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# THE REPORTING RESPONSIBILITIES OF ACCOUNTANTS IN TERMS OF SOUTH AFRICAN ANTI-MONEY LAUNDERING LEGISLATION

by

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## Abstract

Criminals make use of accountants to assist them, knowingly or unknowingly, with complex money laundering schemes. The nature of the accounting profession places accountants in an ideal position to identify possibly money laundering activities.

The purpose of this research is to consider whether the reporting obligations of South African accountants in terms of section 29 of the Financial Intelligence Centre Act, No 38 of 2001, as amended, corresponds sufficiently with the services they provide so as to constitute an effective anti-money laundering measure. In order to evaluate the relevance of section 29, the reporting requirements of accountants practising in South Africa are compared with those of the European Union and the United Kingdom, as well as the requirements of the Financial Action Task Force. The research study will also analyse the money laundering process and the nature of the accounting profession and consider some of the methods used to perpetrate money laundering applicable to accountants.

The research found that accountants in South Africa have a duty to report suspicious transactions only when they are party to such transactions or when they are going either to receive the proceeds of crime or be used for money laundering purposes. Accordingly, in view of the fact that accountants are more likely to be in a position to observe money laundering than to be party to such a transaction, the requirements of section 29 of the Financial Intelligence Centre Act, No 38 of 2001, as amended, are not effective when applied to accountants.

**Key words:**

*Accountant*

*Accounting profession*

*Anti-money laundering*

*Auditor*

*European Union*

*Financial Action Task Force (FATF)*

*Financial Intelligence Centre Act (FICA)*

*Money laundering*

*Section 29 of Financial Intelligence Centre Act No 38 (FICA)*

*Suspicious transaction reporting*

*United Kingdom*

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# TABLE OF CONTENTS

LIST OF ABBREVIATIONS ........ v

GLOSSARY OF TERMS ........ vii

CHAPTER 1: INTRODUCTION ........ 1

1.1 Background to the international anti-money laundering and the combating of the financing of terrorist initiatives ........ 1

1.2 South African anti-money laundering and terrorist financing control framework ........ 4

1.3 The money laundering process ........ 5

1.4 The relevance of accountants in money laundering ........ 6

1.5 Anti-money laundering requirements for accountants ........ 8

1.6 The purpose of the research ........ 10

1.6.1 Research problem ........ 10
1.6.2 Research objectives ........ 10
1.6.3 Research approach ........ 12
1.6.4 Research limitations ........ 12

1.7 Research Design ........ 13

1.8 Research Methodology ........ 14

1.8.1 Advantages and disadvantages of a literature review ........ 14
1.8.2 Literature search strategy ........ 15
1.8.3 Limitations of a literature search ........ 16

1.9 Outline of chapters ........ 17

1.9.1 Chapter 1: Introduction ........ 17
1.9.2 Chapter 2: The nature of money laundering ........ 17
1.9.3 Chapter 3: The role of accountants in anti-money laundering ........ 17
1.9.4 Chapter 4: Accountants' reporting requirements in terms of the Financial Action Task Force Recommendations and European Union and United Kingdom legislation ........ 17
1.9.5 Chapter 5: Reporting requirements in South Africa ........ 18
1.9.6 Chapter 6: Comparison of the South African and international reporting requirements in respect of accountants ........ 18
1.9.7 Chapter 7: Conclusion and recommendations ........ 18

CHAPTER 2: THE NATURE OF MONEY LAUNDERING ........ 19

2.1 The concept of laundering the proceeds of crime ........ 19

2.2 The money laundering process ........ 20

2.2.1 Placement ........ 20
2.2.2 Layering ........ 21
2.2.3 Integration ........ 22

2.3 Examples of money laundering schemes and trends relevant to accountants ........ 22

2.3.1 Money laundering through shell and front companies ........ 24
2.3.2 International trade-based money laundering ........ 24



المنارة للاستشارات
www.manaraa.com

2.3.3 Money laundering through the football sector ....25
2.3.4 Money laundering through the abuse of financial products ....26
2.3.5 Money laundering through the abuse of corporate vehicles and charities ....26
2.3.6 Money laundering through the real estate sector ....27

2.4 Money laundering trends in South Africa ....27

2.5 The consequences of money laundering ....29

2.5.1 For the government and the economy ....29
2.5.2 For the financial sector ....31
2.5.3 For professionals ....31

2.6 Summary ....32

CHAPTER 3: THE ROLE OF ACCOUNTANTS IN ANTI-MONEY LAUNDERING COMPLIANCE AND DETECTION ....33

3.1 The nature of the accounting profession ....33

3.1.1 Audit, review, other assurance and related services ....34
3.1.2 Taxation advisory services ....34
3.1.3 Other advisory services ....34

3.2 Possible use of accountants in money laundering schemes ....35

3.3 Potential for accountants to detect money laundering schemes and red flags for money laundering ....36

3.4 Issue of client confidentiality and legal privilege ....39

3.5 International anti-money laundering obligations for accountants ....40

3.5.1 Financial Action Task Force Recommendations ....40
3.5.2 European Union − Third Directive ....42
3.5.3 United Kingdom anti-money laundering framework ....43
3.5.4 International Federation of Accountants Anti-Money Laundering Report ....43

3.6 Summary ....44

CHAPTER 4: ACCOUNTANTS' REPORTING REQUIREMENTS IN TERMS OF THE FINANCIAL ACTION TASK FORCE RECOMMENDATIONS AND EUROPEAN UNION AND UNITED KINGDOM LEGISLATION ....46

4.1 Financial Action Task Force Recommendations regarding reporting of suspicious and unusual transactions ....46

4.1.1 Reporting obligations for accountants ....46
4.1.2 Confidentiality and privilege ....47
4.1.3 Tipping off ....48

4.2 European Union requirements for reporting suspicious and unusual transactions ....48

4.2.1 Reporting obligations for accountants ....48
4.2.2 Confidentiality and privilege ....50
4.2.3 Tipping off ....50

4.3 United Kingdom requirements for reporting suspicious and unusual transactions ....51

4.3.1 Reporting obligations for accountants ....51



المنارة للاستشارات
www.manaraa.com

4.3.2 Confidentiality and privilege ..... 55
4.3.3 Tipping off ..... 56

4.4 Summary ..... 56

CHAPTER 5: REPORTING REQUIREMENTS IN SOUTH AFRICA ..... 58

5.1 South African legal framework ..... 58

5.2 General reporting obligations regarding suspected money laundering ..... 59
5.2.1 Section 29: Suspicious and unusual transactions ..... 59
5.2.2 Confidentiality and privilege ..... 62
5.2.3 Tipping off ..... 63
5.2.4 Offences and defences ..... 63

5.3 Accountable institutions ..... 64
5.3.1 Obligations of accountable institutions in terms of FICA ..... 64
5.3.2 Accountants as accountable institutions ..... 65

5.4 Reporting obligations of accountants ..... 66

5.5 Supervisory body ..... 68

5.6 Role of accountants and auditors in anti-money laundering compliance ..... 68

5.7 Reporting by accountants ..... 69

5.8 Summary ..... 70

CHAPTER 6: COMPARISON OF THE SOUTH AFRICAN AND INTERNATIONAL REPORTING REQUIREMENTS IN RESPECT OF ACCOUNTANTS ..... 73

6.1 Persons concerned ..... 73

6.2 Anti-money laundering obligations ..... 75

6.3 Suspicious transaction reporting ..... 76

6.4 Confidentiality and privilege ..... 78

6.5 Tipping off ..... 79

6.6 Supervisory body ..... 79

6.7 Summary ..... 80

CHAPTER 7: CONCLUSION AND RECOMMENDATIONS ..... 83

7.1 Background to the research ..... 83

7.2 Main findings ..... 83
7.2.1 Money laundering and anti-money laundering measures ..... 83
7.2.2 Role of accountants in prevention and detection of money laundering and use of accountants to facilitate complex schemes ..... 84
7.2.3 Accountants' anti-money laundering obligations ..... 85
7.2.4 Reporting obligations for accountants ..... 86
7.2.5 Confidentiality and privilege ..... 87
7.2.6 Tipping off ..... 88
7.2.7 Supervisory body ..... 88

7.3 Limitations of the research ..... 88



المنارة للاستشارات
www.manaraa.com

7.4 Conclusion ....................................................................................................89
7.5 Recommendations ..........................................................................................90
7.6 Areas for further research ................................................................................91
REFERENCES ..............................................................................................................93
ANNEXURE 1 ..............................................................................................................100



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# LIST OF ABBREVIATIONS

| | |
|---|---|
| ACCA | Association of Chartered Certified Accountants |
| AML | Anti-money laundering |
| APA | Auditing Profession Act, No 26 of 2005 (South Africa) |
| APB | Auditing Practices Board (United Kingdom) |
| CCAB | Consultative Committee of Accountancy Bodies (United Kingdom) |
| CDD | Customer due diligence |
| CFT | Combating the financing of terrorism |
| DNFBP | Designated non-financial businesses and professions |
| ESAAMLG | Eastern and Southern African Anti-Money Laundering Group |
| EU | European Union |
| FATF | Financial Action Task Force |
| FATF 40 + 9 | FATF Forty Recommendations plus Nine Special Recommendations |
| FAIS | Financial Advisory and Intermediary Services Act, No 37 of 2002 (South Africa) |
| FEE | Federation of European Accountants or Fédération des Experts Comptables Européens |
| FIC | Financial Intelligence Centre (South Africa) |
| FICA | Financial Intelligence Centre Act, No 38 of 2001 read with Financial Intelligence Centre Amendment Act, No 11 of 2008 (South Africa) |
| FIU | Financial intelligence unit (generic term) |
| FSB | Financial Services Board (South Africa) |
| IFAC | International Federation of Accountants |
| IMF | International Monetary Fund |
| IRBA | Independent Regulatory Board for Auditors (South Africa) |
| MLCO | Money Laundering Control Officer |
| MLRO | Money Laundering Reporting Officer |



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| | |
|---|---|
| OECD | Organisation for Economic Cooperation and Development |
| PEP | Politically Exposed Person |
| POCA | Prevention of Organised Crime Act, No 121 of 1998, as amended (South Africa) |
| POCA UK | Proceeds of Crime Act 2002, as amended (United Kingdom) |
| POCDATARA | Protection of Constitutional Democracy against Terrorist and Related Activities Act, No 33 of 2004 (South Africa) |
| RBA | Risk Based Approach |
| Regulations | Regulations in terms of Financial Intelligence Centre Act, 2001 (South Africa) |
| SAR/STR | Suspicious activity/transaction report |
| SAICA | South African Institute of Chartered Accountants |
| SAIPA | South African Institute of Professional Accountants |
| SOCA | Serious Organised Crime Agency (United Kingdom) |
| TCSP | Trust and Company Service Provider |
| TBML | Trade based money laundering |
| Third AMLD | Third Anti-Money Laundering Directive (European Union Directive 2005/60/EC) |
| UK | United Kingdom |
| UK Regulations | Money Laundering Regulations 2007 (United Kingdom) |
| UNODC | United Nations Office on Drugs and Crime |



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# GLOSSARY OF TERMS

**Accountable institutions**

A person listed in Schedule 1 of FICA as amended on the 26 November 2010 by general notice No. 1104 in the South African *Government Gazette*, which lists 16 accountable institutions. This list includes, *inter alia,* banks, long-term insurance companies, practitioners who practise as attorneys, as defined, estate agents, trustees of trusts and financial services providers registered in terms of Financial Advisory and Intermediary Services Act, No 37 of 2002 (FAIS) and who provide investment advice (Independent Regulatory Board for Auditors [IRBA], 2011a:29).

**Accountants in public practice**

"Sole practitioners, partners or employed professionals within professional firms" (Financial Action Task Force [FATF], 2008b:2). Services provided include, but are not limited to, external audit and assurance, accounting and preparation of financial statements, tax advice and planning, internal audit services including recommendations for internal controls and risk reduction, review of regulatory returns, compliance services, advice on deal structuring and investments, and forensic accounting and audit services (FATF, 2008b:4). Throughout this research the terms "accountant" and "auditor" will be used interchangeably as a result of the wide spectrum of services offered and possible overlaps between the two functions. However, this research study refers specifically to accountants and auditors who are members of a self-regulatory body.

**Auditor**

The audit function is defined as the examination of financial statements in order to express an opinion regarding their fairness in accordance with either an identified financial reporting framework or compliance with applicable statutory requirements. An audit may also entail the examination of financial or other information, prepared in accordance with certain criteria, in order to express an opinion on such financial or other information. Audit examinations must be conducted in accordance with applicable auditing standards (IRBA, 2011b:1–10).

**Consultative Committee of Accountancy Bodies (United Kingdom)**

The Consultative Committee of Accountancy Bodies (CCAB) (United Kingdom) is a body representing five major accounting professional bodies in the United Kingdom and Ireland, namely, the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants of Scotland, the Institute of Chartered Accountants in Ireland, the Association of



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Chartered Certified Accountants and the Chartered Institute of Public Finance and Accountancy (Consultative Committee of Accountancy Bodies [CCAB], 2012).

**Customer due diligence**

Customer due diligence is the process by which the identity of the client is established and verified, also known as "Know your client" (CCAB, 2008:79).

**Designated Non-Financial Businesses and Professions**

In terms of the Financial Action Task Force (FATF) Recommendations these include "casinos; real estate agents; dealers in precious metals, precious stones; lawyers, notaries, other independent legal professionals and accountants (this refers to sole practitioners, partners or employed professionals within professional firms)" and "trust and company service providers" (FATF, 2008b:32).

**Defined services (UK term)**

Businesses and individuals acting as auditors, external accountants, insolvency practitioners, tax advisers or trust and company service providers (TCSPs) in the UK, in terms of Regulation 3(1)(c) & (e) of the United Kingdom's Money Laundering Regulations 2007 (UK Regulations), as defined (CCAB, 2008:80).

**Egmont Group**

The Egmont Group of Financial Intelligence Units is an informal international group of financial intelligence units that engages in the sharing of information and best practice (FATF, 2008b:31).

**Eastern and Southern African Anti-Money Laundering Group**

The Eastern and Southern African Anti-Money Laundering Group (ESAAMLG) is a FATF-style regional body which, currently, has 14 members (Financial Intelligence Centre [FIC], 2010:7).

**FATF Recommendations**

The FATF Forty Recommendations plus Nine Special Recommendations were issued by the FATF and provide comprehensive legal and institutional methods to combat money laundering and terrorist financing (United Nations Office on Drugs and Crime & International Monetary Fund [UNODC & IMF], 2005:4). This research study is based on the FATF Recommendations and Guidelines in issue as at 31 December 2011.



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**Federation of European Accountants**

The Federation of European Accountants (FEE) represents 45 professional institutes of accountants and auditors from 32 European countries, including all the EU member states. The FEE has a combined membership of over 700 000 professional accountants working in different capacities (Federation of European Accountants [FEE], 2012). Four of the UK's CCAB members are members of the FEE (FEE, 2009:12).

**Financial Action Task Force**

The FATF is an intergovernmental body established at the Group of Seven Summit in Paris in 1989 to provide standards and develop policies to fight money laundering and terrorist financing (Cox, 2011:16).

**Financial institution**

A financial institution is an entity which is involved in a range of financial activities as defined in the glossary of the FATF Recommendations. Financial institutions include, *inter alia,* persons or entities whose operations include accepting deposits, providing loans and finance leasing, issuing and managing payment methods, issuing financial guarantees and commitments, and investing and managing funds on behalf of a third party (FATF, 2003:13).

**Financial Intelligence Centre**

The Financial Intelligence Centre (FIC) was established in terms of FICA. Its main objectives are to assist with the detection of the proceeds of crime, and the prevention of money laundering and financing of terrorism schemes (FIC, 2010:7). Other activities include the reporting of information to the relevant investigating authorities, monitoring and providing guidance to relevant bodies and individuals, and liaising with other FIUs and other international bodies on AML/CFT activities (De Koker, 2002a:22; FIC, 2010:7).

**Financial intelligence unit**

A financial intelligence unit (FIU) is a central national group which is responsible for collecting, analysing and distributing to relevant authorities information regarding suspicious transactions relating to either money laundering or the financing of terrorism (Egmont Group, 2009).

**Gatekeepers**

Gatekeepers are individuals who "protect the gates to the financial system" and include legal and financial professionals and experts such as attorneys, accountants, tax advisors and



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TCSPs (FATF, 2004:24; 2010a:44). Gatekeepers provide services which allow their clients to arrange and manage their financial dealings (FATF, 2004:24).

**Politically exposed person**

A politically exposed person (PEP) is a person who holds or has held a prominent public position in a foreign country. Family members or close associates of a PEP may attract the same risks as dealing with the PEP him/herself (FATF, 2003:14).

**Registered auditor**

A registered auditor in South Africa is a firm or individual registered as an auditor with the Independent Regulatory Board for Auditors (IRBA) (IRBA, 2011b:1–12).

**Regulated sector (UK term)**

The regulated sector refers to businesses defined in the United Kingdom's Proceeds of Crime Act 2002, as amended (POCA UK) Schedule 9 Part 1, and include, *inter alia,* all businesses in the financial sector, banks, external accountants, auditors, tax advisors, insolvency practitioners, TCSPs and attorneys (Fisher, 2010:3).

**Relevant professional advisor (UK term)**

As defined in POCA UK, a relevant professional advisor is "an accountant, auditor or tax advisor who is a member of a professional body which is established for accountants, auditors or tax advisors ... and which makes provision for: a) testing the competence of those seeking admission to membership and b) imposing and maintaining professional and ethical standards for its members, as well as imposing sanctions for non-compliance ..." (Fisher, 2010:8).

**Self-regulatory body**

A self-regulatory body is an organisation that represents a profession, including accountants, auditors or lawyers. These professionals comprise the membership of the body. This body can regulate the requirements and qualifications for the profession and can also conduct supervisory or monitoring functions (FATF, 2008b:33).

**Supervisory body/authority**

A supervisory body is the relevant, designated, regulatory authority or self-regulatory body whose regulatory authority has been extended to include ensuring compliance with anti-money laundering legislation (IRBA, 2011a:20). The supervisory bodies of accountable institutions in terms of FICA are listed in Schedule 2 of FICA, as amended on the 26 November 2010 by



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general notice No. 1105 in the South African *Government Gazette* (IRBA, 2011a:29). The terms supervisory body or supervisory authority are used interchangeably throughout this research

**Trust and company service provider**

A TCSP is a firm or sole practitioner who acts as an agent in the formation of legal persons, acts as a director or secretary of a company or partner in a partnership, or arranges for someone else to act in these capacities. A TCSP may provide a registered office, business or correspondence address for a legal person or may act as a trustee of a trust or nominee shareholder for another person or arrange for someone else to act in these capacities (FATF, 2010b:8).



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# The reporting responsibilities of accountants in terms of South African anti-money laundering legislation

## CHAPTER 1: INTRODUCTION

### 1.1 BACKGROUND TO THE INTERNATIONAL ANTI-MONEY LAUNDERING AND THE COMBATING OF THE FINANCING OF TERRORIST INITIATIVES

The modern money laundering methods were devised by Meyer Lansky, also known as the "Mob's Accountant", in the 1930s to hide the mob bosses' illegal funds from government scrutiny following Al Capone's downfall when he was convicted of tax evasion (Turner, 2011:2). Money laundering refers to the financial processes used to legitimise the proceeds of the illegal activities of criminals, including the smuggling and selling of drugs, fraud, tax evasion, bribery and corruption, the financing of terrorism and other organised criminal activities (Turner, 2011:1). The money laundering process entails a series of financial transactions that are designed to disguise the illicit origin of the funds and to enable such funds to emerge as legitimate (Buchanan, 2004:117). In South Africa, a money laundering offence involves any activity which may result in the concealment of the nature, source or location of the proceeds of crime, which may allow a criminal to evade prosecution or which may diminish the proceeds of crime (FIC, 2008:4).

Failure to prevent money laundering may damage the integrity of a country's financial institutions while it may also have adverse consequences for the country's economy (Commonwealth Secretariat, 2006:6). It may also have an impact on the stability of the global economy and may undermine international attempts to develop free and fair markets. In addition, money laundering may affect both exchange rates and interest rates, distort prices and create a demand for cash, with all of these factors possibly having an impact on inflation (UNODC & IMF, 2005:1). Furthermore, if money laundering is allowed to continue unimpeded, criminals will continue to finance further criminal activities and the level of crime in a country is likely to increase. Money laundering also encourages other crimes such as fraud, tax evasion and corruption (Commonwealth Secretariat, 2006:7).



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It is essential that criminals be able to launder their illicit funds if they are to enjoy the use of these funds while, at the same time, protecting the source of their funds (FATF, 2011b). Despite the fact that money laundering originated in the early 1900s, it was only towards the end of the 20th century that the prevention and detection of money laundering gained international focus as an effective method of combating organised crime (Commonwealth Secretariat, 2006:6). Since then there have been a number of international initiatives aimed at reducing money laundering (UNODC & IMF, 2005:2).

The first international instrument against money laundering came into force with the adoption of the United Nations Convention against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances (known as the Vienna Convention) in December 1988 (Goredema, 2007:xii). The Vienna Convention provided for comprehensive measures to combat drug trafficking and money laundering and to promote international cooperation between member states (United Nations Office on Drugs and Crime [UNODC], 2011a). In November 2000, the United Nations Convention against Transnational Organised Crime (known as the Palermo Convention) was adopted and came into force in September 2003 (UNODC, 2011b). The Palermo Convention expanded the scope of money laundering offences to include the proceeds of all serious crime (UNODC & IMF, 2005:3).

Following the Vienna Convention, the Financial Action Task Force (FATF) was established at the Group of Seven Summit in Paris in 1989 as part of a global initiative to combat money laundering (Turner, 2011:20). The FATF is an independent, intergovernmental body which provides its members with standards and policies with which to fight money laundering and terrorist financing. Currently, the FATF has thirty-six members (FATF, 2011a) and South Africa has been a member since 2003 (FATF, 2011c). The FATF analysed money laundering methods and trends and, in 1990, issued Forty Recommendations which provide countries with comprehensive anti-money laundering (AML) guidelines (FATF, 2011a).

The 1999 International Convention for the Suppression of the Financing of Terrorism defined terrorism as an act of which the main aim is to “intimidate a population, or compel a Government or an international organisation to do or abstain from doing an act” (Commonwealth Secretariat, 2006:13). Unlike traditional money laundering,



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terrorism may be financed by funds that come from both legal and illegal activities (Pacini, 2002:289). The financing of terrorism is often referred to as "money laundering in reverse" − the funds come from a legitimate source and become dirty through their use (International Federation of Accountants [IFAC], 2004:1).

