

# The role of auditors: Research into organised crime and money laundering

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## INTRODUCTION

This paper is part of a larger project into the nature of organised crime in member states of the Southern African Development Community (SADC), a topic that is currently of key concern to the Institute for Security Studies (ISS). The starting point was an interest in exploring new ways to monitor the relationship between criminal networks and legitimate business in the region. This led to the idea that members of the auditing profession may be strategically placed to have a unique insight into a specific aspect of organised crime, namely money laundering. If the hypothesis was correct and it was found that auditors do have a good insight into money laundering, then it was hoped that future surveys could draw on this expertise—in doing so, it would help develop triangulation techniques that are so important in this field.

However, in addition to exploring the knowledge of auditors, the research presented an ideal opportunity to also explore the regulation of money laundering as well as the potential role auditors may play in it.

To explore these themes, a survey was circulated among employees of four major multinational auditing firms which operate in the SADC region. The South African offices of all four firms assisted the project by disseminating electronic copies of the questionnaire to their various offices—encouraging forensic partners, audit partners and others to participate in the survey. Due to the modest response, the discussion of the results is limited to being rather impressionistic and the paper ends with tentative conclusions and hypothesis.

### Researching organised crime

The ISS has identified organised crime in the SADC region as one of its key interest areas. A core dimension to

this research theme is developing a survey of the growth and nature of organised crime. This task is exceptionally challenging. Appropriate methods for gathering data need to be sufficiently broad so as to capture trends over a large area. However, there remains the danger that such data lacks detail and therefore the regional image is superficial. Moreover, though it may seem rather obvious to point this out, the nature of organised crime is such that it remains hidden from prying eyes.

The covert nature of organised crime means that research methods must be inventive and flexible.

Given the covert nature of the underlying subject, the research methodology of those interested in organised crime must be inventive as well as flexible. Traditional research has greatly relied on the insight of law enforcement. Indeed, the ISS has previously conducted macro surveys of the region based on what the police can confirm. The resulting data is extremely

useful in building up a picture, which can in many instances benefit from data captured using other sources. Broadly speaking, in many countries law enforcement and the criminal justice system as a whole are under-funded and inefficient. The sophisticated operations of criminal networks and organisations may therefore go relatively undetected—police can only report what they know. A related issue is that, with finite resources, law enforcement may choose to focus on particular issues, perhaps for political reasons. The result is that certain types of organised crime (e.g. drug dealing) may be well understood but others are not (e.g. financial scams). More worryingly, while the average police service is no doubt honest and upstanding, others are vulnerable to corruption and criminality. Unfortunately, numerous studies have suggested that instead of being trustworthy commentators on crime, members of the police service are often part of the problem. They might not therefore be the most reliable sources of information.

These methodological challenges to the study of organised crime form the background to the present

study. Law enforcement data is useful but should not be the only data used in a thorough investigation. The task is therefore to find other methods and avenues to harvest data.

In exploring these 'non-traditional' research methodologies there are other avenues available to primary research. First and foremost is the option to perform in-depth qualitative investigations on criminal activity. This may involve interviewing individuals who have been involved in criminal activities. To achieve this a common research technique is to gain the trust of current criminal operators or to interview 'retired' crooks, possibly during their stay in prison. Both these methods have been used to great effect and have formed the bases of many classic studies on organised crime. They are, however, not without methodological pitfalls. For instance, crooks may not make the most reliable of informers, and the reality of organised crime 'on the ground' may be difficult to see for the fieldwork researcher—the adage of not seeing the forest for the trees may be pertinent. Moreover, such studies are time consuming, potentially dangerous and may produce rather specific results. For the broad, regional work that interests the ISS, these research methods are therefore unlikely to provide core data, although in-depth case studies may well be very useful in building up expertise and testing hypothesis on general trends.

In contrast to this direct 'hands-on' research, the remaining available avenues can be considered as operating at arms length, such as those research methods possible from an office far removed from the actual site of the crime. This indirect approach may make use of *lead indicators* of organised criminal activity—for example, the number of arrests made by police, the amount of contraband seized by customs officials, the number of drug addicts seeking rehabilitation and so on. Again, these indicators are not entirely reliable and many may have a spurious relationship with organised crime activity (i.e. they may tell us more about police activity than organised crime).

