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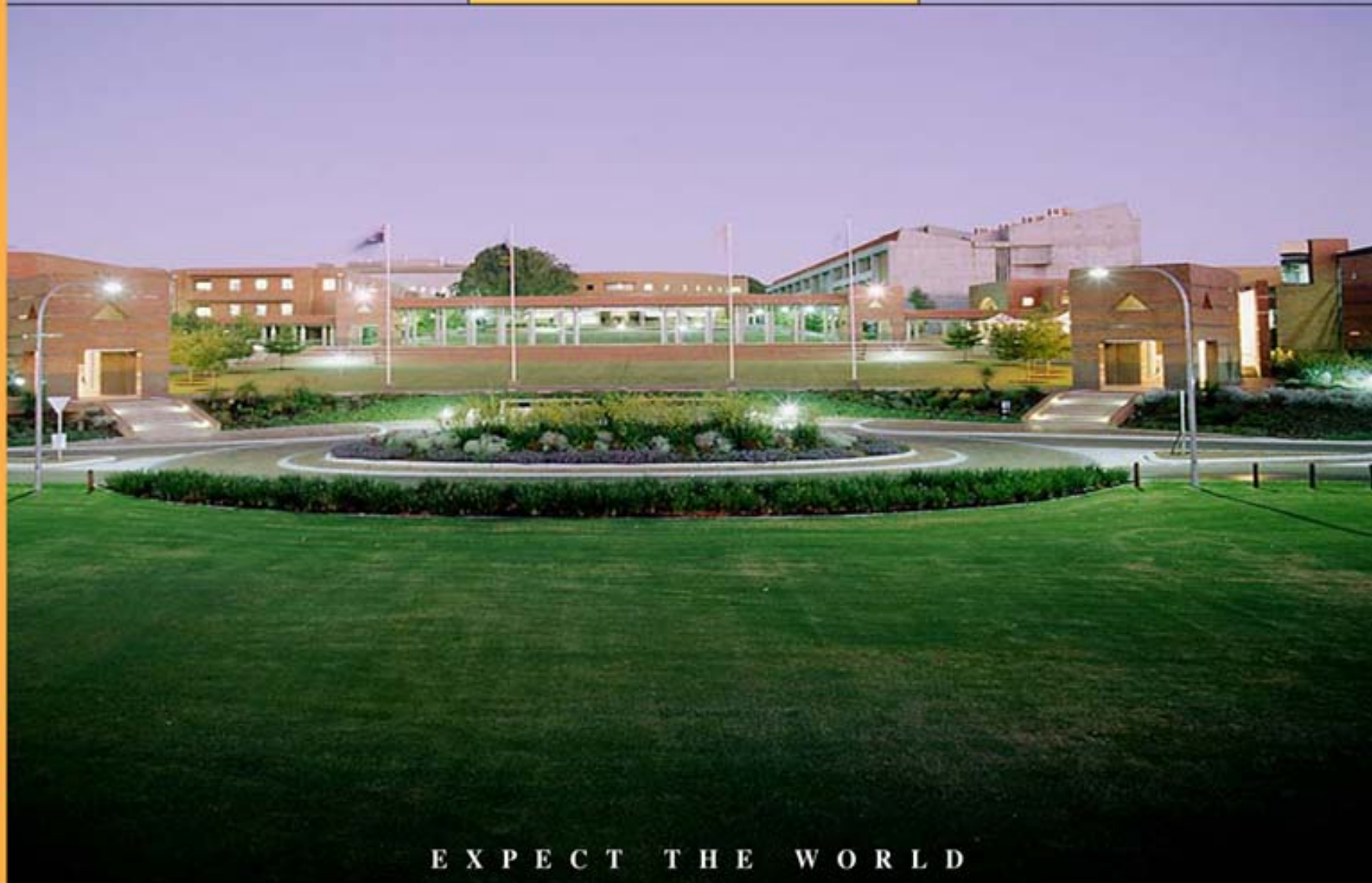

EXPECT THE WORLD

THE NEED FOR A THEORETICAL MODEL OF INTERNATIONAL BEST EVALUATION AND PRACTICE OF ANTI-MONEY LAUNDERING

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- The Financial Action Task Force (FATF) promulgates legislative and regulatory reforms in money laundering and terrorist financing, notably (FATF, 2006). FATF examines methods used to launder criminal proceeds and completes mutual evaluations of its member countries and jurisdictions.
- The FATF Mutual Evaluation Assessment on the Australian AML/CTF Regime (2005) concluded that Australia did *not* comply with accepted global standards.