Following the terrorist attacks on the United States on 11 September 2001 and the promulgation of the USA Patriot Act of 2001, anti-money laundering legislation and controls received even greater international focus (IFAC, 2004:1). The FATF's mandate was extended and Eight Special Recommendations were released to combat the financing of terrorism (CFT) in 2001, with the Ninth Special Recommendation being added in 2004. The FATF Recommendations are accepted worldwide as the primary set of comprehensive AML/CFT standards (Commonwealth Secretariat, 2006:20; IFAC, 2004:5). The FATF issued revised FATF Recommendations on the 16th February 2012 (FATF, 2012). However, this research study is based on the FATF Recommendations and Guidelines in issue as at 31 December 2011.

With the increased focus on the prevention and detection of money laundering through financial institutions and cash smuggling, criminals have devised new techniques in terms of which to launder their illicit funds. In response to these developments the FATF amended the Forty Recommendations and issued the revised recommendations in 2003 (FATF, 2011a). The Forty Recommendations plus the Nine Special Recommendations (known as the FATF 40 + 9) are recommendations to a country's government. It is the responsibility of the individual countries to develop and implement these recommendations with the necessary legislation and regulations (Cox, 2011:17). In 2005, the United Nations Security Council "strongly urged" all member states to implement the international standards as set out in the FATF 40 + 9 Recommendations (Goredema, 2007:75).

The European Union (EU) has issued three directives which combined the FATF's recommendations with EU specific issues to provide an AML legislative and regulatory framework for EU nations. As with the FATF Recommendations, it is the responsibility of each nation to draft the necessary legislation in accordance with these directives. The most current directive, the Third Anti-Money Laundering Directive (Third AMLD), was published on 25 November 2005 and provided a basis



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for the implementation of the FATF's revised recommendations in Europe (Cox, 2011:44).

The FATF monitors member countries' level of implementation of and compliance with the FATF 40 + 9 recommendations through the mutual evaluation programme (FATF, 2010a:7). A country report is issued which rates the country's compliance and indicates any deficiencies in terms of AML/CFT measures. The most recent evaluation report for South Africa was issued in February 2009 (Financial Action Task Force & Eastern and Southern African Anti-Money Laundering Group [FATF & ESAAMLG], 2009:6). In addition, the FATF researches evolving money laundering and terrorist financing techniques and issues typologies reports explaining the nature and characteristics of these methods as well as guidelines for relevant industries on the best approach with which to address these issues (FATF, 2010a:7).

## 1.2 SOUTH AFRICAN ANTI-MONEY LAUNDERING AND TERRORIST FINANCING CONTROL FRAMEWORK

Recognising that global cooperation is essential if AML/CFT measures are to be effective in combating money laundering and the financing of terrorism, South Africa became a member of three international AML/CFT bodies; namely, the FATF, the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) − a FATF-style regional body − and the Egmont Group of Financial Intelligence Units (Egmont) (FIC, 2010:40).

In accordance with international best practice, South Africa has developed an AML and CFT legislative and regulatory framework by promulgating three primary pieces of legislation (Burdette, 2010:11). The Prevention of Organised Crime Act, No 121 of 1998, as amended (POCA) criminalises the act of money laundering and provides for the confiscation and forfeiture of assets. The Protection of Constitutional Democracy against Terrorist and Related Activities Act, No 33 of 2004 (POCDATARA) criminalises terrorist financing. Finally, the Financial Intelligence Centre Act, No 38 of 2001 (FICA) and the Financial Intelligence Centre Amendment Act, No 11 of 2008 (FIC Amendment Act) provide control measures to enable the prevention and detection of money laundering and the financing of terrorism (FATF &



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ESAAMLG, 2009:6–8). This primary legislation is underpinned with regulations and guidelines (Goredema, 2007:77).

The financing of terrorism is defined in POCDATARA and refers to actions that provide financial or any other economic assistance to support terrorist or terrorist related activities or to entities or persons undertaking such activities. Any person who knows, or ought reasonably to have known, that the applicable funds or property would be used for such activities or by such persons is guilty of an offence (IRBA, 2011a:5).

FICA has three principal control measures which may be applied both to money laundering and to the prevention and detection of terrorist financing. These measures include the establishment and verification of clients' identities, record keeping, and the reporting of certain suspicious information (FIC, n.d.:1). FICA also has certain internal compliance requirements to ensure that these control measures are adequately applied. These include requirements as regards the development of internal procedures, the provision of training and the appointment of a Money Laundering Control Officer (MLCO) (IRBA, 2011a:19).

Accountable institutions, as listed in FICA Schedule 1, as amended, must fulfil all of FICA's compliance obligations. Accountable institutions include, *inter alia,* financial institutions such as banks, long-term insurance providers, financial services providers, as well as practitioners who practise as attorneys (IRBA, 2011a:29). However, section 29 of FICA imposes the obligation to report suspicious or unusual transactions on any person who carries on a business, including a manager or employee of a business (FIC, 2008:9).

## 1.3 THE MONEY LAUNDERING PROCESS

Generally, the money laundering process encompasses three basic phases, namely, the placement of the bulk cash derived from illegal activities into the financial system; layering, which involves constructing layers of complex transactions and structures that take on the appearance of legitimate activities; and the integration of the laundered money back into the formal economy so that it appears that the funds are part of legitimate activities. Money laundering is a global occurrence and the layering



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process usually crosses over into two or more countries (Buchanan, 2004:117). Criminals take advantage of differences in terms of the legislation and jurisdiction between countries to help facilitate their schemes (Turner, 2011:12).

The FATF's research has shown that criminal and terrorist organisations use three main methods to implement their money laundering schemes; firstly, by using the financial institutions and their systems through the use of cheques and electronic transfers; secondly, by physically moving the bulk cash through smuggling or couriers and, thirdly, by presenting the facade of trading something of value with false documentation for the goods or services rendered (FATF, 2006b:1).

## 1.4 THE RELEVANCE OF ACCOUNTANTS IN MONEY LAUNDERING

In recent years AML/CFT measures have focused on the prevention and detection of money laundering and the financing of terrorism schemes that make use of financial institutions and cash smuggling with the result that criminals have developed new techniques and found new channels to launder their money (FATF, 2006b:1). The FATF's research has identified the use of professionals such as accountants and attorneys to provide financial advice is a common factor in complex money laundering schemes (FATF, 2010a:45).

Accountants provide a broad range of services to various clients. These services range from general business advice to specific services which include external audit and assurance, accounting and preparation of financial statements, tax advice and planning, internal audit services, review of regulatory returns, compliance services, advice on deal structuring and investments, and forensic accounting and audit services (FATF, 2008b:4). Clients use professionals such as attorneys or accountants to manage their money and other assets or to establish legal entities such as companies or trusts (FATF, 2003:5).

The FATF's research indicates that a number of the services provided by accountants may help to facilitate money laundering schemes. This may happen through the provision of financial and tax advice, establishing trusts, corporate vehicles or complex legal structures, purchasing or selling property, undertaking financial transactions of behalf of the client and providing introductions to financial



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institutions (FATF, 2008b:4). Furthermore, they may assist their clients to take advantage of opportunities in offshore jurisdictions (FATF, 2010b:32).

While accountants may perform these functions while being unaware that they are facilitating illegal activities, the FATF's research indicates that, in some cases, the accountant or other professional was either party to or aware of possible money laundering schemes (FATF, 2006a:5). The number of high profile financial statement or accounting frauds that have shaken the financial world in recent years, resulting in enormous losses to investors, banks and other stakeholders, have placed the auditing profession under increasing scrutiny. This scrutiny has added to the perception that auditing professionals may be involved in complicated money laundering schemes (Standing & Van Vuuren, 2003:3).

Accountants have a role to play in the prevention and detection of money laundering. The range of services provided by accountants gives them access to their clients' accounts and business records. This access means that they are well positioned to identify and report suspicious transactions that may relate to money laundering activities (Melnik, 2000:145).

According to Pacini (2002:289), combating money laundering has been one of the main roles of forensic accountants for several years. Governments and businesses are increasingly looking to accountants to assume a greater role in the fight against corruption with a focus on identifying and investigating "politically exposed persons" (PEPs), money laundering, fraud and related white collar crime (IFAC, 2004:2). It is, however, essential that this role be balanced with a client's expectation of confidentiality and professional privilege (He, 2006:62).

The role of professionals in money laundering has attracted international attention. The Palermo Convention, the FATF's Forty Recommendations, the EU's Third Directive and other national AML laws have all required professionals, including accountants, to assume AML responsibilities (He, 2010:28). As a result of these developments, international regulatory bodies, including the various EU and United Kingdom (UK) accounting and auditing bodies, as well as the South African auditing regulatory body, the Independent Regulatory Board for Auditors (IRBA), have issued



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guidelines on the combating of both money laundering and the financing of terrorism to their members.

### 1.5 ANTI-MONEY LAUNDERING REQUIREMENTS FOR ACCOUNTANTS

Recommendations 12 and 16 are the FATF Recommendations which are applicable to designated non-financial businesses and professions (DNFBPs), including accountants when they perform certain services. Recommendation 12 deals with the requirements regarding conducting customer due diligence, keeping records and considering complex or unusually large transactions in certain situations. Recommendation 16 provides for the requirements to report suspicious and unusual transactions, develop internal controls and the actions to be taken when dealing with countries with inadequate AML measures (FATF, 2003:5–6). With regard to accountants, these recommendations are applicable when they perform certain transactions, such as managing clients' money, assets and bank accounts or the establishment or management of legal entities (FATF, 2008b:2). The FATF Recommendations 12 and 16, as they relate to accountants, are discussed further in the FATF's RBA Guidance for Accountants, issued in 2008 (FATF, 2008b:1–3).

In keeping with FATF Recommendations, the EU's article 2 para 1(3)(a) provides that the Third AMLD's provisions apply to auditors, external accountants and tax advisors when conducting their professional activities, as well as to financial institutions (European Parliament and the Council of the European Union [European Union], 2005:L309/20).

In contrast to the FATF Recommendations and the EU's Third AMLD, FICA's list of accountable institutions per Schedule 1, as amended, includes accountants only if, in terms of item 12, they provide advice or intermediary services regarding an investment in any financial product and they are registered as a financial investment service provider in terms of the Financial Advisory and Intermediary Services Act, No 37 of 2002 (FAIS); or if, in terms of item 2, they act as a trustee (IRBA, 2011a:15–16). However, this limited inclusion of accountants is not in line with the prescibed activities as listed in FATF Recommendation 12 (FATF & ESAAMLG, 2009:161).



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FAIS defines "advice" in section 1 as "any recommendation, guidance or proposal of a financial nature" given to a client in respect of the purchase of or investment in a financial product, or the amendment, termination or replacement of such product. This also includes advice regarding the "conclusion of any other transaction, including a loan or cession, aimed at incurring liability or acquiring rights or benefits in respect of any financial product" (FAIS, 2002:s 1.1). "Intermediary service" refers to the performance of an act other than providing advice; for example, providing safe custody services (FAIS, 2002:s 1.1).

The FATF requires that accountants have a supervisory body with the designated authority to monitor and sanction compliance with AML/CFT requirements (FATF, 2008b:17). In terms of FICA Schedule 2 item 5, as amended, the IRBA is the supervisory body for registered auditors when they meet the requirements of accountable institutions in terms of FICA Schedule 1, as amended (IRBA, 2011a:20). Accordingly, IRBA's supervisory role, in terms of FICA, extends to a segment of the South African accounting services only (FATF & ESAAMLG, 2009:171). In contrast, all five member bodies of the Consultative Committee of Accountancy Bodies (CCAB), as defined in the glossary, as well as the Chartered Institute of Management Accountants, constitute supervisory authorities in terms of the UK's Money Laundering Regulations 2007 (CCAB, 2008:9).

Both the FATF Recommendations 12 and 16 and the FATF RBA Guidance for Accountants, issued in 2008, deal with a range of services provided by accountants. These services are provided not only by registered auditors who are members of the IRBA and whose areas of speciality include auditing and assurance but they are also provided by members of the South African Institute of Chartered Accountants (SAICA), the South African Institute of Professional Accountants (SAIPA), the Association of Chartered Certified Accountants (ACCA) and other accountants who are not regulated in South Africa. The FATF Recommendations and Guidelines are, thus, also applicable to these latter accountants. SAICA, IRBA, ACCA and SAIPA are the four main accounting bodies in South Africa. However, they have not formed a body such as the CCAB in the UK, which provides all of the UK accounting bodies with a common approach.



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## 1.6 THE PURPOSE OF THE RESEARCH

### 1.6.1 Research problem

The reporting of suspicious and unusual transactions is one of the pillars of the AML and CTF requirements with both the FATF Recommendations and the South African FICA dealing specifically with this aspect (FIC, 2008:8). The FATF Recommendation to report suspicious transactions applies to accountants when they perform certain services. Furthermore, the FATF categorically suggests that this reporting requirement be applied to all the professional activities of accountants, including the auditing function (FATF, 2003:6).

The UK's AML legislation requires a suspicious activity report (SAR) to be made when an individual has knowledge or suspicion of, or reasonable grounds to suspect, money laundering (CCAB, 2008: 52). As Melnik (2000:152) argues, accountants may be well placed to identify possible money laundering and, therefore, if they are adhering to the UK reporting requirements, they are required to make a report should they suspect money laundering. Section 29 of FICA and the FIC's Guidance note 4 requires the reporting of suspicious or unusual transactions only if the individual becomes a party to such transactions, if he/she has or is about to receive proceeds that are suspicious or the business concerned has been or is to be used for money laundering purposes (IRBA, 2011a:25). Furthermore, according to Burdette (2010:18), there is uncertainty regarding the meaning of the term "transaction" as it relates to FICA's section 29. Therefore, by extension, there may be confusion regarding when an accountant becomes party to such a transaction and the duty to make a suspicious transaction report (STR) arises.

The research question in this study is whether South African accountants fall within the ambit of the FATF Recommendations and whether the accountants' reporting requirements correspond with the work that they do and, thus, is section 29 relevant to accountants.

### 1.6.2 Research objectives

The FATF has provided an international AML/CFT framework. However, the implementation of this framework has not been consistently applied across countries (Turner, 2011:20). According to Turner (2011:43), while many countries have



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formulated an AML legislation and regulatory framework using the FATF Recommendations as a basis, the implementation of such frameworks may have created the potential for abuse by accountants. Money laundering and the financing of terrorism are global issues and criminals make use of inconsistencies in the legal frameworks of different jurisdictions to further their money laundering or terrorist financing schemes (IFAC, 2004:9). It is, thus, essential that accountants have an understanding of the different jurisdictions' legal and working definitions as applicable to money laundering and the predicate offences, suspicious and unusual activities, and the relevant reporting requirements (IFAC, 2004:9).

However, research has shown that accountants do not always understand how money laundering legislation applies to them and how this legislation impacts on their work (Standing & Van Vuuren, 2003:9). The main aim of this research study is to analyse and evaluate the adequacy of the reporting requirements for accountants in South Africa as regards money laundering. Based on this analysis a conclusion will be drawn as to whether or not these requirements are sufficiently effective to combat money laundering in South Africa. The UK and the EU were chosen for the purposes of comparison as they both have well-developed AML legislation in place as well as a mature accounting profession with a broad range of supervisory bodies which have issued AML guidelines to their members.

The following secondary objectives will also be investigated in an attempt to realise the primary research objective:

- To obtain a general understanding of what is meant by money laundering, the proceeds of crime and the typologies used to perpetrate such crimes.
- To understand the role of accountants in money laundering schemes and the prevention and detection of money laundering.
- To determine what the FATF requirements are for reporting suspicious transactions and how these requirements relate to accountants.
- To establish the reporting requirements for accountants in terms of legislation in both the United Kingdom and the European Union.



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- To establish the reporting requirements for accountants in terms of South African legislation, focusing on South African registered auditors who are members of the IRBA.

### 1.6.3 Research approach

The nature of the accounting profession and the various roles that the accountant assumes will be analysed while the compliance role of accountants will also be considered in order to evaluate whether accountants are well placed to detect money laundering schemes and, thus, whether they should play a role in the fight against money laundering.

As the body responsible for setting the global standard for AML policies, the FATF's recommendations and guidelines regarding suspicious transaction reporting in so far as they are applicable to accountants will be analysed. The relevant AML legislation and guidance notes from the EU and the UK will also be analysed to determine the parameters and reporting requirements for accountants. The various capacities in which accountants may act and role of the supervisory body will also be considered. In addition, the offences and defences relevant to the failure to report a suspicious transaction and the concepts of knowledge and suspicion as well as client confidentiality will be analysed.

In order to ascertain how FICA is applicable to accountants in South Africa, this research study will consider the general AML obligations of accountants and their obligations as accountable institutions in terms of FICA. The reporting responsibilities for accountants in terms of section 29 of FICA will be analysed and compared to those of accountants based in Europe and the UK and to the relevant FATF Recommendations.

### 1.6.4 Research limitations

The research problem will be limited to the responsibilities of accountants in terms of AML legislation regarding the reporting of suspicious and unusual transactions; but it will not deal with reporting duties regarding cash transactions above the prescribed threshold. From a South African perspective the research will focus on the AML reporting responsibilities of the registered auditor. However, the reporting duties of auditors in terms of the South African Auditing Profession Act, No 26 of 2005 (APA)



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will not be discussed. Furthermore, the research problem will not address the financing of terrorism, the combating of the financing of terrorism and POCDATARA reporting responsibilities.

## 1.7 RESEARCH DESIGN

The research design will be based on a review of the available literature on the research topic, together with a critical evaluation and comparison of these publications in relation to the research problem. The reporting requirements for accountants in South Africa will be analysed and compared to the reporting requirements for accountants in both Europe and the UK as regards money laundering.

The primary source of the literature to be reviewed will be reports and guidelines issued by the FATF, the FIC, and the accounting and auditing bodies in the EU, the UK and South Africa. In South Africa these reports and guidelines will be limited to those issued by the IRBA as it was not possible to find any specific guidelines for accountants which were not covered by IRBA. Other primary sources will include organisations that publish money laundering related reports, academic books, professional journals and academic articles published on the topic. Secondary sources will include the official websites of the various bodies.

For the purposes of this research the term "accountants" refers to accountants in public practice. These include sole practitioners, and partners or professionals employed in professional firms (FATF, 2008b:2). The international guidelines issued by the FATF are not aimed at the "internal" professionals employed in other types of businesses (FATF, 2008b:2), as opposed to the IRBA guidelines which provide that, in South Africa, while the business itself may not be an accountable institution, an employee may constitute an accountable institution based on his/her qualifications or duties (IRBA, 2011a:3). Throughout this research study, the terms "accountant" and "auditor" will be used interchangeably as a result of the wide spectrum of services provided and possible overlap of their functions. This research study refers specifically to accountants and auditors who are members of a professional body.



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The research design is based on the assumption that the UK and the EU are the acknowledged “leaders” in AML legislation and strategies.

## 1.8 RESEARCH METHODOLOGY

The methodology used to research and analyse the research problem was limited to a literature review. A literature review is a synthesis and critical evaluation of previously published documents relating to the specific research topic (Hofstee, 2006:91). The purpose of a literature review may be to provide a theoretical base on which to support the research findings (Hofstee, 2006:91).

A thorough review of the available literature should ensure that a similar dissertation on the research topic has not already been conducted, as well as identifying the most current and respected theories regarding the topic and determining the most commonly accepted definitions of the key concepts within this area. In addition, the literature review should identify the findings that have generally been observed regarding the research topic and the methodologies and techniques that resulted in these findings (Mouton, 2009:87).

In this research study, the literature review will focus on literature relating to money laundering, AML recommendations and legislation and the role of accountants in these matters.

### 1.8.1 Advantages and disadvantages of a literature review

According to Hofstee (2006:121), a literature review does not produce new research, but only new views or interpretations of what has already been written. However, literature reviews do provide an opportunity to compare and analyse various viewpoints and the conclusions drawn by a range of researchers. Such a comparison may highlight the way in which the approaches to the topic at hand have changed as well as inconsistencies and contradictions in the research findings on the topic (Leedy & Ormrod, 2010:79).

Literature reviews are vulnerable to possible prejudice and the subjective selection of material on the part of the researcher. Accordingly, the quality of the literature review depends on the researcher’s sourcing relevant and current material and then



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accurately interpreting this material. However, the availability of research material may constitute a limitation (Hofstee, 2006:121).

### 1.8.2 Literature search strategy

A search of the University of Pretoria's online library catalogue was conducted using the following key words: money laundering, anti-money laundering, accountants, auditors, accounting profession, auditing profession, accountant's role in money laundering, South Africa, terrorist financing, section 29, FICA and reporting. The online library services provide access both to academic books and journals held at the library as well as to various electronic journals. The search was restricted to books and articles published in the previous decade with the focus from 2002 onwards, that is, after the FICA date of commencement − 1 February 2002 − and after the revised FATF Recommendations were issued. The research was based on the FATF Recommendations in issue as at 31 December 2011. A general search of the internet, as well as a specific search of relevant websites, was performed using the same parameters.

A search for academic books using the library sources revealed a selection of academic books focusing on the money laundering process and money laundering techniques, as well as the detection, prevention and deterrence of money laundering although no academic books focusing specifically on the reporting responsibilities of accountants with respect to money laundering were found. Nevertheless, references to the role of professionals and accountants were found in chapters of books relating to money laundering and forensic accounting. A search conducted on the internet using Google Scholar, as well as other search engines, produced similar results. Both South African and international books were considered.

Various journal platforms and journal databases were searched for peer reviewed journals on the subject matter. Similar results were found to those arising from the search for academic books. Both South African and overseas professional journals were considered, as well as formal publications from professional bodies; with the majority being available online. However, some material was found in paper-based journals.



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A search was conducted on the websites of local and international accounting and auditing bodies including the International Federation of Accountants (IFAC), the Independent Regulatory Board for Auditors (IRBA), the Federation of European Accountants (FEE), the Consultative Committee of Accountancy Bodies (CCAB), and the Institute of Chartered Accountants in England and Wales (ICAEW). A search was also conducted on the SAICA, ACCA and SAIPA websites, but with no success.

Further searches were performed on the websites of local and international AML bodies such as the Financial Intelligence Centre (FIC), the Financial Action Task Force (FATF), the International Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD), the United Nations Office Against Drugs and Crime (UNODC), the Institute for Security Studies in South Africa, the World Bank and the EU.