A further indirect research method is based on the concept of *triangulation*. Rather than rely solely on the perceptions of police, quantitative surveys should use a wide range of people who may provide contrasting or complimentary views on the nature and extent of organised crime. In identifying these potential points of information it is necessary to consider what groups of people may have a unique insight into aspects of organised crime. After consulting senior research personnel in various South African research organisations, initial thinking led to the hypothesis that auditors may be one of these groups. However, the insight auditors may offer will be restricted to the nature of their work—there is no reason to believe that auditing provides a unique insight into organised crime in general. What may be the case,

however, is that it provides an insight into a specific aspect of organised crime, namely *money laundering*.

The aim of this paper is to explore whether auditors do in fact have a unique insight into money laundering and, if so, to capture some basic regional data on the nature and extent of this crime.

### **A changing environment for money laundering**

While this paper was originally conceived to explore new types of research methods for monitoring organised crime activities, an additional theme was to conduct broad primary research on money laundering in SADC member states and to contemplate the role of auditors in combating this type of activity. Delving into these subplots is perhaps understandable given that fact that the twin themes of auditing and money laundering have become topics of increasing notoriety in the last two years.

A prominent catalyst to the increasing concern with money laundering occurred with the panic that ensued after September 11 over the funding of terror organisations. In recent months, targeting the funds of these rouge elements has greatly elevated the importance of international anti-money laundering

initiatives. However, even prior to September 11, 'going after the money' was rapidly becoming a popular war cry against organised crime in general. The Financial Action Task Force (FATF) is one example of a relatively pro-active inter-governmental approach towards co-operation on this issue—although its membership is almost exclusively drawn from more developed economies. This was partly caused by the realisation that traditional forms of police work—surveillance, seizures and arrests—were simply ineffective in reducing the threat posed by affluent organised crime groups, especially in an era when such groups

were considered to be becoming *transnational*. Far more potent would be to strip such groups of their assets and make the cleaning of dirty money considerably less easy.

It is in this climate that numerous governments, including many member states of SADC, have chosen a 'zero tolerance' approach to money laundering. In countries such as South Africa, 'law 'n order' rhetoric has been backed up by potent legislation that has vastly increased the punishments for accepting the proceeds of crime. Other countries in SADC look set to follow South Africa's lead. This has been bolstered by co-operation among states in the region through bodies such as the East and Southern African Anti-Money Laundering Group (ESAAMLG).

Though they are seemingly unrelated, few would disagree that major corporate scandals in recent months few have put the auditing industry under increased

## The twin themes of organised crime and money laundering have become topics of increasing notoriety in the last two years

scrutiny. Unfortunately, such scrutiny has regularly led to the accusation that many sophisticated money laundering operations have relied on the involvement of auditing professionals. Indeed, it was sad to note that a respondent to the survey that forms the basis of this paper has subsequently been implicated in assisting a major fraud in South Africa: police are investigating the co-accused's involvement in a theft charge of over R100 million. However, although corporate crimes involving auditors is a subject that may require further research in the SADC region, it is not of interest to this paper. Instead, a key aim is to contemplate the role that auditors have in combating money laundering. As will be discussed, there is ample reason to suggest there is a role auditing firms can and do play, although to maximise this role, improvements to both the auditing industry as well as the regulation of money laundering need to be pursued.

### Methods

Core information for this paper was compiled from a questionnaire circulated by the ISS in June 2002 to the four leading auditing firms in southern Africa. This questionnaire was developed with ongoing assistance from various auditors within these companies and their help was of much value.

The questionnaire was designed to elicit information on various topics, including corruption, organised crime and money laundering. For this paper, a select number of questions from this survey are used. The remaining data from the survey, in particular that pertaining to corruption, will be disseminated elsewhere.

As anticipated, the number of questionnaires returned to the ISS was moderate. Those that were returned generally contained good data and respondents had clearly taken much time and effort in preparing their answers.

Although by far the majority of respondents were from South Africa, numerous countries in the SADC region were accounted for. This possibly also reflects the size of the South African economy relative to those of other countries within the region, with the demand that this has, in turn, created for the services of the auditing profession.