- However, FATF did acknowledge Australia's untested proposal to update its legislation to fully implement the Revised Recommendations and the Special Recommendations.

- Best practice towards anti-money laundering activities depends upon a country’s financial intelligence unit (FIU) which receives and processes data (transaction reports) from financial and non-financial institutions to gather intelligence about anti-money laundering activities.

- It is generally recognised that there are four FIU models which predominate around the globe:
  - the judicial model where FIU is subordinate to judicial authorities (for example in Luxembourg and Portugal),
  - the law enforcement model where FIU is subordinate to government law enforcement authorities and investigates cases identified from information provided by the banks and other reporting institutions (for example in UK, Italy, Sweden and Denmark),
  - the administrative model where FIU is an independent agency or a semi-autonomous office within some particular central government ministry (for example in France, Netherlands and Belgium), and
  - the hybrid model where FIU is an independent agency or semi-autonomous office within some particular central government ministry (for example in Australia, Panama, Mexico and US).

- Australian legislative responses to anti-money laundering include the *Criminal Code Act 1995 (Cth)* (Criminal Code), the *Financial Transaction Reports Act 1988 (Cth) (FTRA) in the Anti-Terrorism Bill (No 2) 2005,* and the newer *Anti-Money Laundering and Counter Terrorism Financing Act 2006 (Cth)* (AML/CTF Act 2006).

