turnover in the bank accounts are, which should have been backed up by a thorough business plan.
- The client should have also been asked if he maintains offices, and the number of staff he employees, in order for ABC Associates Ltd to assess whether the client has real business and is able to cope with the volumes declared.

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

If ABC Associates Ltd performs the above thorough due diligence and is unable to justify the business of the client, then it should stop servicing him and consider filling a suspicious report with MOKAS. It should also notify ABC Bank that they stopped servicing this client.

Case study 18

Deposits and Movement of funds between bank accounts.

Facts of the Case

A firm of accountants provides administration and corporate services to a client, a company belonging to a foreign individual (“the Company”), including, amongst others, bookkeeping, accounting, bank signatory services, fiduciary services and assistance in the execution of agreements. The accounting firm outsources tax and VAT expertise to another Cypriot service provider on a need to basis.

The client declared activities of holding of shares in companies operating in the construction materials manufacturing in various jurisdictions around the world. The Company remained dormant for more than a year despite the continuous efforts by the accounting firm to get in touch with the owners.

The Company becomes suddenly active and its activities draw the attention of the accounting firm. More specifically it is involved in:

- Deposits of bank cheques issued involving extraordinarily large amounts of money. The explanation given was that these were the proceeds of the disposal of real estate in an African country.
- Exchange of various currencies in differing amounts through non-European banks opened without the involvement of the accounting firm. The explanation given was that this was done simply to assist the UBO’s brother’s company which operates a photocopying and Exchange Bureau company in a Baltic state.
- The settlement of the accounting firm’s invoices issued, was effected through a seemingly unrelated entity registered in the British Virgin Islands.
- Various other bank receipts and payments were effected as follows:
 - o Remittance of €2.250.000 from another company in the Bahamas. The explanation given was that this remittance is based on a loan agreement, a copy of which was sent to the accounting firm.
 - o Out of this €2.250.000, €1.180.000 was paid out to another account of the Company with another bank abroad.
 - o Issuing of a banker’s draft for €1.000.000 to another company which is also a client of the accounting firm which belongs to another foreign national. Again, this transaction was recorded as a loan provided to this other company.
 - o Payment of the balance to the shareholder by way of a dividend. The shareholder asked for the amount to be paid to the Foundation “Give Peace a Chance”, a non-profit organisation.
 - o Subsequent to the withdrawal the bank account was closed.

Case study 18 (continued)

1. What are the red flags identified which might indicate money laundering activity and/or terrorist financing in this case?

- a. The Company remained dormant for more than a year after inception.
- b. Unable to get in touch with the owners.
- c. Sudden activation of the Company and magnitude of the amounts transacted.
- d. Real estate existed in an African country. The accounting firm was not aware of this.
- e. Settlement of the invoices by an unrelated party.
- f. Mixing the brother's business with the business of the Company.
- g. Dealings with companies located in offshore jurisdictions.
- h. Receiving and granting of loans falling outside the objects/activities of the Company.
- i. Terms and conditions of loans may have not been commercial.
- j. Payment made to a Foundation.
- k. Sudden closure of the bank account.

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- a. The accounting firm may find itself unwittingly being assisting in a money laundering/terrorist financing scheme. Indicators:
 - i. Money transferred from an African country where no or little AML regulation exists.
 - ii. Assisting in the clearance of funds of the brother's business.
 - iii. Transferring of funds in and out of the bank accounts with insufficient justification and with counterparties whose relations with the client has not been established.
 - iv. Dealing with companies in offshore jurisdictions.
 - v. Significant amounts transacted without clear indications of their source.
- b. The accounting firm may be exposed to investigation as a result of possible wrong doings of its client.
- c. The accounting firm may be subject to disciplinary action by the regulator and the court.

3. What KYC/Due Diligence work could the accounting firm have carried out and when?

- a. At the inception of the business relationship the accounting firm should have carried out full KYC / Due Diligence on the individual Ultimate Beneficial Owner i.e. identification, utility bill, searches in various sides, background, source of funds, source of wealth, references, internet searches.
- b. The Group structure should have been established (including holding as well as subsidiary companies).
- c. Justification should have been obtained based on which the company /structure was set up in the first place. What are the structure's commercial, tax and business rational?
- d. The expertise of the UBO and/or directors of the Company should have been established to be able to operate in the specific industry.

Case study 18 (continued)

3. What KYC/Due Diligence work could the accounting firm have carried out and when?
(continued)

- e. The various jurisdictions the company will be operating / transacting within should have been identified.
- f. The accounting firm should have probably classified the client as a high-risk client at the point where it realized that the client is not responding to its requests.
- g. Had the accounting firm established at the outset a proper and comprehensive economic profile, it would have probably classified the clients as High Risk given the high risk jurisdictions it would be operating and transacting with. Additionally, once the accounting firm established that the owners were not responding, it should have definitely classified the client as high risk.