Given the small number of respondents, it was

decided to back up the survey data with a focussed interviews with auditors throughout the SADC region. This was undertaken in consultation with the South African offices of the four auditing firms. Eight interviews were conducted. Of these, three auditors were from South Africa, three from Botswana, one from Tanzania and one from Zambia. The telephone interviews were purposely kept short—averaging approximately 20 minutes each—bearing in mind interviewees' time constraints. Issues of confidentiality preclude this paper from providing direct quotations from the interviews. Rather, the interviews were used to clarify themes and seek advice on a final report. It is hoped that future work can expand on the interviews and provide a more in-depth analysis.

In sum, the data that was collated for this paper only permits an impressionistic analysis.

It is not the intention to suggest that the paper is an in-depth study into what is a highly complex area. The data has, however, allowed core themes to be identified, and it has led to the formulation of hypothesis not only for future research, but importantly also for discussion and debate both among members of the auditing profession and, separately, for scholars of organised crime interested in innovative research methods.

## QUESTIONNAIRE RESULTS

### Respondents

Forty-two completed questionnaires were returned to the ISS from four major multinational auditing companies. Of these 42, the majority of respondents (26) worked as *audit partners*. Of the remaining, nine described

To maximise the role auditors could play, improvements to the auditing industry and the regulation of money laundering need to be pursued

**Table 1: Respondents profile**

Country	Audit partners	Forensic auditors	Other	Private sector	Public sector	Both public and private sectors
South Africa	18	9	6*	22	2	9
Botswana	3			2		1
Zambia	1		1**	1		1
Swaziland	1				1	
Tanzania	1			1		
Malawi	1					1
Mauritius	1					1

\* These respondents described their respective primary field of engagement as: "banking regulator consultant", "risk management", "computer auditor", "investment consultant", "tax consultant", and "technical partner".

\*\* Lawyer.



themselves as *forensic auditors* (see discussion for a definition) and a further seven preferred to class their work as falling in another specialist field. The job titles of these other occupations were diverse and reflect the varied business activities conducted by the larger auditing companies.

As table 1 illustrates, the vast majority of respondents were from South Africa and they undertook audit-related work either exclusively in the private sector or both in the public and private sectors.

### Auditors' experience of money laundering

The questionnaire asked respondents how difficult they thought money laundering was to detect when carrying out an audit. By far the majority thought it was difficult though not many thought it *almost impossible*. Only one auditor described the task as *easy*, however, this respondent provided a note explaining that his answer was intended for forensic auditing only. Unfortunately, the relevant question in the survey had not made the distinction between forensic auditing and general auditing, which was a weakness in its design.<sup>1</sup>

In the eight telephone interviews, the interviewer sought clarity on this issue. Complementing the data from the survey, all eight interviewees agreed that it was very difficult for an auditor conducting general audits to spot instances of money laundering. However, importantly, none felt that it was impossible to do so. The forensic auditors interviewed also agreed that the more in-depth investigative work of forensic auditors provided greater scope for uncovering irregularities.

**Table 2: How difficult is it for auditors to detect instances of money laundering?**

Country	Almost impossible	Difficult	Easy
South Africa	9	23	1
Botswana	1	2	
Swaziland	1		
Tanzania		1	
Mauritius		1	
Zambia	1	1	
Malawi		1	

Providing further weight to the notion that money laundering is difficult to detect, 25 respondents stated that they had never suspected an instance of money laundering in their career.

Of the five who reported suspecting at least four instances of money laundering per year, three were forensic auditors and the other two were audit partners.

This indicates that out of the sample, one in three forensic auditors *suspected* at least four instances of money laundering a year.

**Table 3: How frequently do you suspect instances of money laundering?**

Country	Often At least four times a year	Seldom Once a year	Very seldom Once or twice in your career	Never
South Africa	4	4	5	20
Botswana			2	
Zambia	1			
Swaziland				1
Tanzania				1
Mauritius				1
Zambia				1
Malawi				1

When asked for their view on how many *other* auditors investigated or reported instances of money laundering, the respondents suggested even fewer instances.