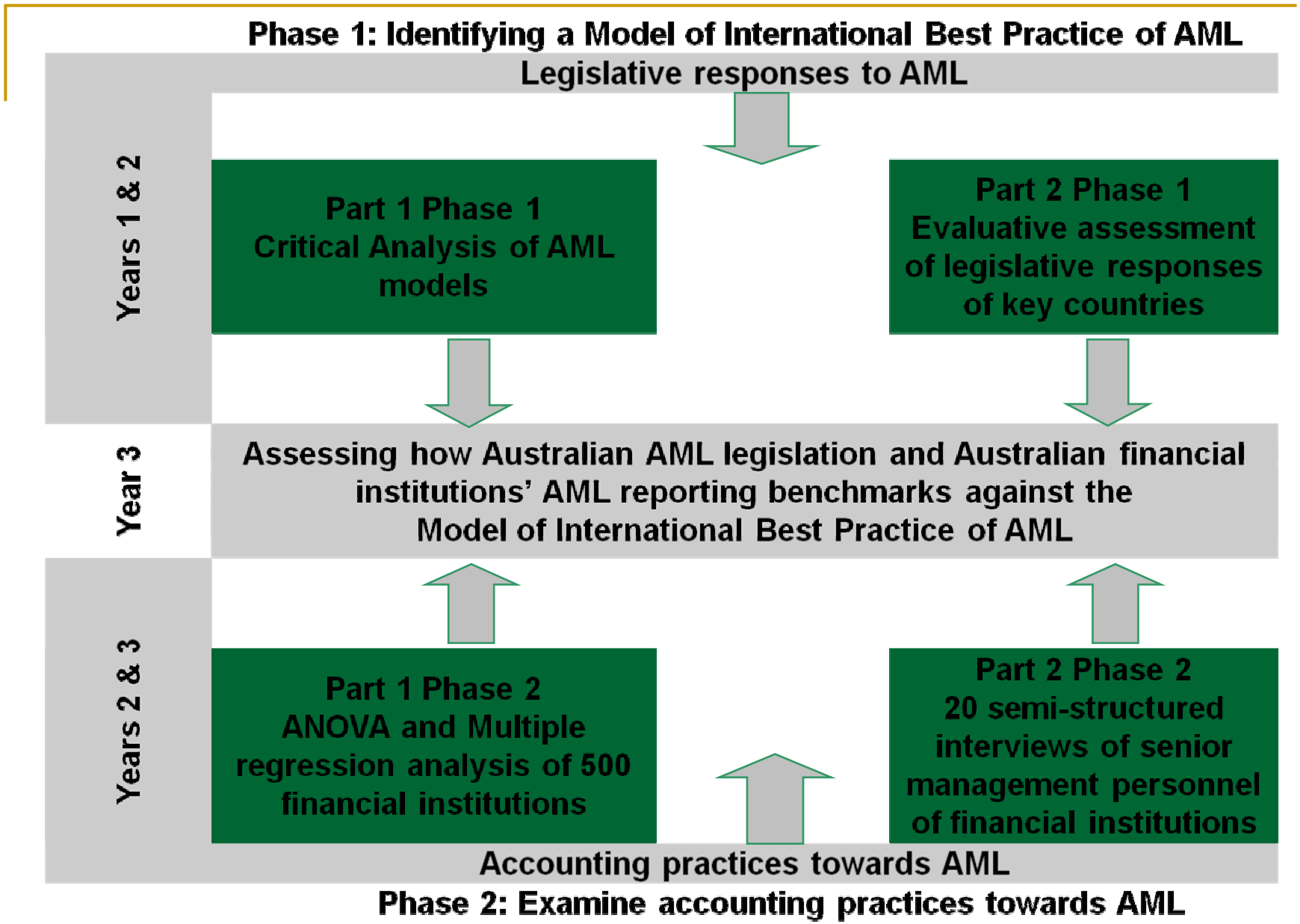
- The AML, which took effect on 13 of December 2006, obliges reporting entities
  - to undertake specified customer identification procedures before providing a designated service;
  - to undertake ongoing customer due diligence to monitor the reasonable risk a service may involve or facilitate money laundering;
  - to undertake customer identification;
  - and to report certain suspicious matters, transactions over $10,000 and international funds transfer instructions to the Australian Transaction Reports and Analysis Centre (AUSTRAC);
  - not to enter into a correspondent banking relationship with a shell bank;
  - to keep records of customer identification procedures for seven years.
- The first question explored in this study is how well this legislation is designed as compared to world's best practice.

- Money laundering remains a clear illustration of the misuse of accounting knowledge as an essential component of financial crime.
- Accountants know the international financial systems, can create nominee (or shelf) companies to receive the proceeds of money laundering and create a labyrinth of misleading audit trails.
- By creating fake balance sheets, fictitious entries, fraudulent and fictitious billing networks and ad hoc estimates specifically for short term assignments, accountants and lawyers are able to resolve the dilemma of ownership rights so that instead of criminals being locked into illegal networks, their social structures allow them to fit into criminal globalisation.

