ANTI-MONEY LAUNDERING: THE BASICS

Installment 6: Businesses in difficulty

Businesses experiencing financial difficulties may have fallen victim to financial crime and can also become a target for criminals. The complexity of these situations increases the risk that an accountant could inadvertently facilitate money laundering. It is important that accountants who provide services to businesses in difficulty be aware of—and effectively mitigate through a risk-based approach—the relevant vulnerabilities.

How can proceeds of crime arise in businesses in difficulty?

Businesses in financial difficulty are vulnerable to exploitation by criminals due to the financial pressures their owners or management may be facing. A criminal could convince a business owner to allow an investment into the business using proceeds of crime. The criminal could later receive payments from the business, which would appear to be legitimate income. Moving funds through the business in this way could mask the trail of criminal proceeds.

In particular, criminals may seek to purchase a cash-based business as a vehicle to clean their dirty money. Owning a cash-intensive business is often a goal for money launderers, as these provide an opportunity to integrate large volumes of cash into the financial system. Disguising proceeds from illegal drugs or other crimes as trading income of a business is one method to achieve the integration.

Businesses experiencing financial problems may also have fallen victim to fraudulent conduct by those within the business. This means that the business could contain proceeds of crime. Professional accountants must take care to approach the situation appropriately.

What does a Risk Based Approach look like?

Professional accountants should consider the following:

- If involved in payments or distributions being made by the company, to whom are they being paid?
- Who are the owners and managers of the business? Will they be receiving monies out of the business?
- Are the trading activities of the entity ones where there is a high risk of money laundering? Or are they at risk of tax or invoice discounting fraud?
- Is the business, its beneficial owners, or the location of the trading activities, in jurisdictions that are considered high risk for money laundering?
- If a third party is seeking to purchase the business, or your client is the purchaser, is there a clear commercial rationale for the proposed acquisition? Who is the third party?
- Can the professional accountant withdraw from the engagement once they have been appointed?

As always, accountants should take reasonable steps to document their risk assessments.

CASE STUDIES

Fraud Within the Business

Mr Smith has been running a company for some years. (Omega Fuelling Stations Ltd, "Omega") which owns fuel stations and adjacent convenience stores. Most of Omega's sales are cash based. Sales have been declining for a period of time and the business is on the verge of failing.

Mr Smith appoints an accountant who specialises in business recovery services to advise on Omega's options for restructuring. The accountant undertakes a review of Omega's financial position and identifies that $50,000 of cash is missing from Omega's accounts. After further investigation a staff member admits that she took the cash to settle personal gambling debts from online poker games.

Mr Smith doesn't want to report the staff member to the police because he doubts the stolen money will be recovered. Regardless of this, having consulted internally and with his professional body, the accountant files a Suspicious Activity Report detailing the employee theft.

All-cash Offer

In normal times, the famous city center of Metropolis was teeming with tourists from all over the world. Dozens of small souvenir shops lined the streets, plying a robust trade in knick-knacks, t-shirts, and other trinkets. A long-standing client of the professional accountant owns one of these shops and has built a successful career out of it. Then in March 2020, COVID-19 changed everything. Tourists stopped coming, and the client's business came to a standstill. Months went by and hope for a quick recovery turned into mounting losses, with all the other souvenir shops in central Metropolis facing the same situation. The professional accountant watched as the client's financial situation became more and more dire, with closure of the business looking like the only way forward.

One day in the autumn of 2020, the client was speaking with a friend, also a souvenir shop owner. The friend mentioned that he has sold his shop and retired. The client was stunned how quickly this had happened. The friend explained that days ago someone came to his shop offering to buy it for an unbelievable price, all in cash, effective immediately. The friend couldn't say no – the offer was too good to pass up. Sure enough days later the client was approached by an individual representing a company making a similar cash offer, with no interest in due diligence.

The client approaches the professional accountant for advice on the sale. The professional accountant finds that the company making the offer is based in an offshore jurisdiction and it is difficult to identify who the beneficial owners are. Alarmed by the red flags in the client's story and the lack of information about the company, the professional accountant says he cannot be involved in advising on the sale of the client's business. The professional accountant files a Suspicious Activity Report to their local Financial Intelligence Unit.

Key Red Flags

- There are ongoing criminal investigations or civil recovery proceedings involving the company's management or beneficial owners.
- There have been employee whistleblowing reports that suggest wrongdoing has taken place.
- A third party makes a very generous offer to purchase a struggling business that has a cash-based activity.

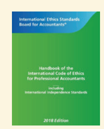
When to Walk Away

- You establish that by paying out funds or assets you would be helping a criminal to pass the proceeds of crime through the entity.
- You uncover fraudulent activity within the business in which the current management are complicit.
- You have concerns over the true identity or background of a third-party purchaser for the business.
- In some cases, the legal regime may mean that a professional accountant is unable to disengage from their insolvency related appointment. Great care must be taken in these cases to obtain all relevant legal protections from committing subsequent money laundering offences.

Filing a Suspicious Activity Report ("SAR")

If you become suspicious that there may be proceeds of crime within the business in difficulty, then you may wish to report your suspicions to the local Financial Intelligence Unit. In some jurisdictions this is a legal obligation for professional accountants.

ADDITIONAL ASSISTANCE



For general guidance, see the FATF's *Guidance for a Risk-Based Approach for the Accountancy Profession*. For detailed local information, including applicable regulatory requirements, contact your Professional Accountancy Organization.

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