**Table 4: How often do other auditors investigate or report instances of money laundering?**

Country	Often At least four times a year	Seldom Once a year	Very seldom Once or twice in your career	Never
South Africa	2	2	1	28
Botswana		1		3
Mauritius	1			
Malawi			1	
Tanzania				
Zambia				2
Malawi				1

Both the survey and the telephone interviews asked auditors to list some of the difficulties auditors faced in detecting transactions involving dirty money. In the list of these difficulties below, where several respondents made similar comments the number of respondents is given in parenthesis.

In **South Africa** the following comments were made:

- Checking for proceeds of crime is outside the scope of an audit appointment (4).
- There is a willingness among clients to accept dirty money (3).



- Auditors have to deal with poor banking documentation (3).
- Money laundering can often be very complex with transactions being 'layered' (3).
- The international dimension of much money laundering makes detection difficult (3).
- The South African economy is predominantly a cash economy (3).
- Auditors have limited access to confidential information (3).
- There is a lack of training in this area.
- There is no centralised body to help with investigations.
- The volume of transactions dealt with in an audit is too high to spot irregularities.
- There is a lack of monetary incentive to conduct investigations.
- The source of funding to set up new businesses can be unclear.
- There are inadequate background checks on foreign investors.
- There is a problem with corruption involving auditors.
- Auditors do not look at 100% of transactions and rely on a sample of transactions.
- There is a lack of co-operation between local and international agencies.

In **Botswana** it was noted that:

- Checking for proceeds of crime is not a primary focus of auditors (2).
- There is difficulty in accessing information from the banking sector (2).
- Company tax laws are poorly enforced.
- Small businesses can exist for years without having an audit.
- Money laundering often occurs across borders.
- Money laundering is highly complex, often involving a 'web of companies'.

In **Mauritius** it was noted that:

- Authorities have been lenient on dealing with money laundering due to the desire of sustaining a good public reputation as an offshore centre.
- There is a lack of training for auditors on money laundering.
- Detecting money laundering is costly.

In **Swaziland** it was noted that:

- Auditing is hampered by collusion between the criminal and the recipient of the deposit.

In **Tanzania** it was noted that:

- The large cash economy makes it extremely difficult to detect money laundering for auditors.
- Money laundering is aided by banking confidentiality.
- Legislation is poorly understood.

In **Zambia** it was noted that:

- Detecting cases of money laundering was hampered by the possibility of 'offending shareholders' in the client's business.
- Auditors do not check every transaction.

Having asked for the reasons why money laundering was difficult to detect, interviewees were also encouraged to explain what clues might lead an auditor to suspect an instance of money laundering. In reply, the theme most consistently noted involved the well-publicised concept of 'know your customer'. As one interviewee explained, auditors have to be aware of transactions 'not keeping with the client's profile'. Typically these irregular transactions would involve large cash payments that seem out of character for the turnover of the business. In addition, four of the eight auditors interviewed stated that all auditors should treat large cash deposits as suspicious.

## THE NATURE OF MONEY LAUNDERING

The questionnaire asked respondents to indicate the prevalence of money laundering in their country over the last five to 10 years. Except for respondents in Botswana, the majority suggested that money laundering is an increasing phenomenon throughout the region.

To elaborate on this perception, respondents were asked to rank the top five business sectors that were most vulnerable to money laundering. Table 5 summarises these answers by listing the business sectors perceived to be the most vulnerable in descending order.

Table 4: Perceptions of the growth in money laundering over the last 5–10 years.

Country	Large increase	Slight increase	Same	Slight decrease	Large decrease	Don't know
South Africa	21	5				7
Botswana						3
Swaziland	1					
Tanzania		1				
Mauritius	1					
Zambia	1					1

**Table 5: Business sectors most vulnerable to money laundering**

Country	Industries
South Africa	Entertainment. Vehicle retail sector. Banking and finance. Arms and defence. Property.
Swaziland	Vehicle retail sector. Banking and finance. Entertainment industry. Commodities trade. Health sector.
Tanzania	Vehicle trade. Mining. Petroleum. Entertainment sector. Sugar trading.
Mauritius	Banking and finance. Commodities trade. Vehicle retail sector. Manufacturing. Pharmaceuticals.
Zambia	Entertainment industry. Vehicle retail sector. Banking and finance. Commodities trade.
Botswana	Property. Construction. Entertainment. Manufacturing. Commodities trade.
Malawi	Entertainment industry. Banking and finance. Vehicle retailing sector. Commodities trade.