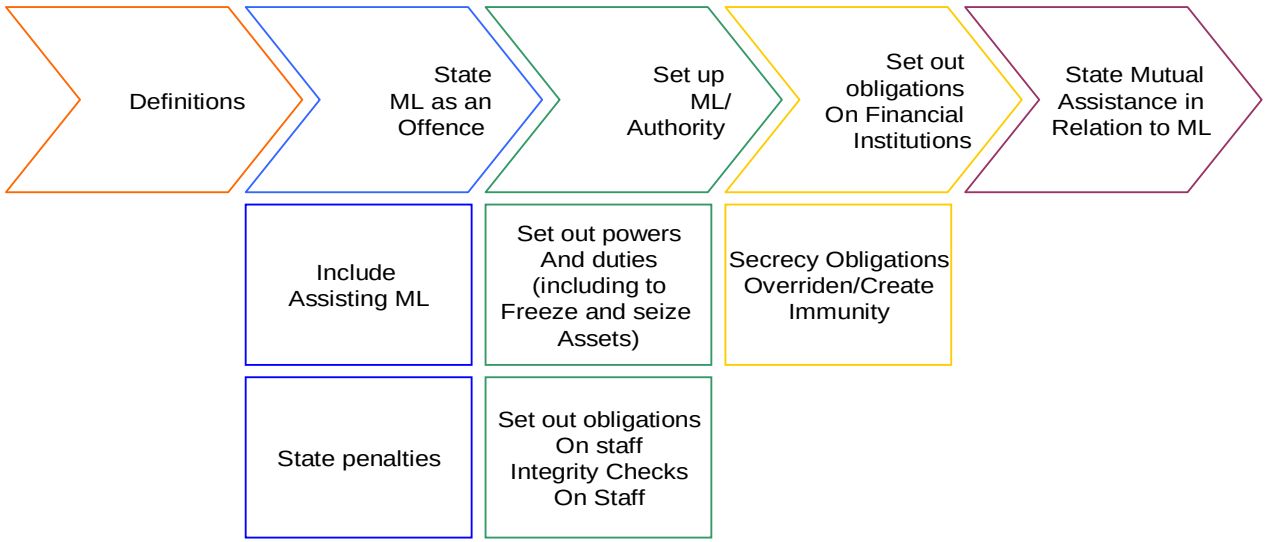
- The AML/CTF Act 2006 creates enormous compliance costs for accountants and their clients.
- The second question explored in this study is the level of communication and compliance by the Australian financial institutions with the new Act (Van Der Zahn, Makarenko, Tower, Kotsyuk, Barako, Chervoniaschaya, Brown, & Kotsyuk 2007).

- The problem of money laundering is pervasive.
- Money laundering corrupts financial markets and erodes the public confidence in the global financial system.
- It does this by involving itself in a wide variety of criminal activities such as bribery, drug trafficking (Pinner, 1994), embezzlement, fraud, illegal arms sales (Baldwin, 2004), insider trading, prostitution rings, smuggling, terrorism (Baldwin, 2004; Line, 2005) and by obscuring illegal origins of profits by making them appear legitimate.
- FATF (2006) estimates that money laundering reduces the annual rate of growth by 2% of the world economy.

- The approach to the theoretical foundation, as shown in the conceptual schema of Figure 1, has two phases.
- Phase One identifies a model of international best practice in terms of legislative responses to anti-money laundering.
- There are a number of Model Laws/Regulations for money laundering (ML) including the Financial Action Task Force Recommendations (FATF Recommendations), the United Nations on Office on Drugs and Crime 2005 – Model legislation on money laundering and financing of terrorism, the Commonwealth Model Law for the Prohibition of Money Laundering & Supporting Documentation and the Inter-American Drug Abuse Control Commission (CICAD) Model Regulations Concerning Laundering Offences Connected to Illicit Drug Trafficking and Serious Offences.


Phase 1: Identifying a Model of International Best Practice of AML
Legislative responses to AML
Years 1 & 2
Part 1 Phase 1
Critical Analysis of AML models
Part 2 Phase 1
Evaluative assessment of legislative responses of key countries
Year 3
Assessing how Australian AML legislation and Australian financial institutions' AML reporting benchmarks against the Model of International Best Practice of AML
Years 2 & 3
Part 1 Phase 2
ANOVA and Multiple regression analysis of 500 financial institutions
Part 2 Phase 2
20 semi-structured interviews of senior management personnel of financial institutions
Accounting practices towards AML
Phase 2: Examine accounting practices towards AML