A search was conducted for dissertations or theses from South African universities relating to the research topic. This search was reasonably successful as regards money laundering issues, reporting requirements in terms of FICA and AML measures. The references used by the authors of these theses, dissertations and articles, as well as the reports from the institutional bodies, provided another source of research material. This search methodology was mainly successful in providing additional sources of articles and reports by self-regulatory bodies or national organisations

### 1.8.3 Limitations of a literature search

It is essential that a literature review be relevant and not out of date (Mouton, 2009:91). In view of the fact that the majority of AML and CFT legislation and practices have only come into effect in the last decade in South Africa the literature search in this research study was limited to publications of no longer ago than nine years.

There is a wealth of information available on money laundering itself as well as the prevention and detection of money laundering. However, most of the information on the reporting responsibilities of accountants, in their various capacities, was sourced from the different accounting and auditing bodies, both locally and internationally. There are, however, a limited number of peer reviewed articles on the AML



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obligations of accountants and, as a result, certain relevant articles were included, even if they dated from more than nine years previously.

## 1.9 OUTLINE OF CHAPTERS

The following is an outline of the chapters contained in this research study.

### 1.9.1 Chapter 1: Introduction

This chapter provides background information on the topic and describes the rationale behind the study. The chapter also discusses the research problem and research question, the assumptions and limitations of the study and the research design and methodology and provides an outline of the subsequent chapters.

### 1.9.2 Chapter 2: The nature of money laundering

This chapter examines the concept of laundering the proceeds of crime and considers the motivation behind AML measures. The money laundering process and methods used in money laundering that may be relevant to accountants are also discussed.

### 1.9.3 Chapter 3: The role of accountants in anti-money laundering

This chapter discusses the various roles that accountants play and the services that they provide. The chapter also considers the red flags that may be indicative of money laundering as well as the reasons why accountants are well positioned to detect money laundering. The role accountants may play in perpetrating money laundering is also discussed. This chapter also considers the conflict between client confidentiality and reporting responsibilities. In addition, the extent to which accountants are included in AML obligations in terms of the FATF Recommendation 12 and 16, the FATF's risk based approach report and the EU's Third Directive are discussed.

### 1.9.4 Chapter 4: Accountants' reporting requirements in terms of the Financial Action Task Force Recommendations and European Union and United Kingdom legislation

This chapter identifies the reporting requirements regarding the reporting of suspicious and unusual transactions in terms of the FATF requirements. It also



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provides an overview of the responsibilities of accountants in the UK and the Europe Union in terms of money laundering reporting and the role of the supervisory body. In addition, the chapter discusses the capacity in which accountants fall within the scope of the reporting obligations. The offences, in terms of failure to disclose and tipping off, and possible defences are also considered.

### 1.9.5 Chapter 5: Reporting requirements in South Africa

In this chapter the legislative requirements in South Africa in terms of money laundering reporting and related offences are identified. The chapter also considers the way in which these requirements are applicable to accountants and determines their reporting obligations and considers the role of the supervisory body. The offences and available defences are also discussed.

### 1.9.6 Chapter 6: Comparison of the South African and international reporting requirements in respect of accountants

This chapter comprises a comparison between the responsibilities of accountants in terms of South African legislation with those of accountants based in Europe and the UK and the FATF Recommendations as they apply to accountants.

### 1.9.7 Chapter 7: Conclusion and recommendations

This chapter contains a summary of the findings of this research study based on the literature review conducted. The chapter also discusses the conclusion drawn in respect of the research problem and the effectiveness of the reporting responsibilities of accountants. Suggestions for further research are also offered.

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# CHAPTER 2: THE NATURE OF MONEY LAUNDERING

## 2.1 THE CONCEPT OF LAUNDERING THE PROCEEDS OF CRIME

In South Africa money laundering is a criminal offence and occurs when a person, who knows or ought reasonably to have known that the applicable funds or property are the proceeds of crime, enters into an agreement or a transaction or undertakes any act relating to these proceeds. Such act or transaction must have the effect of either "*concealing or disguising the nature, source, location, disposition or movement of said property or the ownership thereof or any interest which anyone may have in respect thereof*" or enabling the perpetrator of a criminal offence to avoid prosecution (POCA, s 4).

The proceeds of crime refer to the "fruits" or benefits derived or received from unlawful activities and may refer to any property, advantage or reward (POCA, section 1(i)(xv)). Accordingly, the benefit earned by the criminal may take many forms and is not limited to cash (Burdette, 2010:5). However, these benefits are usually initially in the form of cash, particularly if they are the result of drug trafficking or other organised crimes. This cash then needs to be introduced into the financial system in some way (Commonwealth Secretariat, 2006:8).

In terms of POCA, money laundering in South Africa is not limited to acts relating to the illicit funds from organised crime offences such as drug trafficking but it extends to the proceeds of all unlawful activities (FIC, 2008:11–12). An underlying criminal act is a requirement for a money laundering offence and, thus, it is not possible to view money laundering in isolation (Burdette, 2010:5). However, it is not only drug traffickers and other perpetrators of organised crime who desire to conceal their illicit funds from scrutiny and such funds may arise as result of fraud, tax evasion, bribes, corruption, embezzlement and other illegal acts (Turner, 2011:26–27). In recent years there has been an increase in the laundering of proceeds from financial crime and, specifically, fraudulent activities, including internet and tax fraud (FATF, 2010a:9).

Money laundering schemes cross international borders and, thus, money laundering is a global issue (IFAC, 2004:4) with the need to conceal illicit funds creating a global



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market which attracts people who are able to facilitate the money laundering process. As a result of its covert nature it is extremely difficult to determine the extent of the money laundering industry but it is estimated to comprise between two and five percent of the global domestic product (i.e. US$ 1 trillion to US$ 2,2 trillion). These figures clearly indicate the reason why unscrupulous service providers would look to profit from the industry (Turner, 2011:26).

## 2.2 THE MONEY LAUNDERING PROCESS

Money laundering schemes make use of the systems which have been established to support legitimate economic activities (Goredema, 2004:2). Money laundering is, therefore, often referred to as a financial crime. The process of money laundering does not only entail hiding the illegal funds, as the funds must also become re-usable for other purposes. Thus, in order to do this, money launders use a complex series of transactions which are processed through multiple financial institutions and different jurisdictions (Buchanan, 2004:117).

Money laundering is generally classified into three stages, namely, placement, layering and integration. The funds are introduced into the financial system; they are moved around so as to disguise their original source and they are ultimately re-integrated into the conventional financial system as legitimate funds (Cox, 2011:10). These three stages may happen as three distinct separate phases, they may happen simultaneously or they may overlap with each other (Commonwealth Secretariat, 2006:9). In South Africa, it is mainly the placement stage only which is used in money laundering schemes (De Koker, 2005:Com 1–5). These stages will be discussed individually below.

### 2.2.1 Placement

Placement is the initial phase of the money laundering process. According to Buchanan (2004:117), illicit funds are at their most vulnerable during this phase as the proceeds are usually in the form of large volumes of cash. Placement entails the conversion of the proceeds of crime into another form. It does not, however, only entail depositing the cash into a bank account, although this is the most common method (Cox, 2011:10–11). Money launderers tend to target areas and jurisdictions



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where controls are either limited or weak and the businesses or individuals are in need of cash (Cox, 2011:11).

Money launderers use the placement phase of the process to alter the nature of the proceeds and to bring about a distance between the proceeds and their source while, at the same time, avoiding detection by the authorities (Buchanan, 2004:117). Placement may involve the purchase of high value items such as artwork, antiquities, stamps, coins, precious metals, boats, cars, shares, investments, bonds, or betting chips at a casino; providing cash loans to companies or taking out an insurance policy (Cox, 2011:11). In addition, the cash may be smuggled to foreign jurisdictions to obscure the source of the funds further (Turner, 2011:9) or the cash may be deposited into the bank account of a front company (Buchanan, 2004:117).

### 2.2.2 Layering

Once the initial placement has taken place, layering is used to disguise the proceeds further so that the origin of the funds is even more obscured (Turner, 2011:9). This phase may involve a series of financial transactions that appear to be legitimate based on their frequency, number and complexity (Buchanan, 2004:117). The more layers involved in this process the more difficult it becomes to identify the illegal source and nature of the funds (Turner, 2011:9). According to Cox (2011:12), the funds may be transferred through multiple jurisdictions, a series of companies and two or more offshore financial institutions during this phase. In the more sophisticated schemes, the proceeds may be moved as many as ten times before the final integration.

Layering may be a costly exercise depending on the level of complexity and the degree of secrecy required (Turner, 2011:9). Examples of layering include buying and selling high value assets such as real estate or depositing the funds into an attorney's trust account and then requesting the funds be transferred to a personal account (De Koker, 2005:Com 1–5). In some countries attorneys and accountants are used to establish shell companies to facilitate the layering transactions (Turner, 2011:9).

The level of complexity of the layering phase is dependent on the type of investment made by the money launderer. Private acquisitions of artworks, stamps and antiques



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are low risk avenues for money launderers as the records kept are often poor. There is a higher risk attached to the purchase of real estate as attorneys may scrutinise the deal and perform a due diligence on larger purchases (Cox, 2011:12).

### 2.2.3 Integration

Integration is the final phase of the money laundering process. During this phase the successfully laundered and, therefore, untraceable illicit funds are re-integrated into the mainstream financial system (IFAC, 2004:4). The primary objective of integration is to return the proceeds to the criminal in a way that avoids attracting suspicion (Cox, 2011:13). The funds may then be used to purchase property or to fund more illegal activities (Clark, Kenyon & Shel, 2006:511).

According to Clark *et al.* (2006:511), funds may be integrated through investments or loans or through spending. Other integration methods described by Cox (2011:13–14) include transferring the funds from a shell bank owned by the money launderers to a legitimate bank; the over-invoicing of goods or services which, in turn, allows money to be moved across jurisdictions and provides evidence of the source of the funds, cancelling insurance policies after the premium has been paid, and selling assets such as stamps or precious metals. The objective of these methods is to obtain a payment that is transferred from a legitimate bank into the criminal's bank accounts, with these funds appearing to have come from a legitimate source. The illicit funds will then have been successfully laundered (Cox, 2011:13–14).

## 2.3 EXAMPLES OF MONEY LAUNDERING SCHEMES AND TRENDS RELEVANT TO ACCOUNTANTS

Historically, money laundering has been associated with the abuse of banks and other financial institutions. However, money launderers have devised methods that make use of a variety of different channels in order to achieve their goals (Commonwealth Secretariat, 2006:9). Money laundering schemes may affect ancillary financial services as well as non-financial services businesses (IFAC, 2004:5). In the AML context, the methods criminals use to launder their funds are referred to as "typologies", while these methods may differ between jurisdictions and also change over time (International Monetary Fund [IMF], 2011b).



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Money laundering activities involve the abuse of at least one of the following five areas: cash or bearer negotiable instruments; transfer of value through either international trade, money transfer businesses, third party businesses, remittance systems or emerging payment methods; assets and "stores of value" such as financial products, real estate or moveable goods; gatekeepers; and jurisdictional or environmental aspects (FATF, 2010a:10).

With AML countermeasures focusing on methods using deposits at financial institutions, cash smuggling and acquisitions such as insurance and real estate, money launderers have looked to professionals to assist them in devising more complex methods in order to launder the illicit funds and avoid detection (He, 2010:28). The FATF's research identified the increased use of attorneys and accountants, or "gatekeepers", in money laundering during the 1990s and this trend has continued (FATF, 2004:24). According to De Koker (2002b:35), there is evidence in South Africa that experts in legal, tax, financial or general business affairs are both knowingly and unknowingly assisting criminals with these complex schemes.

The normal activities of accountants, when they are acting as auditors, involve examining their clients' financial records and verifying their accuracy and also reviewing the client's internal controls (Commonwealth Secretariat, 2006:81). In addition, accountants review contracts and documents and conduct analytical reviews in order to identify anomalies. As a result, they may be in a better position to detect suspicious transactions or activities related to money laundering than banks (Melnik, 2000:153).

Examples of the types of money laundering scheme which accountants may be well placed to detect are discussed below. These schemes may also involve accountants, knowingly or otherwise, facilitating the scheme. Many of these schemes use well known money laundering typologies and are often interlinked. The role of the accountant in the detection of money laundering schemes is discussed in more detail in Chapter 3.



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### 2.3.1 Money laundering through shell and front companies

Shell companies are entities that do not carry on any business or commercial operation in the country in which their registered office is situated (Buchanan, 2004:118). They are, in fact, fictitious entities (He, 2010:24). Illicit funds are moved through shell companies which are often based in offshore locations such as the Cayman Islands (Buchanan, 2004:118–119). The shell company is then used to provide an explanation for the source of the criminal's income (He, 2010:24). The shareholders or directors may be family members or third parties acting under the direction of the ultimate owner (De Koker, 2002b:33).

Front companies, on the other hand, are not fictitious entities and they conduct legitimate businesses and earn legitimate income (He, 2010:24). Nevertheless, front companies may be used to layer and integrate illegal proceeds (Buchanan, 2004:118). Front companies are often cash intensive businesses such as restaurants, casinos or liquor stores; as financial institutions are less likely to be suspicious of large cash deposits emanating from these entities (He, 2010:24). Criminals may use a front company in which to invest the proceeds of crime or else comingle the illegal funds with the legitimate earnings from the business (De Koker, 2002b:33).

### 2.3.2 International trade-based money laundering

The globalisation of trade has resulted in trade-based money laundering (TBML) becoming one of the main channels of criminal activities (FATF, 2006b:25). The enormous volume and value of international trade transactions, which shield individual trades from scrutiny, render the trade industry highly attractive to money launderers (He, 2010:23). Other factors which also increase the appeal of the trade industry include the complex foreign exchange and trade finance transactions, the combining of legal funds with illegal funds and the limited volume of customs data and resources available to detect possible money laundering transactions (FATF, 2006b:2).

TBML may be defined as "the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illegal origins or finance their activities" (FATF, 2010a:18).



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TBML is perpetrated either through the intentional misrepresentation of the price, quality or quantity of the goods or services being imported or exported or through fictitious trade activities (FATF, 2008a:2). TBML schemes range from the fairly simple to the more complex which combine TBML schemes with schemes using financial systems and cash couriers (FATF, 2006b:25). The presentation of fraudulent documentation and invoices is often one of the components of TBML schemes (Delston & Walls, 2009:104). Trade finance is the financial component of an import/export deal and involves facilitating the payment for the import/export transaction (FATF, 2008a:2). Trade finance activities include issuing letters of credit for exports and imports, supplying guarantees or standby letters of credit and pre-export financing. All these activities are vulnerable to TBML schemes (Delston & Walls, 2009:104).

Import/export companies may also be used as front companies as the nature of their business provides an acceptable explanation for transfers to and from offshore financial institutions and foreign jurisdictions (Buchanan, 2004:118; He, 2010:24).

### 2.3.3 Money laundering through the football sector

The economic importance of sport on a global scale has increased in recent years and has, thus, attracted large amounts of money to the sports industry (FATF, 2009a:4). As a result, the sports industry has become a target for criminals to launder their illicit funds. Specifically, football's exponential growth and commercialisation since the early 1990s has attracted huge investments, sponsorship and broadcasting deals and made football a global industry which plays a significant role in the world economy (FATF, 2009a:9). Professional football players are sourced from all over the world for astronomical transfer prices (FATF, 2009a:9). This, in turn, has resulted in enormous sums of money flowing across international borders, similar to the trade industry, and, thus, creating opportunities for money laundering (FATF, 2009a:9).

Similar to the TBML techniques, money laundering schemes using the football sector may range from fairly simple to more complicated schemes which make use of cash, international transfers, front companies, PEPs and the exploitation of nonfinancial professionals (FATF, 2009a:37). The complex structures within the industry result in a variety of financial transactions which are susceptible to money laundering



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schemes. These include investment in football clubs, the player transfer market, betting activities and endorsement deals (FATF, 2009a:17). Furthermore, a significant portion of a football club's revenue is derived from the cash received for ticket sales, thus creating the opportunity to launder money by fraudulently misrepresenting the club's revenue figures, as is the case with any cash business (FATF, 2009a:19).

### 2.3.4 Money laundering through the abuse of financial products

Money launderers use the insurance sector to disguise the source and nature of illegal proceeds by either purchasing, changing or redeeming insurance policies or by submitting insurance claims (He, 2010:19). Payments made from insurance institutions are viewed as routine by other financial institutions and, therefore, attract little suspicion (FATF, 2004:15). Once money launderers have successfully acquired an insurance policy using illegal funds and placement has occurred, the risk of detection during the layering and integration phases is reduced (FATF, 2004:15). Money launderers also often make use of insurance brokers as extra cover in order to avoid detection (FATF, 2004:15).

Other financial products used by criminals include investments, securities, bonds and saving products. In view of the fact that these products are closely linked to the financial sector, they may either increase the value of the illegal funds or they may be used as security to obtain a loan from a bank (FATF, 2010a:38).

### 2.3.5 Money laundering through the abuse of corporate vehicles and charities

While corporate vehicles, such as private companies, partnerships and trusts, in general have a legitimate commercial purpose, criminals may abuse these vehicles for illegal purposes including money laundering, bribery and corruption, insider trading and tax fraud (FATF, 2006a:1). Charities and non-profit organisations may also be targeted by criminals for money laundering purposes with these entities being used to pool their funds together with the illegal funds and the money then being transferred as required (FATF, 2010a:31).

Both corporate vehicles and charities provide criminals with the opportunity to hide behind their legitimate economic activities and conceal the beneficial owner of the funds from scrutiny (FATF, 2010a:32). Unscrupulous trust and company service



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providers (TCSPs) may advise criminals on the most appropriate vehicle and location for their purposes (FATF, 2006a:1). Furthermore, criminals may make use of DNFBPs, including accountants, to conceal the true ownership of the entity while continuing to control its activities (Turner, 2011:57).

### 2.3.6 Money laundering through the real estate sector

The real estate sector is yet another area which has been identified as a common target for money laundering. As with the trade industry, the large volume of legitimate real estate transactions and the international nature of the industry may facilitate hiding money laundering transactions from scrutiny (FATF, 2007:4). Methods used for money laundering through real estate include the manipulation of the value of a property or acquisition of a property through a front or shell company using illegal funds (FATF, 2010a:42). The abuse of other corporate vehicles, the use of "gatekeepers", the use of cash to acquire the real estate, and the use of investment schemes or mortgage schemes are other typologies which have been identified in money laundering schemes related to this sector (FATF, 2007:7).

## 2.4 MONEY LAUNDERING TRENDS IN SOUTH AFRICA

South Africa's banking sector has been described as first world with well-developed technology and infrastructure. Nevertheless, South Africa's economy continues to be largely cash based although there is an increasing demand for access to financial services, specifically by the lower income earners (FATF & ESAAMLG, 2009:6). In addition, the largely unregulated informal sector is an important aspect of the South African economy (De Koker, 2002b:34).

In South Africa, the crimes which result in the greatest illegal profits include corruption, fraud, theft, racketeering, smuggling of precious metals, poaching, "419" Nigerian type investment fraud, pyramid schemes, organised crime and other sophisticated investor fraud schemes (FATF & ESAAMLG, 2009:6).

During 2010 and 2011, the FIC team identified a number of internet accommodation scams relating to bogus offerings of lodgings in South Africa during the FIFA 2010 World Cup with the deposits being electronically transferred into a third-party bank account in a foreign country. This account was found to be linked to "419" scams.



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Other illegal schemes which came to light during this period were illegal pyramid investment schemes and South Africa's largest known "Ponzi" scheme (FIC, 2011: 4–5). A Ponzi scheme works on the basis of paying investment returns and withdrawals to earlier investors from the money received from a growing base of new investors (Clauss, Roncalli, & Weisang, 2009:3). Other money laundering activities noted by the FIC team in recent years include the abuse of attorneys' trust accounts and the creation of shell or fraudulent companies with names similar to existing legitimate entities with the aim of perpetrating financial crimes (FIC, 2010:52–53).

In Southern Africa, corruption is a predicate offence for money laundering as well as being a tool with which to facilitate money laundering with the funds being laundered either comprising the proceeds of corruption or else the employees of financial institutions or service providers, for example, government officials or professionals, are paid bribes to facilitate the money laundering scheme or to turn a blind eye to the suspicious transaction (Goredema, 2004:4). Corruption remains a major problem in South Africa (FATF & ESAAMLG, 2009:6).

In South Africa, illegal funds from drug trafficking come mainly from the sale of *dagga* (marijuana), mandrax tablets, ecstasy, cocaine and heroin, with cash as the main method of payment. South Africa has the largest drug industry in the subregion (Goredema, 2004:3) and is also known as a transport point for the trafficking of illegal drugs (FATF & ESAAMLG, 2009:6).

Criminals are known to display their illicit wealth through the acquisition of expensive items such as clothes, vehicles and real estate. These purchases are usually paid for, either partially or totally, in cash. In general, the majority of these assets are bought and kept in South Africa so that the criminals are able to enjoy their assets (De Koker, 2002b:32).

In line with international trends, criminals make use of shell and front companies to launder their funds as well as making use of professionals, such as auditors or attorneys, in order to register their shell companies (De Koker, 2002b:33). Other money laundering trends identified in South Africa include the abuse of financial institutions and corporate vehicles such as trusts, partnerships and companies, as well as cash smuggling through couriers (De Koker, 2002b:31).



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Criminals also make use of the unregulated informal sector and alternative remittance systems in order to launder illegal funds and evade South African exchange controls (De Koker, 2002b: 34–35). The abuse of the informal sector has been identified specifically as an issue of concern in South Africa as the proceeds of crime may be placed, layered and integrated in their entirety through the informal sector and, therefore, successfully laundered before there is any record of the funds in the regulated environment (De Koker, 2002b:35).

According to Burdette (2010:38), to date there has been little focus from a South African law enforcement perspective on the proceeds of crime, with few prosecutions relating to POCA and FICA offences. In addition, while criminals have been prosecuted for their illegal activities and sent to prison, they are still able to enjoy the benefits of their actions once their sentences have been completed (Burdette, 2010:38).

## 2.5 THE CONSEQUENCES OF MONEY LAUNDERING

While money laundering appears to be a victimless form of financial crime, the effects may have far-reaching consequences. The proceeds of crime may be used to corrupt and, eventually, to undermine the economies of communities or even entire countries (FATF, 2004:2). In addition, the damage caused by money laundering may have a national and international impact on social, economic and security issues (FATF, 2010a:12). Despite the fact that money laundering takes place throughout the world the activities have the most damaging impact on the emerging markets (Moshi, 2007:2). The potential impact from the perspective of the government, the economy, the financial sector and the professional is discussed below.