### Auditors and the regulation of money laundering

Auditors were asked in the survey whether there are measures in place in their country to combat money laundering. Only in South Africa and Botswana were there contradictory answers. See table 6.

Those who answered 'Yes' were asked to list these measures. The list for each country in table 7 contains the number of respondents in parenthesis who noted the same measure. Clearly some of the respondents' answers overlap. For example, those who merely stated 'legislation' may have been referring to more than one legislative measure.

**Table 6: Are there measures in place to combat money laundering in your country?**

Country	Yes	No	Don't know
South Africa	26	1	6
Botswana	2		1
Swaziland	1		
Tanzania	1		
Mauritius	1		
Zambia	2		
Malawi	1		

**Table 7. What are these measures?**

Country	Name of measures
South Africa	Banking Code of Ethics (11). Financial Intelligence Centre Act (FICA) (10). Legislation (9). Prevention of Organised Crime Act (POCA) (9). Drugs Trafficking Act (3). Asset Forfeiture Unit (2). Monitory procedures. Corporate governance. Risk management. In-house ethics and value system. Whistleblower protection. Scorpions (Directorate of Special Operations). King II report on corporate governance. Working groups . Deposit Taking Institutions Act. Exchange Control Act . Usury Act.
Botswana	Banking codes of ethics (2). Crime and corruption unit (2).
Swaziland	Money Laundering Act. Banking codes and practices.
Tanzania	Circular on compliance from Central Bank to other banks.
Mauritius	Financial Action Task Force. Economic Crime and Money Laundering Act 200. Tax regulation. ESSAAMLG. UN Convention Against Illicit Traffic in Drugs and Psychotropic Substances.
Zambia	Legislation passed in 2001. Anti-money laundering awareness seminars.
Malawi	Banking code of ethics. Legislation.

Those respondents who were aware of the measures in place to combat money laundering were asked if they thought that the measures were effective. Few felt they were; the majority were unsure. See table 8.

The survey asked respondents to explain their views on the effectiveness of measures to combat money laundering. Few respondents answered this question. However, the answers of those who did are summarised in table 9. Again, where more than one respondent made a similar comment this is indicated in parenthesis.

**Table 8. Do you think that the measures are effective?**

Country	Yes	No	Don't know
South Africa	3	14	16
Botswana	1	1	1
Swaziland			1
Tanzania		1	
Mauritius		1	
Zambia	1		1
Malawi			1

**Table 9. Why do you think measures are effective/not effective?**

Country	Explanations Positive	Critical
South Africa	Encouraged by FICA (2). Legislation is sound. New legislation has raised awareness. AFU is effective.	Weakness of law enforcement/criminal justice system (4). Poor capacity to enforce regulations (2). Poor business values. No major prosecutions. Lack of awareness. Sheer scale of money laundering.
Botswana		Lack of exchange controls. Inventiveness/adaptation of laundering schemes.
Tanzania		Banking confidentiality. Cash economy. Criminal justice system is weak. Corruption.
Mauritius		Inadequate 'know your customer'. Inability to deal with non-cash transfer of funds.
Zambia	Government has taken a zero-tolerance stance. Enforcement authorities are drafting new legislation and are increasing training.	

Respondents were asked whether there were laws in their country that stipulated that auditors must report instances where they suspect money laundering to have occurred. The answers in table 10 suggest that in certain countries there is a great deal of confusion over this aspect of auditing. The South African auditors, particularly, appear to have divergent information on the existing regulatory framework which requires disclosure of suspicious transactions.

**Table 10. Are there laws in your country that require auditors to report suspicious transactions involving money laundering?**

Country	Yes	No	Don't know
South Africa	18	4	11
Botswana		1	2
Swaziland	1		
Tanzania		1	
Mauritius	1		
Zambia	1		1
Malawi		1	

Those who answered 'yes' were asked to list the laws that stipulated that auditors had to report instances of money laundering. In South Africa, the answers to this question suggest further disparity between auditors' legal knowledge, as not all answers were the same.