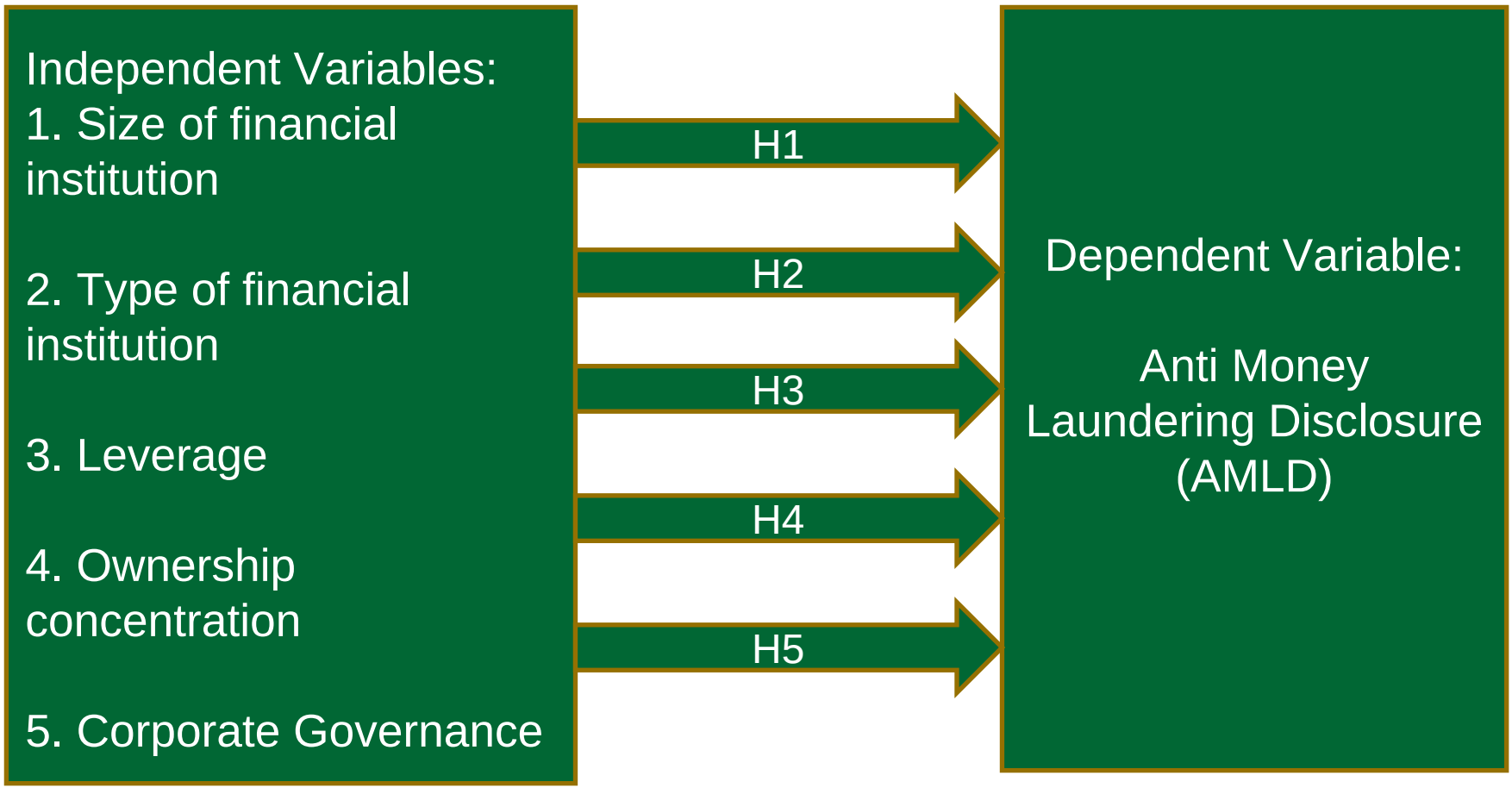
Core Components of a Model of Best Practice for regulating Money Laundering



- Once the Model for International Best Practice is established, Part Two of Phase One focuses on an evaluative assessment of legislative responses of key relevant countries including Australia, the United Kingdom, the United States of America and Singapore whose respective rules will all be benchmarked against this Model.
- The evaluative assessment involves an examination of primary materials for each of these jurisdictions (including legislation and cases), as well as secondary sources (including journal articles).
- This is supplemented by interview insights with relevant governmental agencies' personnel - AUSTRAC in the Australian context and their equivalents in the other jurisdictions.