### 2.5.1 For the government and the economy

Money laundering may have a negative impact on the good governance, transparency and accountability of both public and private organisations (FATF, 2010a:12). Countries with weak AML controls or where there is a lack of enforcement of existing laws are likely to be viewed negatively by the international community and this, in turn, may adversely affect such a country's ability to access international financial systems or obtain foreign investment (Moshi, 2007:2).



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If criminals are successful in concealing and disguising the source of their illicit funds, they are likely to continue and even to increase their illegal activities (FATF, 2010a:12). Accordingly, if money laundering is not addressed and continues unimpeded, the result will be contempt for and a lack of confidence in the rule of law, the legal system and the financial sector. This contempt will, in turn, encourage other financial crimes including fraud, tax evasion and the contravention of exchange controls (Commonwealth Secretariat, 2006:7).

According to Moshi (2007:1), good governance and development are severely undermined by pervasive corruption. In addition, corruption is enabled by money laundering, which may potentially lead to dishonest politicians or crime syndicates acquiring significant economic and financial power which may, in turn, adversely affect a country's economy and democracy (Commonwealth Secretariat, 2006:7). Unscrupulous PEPs may also influence legislation, divert funds intended for public expenditure or derail privatisation plans (FATF, 2010a:48; Moshi, 2007:3).

Dealing with the large volumes of cash emanating from smuggling or cash-intensive businesses or else using third parties in order to place illegal funds increases the risk of theft to businesses or to individuals. In addition, developments in technology have increased the risk of identity theft, thus facilitating many of the money laundering schemes. If these crimes are allowed to continue the public's confidence in the country's security and financial sector will be damaged (FATF, 2010a:19).

Successful tax evasion results in reduced tax revenues for the government and this may adversely affect the country's infrastructure development and growth (FATF, 2010a:12). Once criminals have successfully laundered their illicit funds, these funds may be used either to acquire businesses or to acquire control of private financial institutions or to enable the criminals to become the key players in industry (Moshi, 2007:3). Furthermore, the profits of legitimate businesses may be undermined by businesses which are used for money laundering and whose focus is on laundering the proceeds of crime. These businesses may be able to undercut the prices of the legitimate business (FATF, 2010a:12), and this may impact negatively on the country's economy.



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### 2.5.2 For the financial sector

It is essential that the financial sector attract and retain legitimate funds if it is to be successful (Commonwealth Secretariat, 2006:7). If money laundering is allowed to continue unimpeded the criminals will be enabled to manipulate the financial institutions in order to develop and grow their criminal activities (IFAC, 2004:5). The continued abuse of a country's financial institutions by money launderers may lead to a loss of confidence in the credibility of the financial sector and also harm the reputation of the financial industry, as well as that of individual financial businesses. This may, in turn, result in a loss of legitimate business on the part of the financial institutions and also, potentially, the country (FATF, 2010a:24). Furthermore, the financial sector may be exposed to financial risks and potential legal liabilities (Moshi, 2007:3).

In addition, the abuse of the securities market for money laundering purposes may impact on the securities market prices thereby reducing investor confidence (FATF, 2010a:39).

### 2.5.3 For professionals

The use of professionals such as accountants and attorneys and other TCSPs to facilitate money laundering may harm the reputations of the individuals and businesses concerned as well as the sector as a whole. The participation of professionals in money laundering schemes brings the integrity of the profession as a whole under scrutiny and may have long-term negative effects (Commonwealth Secretariat, 2006:7). In addition, the influence of criminals on professionals may negatively affect decision making, thus further damaging the reputation of the industry (FATF, 2010a:46).

Those professionals who are exploited for money laundering are likely to be vulnerable as regards other crimes such as fraud and they may be subjected to physical threats so as to ensure their continued compliance. In addition, dishonest professionals have access to more income than honest professionals, thus making their businesses more profitable and creating imbalances in the industry (FATF, 2010a:46).



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## 2.6 SUMMARY

Money laundering is the method by which criminals conceal and disguise the true source and ownership of the proceeds arising from their criminal activities in order to evade prosecution, conviction and, ultimately, the loss of their illegal funds (Commonwealth Secretariat, 2006:6).

In South Africa, laundering the proceeds of crime, as described in section 4 of POCA, is a criminal offence (Burdette, 2010:5). The proceeds of crime refer to the benefits arising from any unlawful activity (Burdette, 2010:6). Criminals are maximising the opportunities presented by international developments in technology, payment methods, financial products and commercial products in order to launder their illegal funds (FATF, 2010a:9). Money laundering schemes may range from a straightforward scheme to complex schemes comprising several transactions which are processed through multiple entities and jurisdictions (Buchanan, 2004:115; He, 2010:31). While banks used to be the primary targets of money launderers, nonfinancial businesses are now also vulnerable to their schemes (IFAC, 2004:9).

The worldwide economic integration has resulted in the issues arising from money laundering becoming matters of global concern (IMF, 2011a:1). According to Min Zhu, the Deputy Managing Director of the IMF, money laundering is a financial crime that impacts on the economy. It may also threaten the general stability of a country as well as that of the financial sector. However, the integrity of the international financial system and international markets may be protected by effective AML measures. In addition, there is both a moral and an economic imperative to implement the necessary controls to prevent and detect money laundering (IMF, 2011a:1).



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# CHAPTER 3: THE ROLE OF ACCOUNTANTS IN ANTI-MONEY LAUNDERING COMPLIANCE AND DETECTION

## 3.1 THE NATURE OF THE ACCOUNTING PROFESSION

Accountants in public practice provide a level of assurance to a range of stakeholders, including investors, government bodies and other third parties, that the entity that they have audited complies with the relevant laws and regulations, thereby protecting the stakeholders' interests. One of the primary principles regarding accountants in public practice is that they are independent of their clients and, thus, that they are objective and impartial and may be regarded as "public watchdogs" (Melnik, 2000:151).

As stated by Melnik (2000:152), the accountancy profession, as regards accountants in public practice, is highly regulated. In South Africa, the Accounting Practices Board sets the official accounting standards and has approved the South African Generally Accepted Accounting Practices (GAAP). The South African auditing profession is governed by the APA, which provided for the establishment of IRBA (IRBA, 2011b:1–13). South Africa adopted the International Financial Reporting Standards and International Standards on Auditing in January 2005 (South African Institute of Chartered Accountants [SAICA], 2011a).

In line with *The Code of Ethics for Professional Accountants* of the International Ethics Standards Board of Accountants published by IFAC, the IRBA has developed a Code of Professional Conduct which outlines the ethical standards expected of registered auditors (IRBA, 2011b:4–8). When providing professional services auditors must comply with this code so as to ensure that they meet their responsibility to act in the public interest (IRBA, 2011b:4–8).

Throughout the world, accountants provide businesses with general business advice, as well as providing a broad range of services to a variety of clients (FATF, 2008b:3). Accordingly, accountants have knowledge and expertise as regards business operations, investments, mergers and acquisitions, tax issues, corporate structuring and the legal and technical issues surrounding these concepts (FATF, 2010b:43).



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Some of the professional services provided by accountants are briefly discussed below.

### 3.1.1 Audit, review, other assurance and related services

Accountants may, as external auditors, perform financial statement audits and review company systems and accounting principles while examining the accuracy of the financial records (SAICA, 2010). The external auditor's responsibility includes issuing an opinion regarding the fair presentation of the client's annual financial statements (SAICA, 2010). In addition, the external auditor is required to determine that the financial statements, in their entirety, are not materially misstated, either by fraud, error or failure to comply with relevant legislation and regulations (IRBA, 2011a:21). The "audit" of these financial statements must be conducted in accordance with prescribed auditing standards (IRBA, 2011b:1–11).

Accountants provide other assurance-related services such as regulatory reporting, and performance and sustainability reporting (IRBA, 2011b:4–13). Accountants may also provide secretarial and accounting services. These services entail performing the client's secretarial work, as required in terms of statute, and preparing the client's accounting records and financial statements based on the recognised financial reporting standards (IRBA, 2011b: 4–14).

### 3.1.2 Taxation advisory services

Accountants may advise their clients on how to reduce their tax burden legally through effective tax planning (FATF, 2008b:3). The tax services provided may also include the submission of tax returns, assistance with the resolution of tax problems and advice on tax implications and litigation issues (SAICA, 2010).

### 3.1.3 Other advisory services

There are also a wide range of advisory services offered by accountants. These include accounting and financial management advisory services, business performance services, corporate financial services, corporate recovery services and information technology advisory services (IRBA, 2011b:4–14). Accountants may also provide advice on corporate structures, succession planning and business plans (SAICA, 2010). Other services include insolvency services, investment advice and safe custody services (FATF, 2008b:4).



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Accountants may provide specialist forensic accounting services. These involve the investigative accounting of suspected fraudulent activities, as well as providing expert witness testimony (SAICA, 2010). Forensic services may also involve ethics and integrity checks, fraud risk management and other investigations, as required (IRBA, 2011b:4–15). When there is a suspicion of money laundering, a forensic accountant who specialises in AML may be used to conduct an investigation, a compliance analysis or controls review (Clark *et al*., 2006:518).

Another advisory service provided is that of the internal audit. This includes risk management and compliance services and may entail the review and inspection of a client's internal controls (FATF, 2008b:3).

It is clear from the variety of services provided by accountants to their clients that accountants may become intimately involved in their clients' operations and they may be consulted on a variety of business issues.

## 3.2 POSSIBLE USE OF ACCOUNTANTS IN MONEY LAUNDERING SCHEMES

Accountants have a good social standing and are known to operate in a regulated and ethical industry and, thus, their activities do not normally attract suspicion (He, 2006:64). Accordingly, criminals often make use of accountants in order to add an additional layer of legitimacy to their financial operations (FATF, 2004:27). Furthermore, the issue of confidentiality and privilege between accountants and their clients renders the use of these professionals attractive to money launderers (He, 2006:64).

Many of the services offered by accountants to legitimate clients for commercial purposes are useful to money launderers (He, 2010:28). According to Turner (2011:43), in certain countries accountants even market services that appear to be directed specifically at money laundering. Criminals use accountants to assist with the establishment of complex corporate structures, including trusts, for the purpose of obscuring the connection between the perpetrator and the proceeds of the crime (FATF, 2008b:4). In addition, accountants may also be used to negotiate deals on behalf of the criminal, for example, in football related deals (FATF, 2010b:43).



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Accountants may assist with the purchase or sale of real estate which may constitute either the layering or integration phase of a money laundering scheme. Criminals also make use of accountants for tax advice on methods to reduce their tax liability or even to evade taxation completely (FATF, 2008b:4). Accountants may also perform a range of banking transactions on behalf of the client; including the preparation of cheques, electronic fund transfers, cash deposits and withdrawals, buying or selling of foreign exchange, or effecting an introduction to a financial institution (FATF, 2008b:4). According to Turner (2011:43), if the client's funds come from illegal activities, the valid services provided by accountants may constitute money laundering.

The FATF's typologies research has identified a number of case studies in which accountants have been used to facilitate money laundering schemes (Nuthall, 2004). Case studies have also revealed the existence of corrupt accountants who keep the financial accounts of a number of fictitious entities and also prepare fictitious invoices and documentation to substantiate the movement of funds between these entities (Turner, 2011:43). The FATF has also identified case studies where TCSPs have played a role in TBML schemes and the formation of shell companies to conceal the identity of the beneficial owner (FATF, 2010b:69).

Another FATF case study revealed that an accountant had provided services to an illegal drug cartel as the cartel's "legal and financial consultant". These services included registering companies, opening bank accounts, providing investment advice as well as identifying the most suitable financial techniques and transactions to be used to ensure that the investments appeared both legitimate and profitable (Nuthall, 2004).

## 3.3 POTENTIAL FOR ACCOUNTANTS TO DETECT MONEY LAUNDERING SCHEMES AND RED FLAGS FOR MONEY LAUNDERING

Criminals are inclined to use corporate vehicles as a conduit for their money laundering activities and, therefore, it is unlikely that these activities will have an effect on the financial statements of the company concerned; in contrast to other white collar crimes such as fraud (Clark *et al.,* 2006:512). Accordingly, it is considered doubtful that money laundering activities would be detected during the



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financial statement audit (IFAC, 2004:6). However, money laundering activities are still an issue for external auditors as these activities may have an indirect impact on the financial statements of the entity (IFAC, 2004:6) while being associated with money laundering activities may expose the entity to legal, reputational and operational risks (Clark *et al.,* 2006:517).

Despite the general opinion that money laundering is unlikely to be detected during the financial statement audit (Clark *et al.,* 2006:512; Standing & Van Vuuren, 2003:10), it is essential that accountants obtain a comprehensive understanding of the client's business and activities during the audit (Melnik, 2000:152). Accordingly, it is incumbent on the accountant both to conduct tests of the controls and processes of all the key business areas and to test bank reconciliations (Melnik, 2000:152). This access to the client's records and operations increases the potential of accountants as regards detecting money laundering activities (Melnik, 2000:153).

Melnik (2000:156) argues that, unlike financial institutions, accountants are not limited to analysing single transactions and they are able to consider the entire situation over a period of time. This means that they are in an excellent position to identify and question anomalies. According to Melnik (2000:158), it is probable that accountants will "know their client" better than financial institutions and they are, thus, in a better position to authenticate the information provided and are more likely to detect money laundering activities.

Apart from financial audit services, there are other services provided by accountants which may provide greater opportunities to identify money laundering. These services include forensic accounting, regulatory examinations, compliance and operational auditing, risk management and tax advisory services (IFAC, 2004:16). Accountants are increasingly being requested to conduct independent money laundering risk assessments, AML compliance reviews and special audits (IFAC, 2004:17) and many of these services may help to prevent as well as to detect money laundering.

The FATF's RBA Guidance for Accountants provides a range of risk factors that accountants may encounter and that may be possible indicators of money laundering



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(FATF, 2008b:21). Some of the possible red flags that may indicate that a client is a high money laundering risk are discussed below.

A lack of transparency where it appears that the client is trying to disguise the nature of his/her business, transactions and ownership is a key factor which may indicate a higher money laundering risk. This may be identified by lack of contact or face-to-face meetings with the client or an inexplicably complex corporate structure and changes in ownership. Other indicators of a lack of transparency include difficulties in determining the entity's activities or instances in which management follows the directions given by unidentified persons (FATF, 2008b:22). Clients who change accountants or bookkeepers regularly or have different accountants for each connected entity may also be considered suspicious (IFAC, 2004:36).

Transactions or structures that are inconsistent with the client's usual business operations should be regarded as high risk (FATF, 2008b:21). These may include staffing levels or structures inconsistent with the size and nature of the business, activity on the part of a client who has been dormant in the past or payments from an external party which bear no apparent relationship to the transaction concerned (FATF, 2008b:22). The financial performance of the entity that does not match the expected results, for example the company is recording a loss but continues to operate without a logical explanation, would also be considered unusual (IFAC, 2004:36). Other indicators include the payment of disproportionate fees, commissions or transactions which do not accord with the standard industry practice or which have no business rationale (FIC, 2008b:16).

Clients who operate in industries or have operational structures that are vulnerable to money laundering may also be considered high risk for money laundering (FATF, 2008b:21), while cash-intensive businesses or businesses that have dealings with PEPs are also high risk (FATF, 2008b:23). Accountants may identify irregularities regarding unusual cash or financial transactions (Standing & Van Vuuren, 2003:10). These suspicious transactions may include frequent deposits or withdrawals below the reporting threshold, unwarranted transfers to and from bank accounts and payments or receipts from jurisdictions deemed "high risk" (Clark *et al.,* 2006:522). Some of these transactions may be identified by the accountant when conducting a review of the bank reconciliation and should be questioned (Melnik, 2000:157).



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Transactions which are unauthorised, improperly accounted for or have an insufficient audit trail should be considered red flag indicators (IFAC, 2004:7). These transactions may indicate fraudulent transactions relating to the misrepresentation of the price, quality or quantity of the goods or services being traded (FATF, 2008b:23).

However, these red flags should be regarded only as indicators that the client is high risk and the accountant may discover that there is a legitimate economic reason for these factors after a satisfactory review (FATF, 2008b:21). Furthermore, in the UK, accountants are not required carry out additional investigations in order to obtain more details of any criminal offences (Auditing Practices Board [APB], 2010:11). However, it is essential that an accountant maintain an attitude of professional scepticism and consider transactions that appear unusual or out of place as suspicious and meriting further investigation (IRBA, 2011a:24).

### 3.4 ISSUE OF CLIENT CONFIDENTIALITY AND LEGAL PRIVILEGE

The concept of client confidentiality may cause discomfort for accountants when considering money laundering reporting obligations. In addition, this issue may create a conflict between AML measures and the protection of the client's right to confidentiality (He, 2006:67).

The relationship between the accountant and client has always been managed within the ambit of client confidentiality and the accountant must treat the information obtained during the professional and business relationship with the client as confidential (IRBA, 2011b:4–19). Any disclosure of confidential information to third parties is considered a breach of the accountant's ethics and code of conduct (Melnik, 2000:166). In terms of the IRBA's Code of Professional Conduct, confidential information may be disclosed only with proper authority or if there is a lawful or professional obligation to divulge the information (IRBA, 2011a:24).

Essentially, the accountant must have unrestricted access to the client's entire body of information, including all documents and accounts, if he/she is to conduct the financial statement audit satisfactorily (IFAC, 2004:17). However, if accountants are to be required to report the suspicious activities of their clients, it may be argued that the client will no longer trust the accountant and the relationship may be irreparably



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damaged (He, 2006:66). Accountants are also concerned that the client may sue for breach of contract or false accusation if they disclose confidential information (Standing & Van Vuuren, 2003:10).

Nevertheless, there is a distinction between information that is confidential and information that is subject to legal privilege (Van der Westhuizen, 2004a). Privilege applies to confidential communications between an attorney and his client for the purpose of obtaining legal advice or in respect of litigation which is pending, contemplated or has already started (FIC, 2008:19). However, confidentiality is not privilege and money laundering legislation, specifically as regards reporting obligations in terms of AML, may limit the client's right to confidentiality (Burdette, 2010:33).

## 3.5 INTERNATIONAL ANTI-MONEY LAUNDERING OBLIGATIONS FOR ACCOUNTANTS

The international nature of money laundering and the continually evolving cross-border schemes have led to global and regional initiatives endorsing international cooperation and coordination (Moshi, 2007: 3). A consistent international approach is required if money laundering is to be addressed effectively (Cox, 2011:45). The international approach relevant to accountants is discussed below.

### 3.5.1 Financial Action Task Force Recommendations

As discussed in Chapter 1, the FATF is a "global policy making body" which was established at the G7 Summit in Paris in 1989 to develop a coordinated international response to addressing money laundering and terrorist financing concerns (FEE, 2009:7). The FATF has developed standards for national AML and the counter-financing of terrorism programmes (FEE, 2009:7). The FATF collaborates with the IMF, the World Bank, the United Nations and FATF-styled regional bodies (IMF, 2011a). The standards developed by the FATF, known as the FATF 40 + 9 Recommendations, set out a universal AML framework for national governments (IMF, 2011a). The recommendations have been endorsed by a number of international bodies (Cox, 2011:17). South Africa is the only African member of the FATF, which currently has thirty-six members (FIC, 2011:10).



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In 2008, the FATF issued the RBA Guidance for Accountants. This guidance provides accountants with the high level principles and procedures involved in applying a risk-based approach to combating money laundering and terrorist financing (FATF, 2008b:2). The aim of this approach is to ensure that risks are identified and resources focused on those areas that are at a high risk of money laundering (FEE, 2009:8). The guidance was developed in consultation with representatives from the accounting profession, and included the FEE and ICAEW (FEE, 2009:8).

The FATF Recommendations provide AML measures across a broad spectrum. However, for the purpose of this research, only those recommendations applicable to accountants, together with the FATF's RBA Guidance for Accountants, will be addressed.

The FATF Recommendation 12 stipulates that DNFBPs must comply with the requirements as regards conducting customer due diligence, keeping records and considering complex, unusual large transactions, in certain situations (FATF, 2003:5). With regard to accountants this is applicable when, in terms of 12(d),

> … they prepare for or carry out transactions for their clients concerning the following activities: buying or selling real estate; management of client money, securities or other assets; management of bank, savings or securities accounts; organisation of contributions for the creation, operation or management of companies; or creation, operation or management of legal persons or arrangements, and buying and selling of business entities (FATF, 2008b:2).

Customer due diligence (CDD) entails establishing and verifying the identity of the client, determining the beneficial owner of the entity and gathering additional information in order to obtain an understanding of the client's business and situation (FATF, 2008b:25). The CDD process should enable the accountant to feel confident that he/she knows the true identity of the client and the expected actions of the business (IFAC, 2004:8). Ongoing monitoring based on a risk assessment is recommended, as the accountant will then be able to judge the degree of consistency of the client's behaviour (FATF, 2008b:26).



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Accountants are required to keep records of the documents collected during their due diligence process as well as transaction records. In addition, some form of ongoing monitoring aimed at detecting unusual transactions, which appear to have no economic or legal purpose, is required (FATF, 2008b:10).

The requirement to report suspicious and unusual transactions is one of the FATF's most important countermeasures against both money laundering and the financing of terrorism (FIC, 2008:8). Recommendation 13 provides for a financial institution to report a suspicious transaction to the FIU if it suspects that the client's funds are the proceeds of criminal activities (FATF, 2003:5). The FATF Recommendation 16 requires that Recommendation 13 applies to accountants when they undertake a financial transaction related to the activities as set out in 12(d) on behalf of or for a client (FATF, 2003:6).

Accountants who meet the requirements in terms of 12(d) are required to develop AML programmes which include internal controls and policies and employee screening processes, provide ongoing training for staff, and audit the AML programme (FATF, 2003:6). In view of the fact that professional accounting firms have limited staff, the internal control programme should be appropriate for the size of the business (FATF, 2008b:28).

### 3.5.2 European Union – Third Directive

The EU requires all member states to implement AML measures. The relevant EU directive comprises the Third AMLD which has been in force since December 2005 and is based substantially on the FATF Recommendations (FEE, 2009:6). National governments are required to convert the requirements of the Third AMLD into local law (Cox, 2011:44).

In terms of the Third AMLD, local AML provisions must apply to, *inter alia*, auditors, external accountants, tax advisors and TCSPs when acting in their professional capacity. The Third AMLD also stipulates that these professionals have a number of AML obligations which include conducting customer due diligence, reporting and record keeping obligations, developing internal processes and providing staff and accountants with relevant AML training (FEE, 2009:6).



