

Sound Management of Risks Related to Money Laundering (ML) and Financing of Terrorism (FT)

The ever increasing role of external auditors in the management of diverse forms of risks, as well as the significance of their involvement in managing those risks in an ever changing financial environment, cannot be over emphasised.¹

Annex 2 paragraph 5 of the Basel Committee's Consultative Document² states that banks that undertake correspondent banking activities should conduct an appropriate assessment of the ML/FT risks associated with correspondent banking activities.

What constitutes a comprehensive definition of the scope of „correspondent banking activities“ and whether such a list is sufficiently exhaustive must surely constitute one of the areas of focus in the ongoing efforts recently being undertaken by the FATF – according to the List of Relevant FATF Recommendations under Annex 3³ of the Consultative Document.

In relation to the three lines of defence highlighted under paragraphs 18 to 25, within the context of Anti Money Laundering (AML) and Countering Financing of Terrorism (CFT), the following observations will be made:

First line of defence

i) With respect to the first line of defence, as highlighted under paragraph 18, reference to the fact that „there should be internal procedures for detecting and reporting suspicious transactions“, as well as other sections of the document, highlights the need for a consideration of detective measures. Focus should (rightly) be accorded to detective (as well as preventive measures) – rather than corrective measures as this could save banks not only huge costs, but also avoid potentially damaging reputational consequences where a bank (particularly through its personnel), is knowingly or unknowingly involved in activities related to money laundering and/or the financing

¹ See M Ojo, Addressing Risk Challenges in a Changing Financial Environment. Paper presented at "Strategies For Solving Global Crises Conference"

² Basel Committee on Banking Supervision, Consultative Document „Sound Management of Risks Related to Money Laundering and Financing of Terrorism June 2013, Bank for International Settlements Publications

³ R.13: Correspondent Banking; *ibid*

of terrorism.

Whilst prompt detection of such activities certainly has its merits, very early or early detection has even greater benefits. The probability that such activities would be detected earlier, also increasing according to the level of expertise and experience acquired or retained by those involved in the detection of such activities.

Second line of defence

ii) In respect of the second line of defence, that is, the chief officer in charge of AML/CFT should have „responsibility for ongoing monitoring of the fulfilment of all AML/CFT duties by the bank“, this line of defence should also incorporate the benefits of having, particularly, external auditors involved in the monitoring process.

This would enhance objectivity and independence, in view of the fact that the chief officer in charge of AML/CFT should not be completely excluded as being immune from collusion possibilities (with money launderers or those involved in financing terrorism), as well as increased facilitation of the all important need for effective segregation of duties.

Whilst the need for segregation of duties is clearly given prominence and due consideration under paragraphs 21-23, further need for enhanced independence and objectivity in respect of operations performed as a means of facilitating this line of defence, should also take into consideration the fact that immense expertise – in respect of sample testing of compliance and the review of exception reports (paragraph 20), could also be derived through the employment of auditors within such procedures. Such a consideration would greatly enhance independence in the performance of operations, as well as assist to mitigate or avoid potential situations where the chief officer in charge of AML/CFT could be exposed to threats which could result in the occurrence of conflicts of interests.

Third Line of Defence

iii) In respect of the third line of defence, whilst training provided to bank personnel and staff would certainly go a long way in helping to alert to detect „suspicious“ categories of customers, group of accounts, transaction patterns or product usage, the ability of the bank to „effectively monitor and identify suspicious activity“ would not only require access to updated, comprehensive and accurate customer profiles and records, but also (require) the incredibly beneficial expertise provided by external auditors in evaluating and monitoring timely information needed to „identify, analyse and effectively monitor“ customer accounts.

Even though the importance of internal audit and external auditors are highlighted under this line of defence, the contribution that can be made by forensic accountants is also worthy of consideration.

Internal audit, as well as external auditors, do not only play vital roles in the independent evaluation of risk management, internal controls and procedures, checking for compliance with rules regulations, but also in areas where possible collusion between key and/or general management (responsible for oversight of such procedures) and money launderers, as well as those involved in the financing of terrorism, could occur.

With respect to such a collusion, the detection and prevention of fraudulent acts carried out by such key and general personnel – acts which serve as a means of concealing illegal activities, constitutes a vital area of focus.

Opportunities for fraud involvement may arise (through key or general personnel) as a result of the following:

- Numerous subjective accounting judgments
- Ineffective monitoring mechanisms
- Complex organisational structure
- Significant deficiencies in internal control

Generalized Audit Software is frequently used by many audit firms in analysing fraud possibilities, through the performance of the following functions:

- Verification of mathematical extensions
- Statistical selection
- Searching for duplicates
- Analysis of unusual patterns in data
- The identification of unusual sources of entries to an account
- The identification of missing data which can be further investigated by the auditor

Having highlighted the vital role of audits in preventing and detecting situations whereby key or general personnel could be involved in the cover up of money laundering activities or activities related to the financing of terrorism, the benefits of also incorporating forensic accountants in the process, is also introduced:

- *Forensic accounting is an extension of auditing – which focuses on detailed investigation of situations where fraud has already been identified or where fraud is highly suspected.*“

The dual nature of risks and the risks involved in the management of risks such as internal control risks, hence needs to be considered. Whilst risks persist through the process whereby banks are used intentionally or unintentionally for criminal activities, institutional risks which arise in respect of those supposed to be efficiently managing and monitoring those risks should also constitute an area of focus. Such institutional risks comprising of risks which are not only attributable to the firm or organisation where models (such as internal controls) or techniques are operated, namely internal control risks, but also the risks involved in managing those risks.

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Marianne Ojo, PhD, LLM