**Table 11. If yes, what are these laws?**

Country	Laws
South Africa	Public Accountants and Auditors Act (8). Prevention of Organised Crime Act (7). Financial Intelligence Centre Act (7). Diamond Act (1). Banks Act (1).
Swaziland	Money laundering Act.
Mauritius	Economic Crime and Anti Money Laundering Act 2000.
Zambia	Prohibition and Prevention of Money-Laundering Act.

The survey asked whether those who stated that they had suspected an instance of money laundering (16 respondents) reported the case and, if so, to whom. Only in South Africa did an encouraging majority of auditors report the matter to another party.

**Table 12. In instances when you did suspect money laundering, did you report it?**

Country	Yes	No
South Africa	9	4
Botswana		2
Zambia		1

**Table 13. To whom did you report it?**

South Africa	Asset Forfeiture Unit (2). South African Police Service (SAPS) (2). Financial Intelligence Centre Forensic unit at the bank concerned. Transfer attorneys—property transactions Another auditing firm. The regulator commissioning the appointment. Commercial Crime Unit. Client being audited.
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When asked if the reported case was acted upon, six said it was and three said they didn't know. The questionnaire unfortunately did not attempt to engage the respondents on what type of action this entailed—i.e. had any prosecutions resulted, or attempts to launch a criminal investigation of the suspected money laundering.

## DISCUSSION

The very modest data contained in the survey, backed up by comments made in the eight interviews, can be combined to raise a series of discussion points. These discussion points are intended merely to raise further debates and highlight key concerns.

### Can auditors be used for research on organised crime?

As discussed above, researchers will require inventive research methods in order to build an understanding of activities associated with organised crime. One of the core themes behind both the survey and the telephone interviews was to establish whether auditors had a special insight into an aspect of organised crime, namely the laundering of proceeds of illicit enterprise. If so, then future research on organised crime by institutions such as the ISS should tap into this source of knowledge.

In order for auditors to be considered to have a unique insight into money laundering they should have expertise as well as exposure. However, the survey suggests that the vast majority of the respondents had no exposure to money laundering and few had a specialist insight—25 of the 42 respondents to the questionnaire reported that they had never suspected an instance of money laundering and a further seven stated that they had only encountered one or two cases in their entire careers. Moreover, 34 reported that they were unaware of other auditors suspecting or reporting instances of money laundering. There is therefore no clear reason to think that most auditors can provide a reliable insight into the nature and extent of money laundering. It follows that it is unclear on what basis 29 of the respondents claimed that the extent of money laundering in their country had increased over the last 5–10 years. It may be the case that such perceptions only reflect popular views held by the public, perhaps inspired by government rhetoric, police reports, increased media interest or the occasional well publicised scandal. This is not to say that the views of auditors are not worthwhile, merely that research should guard at making hasty conclusions based on the perceptions of individuals whose expertise lies elsewhere. Unfortunately, this error is one replicated in many crime surveys, especially on hidden activities such as organised crime and corruption.

However, while the general perception of auditors on money laundering may present nothing unique or insightful, it is necessary to distinguish between the work of forensic auditors and other types of auditing. As many





respondents to the survey noted, the nature of basic audits may mean that in the vast majority of instances, laundered money will go unnoticed. This is not necessarily the case for the more detailed and investigative work of forensic auditors. Indeed, a small number of auditors in South Africa have worked with law enforcement agencies on organised crime investigations. Clearly these professionals represent an excellent resource for further qualitative research into activities associated with organised crime.

Nonetheless, a point of warning should be noted. The experience of forensic auditors may be determined by the selective nature of law enforcement investigations, which in turn may limit their expertise on the subject. For example, it may be the case that law enforcement is particularly concerned with combating the laundering of *drug money*. This form of criminal activity may involve rather crude forms of money laundering involving large amounts of used cash. Forensic auditors called in to assist with law enforcement investigations may well develop an expertise on this type of money laundering.

In contrast, other types of organised criminal activities, such as corporate fraud, may go relatively unnoticed by law enforcement and thus rarely will forensic auditors become involved in investigating such phenomena. It may be the case that these types of crime involve very different strategies to legitimise dirty money, perhaps relying more on complex electronic transactions rather than finding a willing outlet for a bag of cash. Therefore, forensic auditors may have a penetrating insight into certain types of money laundering and not others. Future research on organised crime must be aware of this.