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### 3.5.3 United Kingdom anti-money laundering framework

The UK's key AML rules are set out in the Proceeds of Crime Act 2002, as amended, (POCA UK), the Money Laundering Regulations 2007 (UK Regulations), the Terrorism Act 2000 as amended, and the Terrorism Act 2006 (CCAB, 2008:7).

The UK implemented the Third AMLD through the UK Regulations (Cox, 2011:45). The key requirements of the UK Regulations applicable to business and persons subject to these regulations include the establishment of AML policies and procedures regarding CDD, reporting, record keeping, internal control, risk assessment and management, and compliance with and communication of these policies and procedures (Cox, 2011:68). The UK Regulations are applicable to businesses and persons within the "regulated sector", as defined in POCA UK Schedule 9 Part 1 (CCAB, 2008:11). These include, *inter alia*, auditors, external accountants, insolvency practitioners, tax advisors and TCSPs (CCAB, 2008:8).

### 3.5.4 International Federation of Accountants Anti-Money Laundering Report

In 2004 the IFAC published an Anti-Money Laundering Paper aimed at fostering awareness on the part of accountants as regards money laundering issues and related professional obligations (IFAC, 2004:n.p). In countries with risk and regulatory compliance requirements, regulators expect good governance on the part of financial and non-financial institutions in terms of AML. However, it is essential that accountants understand key aspects of AML compliance and risk management so that they may avoid being caught unawares by compliance failures or exploitation by third parties for money laundering purposes (IFAC, 2004:17).

Irrespective of the legal requirements, the IFAC recommends that an AML governance programme be adopted by businesses which includes a board approved, written AML compliance programme; AML, CDD, anti-corruption and STR policies and procedures; a corporate code of ethics which includes an AML policy; the appointment of a Money Laundering Reporting Officer (MLRO) and a training and awareness programme (IFAC, 2004:18).



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## 3.6 SUMMARY

The ongoing efforts of financial institutions to fight money laundering have resulted in criminals devising more complex schemes to disguise and convert the proceeds of their crimes (FATF, 2006a:1). In addition, criminals are using the expertise of professionals including accountants to assist them, either knowingly or unknowingly, with these complex schemes and to reduce suspicion relating to their activities (He, 2006:68). The use of accountants for money laundering schemes is, to a certain extent, linked to the range of services they provide and which relate to legitimate economic activities. The fact that accountants are well respected and they have a social standing means that there is little suspicion that they will indulge in criminal activities. Furthermore, the concept of client confidentiality renders accountants reluctant to disclose suspected money laundering (He, 2006:68). These factors all mean that accountants are vulnerable to money laundering schemes (He, 2006:68).

Accountants are expected to be independent professionals, who have a duty to protect the interests of a range of stakeholders (Melnik, 2000:152). While there is no expectation that accountants must examine every transaction effected by their clients, they are often, as a result of the services they provide, in a position to notice irregularities and suspicious activities on the part of either by their clients or a third party, (FATF, 2008b:26). The accountant’s access to the client’s records, business operations and confidential information, and familiarity with management makes it more likely that they will detect suspicious activities than either financial institutions or other service providers (FATF, 2008b:26; He, 2006:26).

The role that accountants play in the economy means they are able to assist in preventing and detecting money laundering (Melnik, 2000:154). According to Delston and Walls (2009:107), reliance should not be placed on banks only to identify money laundering as they do not always have the expertise or in-depth knowledge required to identify all of the red flags. Accordingly, other role players should also take on the responsibility of identifying suspicious and unusual transactions.

In terms of the FATF Recommendations, the EU Third AMLD and the UK legislation, accountants must take on AML responsibilities and they are required to conduct CDD, maintain records, develop internal procedures and report suspicious



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transactions. Accountants are also expected to use their professional judgement, exercise professional scepticism and be alert to possible red flags which may indicate suspicious activities relating to money laundering (CCAB, 2008:54).

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# CHAPTER 4: ACCOUNTANTS' REPORTING REQUIREMENTS IN TERMS OF THE FINANCIAL ACTION TASK FORCE RECOMMENDATIONS AND EUROPEAN UNION AND UNITED KINGDOM LEGISLATION

If national AML measures are to be successful, it is essential that financial institutions, professional firms and other designated businesses be required to report any knowledge or suspicion of money laundering without delay (Commonwealth Secretariat, 2006:93). The reporting obligations and surrounding issues relevant to accountants in terms of the FATF Recommendations and EU and UK legislation are discussed below. It is noted that, although the Recommendations and legislation are applicable to a range of financial institutions and other DNFBPs, this discussion will focus on the responsibilities of accountants. The relevant issues that will be discussed include client confidentiality and legal privilege, prohibited disclosures and defences available in the case of non-reporting.

## 4.1 FINANCIAL ACTION TASK FORCE RECOMMENDATIONS REGARDING REPORTING OF SUSPICIOUS AND UNUSUAL TRANSACTIONS

### 4.1.1 Reporting obligations for accountants

In terms of FATF Recommendation 16, the requirement to report suspicious transactions regarding money laundering to the FIU applies to DNFBPs, although it is subject to certain qualifications. The FATF recommends that accountants should be required to make an STR "when, on behalf of or for a client, they engage in a financial transaction in relation to the activities described in Recommendation 12(d)". Furthermore Recommendation 16 firmly suggests that this reporting requirement be applied to all the professional activities of accountants, including the auditing function (FATF, 2003:6).

Suspicious transactions include attempted transactions and have no minimum threshold (FATF, 2003:Annex 5). Suspicions may arise as a result of suspicious circumstances, for example, business or management structures which either do not make economic sense or have no purpose, as well as suspicious transactions, such as fraudulent activities (FATF, 2008b:27).



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Accountants may not take a risk-based approach as regards the requirement to make an STR and a report must be made when so required in terms of the legislation of the country concerned (FATF, 2008b:27). However, a risk-based approach may be used to identify clients, services or areas that are a higher risk for money laundering and additional resources may then be allocated to those areas. This approach may facilitate the identification of suspicious activities and unusual transactions (FATF, 2008b:27).

When deciding whether to report suspected money laundering, accountants must consider whether any of the following factors are applicable in the country concerned. Do the applicable activities constitute reportable (suspected) money laundering in that country? Is the information obtained subject to legal privilege, as defined by that country? If there is no requirement to make an STR in terms of national law, may the accountant make a voluntary report, consistent with his/her professional ethical obligations to protect the public interest? In addition, the accountant must also be mindful of any other legal or professional requirements of the country that may be applicable (FATF, 2008b:27).

The FATF Recommendations require accountants to institute a self-regulatory body or designated authority responsible for ensuring that accountants comply with the relevant AML/CFT requirements. This regulatory body must also have the power to monitor and sanction accountants (FATF, 2008b:17). Accountants may report their suspicions to their self-regulatory body, on the proviso that this body cooperates with the FIU (FATF, 2003:Annex:5).

#### 4.1.2 Confidentiality and privilege

Client confidentiality does not constitute legal privilege (FATF, 2008b:3) and each individual country must define the parameters for legal privilege (FATF, 2003:Annex 5). Accountants are not required to make an STR if the information obtained is subject to legal privilege (FATF, 2003:6).

The FATF Recommendations require that firms, partners and employees be legally protected from any litigation arising from a breach of confidentiality when making an STR if the STR is made in good faith to the FIU. Specific knowledge of the



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underlying criminal action is not required and the suspected activity may not even have taken place for a report to be made (Commonwealth Secretariat, 2006:145).

#### 4.1.3 Tipping off

Accountants, among others, are prohibited from "tipping off" the client if money laundering is suspected and reported to the authorities (FATF, 2003:6). Clearly, the information provided to the FIU or law enforcement authorities may be of little value if the suspect is aware that a report has been made (IFAC, 2004:8). Accountants should not carry out any investigations into suspected money laundering unless this is within the scope of their engagement. Unauthorised investigations by the accountant, beyond the scope of the engagement, may provide a warning to the money launderer of the suspicions (FATF, 2008b:26). However, when independent legal professionals, including accountants, acting in an independent capacity, advise clients against taking an illegal action, such actions do not constitute tipping off (FATF, 2003:Annex 5).

### 4.2 EUROPEAN UNION REQUIREMENTS FOR REPORTING SUSPICIOUS AND UNUSUAL TRANSACTIONS

#### 4.2.1 Reporting obligations for accountants

In terms of the Third AMLD Article 22, institutions or persons covered by the directive, including directors and employees of the institutions, are obliged to report to the national FIU if said person "knows, suspects, or has reasonable grounds to suspect money laundering ... is being or has been committed or attempted" (European Union, 2005:L309/27). This reporting obligation applies to external accountants, auditors, tax advisors and TCSPs; and there are no exemptions from reporting as regards the size of the transaction (FEE, 2009:15). However, the Third AMLD does not provide definitions of these professional activities. For the purposes of this discussion, the term "accountants" includes external accountants, auditors and tax advisors.

The qualifications and market access requirements for the accountancy profession differ widely as regards the various member states of the EU. It is noted that, while auditing services are, in general, provided by registered auditors only, other accounting services such as tax advice or bookkeeping may not necessarily be



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regulated and may be offered by persons who are not members of a professional body or who have no specific qualifications (FEE, 2009:18). However, with the exception of Belgium, France and Poland, the EU member states have applied national AML legislation to anyone providing accounting or tax services and, thus, the legislation is not restricted to members of a regulated profession (FEE, 2009:18).

The Third AMLD Article 20 requires that special consideration be given to any activity which, by its nature, is likely to be associated with money laundering as well as to unusually complex or large transactions or transactions which have no clear economic or legal purpose (European Union, 2005:L309/27). However, while there is a reporting obligation when money laundering is suspected or when there are reasonable grounds for such suspicion, the Third AMLD does not define what comprises a "suspicion" or "reasonable grounds to suspect" money laundering (FEE, 2009:27). It is suggested that accountants in Europe follow the guidelines provided by the FATF RBA Guidance for Accountants regarding suspicious circumstances and transactions (FEE, 2009:27).

Article 37 of the Third AMLD provides that a competent authority must be appointed to monitor and ensure compliance by the persons covered by the directive. This supervisory function may be performed by a self-regulatory body (European Union, 2005:L309/30) with self regulatory bodies playing an important role in the reporting process (European Commission [EC] – Deloitte, 2009:7). While the Third AMLD requires SAR/STRs to be reported to the relevant FIU, Article 23 provides that a suitable self-regulatory body of the accounting profession may be appointed to receive such reports. These reports must then be forwarded to the relevant FIU (European Union, 2005:L309/27). However, most EU countries require that the report be made directly to the FIU (FEE, 2009:28).

The Third AMLD does not specify that a MLRO must be appointed by a firm to receive internal reports, assess these reports and file them with either the FIU or self-regulatory body, if appropriate. However, many countries in Europe have introduced the concept of a MLRO in order to centralise the reporting obligations (FEE, 2009:26). The use of an MLRO may ensure that reports are dealt with swiftly and confidentially (Commonwealth Secretariat, 2006:95).



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Despite the fact that non-financial professionals, including accountants, have been included in the EU's AML reporting obligations, the number of reports made by these professionals throughout Europe has remained relatively low when compared to the number of reports from financial institutions (EC – Deloitte, 2009:243). The reasons for this low level of reporting are considered to be as a result of limited awareness and training, difficulties as regards the implementation of CDD processes and a lower number of suspicious transactions being handled by these professions compared to financial institutions (EC – Deloitte, 2009:243).

### 4.2.2 Confidentiality and privilege

The EU legislation provides whistleblowers with some protection for disclosures made in good faith. In terms of Article 26, a report made by a director or employee of an institution will not constitute a breach of confidentiality obligations in terms of any contractual, legislative, regulatory or administrative provisions and will not attract any liability (Cox, 2011:57).

Article 23(2) provides that accountants and attorneys are not obliged to report information received from or regarding their clients in the course of establishing the legal position of their client or while representing their clients during legal proceedings (Cox, 2011:51). This provision provides protection of information obtained which is subject to legal professional privilege. However, it is argued this is more likely to apply to attorneys than to the members of other professions (EC–Deloitte, 2009:222).

### 4.2.3 Tipping off

Following the FATF Recommendation, the Third AMLD requires that accountants are prohibited from disclosing to either the client or to a third person that an SAR/STR regarding money laundering has been sent to the FIU or appointed self-regulatory body (Cox, 2011:57). However, if an accountant is advising a client against a criminal course of conduct, this does not constitute "tipping off" (European Union, 2005:L309/28). Nevertheless, this prohibition does not prevent further investigation by the accountant regarding the nature of the transactions in order to complete his/her assignment; although such further investigation may require discussion with senior management (FEE, 2009:29).



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## 4.3 UNITED KINGDOM REQUIREMENTS FOR REPORTING SUSPICIOUS AND UNUSUAL TRANSACTIONS

The money laundering offence in the UK, as defined in POCA UK, basically covers any activity related to “criminal property” (Cox, 2011:65). Criminal property comprises the benefit arising from criminal conduct (APB, 2010:4), while criminal conduct relates to all unlawful acts within the UK (Cox, 2011:65). Money laundering includes a person being in possession of the benefits of his own unlawful activities (CCAB, 2008:13). However, a money laundering offence is not perpetrated if the person involved did not know or did not suspect that the funds in question were the proceeds of unlawful activities or if the suspicious activity was reported to the MLRO or relevant authority and consent was obtained prior to the act (CCAB, 2008:13).

The UK Regulations require that all accountancy practices be supervised by an appropriate AML supervisory authority. As regards the majority of auditors, external accountants, insolvency practitioners or tax advisers, this supervisory body is their relevant professional body. All five CCAB bodies, as listed in the glossary, as well as other accounting and tax bodies, such as the Chartered Institute of Management Accountants, constitute supervisory authorities. Any accountant who is not a member of one of these bodies, but who still falls within the ambit of the UK Regulations, will be supervised by Her Majesty’s Revenue and Customs (CCAB, 2008:9).

The CCAB has provided AML guidelines for the accounting sector in the UK as regards the interpretation of the provisions of the UK Regulations and primary AML/CFT legislation as well as practical advice on best practice. These guidelines have been approved by Her Majesty’s Treasury (CCAB, 2008:1). The reporting obligations for accountants based in the UK are discussed below.

### 4.3.1 Reporting obligations for accountants

The UK Regulations are applicable to businesses and individuals who act in the UK as auditors, external accountants, insolvency practitioners, tax advisers or TCSPs, in terms of Regulation 3(1)(c) and (e), hereafter referred to as the “defined services” (CCAB, 2008:7). These services are all defined in Regulation 3 of the UK Regulations. External accountants are defined as someone whose business includes



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the provision of accountancy services to other persons. “Accountancy services”, as defined by the CCAB, includes any contracted services relating to the recording, review, analysis, calculation or reporting of financial information (CCAB, 2008:8).

The CCAB guidelines define “individuals” as “sole practitioners and the partners, directors, subcontractors, consultants and employees of businesses” (CCAB, 2008:80). For the purposes of UK based accountants, the term “businesses” refers to companies, partnerships or other organisations which carry out the defined services (CCAB, 2008:79).

Following the enactment of the UK Regulations, the FATF conducted a follow up review of the UK’s AML/CFT system and assessed those areas which were previously found to be either partially or non compliant in the 2007 Mutual Evaluation report (FATF, 2009b:4). The review found that, in general, the UK Regulations apply to the full range of DNFBPs’ activities, as specified in the FATF Recommendations (FATF, 2009b:14).

The obligation to report arises “when a person knows or suspects or has reasonable grounds for knowing or suspecting that another person is engaged in money laundering”. However, such information must be obtained during the course of business within the regulated sector (CCAB, 2008:15). In addition, the person must be able to identify or assist with identifying the suspected party, or have information regarding the location of the illegal proceeds (CCAB, 2008:15). A report must be made regardless of the value involved or the seriousness of the crime (APB, 2010:12). These obligations are applicable to all relevant employees of the defined businesses and employees must, therefore, be made aware of their obligations (Cox, 2011:207). This type of report is known as a “protected disclosure” (CCAB, 2008:52).

Individuals within the defined services, who know, suspect or have reasonable grounds to suspect that money laundering is taking place and fail to disclose this knowledge or suspicion, perpetrate an offence (CCAB, 2008:14). The disclosure must be made via an internal report to the MLRO or via an SAR to the Serious Organised Crime Agency (SOCA) without delay (CCAB, 2008:15). The MLRO must assess the internal report and, if warranted, make a report to SOCA (APB, 2010:13).



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The terms “knowledge” and “suspicion” are not defined in the UK legislation and, thus, interpretation of these terms relies on legal judgements, the ordinary meaning of the words and the CCAB Guidance (CCAB, 2008:19). “Having knowledge” implies actually knowing that something is happening (Commonwealth Secretariat, 2006:138) while suspicion is more than supposition but less than knowledge; and it must have arisen from some form of evidence (Commonwealth Secretariat, 2006:138). The knowledge or suspicion must relate to money laundering and does not include an unintentional error made by the client which may be unlawful. In such an instance the client may be advised to correct the error and no report will be necessary if the matter is addressed (CCAB, 2008:19).

An accountant within the defined services is required to make a report when there are reasonable grounds for knowing or suspecting money laundering (CCAB, 2008:20). This stipulation creates an objective test in that it is not possible for accountants to assert ignorance where a person with the same training and position would reasonably be expected to know or suspect money laundering in the same situation (Commonwealth Secretariat, 2006:138). However, reasonable grounds are not the same as the existence of high risk factors, which call for increased awareness when conducting CDD and undertaking professional work for a client. For reasonable grounds to exist it is essential that there be sufficient information available to move past mere speculation that money laundering is likely (CCAB, 2008:20).

Professionals are expected to make enquiries that would reasonably be expected of a person with those qualifications, experience and expertise in those circumstances, and within the scope of the contracted work. They are then expected to draw reasonable conclusions and not to ignore the information they have acquired (CCAB, 2008:20). However, additional enquiries to obtain more information on the criminal offence are not required (APB, 2010:11). However, if further enquiries are made, the accountant should take care to not to tip off the client, or the client’s management or directors (APB, 2010:12).

Regulation 20 of the UK Regulations provides that persons covered by the regulations must have policies and procedures that provide for the identification and scrutiny of complex or unusually large transactions or unusual patterns of



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transactions that have no visible economic or legal purpose, or any other activity which may possibly, as a result of its nature, be linked to money laundering. Businesses within the defined services may encounter activity in the client's business which may be perceived as possibly being linked to money laundering as a result of its nature and such businesses have a duty to pay special attention to such activity (CCAB, 2008:30).

The following defences are available to persons who fail to report, namely, there is an acceptable explanation for failing to disclose (duress or threats to safety would possibly be considered acceptable); the legal privilege exemption applies, the person had no knowledge or suspicion that money laundering had occurred and had not been given the mandatory training by his/her employer; or the money laundering is occurring outside of the UK and is not illegal in the country in which it is occurring (CCAB, 2008:15).

In addition to making an SAR, accountants may need to obtain prior approval from SOCA to provide a service that may constitute money laundering. Furthermore, continuing to act for the client may, itself, constitute money laundering and the accountant should consider whether it would be preferable to resign, after consultation with the MLRO (APB, 2010:17).

POCA UK also provides that any persons who form a money laundering suspicion during the course of their trade, profession, business or employment, even if they are not acting within the defined services or other regulated services, may make a protected disclosure (CCAB, 2008:52). A voluntary report may, therefore, be made by any business, individual or other organisation to SOCA in the public interest (CCAB, 2008:52).

An analysis of the spread of total SARs submitted over the period from October 2007 to September 2009 revealed that accountants had provided three percent only of the total reports submitted to SOCA, while nearly eighty percent had been provided by the banking sector (Serious Organised Crime Agency [SOCA], 2010:13).



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### 4.3.2 Confidentiality and privilege

Accountants may not use client confidentiality concerns as a reason not to report, except if privilege applies. Accountants are legally protected against breach of any confidentiality restrictions provided that the report was properly made. However, this protection does not apply if a report was made based on either speculation or "just in case" (CCAB, 2008:53). While legislation provides protection against civil action arising from a breach of confidentiality, accountants have no protection against reputational damage arising from such a breach, if the breach was made in error (Commonwealth Secretariat, 2006:95). The personal security of accountants may even be endangered. Accordingly, it is essential that there be processes in place to protect the confidentiality of such reports, both internally and externally (CCAB, 2008:62).

In the UK the approach is adopted that the legal privilege exemption does not, in general, extend to auditors who are carrying out standard audit work (APB, 2010:15). Furthermore, regular book-keeping, preparation of financial statements or tax compliance do not give rise to this exemption (CCAB, 2008:66).

The defence of privilege circumstances in terms of POCA UK was amended in 2006 to extend this defence to relevant professional advisors (APA, 2010:14). The privilege exemption was extended to accountants and tax advisors in order to address the concern that members of these professions were being placed at a competitive disadvantage as compared to the legal profession (Fisher, 2010:8).

In terms of the UK legislation, a relevant professional advisor (an accountant, auditor or tax advisor who is a member of a professional body, as defined in the glossary), is exempted from making a SAR if the information based on which the knowledge or suspicion arose was obtained in privileged circumstances (CCAB, 2008:63). However, this exemption is subject to the proviso that the information was not given to the professional for the purposes of furthering the criminal's activities (CCAB, 2008:67). Privileged circumstances may arise if, for example, advice on legal issues such as tax or company law matters is requested (APB, 2010:14). It is, however, noted that these privilege circumstances affect only the obligation to report money laundering and other related disclosures in terms of POCA UK. Legal professional



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privilege is not extended to advice provided by relevant professional advisors in any other circumstance (CCAB, 2008:64).

#### 4.3.3 Tipping off

In the UK, tipping off is an offence. Tipping off may occur when a person within the defined accounting services makes the following disclosures. Firstly, disclosing that a report to the relevant authority has been submitted or, secondly, revealing that an investigation into suspected money laundering offences is either being considered or is being conducted. In both cases, the likelihood should exist that such disclosures will prejudice the ensuing enquiry (APB, 2010:15). In addition, the information revealed must have been obtained in the course of business within the defined services (CCAB, 2008:16). The individual has a defence if he/she did not anticipate that revealing this information was likely to prejudice any investigation (Cox, 2011:228).