- Phase Two incorporates two parts. Part One assesses how 500 Australian financial institutions benchmark against this Model of International Best Practice through an analysis of financial year ending 2008-2010 annual reports. A comprehensive and diverse sample frame is selected including:
  - 229 authorised deposit-taking institutions (ADIs) (51 banks, totalling assets of A$1369b, 14 building societies, totalling assets of A$16b, 164 credit unions, totalling assets of A$33b) supervised by Australian Prudential Regulation Authority (APRA),
  - 110 non-authorised deposit-taking institutions (non-ADIs) (26 merchant banks, totalling assets of A$80b and 84 finance companies, totalling assets of A$87b) supervised by the Australian Securities and Investment Commission (ASIC),
  - 170 insurers (37 life insurance companies, totalling assets of A$188b and 133 general insurance companies, totalling assets of A$97b) supervised by APRA, and,
  - 91 fund managers (drawn from 9062 superannuation funds, totalling assets of A450b, public unit trusts, totalling assets of A$180b, cash management trusts, totalling assets of A$37b, common funds, totalling assets of A$10b and 27 friendly societies totalling assets A$5b), (Reserve Bank of Australia, 2007).

Regression Analysis Key Variables



- Part Two of Phase Two gathers valuable insights from senior management in Australian financial institutions.
- Key issues of concern include:
  - the most influential factors shaping the anti-money laundering problem now and in the future,
  - how technology affects these issues, how financial institutions should best respond and
  - how best such preventive activities should be communicated, including the issue of confidential data for the government as well as key government officials (such as AUSTRAC and the Attorney General's Department).

- A potential source of data are semi-structured interviews with senior management personnel in Australian financial institutions and any documentation collected during the interview process (e.g. internal memos, consultancy reports).

- The project's twin goals of identifying legislative responses to AML and how accounting practices benchmark against a Model of International Best Evaluation and Practice could provide unique information on
  - how to tackle both national and cross-national AML legislation inconsistencies;
  - how to avoid the haemorrhaging of revenue from the Australian Taxation Office;
  - how to offer the Australian government the best chance of developing innovative and rapid solutions to serious threats, such as the disruption of domestic and international financial systems (Buchanan, 2004), the promotion of poor economic policies (Johnston & Abbott, 2005) and the risk of terrorist financing and large-scale criminal activity.

- Being able to effectively counter money laundering activities will assist the government in combating escalating crime costs, estimated by the 2000 report from the Prime Minister's Science, Engineering and Innovation Council to be at least $18 billion per annum.

- It is particularly important to put together the unique combination of accounting and legal skills to examine an issue for safeguarding Australia and to combine leading edge legal research together with accounting research expertise to gather novel and more comprehensive insights into money laundering through multiple research paradigms which in turn provide multi-faceted means of looks at the problem of AML.

- The world is now characterised by the widespread and rapid movement of data and money which is now increasingly digitally encoded.
- Many money laundering activities form part of this data movement and this project aims to offer solutions (both in terms of legislative responses and in promoting sound accounting practices) to safeguard Australia's national interests from terrorism and crime activities that may be linked to these activities.

- The magnitude of the problem should not be underestimated with the Australian Federal Police estimation of the cost of money laundering at as much as $2 trillion throughout the world (Deloitte, 2008).

- This theoretical project seeks to establish a Model of International Best Evaluation and Practice (a ‘gold standard’) for both global legislative responses and accounting practices that relate to anti-money laundering activities).
- This represents a significant and novel theoretical construct which will underpin the research to be undertaken by this project. Having established the Model, the research will then undertake a benchmarking exercise which will focus on an evaluative assessment of how Australian legislative and accounting practices measure against this Model.
- The findings of this phase of the project will significantly add to the existing literature in this area.

- The paper raises two policy issues related to Australia's anti-money laundering initiatives:
  - anti-money laundering practices will improve if sound theoretical foundations are applied to the construction of a Model of International Best Evaluation and Practice; and,
  - government bodies are less likely to less prescriptive arrangements if they absorb a theoretical foundation of evaluation and practice of anti-money laundering initiatives.