4. What steps may the accounting firm undertake to mitigate its risks and possible exposure?

- a. Immediately re-perform all KYC/DD on the UBO and directors of the Company.
- b. Perform KYC/DD on all the parties that appeared to be involved with the Company and/or its UBO and directors.
- c. Review all agreements regarding the sale of the property in the African country and establish how it was acquired, review the parties involved and carry out KYC/DD on all parties involved.
- d. Review all loan agreements and establish their legitimacy and commercial rational. Carry out DD on counter parties.
- e. Consider terminating the business relationship and filing a SAR with MOKAS.

Case study 19

Granting of loans, impairment of assets and services without substance

Facts of the Case

An accounting firm is providing administrative and corporate services to a company (“the Company”) belonging to two French individuals.

The services provided by the accounting firm include amongst others:

- Bookkeeping and accounting,
- Bank signatory services,
- Directorship services (directors of the accounting firm act as joint directors with directors appointed by the shareholders),
- Assistance in the execution of agreements.

The activities of the Company vary significantly and include:

- the holding of shares in, mostly, French companies, operating in the telecommunications industry;
- the provision of consultancy services; and
- the granting of loans.

The Company does not have substance in its country of domicile nor elsewhere nor does it employ any employees. The Company has issued a number of Powers of Attorney (POA’s) to various individuals. This was instructed by the shareholders as it would enable the firm to carry out its activities more effectively. It happens that some of these POA’s are quite wide and general.

The Company has minimum share capital and its sources of finance appear to be loans from its shareholders but also from other companies registered in offshore jurisdictions, which appear to be unrelated to the Company. The Company’s financial statements in the first two years of operation showed significant losses attributable to the impairment of investments in the subsidiaries and loans granted, both of which are the Company’s major assets.

The auditors of the company, an audit firm in Cyprus, issued a qualified audit opinion on the grounds that they could not ascertain and verify the value of the investments and the loans and consequently, their impairment. The auditors also raised concerns as to the validity and commerciality of the loan agreements as well as to the legitimacy of invoices issued primarily to companies located in high tax jurisdictions.

Case study 19 (continued)

1. What are the red flags which might indicate money laundering activity and/or terrorist financing in this case?

- Quite a wide range of activities carried out by the Company.
- Lack of substance and employees. Who provides the consultancy services? Who takes decisions?
- Impairment of assets. Is there a possibility that the investments were acquired at a premium value? If yes why?
- Is there a possibility for the loans to have been granted without proper due diligence being carried out/without appropriate collaterals/without appropriate guarantees/without appropriate securities/without a commercial rate of interest/without a repayment period? If yes why? Who granted the loans? Why? What is the commercial rationale?
- The issue of POA's to various individuals especially the ones which are quite wide and general. Who has control over the actions of the attorneys? It seems that there are no safeguards to ensure that the attorneys are acting in good faith and to the best interests of the company.

2. What are the risks and the potential threats that the accounting firm may be faced with in this situation?

- The accounting firm may find itself unwittingly being assisting in a money laundering/terrorist financing scheme. Indicators:
 - o Varying and wide range of activities.
 - o No substance exists nor is any expertise possessed. On what basis are the consultancy services provided, what type of consultancy services are provided and by whom? Is the impairment of the assets a consequence of such lack of expertise or is it something else?
 - o Sources of finance not from financial institutions. Where are the shareholders' funds coming from? Has the accounting firm verified their source of wealth and source of funds? What about the loans from unrelated parties?
 - o Inability to verify the value of the Company's major assets.
 - o Dealings with offshore jurisdictions.
- The accounting firm may be exposed to investigation as a result of wrongdoing by its client.

Case study 19 (continued)

3. What KYC/due diligence work should the accounting firm have carried out?

- Full KYC/DD on individual UBO's should have been performed, i.e. identification, utility bill, background, source of funds, source of wealth, references, filtering against sanctions and PEP lists, internet searches, etc.
- The full group structure should have been established showing all entities (both holding companies and subsidiaries). The structure's commercial, tax and business rationale should also have been established.
- The expertise possessed by the UBO's and/or directors and/or attorneys of the Company should have been established to be able to operate in the specific industries.
- Evidence should have been obtained as to the value of investments/loans granted.

4. What steps could the accounting firm undertake to mitigate its risks and possible exposure?

- Immediately perform KYC/DD on the UBO's, the directors and the Attorneys, if not done already.
- Immediately perform KYC/DD on the Company's counterparties especially in relation to the parties involved with the acquisition and disposal of shares/investments and loans received and granted.
- Carry out a detailed search in relation to the Company's investments.
- Scrutinise all agreements entered into by the Company.
- Seriously consider filing a report with MOKAS and terminating the business relationship.
- Request detailed explanations the moment it was established that the Company is suffering losses on its major assets.