There are, however, exceptions to the disclosure prohibitions. Disclosures made in order to deter a client from pursuing criminal behaviour are permitted (FEE, 2009:29) while other permitted disclosures include reports to the supervisory body, law enforcement body, another employee within the same firm or between institutions. For example, disclosures are permitted from one accountant to another regarding the same client or a former client of both accountants (CCAB, 2008:17). If an accountant believes his/her client is engaged in money laundering, the auditor may wish to terminate the relationship. A conflict then arises between the information which is required by legislation to be disclosed on termination and the risk of tipping off the client. Legal advice should be sought in this situation (APB, 2010:18).

Prejudicing the investigation is a further offence and involves a person who has knowledge or suspicion of a money laundering investigation revealing information which is likely to harm the investigation; or tampering with, concealing or disposing of pertinent documents (APB, 2010:16).

### 4.4 SUMMARY

The reporting of suspicious and unusual transactions is considered a vital component of the AML framework of any country (FIC, 2008:8). The FATF



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Recommendations as well as EU and UK legislation have imposed reporting obligations on accountants. In the UK, these reporting obligations are applicable to businesses and individuals who provide the defined services (CCAB, 2008:80) while, in both the EU and UK, the reporting obligations apply to anyone providing accounting services, even if they are not members of a regulated profession (FEE, 2009:18). In the UK, all of the CCAB members constitute AML supervisory authorities (CCAB, 2008:9). As a result, the majority of accountants are enmeshed in the AML net.

In terms of EU and UK legislation, accountants are required to make a report when they have grounds either to know or to suspect that money laundering is occurring or being attempted (Cox, 2011:207). In the UK, a suspicious activity report is made when some activity or conduct, which has the features of money laundering, is observed during the course of business (CCAB, 2008:55). It is noted that, in the EU and UK, there is no requirement that the reporting business is receiving or is about to receive the proceeds of money laundering or is being used for money laundering before a report must be made.

Accountants may not use client confidentiality as an excuse for not reporting (CCAB, 2008:53). The EU and UK legislation provides accountants with protection from being sued for breach of confidentiality and also prohibits disclosing to the client that a suspicion report has been submitted (Commonwealth Secretariat, 2006:94). POCA UK has been amended to extend the legal privilege exemption to relevant professional advisors, but only in terms of the obligation to report money laundering (CCAB, 2008:64).

It is anticipated that, in terms of national legislation, accountants will be either legally required to make an SAR/STR or legal privilege will apply, preventing suspicious reporting. However, if there is some flexibility in the reporting requirements, accountants should, nevertheless, consider that these reports are essential in the fight against money laundering and other financial crimes; and furthermore, they should consider their ethical obligations to protect the public interest (FATF, 2008b:27). Many professional bodies in the EU are of the opinion that applying AML obligations to the accounting profession will have a definite impact on the war against money laundering (FEE, 2009:16).



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# CHAPTER 5: REPORTING REQUIREMENTS IN SOUTH AFRICA

## 5.1 SOUTH AFRICAN LEGAL FRAMEWORK

South Africa's AML framework is governed by both POCA and FICA. POCA provides for the main money laundering offence while FICA sets out the administrative money laundering control requirements for accountable institutions and ordinary businesses (Agulhas & De Koker, 2003:2).

As stipulated in POCA the offences relating to money laundering include participation in money laundering transactions and acquiring, making use of or possessing the proceeds of the criminal activities of someone else (IRBA, 2011a:6). Of particular relevance to accountants is the money laundering offence created by POCA section 5 regarding the provision of assistance to another to enable the retention or control of the proceeds of unlawful activities (Burdette, 2010:14). It is, thus, only a person who knows or ought reasonably to have known the funds in question were the proceeds of crime who commits a money laundering offence (De Koker, 2005: Com 2–24).

The term "proceeds of unlawful activities" is defined by FICA, with reference to POCA, as "any property or any service, advantage, benefit or rewards; which are derived, received or retained, directly or indirectly, in South Africa or elsewhere, at any time before or after the commencement of POCA, in connection with or as a result of any unlawful activity carried on by any person" (FIC, 2008:11). "Unlawful activity" is described as "any conduct which constitutes a crime or which contravenes any law whether such conduct occurred in the Republic or elsewhere" (FIC, 2008:12).

FICA came into effect on 1 February 2002 and provided for the establishment of the Financial Intelligence Centre (FIC) (Burdette, 2010:15). The aim of the FIC is to assist with the detection of the proceeds of crime and the prevention of money laundering (Burdette, 2010:15). All reports made in terms of FICA are sent to the FIC which analyses the reports and distributes information to the applicable investigating authorities (IRBA, 2011a:7). FICA was amended in terms of the Financial Intelligence Amendment Act, No 11 of 2008, which came into operation on 1



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December 2010 (IRBA, 2011a:3). Accordingly, FICA must now be read with the amendments as well as the regulations and exemptions as amended. In addition, the FIC has issued guidance notes on compliance with specific FICA requirements (Burdette, 2010:15).

FICA provides for three categories of institutions, each with different responsibilities and obligations in terms of FICA. Firstly, accountable institutions, listed in Schedule 1, must comply with all of the requirements of FICA. Secondly, reporting institutions, listed in Schedule 3, being dealers in motor vehicle and dealers in Kruger rands, must report suspicious or unusual transactions and cash transactions above the prescribed amount. Finally, any person who carries on, is in charge of, manages or is employed by a business has a duty to report suspicious or unusual transactions (Agulhas & De Koker, 2003:2).

In January 2011, the IRBA issued *A Guide for Registered Auditors Combating Money Laundering and Financing of Terrorism* (hereafter referred to as the IRBA Guide) to provide its members with general guidance on South African AML/CFT measures. The IRBA Guide provides guidance for registered auditors as regards their compliance obligations, their responsibilities when conducting an audit and the supervisory role played by IRBA in terms of FICA (IRBA, 2011a:n.p.).

The generic reporting obligations of suspicious and unusual transactions related to the proceeds of unlawful activities and money laundering, in terms of FICA, and the way in which these obligations apply to accountants are discussed later in this chapter. The FATF and ESAAMLG Mutual Evaluation Report of South Africa, issued in 2009, identified certain deficiencies in South Africa's AML measures as they apply to accountants and these are also discussed in this chapter.

## 5.2 GENERAL REPORTING OBLIGATIONS REGARDING SUSPECTED MONEY LAUNDERING

### 5.2.1 Section 29: Suspicious and unusual transactions

In terms of South African legislation, with effect from 3 February 2003, the duty to report suspicious and unusual transactions is imposed by FICA section 29. This replaced the reporting obligation as stipulated in POCA section 7 (De Koker, 2005:Com 3–7). There is, however, no monetary threshold applicable to this section



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and, if circumstances arise which indicate the possibility of a suspicious or unusual transaction, this must be reported, regardless of the amount (FIC, 2008:17).

This reporting obligation applies to any person who carries on a business, including a manager or employee of a business (FIC, 2008:9). The term "business" is not defined in FICA, but the ordinary meaning of the term, namely, that a business is a commercial activity or institution, should apply (FIC, 2008:9). A business was defined in Standard General Insurance Company v Hennop 1954 4 SA (A) as "anything which occupies the time and attention and labour of a man for the purposes of making a profit" (IRBA, 2011a:9).

Section 29(1) of FICA provides that, if any person, as described above, has knowledge or a suspicion that certain transactions are of a suspicious or unusual nature, as specified in the section, then that person is obliged to report this to the FIC (De Koker, 2005: Com 3–8). The obligation arises when a person has knowledge of certain facts or if that person should reasonably have known or been suspicious about certain facts (FIC, 2008:10). However, reporting in terms of section 29 refers to situations and transactions dealing with the proceeds of unlawful activities and money laundering, and not to general criminal activities (FIC, 2008:12). Section 29(1) requires reporting on a broad range of circumstances regarding both the business itself and the business's transactions (De Koker, 2002a:28).

Circumstances relating to the business which should be reported are as follows: if the business has received or is going to receive the proceeds of crime or is going to be used to launder money (FIC, 2008:10). It is noted that this duty applies only to the business which is receiving the unlawful proceeds; and no reporting duty arises if the proceeds have been received or are about to be received by another business (De Koker, 2005: Com 3–9). It is noted that there is a peculiarity in the wording of section 29, which refers to situations in which proceeds are "received", as compared to the wording of section 28 of FICA which creates a reporting duty when cash is "received" or "paid" by an accountable or reporting institution.

A circumstance that gives rise to a suspicious transaction to which the business is a party concerns transactions between the business and its clients and the client's reason for undertaking the transaction (FIC, 2008:11). This may apply to either a



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single transaction or a range of transactions where a person knows or suspects that a transaction or series of transactions to which the business is a party:

i. "facilitated or is likely to facilitate the transfer of proceeds of unlawful activities ...;
ii. has no apparent business or lawful purpose;
iii. is conducted to avoid giving rise to a reporting duty under this Act or;
iv. may be relevant to the investigation of an evasion or attempted evasion of a duty to pay any tax ... administered by the Commissioner of the South African Revenue Service; or
v. relates to an offence related to the financing of terrorist and related activities" (FICA, section 29).

FICA section 29(2) states that a report must be made even if mere enquiries are being made regarding a transaction which would have had the effect of causing one of the circumstances as listed above to occur.

A "transaction" is defined as a "transaction concluded between a client and an accountable institution in accordance with the type of business carried on by that institution" (FICA, section 1). If this definition is applied to section 29, it would appear that any suspicious transactions concluded by any other business apart from accountable institutions are not reportable, thus rendering section 29 meaningless to all except accountable institutions (Burdette, 2010:18). De Koker (2005: Com 3–9) contends that the definition of "transaction" in terms of section 1 should not apply to section 29. Van der Westhuizen (2004c) further argues that the "ordinary, grammatical meaning" should be applied to the term for the purposes of section 29.

It is noted that, as with the reporting obligation regarding suspicious or unusual circumstance relating to the business, the reporting duty regarding suspicious transactions arises only if the business is party to the transaction (De Koker, 2005: Com 3–9).

Knowledge is defined as actual knowledge − an awareness, conviction or belief arising from circumstances such as actual participation in an offence or receiving information from criminals regarding an offence. Another element of knowledge is



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known as “wilful blindness”; where a person has a strong suspicion of a wrongful act but intentionally fails to pursue that suspicion or make reasonable enquiries into the matter, it is not possible for the person to claim a lack of knowledge regarding the matter (De Koker, 2005: Com 2–25).

Suspicion is not defined in FICA and, thus, interpretation of this term relies on both the ordinary meaning of the word and on legal judgements (FIC, 2008:13). The ordinary meaning of suspicion relates to the belief an individual has of the existence of something without having any proof to verify that belief (FIC, 2008:13). Circumstances which may appear suspicious to one person may not be so to another and, as such, the suspicion is a subjective state of mind (Burdette, 2010:19). Burdette (2010:19) argues that, for the purposes of FICA, there must be some reasonable grounds for a suspicion to arise and the suspicion should not be based on wild speculation. A level of objectivity is, however, provided in FICA section 29(1) by the phrase “ought reasonably to have known” (FIC, 2008:13). In addition, section 29(2) provides that the basis for the suspicion or knowledge must also be reported when an STR is made to the FIC (De Koker, 2005: Com 3–11).

### 5.2.2 Confidentiality and privilege

In terms of FICA section 37(1), no duty of secrecy or confidentiality in terms of South African law may prevent compliance with the duty to make an STR under FICA. However, this provision does not apply to situations where legal professional privilege, as defined in section 37(2), protects confidential communications between an attorney and the attorney’s client (FIC, 2008:19). However, legal privilege extends only to the relationship between an attorney and his client and does not include communications between accountants or other professionals and their clients (Burdette, 2010:26).

As discussed in Chapter 3, information that is confidential is not the same as information that is subject to legal privilege. There is, however, uncertainty concerning the interpretation of legal privilege (FATF & ESAAMLG, 2009:170).

FICA section 38 provides legal protection for a person who makes an STR in good faith; in that no legal action may be taken against such a person for breach of confidentiality (Burdette, 2010:20).



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### 5.2.3 Tipping off

In line with the FATF's Recommendation 14, section 29(3) of FICA prohibits the disclosure by the reporting person of the fact that an STR has been submitted, or of any information regarding the report, to either the person about whom the report is made or to any other person, subject to certain stipulated exceptions. In terms of FICA section 29(4) this prohibition is also extended to any another party who may know or suspect that an STR has been submitted (FIC, 2008:20).

The exceptions to this prohibition include situations where the information is disclosed in terms of the person's legislated powers and duties in order to carry out the provisions of FICA and for the purpose of legal proceedings or in terms of a court order (FIC, 2008:20).

### 5.2.4 Offences and defences

Failure to report a suspicious or unusual transaction is an offence in terms of FICA section 52. Furthermore, the report must contain the prescribed information and be submitted within the prescribed timeframe, with failure to do so also comprising an offence. FICA section 52(2) provides that any person who reasonably ought to have known or suspected the existence of any of the situations as described in section 29, and who negligently fails to report the information, is guilty of an offence (Burdette, 2010:21).

Section 69 of FICA provides that, if a person who is an employee, director or trustee of an accountable institution is charged with failure to make an STR, such a person may raise the defence that he/she reported the issue to the appropriate compliance officer or, in certain cases, his superior, if it may be proved (FIC, 2008:21). However, this defence is not available to ordinary businesses or reporting institutions and their employees and directors who must make an STR directly to the FIC (De Koker, 2005:Com 3–28).

By processing or concluding a suspicious transaction, a person is committing a money laundering offence in terms of POCA. However, if the suspicious transaction was reported to the FIC in terms of section 29, this fact may be used a defence (Agulhas & De Koker, 2003:3).



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Failure to comply with AML obligations may have serious consequences. The penalty for a person convicted of non-reporting is imprisonment for a period of up to fifteen years or a fine of up to R100 million (FICA, section 68).

## 5.3 ACCOUNTABLE INSTITUTIONS

### 5.3.1 Obligations of accountable institutions in terms of FICA

Accountable institutions are entities or individuals whose business activities are listed in Schedule 1 of FICA (Agulhas & De Koker, 2003:4). Accountable institutions include, *inter alia*, financial institutions such as banks, long term insurance providers, financial services providers, estate agents as well as attorneys (IRBA, 2011a:29).

In addition to the section 28 and 29 reporting requirements, all other AML/CFT compliance obligations, as required by FICA, are applicable to accountable institutions (De Koker, 2002a:43). In terms of section 21(1), accountable institutions have a duty to establish and verify the identity of potential clients before embarking on any dealings with them (De Koker, 2002a:25). This includes establishing and verifying the identity of other persons on whose behalf the client may be acting (FICA, section 21(1)(b)). FICA section 22 requires accountable institutions to maintain detailed records of the client's identity while documents used to verify the identity, the nature of the business relationship and details of all transactions with the client must be kept for a period of at least five years.

Accountable institutions are required to develop and implement appropriate internal controls (Agulhas & De Koker, 2003:5). Regulation 27 of the Regulations in terms of FICA (Regulations) provides that accountable institutions must provide staff with processes and guidance to facilitate the identification of suspicious and unusual transactions, to ensure that such transactions are reported promptly and to ensure that responsibilities are properly allocated (Regulations, 2003:32).

An accountable institution must provide training to its employees to enable them to comply with both FICA and the relevant internal rules. Furthermore, accountable institutions must appoint a compliance officer whose duties include ensuring that both the accountable institution and its employees comply with their FICA obligations and the internal rules (FICA, section 43).



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Many of the examples of the red flag indicators of suspicious or unusual transactions as listed by the FIC's Guidance Note 4 on Suspicious Transaction Reporting arise during the identification and verification process (FIC, 2008:16). It is, thus, argued that, while the additional obligations may be considered onerous for accountable institutions, they will help facilitate the identification and reporting by employees of suspicious and unusual transactions.

### 5.3.2 Accountants as accountable institutions

The schedule of accountable institutions does not specifically include accountants and auditors as regards the general business activities of accountants and auditors. However, an accountant or accounting firm will be considered an accountable institution if any of the activities listed in Schedule 1 of FICA are conducted by the business. These activities may constitute part of the scope of a business unit of the accounting firm (Agulhas & De Koker, 2003:4). Furthermore, according to the IRBA Guide, the qualifications and activities of the firm's employees may result in an employee being classified as an accountable institution (IRBA, 2011a:15.).

The services, in terms of Schedule 1, considered most likely to apply to accountants are item 12 and, to a lesser extent, item 2. Item 12 refers to a person who is a registered financial service provider, in terms of the FAIS Act, and who provides investment advice and intermediary services relevant to a financial product (IRBA, 2011a:15). Investment advice and intermediary services are defined in Chapter 1 of this research study. Item 2 refers to the trustees of trusts who administer trust properties as part of their regular business. It is noted that exemptions 7 and 10(2) of the Regulations provide for exemptions from client identification and record keeping obligations, for both items 12 and 2 respectively, in limited circumstances (IRBA, 2011a:16).

The FIC has issued a Public Compliance Communication to provide clarity on the scope of item 12 in respect of registered auditors (FIC, 2012:3). In terms of item 12, registered auditors who provide advice or intermediary services as regards the investment of financial products may be regarded as accountable institutions, by virtue of their carrying out this business (FIC, 2012:4). It is, thus, implied that such registered auditors are licensed financial services providers in terms of the FAIS Act (FIC, 2012:4).



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IRBA recommends that registered auditors who are not accountable institutions appoint a compliance officer (IRBA, 2011a:4). Furthermore, when accepting a new client and conducting an audit, auditors are required to consider the integrity of the client, understand the nature of client's business and the industry in which the client operates, assess the client's internal controls and assess the risk of material misstatement (IRBA, 2011a:22). It is, thus, argued that, in effect, the auditor does conduct some form of customer due diligence, even if the auditor is not an accountable institution.

South Africa's AML/CFT mutual evaluation conducted by the FATF and ESAAMLG identified the limited scope of activities which will result in accountants being accountable institutions as an issue and out of line with Recommendation 12 (FATF & ESAAMLG, 2009:161). In addition, it was found that, although accountants may participate in the creation or management of companies, when they conduct this business activity they are not subject either to FICA or to any supervision (FATF & ESAAMLG, 2009:177).

## 5.4 REPORTING OBLIGATIONS OF ACCOUNTANTS

The reporting of suspicious or unusual transactions in terms of section 29 of FICA is applicable to all businesses (FATF & ESAAMLG, 2009:166). However, the obligation to make an STR arises only when the reporter's business has received or is about to receive the proceeds of unlawful activities, is party to a transaction linked to money laundering or tax evasion or has been or is being used for the purpose of money laundering (IRBA, 2011a:25). Accordingly, an accountant's business must be linked to the suspicious transaction if the reporting obligation is to arise (Agulhas & De Koker, 2003:5).

The obligation to report, in terms of section 29, will not, in general, apply to an auditor who, during an audit, perceives that his client has entered into a suspicious transaction with another party, as neither the auditor nor his business were party to the transaction (IRBA, 2011a:25). However, if an accountant or auditor becomes party to a suspicious or unusual transaction, has received or is about to receive proceeds of crime, or has been or is about to be used for money laundering purposes in some way, the duty to report arises (Agulhas & De Koker, 2003:5). The



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duty to report will arise if, for example, the client is a front for a money laundering scheme and the auditor determines that the client is using the auditor's reputation to legitimise the client's operations or that the fees paid by the client are "tainted" as a result of these illegal operations (IRBA, 2011a:25). "Tainted" property refers to any benefit arising from or connected to unlawful activities (IRBA, 2011a:10).

Agulhas and De Koker (2003:5) argue that, if the suspicious transaction does not fall within the limited scope of section 29, the duty to report does not arise and there may be a breach of client confidentiality if the accountant submits an STR. The protection against breach of confidentiality as provided in terms of section 38(1) applies only to those who apply FICA's provisions in good faith (Agulhas & De Koker, 2003:5).

An accountant is prohibited from tipping off the client or another party that an STR has either been made or is being contemplated. There is a concern that an accountant in such a position may tip off the client if the audit is continued and further questions regarding the suspicious transaction are asked (Agulhas & De Koker, 2003:5). However, *bona fide* enquiries made in the course an audit in order to obtain sufficient audit evidence to substantiate the opinion of the financial statements as well as the actions taken to meet the requirements of the APA procedures do not constitute tipping off (IRBA, 2011a:26). Auditors are required to make enquiries and disclosures in order to comply with legislation and protect the public interest. Legal advice should be obtained if there is a concern that the client may be tipped off as a result of enquiries or disclosures (IRBA, 2011a:26). This may be a further concern if the auditor wishes to resign from the audit if he/she believes the client is engaged in money laundering.

It is essential that accountants be aware of both their reporting obligations and of the fact that allegations of participation in money laundering, whether intentional or not, may result in a loss of reputation as well as having a damaging effect on business dealings (IRBA, 2011:4).



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## 5.5 SUPERVISORY BODY

The IRBA is listed as a supervisory body in terms of Schedule 2 of FICA (IRBA, 2011a:20). Accordingly, overseeing compliance with FICA by registered auditors whose activities fall within the ambit of Schedule 1 of FICA is the responsibility of the IRBA (IRBA, 2011a:3). The Financial Intelligence Centre Amendment Act, No 11 of 2008 extended the scope of the IRBA's inspection and enforcement powers with the effect that IRBA may conduct inspections of all audit firms (IRBA, 2011a:3).

However, the IRBA has jurisdiction over registered auditors only, of which there are approximately 4 500 in South Africa (FATF & ESAAMLG, 2009:171). There are currently approximately 26 000 local Chartered Accountants in South Africa (SAICA, 2011b). Accordingly, the IRBA's supervisory role is limited to a relatively small number of accountants (FATF & ESAAMLG, 2009:171).

The Financial Services Board (FSB) is also listed as a supervisory body and is responsible for ensuring compliance by institutions registered in terms of the FAIS Act (FIC, 2012:5). Therefore, an accountant, who is not a registered auditor, may be supervised by the FSB if the accountant is providing investment advice. However, the FSB's supervisory role does not extend to other activities provided by accountants and which should, according to the FATF Recommendations, be covered by a supervisory body (FATF & ESAAMLG, 2009:171).

## 5.6 ROLE OF ACCOUNTANTS AND AUDITORS IN ANTI-MONEY LAUNDERING COMPLIANCE

Fraud, error and non-compliance with relevant legislation may result in the misstatement of a client's financial statements. The money laundering offence, whether perpetrated intentionally or negligently, amounts to non-compliance with legislation. Although auditors are not legally required to conduct tests specifically designed to detect money laundering, the risk that money laundering may be taking place should be assessed (IRBA, 2011a:21). Furthermore, the auditors should consider the risk of non-compliance with AML control obligations by their client; for example, whether the client an accountable institution and what steps have been taken to comply with FICA (Agulhas & De Koker, 2003:6). Auditors are required to



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understand the laws and regulations applicable to their clients so as to enable them to make this determination (IRBA, 2011a:23).