### **Do auditors understand the regulation of money laundering?**

While most auditors were aware that there were measures in their country to combat money laundering, the survey suggests that there is a great deal of confusion as to what these measures are and how they affect the work of auditors. For instance, in South Africa, 26 of the 33 respondents stated that they were aware of measures to combat money laundering. However, when asked to name these measures, respondents provided a diverse list and rarely was one reply the same as another. The fact that seven respondents out of 33 in South Africa were not aware of any measures to combat money laundering was astonishing.

Confusion among the respondents is even greater with regard to the legal obligation to report suspected instances of money laundering. In South Africa, 18 of the 33 respondents claimed that there is a legal responsibility, while four said there was not and 11 were unsure. Similarly in Botswana, two out of three respondents were unsure while one stated that there was no obligation.

The consequence of this confusion was hinted at when those respondents who had suspected an instance of money laundering were asked whether they reported it and if so, to whom. In South Africa, 13 respondents said they had experienced at least one instance when they suspected money laundering. Of these 13, four did not report it and the remaining nine reported the crime to a diverse range of people or organisations.

The muddled answers to the survey suggest two problems. First, auditors may be provided with inadequate training and updates on changes to formal measures to combat money laundering. This may reflect a general lack of interest in money laundering issues within the industry. Second, the numerous measures to combat money laundering that do exist have been created in an ad-hoc manner and have been poorly explained and promoted. This may reflect an unsystematic approach towards money laundering by the authorities.

In South Africa, it is hoped that the newly formed Financial Intelligence Centre (FIC) will do much to clarify regulations, as well as simplify the procedure of reporting and investigating specific money laundering operations. If this is the case then the experience of the FIC may prove of use to similar nascent structures within the SADC region (for more information on the FIC, see box 1 on page xx). The FIC could in turn benefit from examining the experience of other countries in the region that have set up similar structures. These include Mauritius (Financial Intelligence Unit), Namibia (Namibian Financial Supervisory Authority), Tanzania (Prevention of Corruption Bureau), and Zambia (the Anti-Money Laundering Authority and Anti-Money Laundering Investigations Unit). A draft law in Lesotho also proposes the establishment of an anti-money laundering authority.<sup>2</sup>

The survey suggests a great deal of confusion among auditors regarding measures to combat money laundering and how these affect their work

However, the major auditing firms must also show an active interest in matters relating to money laundering as well as providing training to their employees on this topic. In this regard some auditing firms seem far more interested than others. Indeed, one firm has gained a healthy reputation as an industry leader in anti-money laundering training and should be congratulated for this. Even so, it is interesting to note that not all respondents to the survey from this firm were aware of measures in place in their country to combat money laundering.

### **Is there a potential role for auditors in combating money laundering?**

From a perspective outside the industry it may be understandable to at least contemplate a proactive role for auditors in the fight against money laundering. As auditors scrutinise clients' books and should notice any irregularities in their business's turnover, some may want



to see auditors as the first line of defence against money laundering.

However, the survey has suggested that it is extremely unlikely that most auditors will notice instances of money laundering. According to the survey, it seems that auditors conducting general audits are not looking for evidence of this type of crime—it is “outside the scope of general audits”. Moreover, most agree that even if auditors were looking for money laundering, rarely would they be successful. The reasons for this are numerous and involve the complex nature of laundering dirty money, the ambiguous or confidential nature of business and collusion between auditors’ clients, criminals and corrupt officials. This is further compounded by the fact that auditors are briefed by their clients themselves. When a client limits the time allocated for an audit—often for reasons associated with cost—this results in narrowing the scope of an audit. Smaller suspect transactions, for example, could therefore go unnoticed or uncommented on.

According to the auditors interviewed, the only clues of irregularities that auditors are likely to pick up during an audit involve large cash deposits or financial transactions not in keeping with the client’s profile. What this suggests is that a business or individual laundering money would have to be rather naïve or foolish to get caught from evidence arising from a general audit.