Accountants and auditors may assist their clients with implementing AML controls and ensuring the clients are complying with all applicable legislation and regulations (Agulhas & De Koker, 2003:6). If services are provided to an international client, consideration must be given to the foreign country's AML/CFT legislation (IRBA, 2011a:4). Auditors may also be engaged to conduct detailed investigations which are beyond the scope of standard audits if a client has concerns regarding money laundering (IRBA, 2011a:22).

## 5.7 REPORTING BY ACCOUNTANTS

According to a survey conducted by Standing and Van Vuuren (2003:9), while most accountants are aware that there are AML measures in place in South Africa, many are confused as to what these measures are and how they impact on their work. In addition, there is greater confusion regarding the legal reporting requirements of suspected money laundering (Standing & Van Vuuren, 2003:9). It has also been found that there is confusion within the accounting industry regarding both the definition of investment advice and when the requirements relevant to an accountable institution become applicable (FATF & ESAAMLG, 2009:166). As discussed previously, apart from IRBA, none of other accountancy bodies in South Africa has issued guidelines to assist their members in understanding the requirements of FICA.

A number of inspections conducted of registered auditors during 2011 determined that there are several auditors who are uncertain regarding the definition of an accountable institution. Furthermore, in general, no AML training is being provided on the IRBA Guide, no compliance officers are being appointed and, apart from a small number of firms, no reporting procedures have been put in place. It would appear that auditors are either of the opinion that the IRBA Guide does not apply to them or they do not have the resources available to implement the requirements (Brink, 2011:11).



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Auditors are relying on the Reportable Irregularity procedure provided for in section 45 of the South African APA as regards compliance with AML legislation (Brink, 2011:11). The reporting requirements in terms of the APA are, however, beyond the scope of this research.

The FIC received 37 000 STR's during the year ended 31 March 2011, with 94% of these reports being received from the financial sector (FIC, 2011:6). The FIC does not, however, provide statistics on the number of reports received from accountants and auditors. Based on the discussion above, it is anticipated that the number of STRs made to the FIC by accountants and registered auditors would be extremely low.

## 5.8 SUMMARY

FICA section 29 creates the obligation to report suspicious or unusual transactions relating to money laundering, the proceeds of crime or terrorist activities (FIC, 2008:12). Failure to report a suspicious or unusual transaction is an offence in terms of section 52 of FICA and would result in serious criminal and civil penalties (Burdette, 2010:21). Any person who carries on, manages or is in charge of, or is employed by a business and knows or suspects certain facts, has an obligation to make an STR to the FIC. The report must contain the basis on which the suspicion or knowledge has arisen as well as prescribed details of the transaction and must be made within 15 business days (Van der Westhuizen, 2004b).

However, suspicious conduct on the part of a client does not automatically create the obligation to make an STR and section 29 sets out certain criteria which must be met before the obligation arises (Van der Westhuizen, 2004b). For the reporting obligation to arise the business must become party to a transaction that will either facilitate money laundering or has no legal or business purpose or the business itself must be in the process of being used or will be used in some way for money laundering purposes (IRBA, 2011a:3). In addition, there must be a connection between the reporting person's business and the suspicious or unusual transactions or act (Van der Westhuizen, 2004b). However, unless the business is party to the transaction or has or is about to receive the proceeds of unlawful activities or be used for money laundering purposes, no duty to make an STR arises (De Koker,



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2005:Com 3–9). Therefore, with regard to accountants in their capacity as auditors, this reporting duty will not arise during the normal course of an audit (FATF & ESAAMLG, 2009:169).

The notion of a "suspicious or unusual transaction" is vague and FICA does not provide a definition of the term (Van der Westhuizen, 2004b). Furthermore, while the term "transaction" is defined by FICA, this definition is confusing and requires clarification (Burdette, 2010:18).

While accountants and auditors have a duty of confidentiality, the duty of confidentiality is not absolute (Agulhas & De Koker, 2003:5) with FICA overriding secrecy and confidentiality obligations in terms of South African law (FIC, 2008:19). Confidentiality is not privilege and privilege extends only to an attorney–client relationship, it does not extend to either accountants or auditors (Burdette, 2010:26, 33).

Accountable institutions are required to comply with a number of AML administrative measures, including customer identification and verification, record keeping, developing and implementing internal procedures, providing relevant training and appointing a MLCO to ensure compliance (Burdette, 2010:22). A director or employee of an accountable institution may report their suspicions to either the compliance officer or the MLCO (FIC, 2008:21). However, it is argued that these measures facilitate the identification and reporting of suspicious and unusual transactions.

Accountants and auditors are not listed as accountable institutions in their normal capacity (Agulhas & De Koker, 2003:4) and are included as accountable institutions only when they provide investment advice or intermediary services (FATF & ESAAMLG, 2009:161). However, this is not in line with FATF Recommendation 12, as accountants are not included when they provide all of the activities prescribed in Recommendation 12 (FATF & ESAAMLG, 2009:161).

In terms of the supervision, as required by the FATF, IRBA is the designated supervisor for AML/CFT compliance on the part of registered auditors (FATF & ESAAMLG, 2009:171). However, registered auditors comprise a fairly small number



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of the accounting profession in South Africa only and, therefore, IRBA's supervision is limited to a small number of accountants (FATF & ESAAMLG, 2009:171). The FSB is also a supervisory body for accountants who provide investment advice and who are not registered auditors. Nevertheless, there are still some accountants who are not supervised (FATF & ESAAMLG, 2009:171).

Research has found that accountants lack clarity regarding the overall AML measures in place in South Africa and the way in which these measures impact on their activities (Standing & Van Vuuren, 2003:9).



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# CHAPTER 6: COMPARISON OF THE SOUTH AFRICAN AND INTERNATIONAL REPORTING REQUIREMENTS IN RESPECT OF ACCOUNTANTS

This chapter should be read in conjunction with the table in Annexure 1, which provides an overview of the FATF Recommendations applicable to this research and the application of these recommendations by the EU, UK and South Africa.

There are international expectations that accountants and auditors are able to identify and report on suspicious transactions that are indicative of money laundering (Agulhas & De Koker, 2003:6). As discussed in prior chapters, the FATF Recommendations, the EU and the UK have incorporated accountants into their AML frameworks. This chapter will briefly highlight the differences as regards the responsibilities of accountants in terms of South African legislation and those of accountants based in Europe and the UK and the FATF Recommendations as they apply to accountants.

## 6.1 PERSONS CONCERNED

The FATF Recommendations set out measures to be implemented to prevent money laundering and that apply to financial institutions as well as to DNFBPs, including accountants when their activities fall within the ambit of FATF Recommendation 12 (FATF, 2003:2). The activities applicable to accountants include buying and selling real estate or business entities; managing bank, savings or securities accounts; organising contributions for the creation, operation or management of companies and creating, operating or managing legal persons or arrangements (FATF & ESAAMLG, 2009:165).

The FATF identified that accountants in public practice provide a range of services to their clients, for example, audit and assurance services, bookkeeping, the preparation of financial statements, tax advice and planning, internal audit services including recommendations regarding internal controls and risk reduction, review of regulatory returns, compliance services, advice on deal structuring and investments, and forensic accounting and audit services (FATF, 2008b:3–4). The services provided by accountants which are the most useful to potential money launderers



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include financial and tax advice, the formation of corporate vehicles or other complex legal arrangements, the buying or selling of real estate or performing financial transactions on behalf of their clients (FATF, 2008b:4). Accountants may also perform trust and company services as covered by the FATF (FATF, 2008b:2).

The EU Third AMLD's AML provisions apply to financial institutions and credit institutions as well as to a range of professional activities which include those performed by external accountants, auditors, tax advisors and TCSPs, when they are acting in their professional capacity (European Union, 2005:L309/20).

The UK's AML legislation follows the EU's directive and applies to businesses of which the activities fall within the regulated sector, as defined, and includes external accountants, auditors, tax advisors and TCSPs as well as insolvency practitioners, as defined in the UK Regulations (CCAB, 2008:7). In addition, the UK AML legislation applies to any individual who provides accounting or tax services; and is not limited to either those permitted to provide a regulated service or those who are members of a regulated profession (FEE, 2009:33). FATF found that, in general, the full range of activities of DNFBPs, as defined in the FATF Recommendations, are included in the UK Regulations (FATF, 2009b:14). No specific deficiency regarding accountants and the range of activities provided by accountants, in terms of Recommendation 12, was identified by the FATF in the follow up report. It may, thus, be inferred that the UK have extended the reporting obligations to all of the professional activities of accountants, as suggested by the FATF.

South Africa's FICA stipulates three different classifications for businesses or individuals which determine the money laundering control obligations of either those businesses or those individuals. These classifications include accountable institutions; reporting institutions and any other business or person who manages or is employed by a business which is not either an accountable or a reporting institution (De Koker, 2005:Com 4–3).

The list of accountable institutions includes many of the same financial institutions which are listed in the EU and UK's AML legislation. However, unlike the EU and the UK legislation, South Africa's FICA does not specifically include accountants and auditors as accountable institutions. Auditors are included only if they provide



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services as listed in Schedule 1 (IRBA, 2011a:15). The activities, per Schedule 1, which are most applicable to auditors include the activities involved when they act as financial services providers and provide investment advice or act as trustees (IRBA, 2011a:16). The FATF and ESAAMLG identified the limited scope of activities which result in accountants being regarded as accountable institutions as being out of line with Recommendation 12 (FATF & ESAAMLG, 2009:161).

### 6.2 ANTI-MONEY LAUNDERING OBLIGATIONS

The FATF Recommendations require accountants who fall within the ambit of the recommendations to conduct CDD, keep records of the due diligence and any transactions and consider complex or unusual transactions (FATF, 2008b:2). Accountants are also required to report suspicious or unusual transactions to the FIU (FATF, 2003:5). Other obligations include developing internal AML controls and providing ongoing AML training to employees (FATF, 2008b:27–28). The FATF encourages countries to extend the reporting duty to all professional activities carried out by accountants, including auditing (Agulhas & De Koker, 2003:6).

In terms of the Third AMLD, the accounting profession must comply with the full set of AML obligations as set out in the directive. These obligations include applying CDD measures, reporting and record keeping obligations and the requirement to develop appropriate and adequate internal procedures, train staff and raise the awareness of money laundering (FEE, 2009:13). The internal procedures must cover the above obligations as well as provide policies in respect of risk assessment, risk management and compliance management and communication (FEE, 2009:14). The EU's AML obligations include the requirement to consider complex or unusually large transactions, transactions with no obvious economic or legal purpose or activities which, by their nature, are likely to be connected to money laundering (European Union, 2005:L309/27).

The UK Regulations follow the requirements set out in the Third AMLD and create the same AML obligations for professionals within the defined services in the UK. In addition, the UK Regulations provide for a MLRO to be appointed to receive and assess internal reports of suspicious or unusual transactions or activity before reporting to SOCA (CCAB, 2008:11).



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In South Africa, each of the three classifications, under FICA, has different AML obligations. Accordingly, an accounting business must determine under which classification it falls before it may establish which AML obligations are applicable (Agulhas & De Koker, 2003:3).

Accountable institutions must comply with all of FICA's compliance obligations (De Koker, 2002a:43). Accountable institutions have a duty to identify clients, keep records of business relationships and transactions, develop appropriate internal rules, provide AML training to their employees and appoint a compliance officer (Burdette, 2010:22). Accountable institutions are also obliged to report suspicious and unusual transactions, in terms of section 29, as well as cash transactions over the prescribed amount (Agulhas & De Koker, 2003:2). Employees, directors, trustees or partners of accountable institutions may report suspicious and unusual transactions to the MLCO or to the FIC (FIC, 2008:21). FICA does not expressly require institutions to consider transactions based on their complexity, size or unusual patterns (FATF & ESAAMLG, 2009:9).

Reporting institutions have two AML duties only − the duty to report suspicious and unusual transactions, in terms of section 29, and to report cash transactions over the prescribed amount directly to the FIC (Agulhas & De Koker, 2003:2).

Any other business, which is not an accountable or reporting institution, has a duty to report suspicious and unusual transactions directly to the FIC, in terms of section 29 (Agulhas & De Koker, 2003:2).

### 6.3 SUSPICIOUS TRANSACTION REPORTING

The FATF Recommendation 16 requires accountants to report suspicious transactions when they undertake financial transactions on behalf of or for their clients (FATF, 2003:6). The FATF provides that the reporting obligation arises when the institution suspects or has reasonable grounds to suspect that the funds are the proceeds of crime (FATF, 2003:5). The grounds for reporting include suspicious situations and suspicious transactions (FATF, 2008b:27).



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The EU's Third AMLD provides that the institutions and persons covered by the directive and, where applicable, their directors and employees, must report suspected money laundering (European Union, 2005:L 309/27). The Third AMLD provides that such persons are required to make a report to the national FIU when they know, suspect or have reasonable grounds for suspecting that money laundering is or has been occurring or is being attempted (FEE, 2009:27).

POCA UK requires a person to make a report to the MLRO or SOCA if he/she knows or suspects or has reasonable grounds to suspect that another person is engaged in money laundering and such information has come to his/her attention in the course of business in the regulated sector (CCAB, 2008:15). In the UK, individuals must consider whether an activity or behaviour which been noticed during the course of business has the features of money laundering and, if so, they must report their suspicions to the MLRO (CCAB, 2008:55).

In terms of section 337 of POCA UK, any persons who form a money laundering suspicion during the course of their trade, employment or professional activities may report such suspicion, even if they do not act within the regulated sector. Therefore, a voluntary report may be made by any individual, business or other institution, for example, a charity (CCAB, 2008:52).

In South Africa, the duty to report suspicious and unusual transactions applies to any person who carries on a business, is in charge of or manages or in employed by a business (FIC, 2008:9). However, this obligation is applicable only to businesses which conduct commercial activities and does not include charities or public sector institutions (FIC, 2008:9).

In terms of section 29 of FICA, the duty to make an STR arises when a person either knows certain facts or when circumstances arise where the person ought reasonably to have known or suspected certain facts (FIC, 2008:10). Unlike the EU and the UK, the obligation to report arises only when the business has or is going to receive the proceeds of criminal activities or when the business is party to a transaction that will either facilitate money laundering or has no legal or business purpose (IRBA, 2011a:3). Suspicious behaviour by one's client does not automatically create the



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duty to report such activity to the FIC and certain criteria must be met before the obligation arises (Van der Westhuizen, 2004b).

The term "transaction" is defined in FICA. However, as discussed in Chapter 5, this definition is confusing as it would appear that it applies only to transactions between accountable institutions and their clients (Burdette, 2010:18).

In both the UK and South African legislation, the term "suspicion" is not defined and interpretation relies on both case law and the ordinary meaning of the word (CCAB, 2008:18; FIC, 2008:13). Suspicion is, therefore, subjective and, thus, the UK legislation provides for an objective test in that a report should be made if there are reasonable grounds for suspicion (Fisher, 2010:5). This test acts as a deterrent to negligence on the part of the accountant and ensures that the information is not ignored (Fisher, 2010:5). Similarly, FICA section 29 incorporates objectivity with the phase "ought reasonably to have known or suspected". This phase, together with the requirement that the grounds on which the knowledge or suspicion is based must be reported, support the argument that the suspicion must have a reasonable, objective basis (Burdette, 2010:19).

## 6.4 CONFIDENTIALITY AND PRIVILEGE

The EU, UK and South African legislation all follow the FATF Recommendation and provide protection for a person who makes a report in good faith against litigation arising from any breach of confidentiality. Considerations of client confidentiality may not prevent a person from complying with the duty to report under the applicable AML legislation (CCAB, 2008:53; FIC, 2008:19).

The FATF recommends that, in instances where accountants suspect money laundering but the information is subject to legal professional privilege, similar to the legal privilege applicable to attorneys, they are not required to report their suspicion (FATF, 2008b:3). The Third AMLD follows this recommendation in that auditors, external accountants and tax advisors are not obliged to apply the reporting requirements to information obtained while determining the legal position of their clients or while representing their clients during legal proceeding (FEE, 2009:28).



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The original POCA UK applied the legal privilege exemption to attorneys only. However, this exemption was extended to relevant professional advisors in order to address concerns regarding attorneys having a competitive advantage over accountants and tax advisors (Fisher, 2010:8). However, this privilege exemption applies only to the obligation to report money laundering and other related disclosures in terms of POCA UK and it does not extend to advice provided by relevant professional advisors in any other circumstance (CCAB, 2008:64). Furthermore, this exemption applies only to advice on legal issues and does not apply to standard accounting and auditing work (CCAB, 2008:66).

FICA also provides for the protection of information subject to legal privilege. However, in terms of section 37, the common law right to legal professional privilege extends only to communications between attorneys and their clients (FIC, 2008:19). In South Africa, privilege does not extend to confidential communications between accountants and their clients (Burdette, 2010:26).

## 6.5 TIPPING OFF

The EU, UK and South African legislation all follow the FATF Recommendation and prohibit the disclosure to the client or any third party of the fact that a report has been made. However, this prohibition is subject to exemptions. The UK permits disclosures between institutions or to a supervisory authority for the purpose of preventing money laundering (CCAB, 2008:17). It is also an offence, in the UK, if someone who knows or suspects a money laundering investigation is being carried out makes a disclosure which is likely to prejudice the investigation or tampers with documents relevant to the investigation (CCAB, 2008:18).

## 6.6 SUPERVISORY BODY

The FATF requires that accountants have a self-regulatory body which is responsible for monitoring and ensuring AML compliance (FATF, 2008b:17). The Third AMLD provides that competent authorities must be appointed to monitor and ensure compliance with the directive while also providing that self-regulatory bodies may perform this function (FEE, 2009:24). In the UK, the CCAB was formed to constitute a consultative forum which acts collectively on behalf of the accounting profession



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(CCAB, 2012). All of the CCAB member bodies are AML supervisory bodies in terms of the UK Regulations, as are other UK accounting and tax bodies (CCAB, 2008:9). As a result, the majority of accounting professionals in the UK are members of a supervisory body.

In contrast to the UK, the IRBA is the only supervisory body among the accounting bodies in South Africa and has authority over registered auditors only. As a result only a small number of accountants in South Africa have a designated supervisor (FATF & ESAAMLG, 2009:171).

## 6.7 SUMMARY

The analysis in this chapter has identified a number of differences between the EU, UK and South Africa's interpretation and implementation of the FATF Recommendations. The FATF identified deficiencies regarding accountants as regards the application of the FATF Recommendations in terms of the South African AML measures in the 2009 Mutual Evaluation Report.

The EU and UK's AML framework applies to anyone providing accountancy or tax services and it is not limited to the members of a professional body (FEE, 2009:13). The UK has implemented the Third AMLD fully and requires accountants based in the UK to comply with a comprehensive set of AML obligations (FEE, 2009:17–18).

In contrast, South Africa's FICA provides for three different classifications of businesses and each classification must comply with different AML obligations (Agulhas & De Koker, 2003:2). Unlike in the UK, accountants in South Africa are not specifically included in the FICA in their capacity as accountants or auditors (Agulhas & De Koker, 2003:4). According to De Koker (2002a:21), it may prove difficult to establish whether a specific person or business meets the criteria of an accountable institution and which AML obligations would apply. The FATF and ESAAMLG rated South Africa as non-compliant with Recommendation 12, with one of the contributing factors being the fact that accountants are not included as accountable institutions when conducting all of the activities prescribed in that recommendation (FATF & ESAAMLG, 2009:166).



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The EU and UK require accountants who know or suspect or have reasonable grounds to suspect money laundering is taking place or will take place, to report such information and failure to do so constitutes an offence. In terms of the UK legislation, the information must have come to the person in the course of business within the regulated sector (CCAB, 2008:15). Persons who work outside the regulated sector may make a voluntary report (CCAB, 2008:52).

In South Africa, suspicions of money laundering must be reported only when the reporting business is party to a suspicious transaction or is about to receive the proceeds of money laundering or be used for money laundering purposes in some way (FIC, 2008:10). Therefore, even if suspicious conduct or a suspicious set of circumstances concerning one's client are observed, no duty to report these suspicions arises unless the individual's business is linked to either the offending transaction or act (Van der Westhuizen, 2004b). In addition, there is confusion regarding the interpretation of the term "transaction" which requires clarification (Burdette, 2010:18).

Legal privilege exemption is recognised throughout the FATF, EU, UK and South Africa as a defence for failing to disclose suspicious activity or transactions. The UK has made a special provision to extend the privilege exemption to accountants who meet the requirements of a relevant professional advisor for matters regarding legal advice or litigation, but only as it affects the duty to submit a SAR (CCAB, 2008:63). In South Africa, no such provision has been made and the legal privilege exemption applies to attorney–client relationships only (Burdette, 2010: 26).

The EU, UK and South Africa all prohibit the disclosure to the client of the fact that a report has been made. The UK does, however, allow disclosures between institutions or to a supervisory authority for the purpose of preventing money laundering (CCAB, 2008:17). In addition, it is a further offence to prejudice the investigation in any way in the UK (APB, 2010:16).

The majority of accountants in the UK have designated supervisory bodies in terms of the UK Regulations (CCAB, 2008:9). However, in South Africa, registered auditors only have a supervisory body in terms of FICA; while registered auditors comprise a



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relatively small number of the accounting profession in South Africa (FATF & ESAAMLG, 2009:171).



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# CHAPTER 7: CONCLUSION AND RECOMMENDATIONS

## 7.1 BACKGROUND TO THE RESEARCH

This research examines the accountant's duty to report suspicious and unusual transactions in terms of section 29 of FICA, as compared with the requirements regarding accountants in the EU and the UK and the FATF Recommendations. The objective of the research is to determine whether or not the South African reporting obligation for accountants is in compliance with the international guidelines of the FATF and follows the best practice established by the EU and UK.

In order to realise this objective and to place the issue into context, the meaning of money laundering, the money laundering process and the proceeds of crime and some of the typologies, as relevant to accountants and used to perpetrate money laundering, were examined. The nature of the accounting profession, the services it provides and the role accountants may play in preventing and detecting money laundering schemes were evaluated in order to understand the necessity for the accounting profession to assume AML obligations. The role accountants play in, knowingly or unknowingly, facilitating money laundering through their various services was also researched.

The FATF Recommendations and the EU and UK legislation regarding reporting requirements for accountants were analysed. The South African AML legislative and regulatory framework regarding money laundering, in terms of POCA, and the obligation to report suspicious and unusual transactions in terms of FICA were discussed. The South African reporting requirements were then compared to both the FATF Recommendations and the EU and UK requirements.

## 7.2 MAIN FINDINGS

### 7.2.1 Money laundering and anti-money laundering measures

Money laundering is a financial process used by criminals to disguise the origin of the proceeds of their criminal activities so they are able to enjoy the use of these funds (FATF, 2011b). Money laundering is a financial crime which affects both local and global economies as money laundering schemes often cross international borders. In addition, money laundering may threaten the integrity of both the local



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and international financial industry and the international markets as well as undermining the overall stability and good governance of a country (IMF, 2011a:1).

In response to international concerns regarding money laundering, the FATF was established in 1989 as an international AML standard setting body. The FATF has issued Forty Recommendations, which set out the AML countermeasures which countries should implement to combat money laundering (FATF, 2011b). The FATF also monitors the level of compliance of member countries and issues guidelines and typology reports (FATF, 2011a).

South Africa is a member of the FATF and has developed an AML legislative and regulatory framework which comprises two primary pieces of legislation, namely, POCA and FICA, in order to address the requirements of the international standards (Agulhas & De Koker, 2003:2). In South Africa, money laundering is a criminal offence and applies to the laundering of any benefits arising from any form of crime (Burdette, 2010:6).

Money laundering schemes may range from a straightforward scheme to complex schemes comprising several transactions which are processed through multiple entities and jurisdictions (Buchanan, 2004:115; He, 2010:31). The ongoing efforts of financial institutions to fight money laundering have resulted in criminals devising increasingly more complex schemes to disguise and convert the proceeds of their crimes (FATF, 2006a:1).

### 7.2.2 Role of accountants in prevention and detection of money laundering and use of accountants to facilitate complex schemes

Criminals are using the expertise of accountants to assist them, knowingly or unknowingly, with their complex schemes and to reduce suspicion regarding their activities (He, 2006:68). The use of accountants for money laundering schemes is, to a certain extent, linked to the wide range of financial and economic services which they provide (He, 2006:68). Accountants in public practice provide services which range from, *inter alia*, audit functions, taxation advice, financial management and accounting services to consulting and corporate finance (SAICA, 2010). Accountants are well respected and have social standing and, therefore, there is little suspicion that they will indulge in criminal activities. Furthermore, the duty of client



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confidentiality renders accountants reluctant to disclose suspected money laundering. These all factors increase the vulnerability of accountants to money laundering schemes (He, 2006:68).

Accountants are expected to be independent professionals who have a duty to protect the interests of a range of stakeholders (Melnik, 2000:152). While there is no expectation that accountants must examine every transaction carried out by their clients, they are often, as a result of the services they provide, in a position to notice irregularities and suspicious activities, either by their clients or a third party (FATF, 2008b:26). Accountants have access to their client's records, business operations and confidential information and they build relationships with management. As a result, it is considered more likely that accountants will detect suspicious activities than financial institutions (FATF, 2008b:26; He, 2006:26).

### 7.2.3 Accountants' anti-money laundering obligations

In terms of the FATF Recommendations, the EU's Third AMLD and UK legislation, accountants must take on AML responsibilities. Accountants in the EU and the UK are required to conduct CDD, keep records, develop internal procedures and report suspicious transactions (FEE, 2009:18). The AML framework of the EU and the UK applies to anyone providing accounting services, even if they are not members of a regulated profession (FEE, 2009:18). With regards to accounting services, the AML legislation in the UK is applicable to businesses and individuals who are auditors, external accountants, tax advisors or insolvency practitioners, as defined in the UK Regulations (CCAB, 2008:80).

FICA provides for three different classifications of businesses and each classification must comply with different AML obligations (Agulhas & De Koker, 2003:2). However, accountants are not specifically included in FICA in their capacity as accountants or auditors (Agulhas & De Koker, 2003:4). The primary classification is that of an accountable institution. Accountable institutions are required to comply with a number of AML administrative measures, including customer identification and verification, record keeping, developing and implementing internal procedures, providing relevant training and appointing a MLCO to ensure compliance (Burdette, 2010:22).



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Accountants are regarded as accountable institutions only when they provide either investment advice or intermediary services (FATF & ESAAMLG, 2009:161). The FATF and ESAAMLG Mutual Evaluation found South Africa to be non-compliant with Recommendation 12 as accountants are not included in FICA when conducting all of the activities listed in the FATF Recommendations (FATF & ESAAMLG, 2009:217).

### 7.2.4 Reporting obligations for accountants

The obligation to report suspicious and unusual transactions is considered to be a critical component of any country's AML plan (FIC, 2008:8). Following the FATF Recommendations, the EU and UK legislation requires accountants to make a report when they have grounds to know or suspect money laundering is occurring or being attempted (Cox, 2011:207). A suspicious activity report is made when some activity or conduct which has the features of money laundering is observed during the course of business (CCAB, 2008:55).

FICA section 29 creates the obligation to report suspicious or unusual transactions relating to money laundering, the proceeds of crime or terrorist activities (FIC, 2008:12). Failure to report a suspicious or unusual transaction is an offence in terms of section 52 of FICA and results in serious criminal and civil penalties (Burdette, 2010:21). Any person who carries on, manages or is in charge of, or is employed by a business and knows or suspects certain facts, has an obligation to make an STR to the FIC (Van der Westhuizen, 2004b).

Unlike the UK requirements, suspicious conduct on the part of a client does not automatically create the obligation to make an STR, in terms of FICA. In South Africa, the duty to report suspicious and unusual transactions applies only in situations where the reporting business is party to a suspicious transaction or has or is about to receive the proceeds of money laundering or be used for money laundering purposes (Agulhas & De Koker, 2003:5). There must be a connection between the reporting person's business and the suspicious or unusual transactions or act (Van der Westhuizen, 2004b). Therefore, with regard to accountants in their capacity as auditors, this reporting duty will not arise during the normal conduct of an audit (FATF & ESAAMLG, 2009:169). This is, however, not the case in the EU and the UK, where auditors are specifically included.



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The notion of a "suspicious or unusual transaction" is vague and FICA does not provide a definition for the term (Van der Westhuizen, 2004b). Despite the fact that FICA does define the term "transaction" there is, however, uncertainty regarding the meaning of a "transaction" as it relates to FICA's section 29. Consequently, a more robust definition is required (Burdette, 2010:18).

Reports indicate that, in areas where accountants have an obligation to make STR/SARs, the number of reports made is low. This low level of reporting is attributed to a lack of awareness, hesitancy and issues of client confidentiality (FATF, 2004:26). Overall, the research found that there is a lack of understanding within the accounting profession as regards the AML legislative framework in South Africa and the way in which it applies to the activities of the profession (Brink, 2011:11; Standing & Van Vuuren, 2003:9).

### 7.2.5 Confidentiality and privilege

While accountants and auditors do have a duty of confidentiality, this duty of confidentiality is not absolute (Agulhas & De Koker, 2003:5). Accountants may not use client confidentiality as an excuse for not reporting (CCAB, 2008:53) and FICA overrides the secrecy and confidentiality obligations in terms of South African law (FIC, 2008:19). The EU, UK and South African legislation provides accountants with protection from being sued for breach of confidentiality and also prohibits disclosing to the client that a suspicious report has been submitted. On the other hand, the UK permits disclosures between accountants of the same standing in order to prevent a money laundering offence (CCAB, 2008:17).

Legal privilege exemption is recognised throughout the FATF, EU, UK and South Africa as a defence for failing to disclose suspicious activity or transactions. The UK has made special provision to extend the privilege exemption to accountants who meet the requirements of a relevant professional advisor in terms of matters regarding legal advice or litigation, but only as it affects the duty to submit a SAR (CCAB, 2008:63). In South Africa, no such provision has been made. Burdette (2010:26) has found that the legal privilege exemption in South Africa applies to attorney–client relationships only.



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### 7.2.6 Tipping off

The EU, UK and South Africa all prohibit the disclosure to the client of the fact that a report has been made. The UK does, however, allow disclosures between institutions or to a supervisory authority for the purpose of preventing money laundering (CCAB, 2008:17). In addition, it is a further offence to prejudice such an investigation in the UK (APB, 2010:16).

### 7.2.7 Supervisory body

In terms of the supervision as required by the FATF, the IRBA is the designated supervisor as regards AML/CFT compliance on the part of registered auditors (FATF & ESAAMLG, 2009:171). However, registered auditors comprise only a fairly small number of the accounting profession in South Africa and, therefore, the IRBA's supervision is limited to a limited number of accountants (FATF & ESAAMLG, 2009:171). The FSB is also a supervisory body for accountants providing investment advice and who are not registered auditors. There are, however, still activities which are conducted by accountants which are not supervised (FATF & ESAAMLG, 2009:171). In contrast, the majority of accountants in the UK have designated supervisory bodies in terms of the UK Regulations (CCAB, 2008:9).

## 7.3 LIMITATIONS OF THE RESEARCH

FICA section 29 also applies to the reporting of any suspicious and unusual transactions that may be indicative of the financing of terrorism. However, this was beyond the scope of this research study. In addition, the reporting requirements for auditors in terms of the APA were also not discussed in this research.

With the exception of IRBA, the South African accounting bodies have not issued their own AML guidelines to their members and, as the IRBA applies to a relatively small number of accountants only, this imposed a limitation on the research. Furthermore, there is limited South African research available as regards professional and academic articles on both the AML duties of South African accountants and also FICA's reporting obligation as it relates to accountants. The lack of statistics available on reporting by accountants in South Africa imposed a further limitation on the research.



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## 7.4 CONCLUSION

Money laundering is a global issue which affects all areas of the economy. While money laundering is considered a financial crime, the combating thereof is not confined to the purview of financial institutions and other role players, including the accounting profession, should also assume AML responsibilities.

Accountants may prevent as well as detect money laundering because of the role that they play in the economy (Melnik, 2000:154). Accountants often have access to information which may be essential in understanding complex schemes and, therefore, they may play an important part in the detection of these schemes (FATF, 2004:26). In addition, accountants are better placed to distinguish between authentic and false information than financial institutions (He, 2006:68). It is, however, essential that the accounting profession, when providing financial services, has a clear legal framework in terms of which suspicious activities or transactions may be reported (FATF, 2004:26).

While it may be difficult to recognise money laundering transactions, accountants should be honest, observant and diligent; and apply their knowledge, expertise and common sense (Agulhas & De Koker, 2003:6). In order to protect both their reputation and business, it is in the best interests of accountants to ensure that their clients are not implicated in money laundering and that they, as accountants, are not unwittingly facilitating money laundering (Melnik, 2000:171). Accountants should apply their professional judgement, exercise professional scepticism and be alert to possible red flags which may indicate suspicious activities relating to money laundering (CCAB, 2008:54).

Accountants in South Africa provide a range of financial services which, in addition to audit services, may provide opportunities to detect money laundering. These services fall within the ambit of the FATF Recommendations. However, the limited circumstances in respect of which section 29 becomes applicable means that, while accountants may become aware of a suspicious or unusual transaction or activity; they are not necessarily, in terms of section 29 of FICA, under any obligation to report this. In other words, section 29 does not adequately address the type of



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services provided by accountants which may result in accountants detecting possible money laundering even if the accountant in question is not party to the transaction.

The mutual evaluation conducted by the FATF and ESAAMLG identified a deficiency in FICA as regards which not all of the activities conducted by accountants in South Africa are covered in terms of the list of accountable institutions (FATF & ESAAMLG, 2009:161). For example, there is no specific inclusion of accountants as accountable institutions. In contrast, the EU and UK have specifically included accountants, auditors, tax advisors and TCSPs in their AML framework. If an accountant is not an accountable institution there is no requirement to comply with the comprehensive set of AML obligations which, it is argued, will raise awareness and facilitate the identification of suspicious or unusual transactions pertaining to money laundering.

It may, therefore, be concluded that the current AML legislation, as it applies to South African accountants, is not in compliance with international standards.

## 7.5 RECOMMENDATIONS

The FATF has strongly urged countries to apply the requirement to report suspicious transactions to all of the professional activities of accountants (FATF, 2003:6). The UK has placed positive responsibilities on accountants to fight money laundering. When accountants in the UK have knowledge or suspicion that their clients are involved in money laundering, they are required to report this information to the relevant authority (Melnik, 2000:161). It is, thus, recommended that similar reporting obligations be placed on accountants in South Africa and that the reporting obligation is not limited to situations in which the accountant is party to a money laundering transaction or to a transaction which is going to be used for money laundering purposes. An accountant should have a duty to report when they detect possible money laundering by their client. This would eliminate any confusion regarding the interpretation of the term “transaction” and also when a business becomes party to such a transaction. This obligation should extend to all professional accountants, including external accountants, auditors, tax advisors and accountants when they act as TCSPs.



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It is also recommended that all professional accountants should be classified as accountable institutions, when providing the services envisaged by the FATF RBA Guidance for Accountants, and that they be required to comply with the full set of AML obligations. The supervisory bodies for the accountants should include all self-regulatory bodies with accountants as members. This would include SAICA, SAIPA and ACCA. This would, in turn, ensure that all accountants are included in the AML net. In addition, these bodies should raise awareness, provide AML training and assist accountants with understanding and executing their reporting obligations. It is further recommended that the South African accounting bodies form a collaborative body similar to the CCAB to ensure there is a consistent approach to money laundering.

Attorneys in South Africa are in a preferential position as regards advising clients on legal matters as the legal privilege exemption applies to them. If a South African accountant provides tax advice to his/her client, no such exemption applies while the duty of confidentiality does not prevent the accountant from complying with the obligation to report. It is recommended that South Africa emulate the UK provisions and extends legal professional privilege to accountants who meet similar criteria to those set by POCA UK. However, this exemption would apply only to suspicious transaction reporting in terms of FICA.

With regards to the FIC, the FIC does not provide a breakdown of the STRs received by category, namely, accountable institutions, reporting institutions and other business. It is recommended that an analysis of STRs, similar to the analysis of cash threshold reports received and contained in the Summary Report of the Financial Intelligence Centre Annual Report 2010/2011, be provided.

## 7.6 AREAS FOR FURTHER RESEARCH

Similar to this research study, the role which accountants play in combating the financing of terrorism could be researched. Another area for further study may be to consider the impact on a business, in terms of overall AML responsibilities, if one section of the business only provides services that are classified as activities of an accountable institution or if an employee is defined as an accountable institution on the basis of his/her qualifications.



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The concept of a "transaction" could be explored further, to consider whether the terminology in section 29 of FICA focuses on financial dealings between financial institutions, such as banks and their clients, only. In addition, does a "transaction" refer to a cash transaction only and would a suspicious journal entry, for example, meet the requirements of a transaction?

The range of services provided by accountants, as listed in the FATF RBA Guidance for Accountants, goes beyond the services prescribed in the FATF Recommendation 12. Accordingly, a possible area of further research may be to consider the completeness of FATF Recommendation 12. In addition, the broad range of services provided by accountants in South Africa may be researched and compared to the both the FATF Recommendation and the FATF RBA Guidance for Accountants.

The legal position of an accountant who conducts an investigation of behalf of an attorney, in terms of the work product arising from such investigation and the concept of legal privilege in South Africa and whether the accountant falls under the same legal privilege exemption applicable to the attorney, may be an area for further research. Similarly, the application of the tipping off prohibition to forensic accountants while conducting an investigation and possible defences available to them for inadvertently tipping off a suspect may also constitute a further research subject.



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**Annexure 1**

## Analysis of the implementation of FATF Recommendations as applied to accountants

| FATF Recommendation | FATF RBA for Accountants | EU application<br>Third AMLD | UK application<br>UK Regulations and POCA UK | SA application<br>FICA |
|---|---|---|---|---|
| ***Persons concerned*** | | | | |
| **Recommendations apply to accountants when (on behalf of clients) the following activities are carried out:** | **Applicable services of accountants in public practice (sole practitioners, partners or employed professionals within professional firms:** | **The following legal or natural persons acting in the exercise of their professional activities (Article 2):** | **Applies to the following persons acting in the course of business carried on by them in the UK (Regulation 3 (1)(c) and 3(1)(e))** | **Accountants are not specifically listed as Accountable Institutions on Schedule 1 or elsewhere in FICA** |
| Buying and selling real estate or business entities<br>Managing bank, savings or securities accounts<br>Organising contributions for the creation, operation or management of companies<br>Creating, operating or managing legal persons or arrangements | Audit and assurance services<br>Book-keeping and preparation of annual and periodic accounts<br>Tax compliance work and advice on the legitimate minimisation of tax burdens<br>Internal audits and advice on internal control and risk minimisation<br>Regulatory and compliance services<br>Insolvency/receiver-manager/bankruptcy related services<br>Advice on structuring of transactions, and succession advice<br>Advice on investments and custody of client money<br>Forensic accountancy | Auditors<br>External accountants<br>Tax advisors<br>TCSPs<br>(no further definition provided) | Auditors<br>External accountants<br>Insolvency practitioners<br>Tax advisors<br>TCSPs<br>(each of these functions is defined in the UK Regulations)<br>Applies to anyone providing accountancy or tax services<br><br>Per Mutual Evaluation report of UK: No scoping issues, all DNFBPs per FATF included | In terms of Schedule 1, accountants are Accountable Institutions when:<br>Carry on the business of a financial services provider requiring authorisation in terms of FAIS Act and provide investment advice or intermediary services (item 12)<br>Act as a trustee of a trust *inter vivos* or *mortis causa* (item 2)<br><br>Per Mutual Evaluation report of SA: There are deficiencies in Schedule 1 as not all activities of DNFBPs are included. |
| ***Anti-money laundering obligations*** | | | | |
| **Recommendation 12** | | | | |
| Customer due diligence | Can apply a RBA | All persons covered by directive must conduct CDD (Article 7)<br><br>Can apply a RBA | All persons covered must conduct CDD (UK Regulations)<br><br>Can apply a RBA | Accountable institutions must conduct client identification and verification (section 21)<br>Limited provision for a RBA |
| Record keeping | Must comply with regulatory requirements | All persons covered by directive must keep records (Article 30) | All persons covered must keep records (Regulation 19 ) | Accountable institutions have a duty to keep records (section 22) |
| Consider complex, unusual large transactions | Can be part of service provided or be a risk indicator | All persons covered by directive must consider complex, unusual large transactions (Article 20) | Persons covered must have policies and procedures that provide for the identification and scrutiny of complex or unusually large transactions (Regulation 20) | No specific provision requiring special attention to complex, unusually large transactions |
| **Recommendation 16** | | | | |
| <u>Suspicious transaction reporting:</u><br>If there are reasonable grounds to suspect that the funds are proceeds of a criminal activity | Not subject to RBA | Persons covered by the directive and their directors and employees are obliged to report to the FIU if they know, suspect or have reasonable grounds to suspect money laundering is being or has been committed or attempted (Article 22) | When a person knows or suspects or has reasonable grounds for knowing or suspecting that another person is engaged in money laundering, and the information arose during the course of business within the regulated sector (s330 POCA UK) | Any person who carries on a business, is in charge of or manages or in employed by a business who knows or ought reasonably to have known or suspected that:<br>The business has or is going to receive the proceeds of criminal activities or the business is party to a transaction that will facilitate money laundering or has no legal or business purpose, must make a STR (section 29) |

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## Analysis of the implementation of FATF Recommendations as applied to accountants

| FATF Recommendation | FATF RBA for Accountants | EU application<br>Third AMLD | UK application<br>UK Regulations and POCA UK | SA application<br>FICA |
|---|---|---|---|---|
| **Recommendation 16 (cont'd)** | | | | |
| R16 (a) - countries urged to extend reporting requirement to all professional activities of accountants, including auditing | | Applies to all representatives of the accounting profession | Has been extended to auditors, external accountants, tax advisors and insolvency practitioners | All "businesses" are subject to suspicious reporting obligations |
| If legal privilege or professional secrecy applies, no reporting obligation arises | Each country to define, but legal privilege is not confidentiality | Members states can provide that: Auditors, external auditors and tax advisors are not obliged to report information received from or regarding their clients in the course of establishing the legal position of their client or while representing their clients during legal proceedings (Article 23(2)) | Legal privilege exemption extended to a relevant professional advisor, as defined, for the purpose of making money laundering reports only (s330(6) POCA UK)<br>Considerations of client confidentiality cannot prevent reporting | Legal privilege exemption applies to communications between attorneys and their clients which meet the definition of privilege (section 37(2))<br>No duty of confidentiality can prevent any person from reporting under FICA (section 37(2) |
| Protection against breach of confidentiality | | Protection for director or employee of an institution for reports made in good faith (Article 26) | Any report properly made is not a breach of any restriction on disclosure of information | No legal action can be taken against a person who makes a report in good faith (section 38) |
| Tipping off prohibited | Accountants to be mindful of tipping off client and conducting investigation beyond the scope of the engagement | Professional may not disclose to the client or third persons that a report have been submitted (Article 28(1)) | Tipping off is an offence, as is prejudicing the investigation (s333A and S324 POCA UK) | A person involved in reporting is prohibited from tipping off the client or any third party. Tipping off is an offence (section 29(3)) |
| Training and awareness required | All relevant staff to receive appropriate AML training based on functions undertaken | Persons covered by the directive must raise awareness of staff re the Third AMLD and provide AML training (Article 35) | All relevant employees must be made aware of the AML legislation and receive training on how to identify and handle suspicious transactions and activities (Regulation 21) | Accountable institutions must provide training on FICA and the internal rules (section 43) |
| Internal AML controls to be developed | Embed risk based process through culture of compliance and senior management ownership and support | Persons covered by the directive are required to establish adequate and appropriate policies and procedures (Article 34) | Persons covered by the UK Regulations are required to establish and maintain appropriate and risk sensitive policies and procedures (Regulation 20) | Accountable institutions must develop and implement internal rules regarding customer identification, recordkeeping and suspicious transaction reporting (section 42) |
| **Other relevant recommendations**<br>R 24 - Supervision required | Designated competent authority or self regulatory body to be appointed to monitor and ensure compliance | Competent authority or self regulatory body to monitor compliance (Article 37) | All six CCAB members are supervisory bodies (Schedule 3 UK Regulations)<br>Accountants who are not supervised by a professional body are supervised by HM Revenue and Customs under Regulation 23(1)(d)(iv). | Supervisory body for accountants is IRBA, which only supervises registered auditors<br>FSB is supervisory body for persons registered in terms of FAIS Act. |

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