The potential for auditors to become some sort of *money laundering police* is further undermined by factors that may deter auditors reporting suspected cases to the authorities. Perhaps most importantly, there is an ambiguous relationship between the auditing company and the client being audited. In Botswana for instance, auditors report being compromised by a confidentiality agreement between them and their clients that has the effect of prohibiting auditors from reporting irregularities to the authorities. In other countries, where auditors are requested to report money laundering to the authorities, many would be reluctant due to the risk of being sued by a client in the advent of an unsuccessful prosecution or false accusation. It is for this reason that three of the auditors interviewed suggested that the most likely response by an auditing firm if they suspected a client to be involved in money laundering would be either to warn the client privately or decide to refuse the client’s business. In this situation, the client will be free to seek an alternative auditing company.

This lack of willingness to report instances of money laundering may be exacerbated by the fact that many auditors have little confidence in the capacity of law enforcement to manage money laundering cases. For example, in Tanzania an auditor interviewed lamented

that corruption and inadequate expertise from within law enforcement made it highly improbable that the authorities could successfully prosecute a major money laundering case. One can speculate that this situation encourages a high degree of apathy among those auditors contemplating reporting criminal activities to the authorities.

Finally, there appears no obvious incentive for auditing firms to report cases to the authorities—other than what may be a residual ‘professional ethic’. Some may feel that auditors should not require an incentive, and no doubt many will not. However, if the process of reporting is both unfamiliar and potentially time consuming one can appreciate a degree of reluctance on behalf of the auditing industry, especially given the general pessimism that may exist over the efficiency of law enforcement.

None of these factors that undermine auditors reporting suspected cases to the authorities are insurmountable. Law makers may decide to protect auditing firms from being sued if they wrongfully accuse a client of money laundering, the efficiency of law enforcement can be improved to the point that auditors feel confident in reporting cases, there may be merit in awarding auditing companies a monetary reward for successfully reporting an instance of money laundering, and so on. Industry bodies or professional associations representing auditors could also play a role in promoting awareness of the issue or mandatory reporting guidelines to which member firms can ascribe. However, until such measures are explored it seems highly unlikely that auditing firms will embrace the notion of policing money laundering.

Nevertheless, there still remain various positive roles for auditing firms to play in combating money laundering. For example, at present some of the major auditing firms in countries such as South Africa are assisting law enforcement with investigations into the financial activities of notorious criminals. This reflects the general trend to ‘go after the money’ of organised crime. Clearly, law enforcement agencies recognise that employees in auditing firms have expertise that is lacking in specialist units in the criminal justice system. According to one individual working in this capacity, this is not a highly profitable relationship for the auditing firms involved, but one the firms pursue nonetheless. One can speculate that some auditing firms will respond well to the opportunity to work with authorities and acquire recognition for making valuable contributions to the local economy.

A further important role that some auditing companies are exploring involves ensuring that clients are aware

There appears no obvious incentive for auditing firms to report cases to the authorities other than a residual ‘professional ethic’

of the phenomenon of money laundering and have taken the necessary precautions to limit their chances of receiving the proceeds of crime. In other words, auditing firms have the potential to educate their clients in order to make it less easy to launder money through their business, which in turn limits their clients' exposure to *inadvertently* laundering dirty money—a crime that could have disastrous consequences for the business involved. Indeed, the demand for this service may increase throughout SADC due to the increasing risks associated with being implicated in money laundering scams.

Of course, the overall impact of auditing firms educating their clients to limit their risks against money laundering may be undermined by the fact that many businesses that accept dirty money, do so willingly. It is likely that such firms will show less interest in anti-money laundering training provided by auditing firms. Thus, all auditing firms can hope to do is to provide guidance to businesses that are concerned about money laundering. While this may mean auditing firms can do little to stop much money laundering activity, they can help create an economy in which businesses have few excuses for becoming involved in laundering dirty money, or at least, have fewer excuses to turn a blind eye to suspicious funds.

### How effective is the fight against money laundering?

Although the quantitative data provided by the respondents to the survey should be treated with caution, the results show that a minority of auditors were confident in their country's measures against money laundering—only five of the 42 respondents thought they were effective. In agreement with the tentative results of the survey, all eight auditors interviewed also felt that the current measures to combat money laundering in their countries were not effective.

This result is important, if for no other reason than it suggests auditors *perceive* regulations to be ineffective. As discussed above, a lack of confidence in the authorities may engender a degree of apathy in reporting—and perhaps, even investigating—instances of money laundering. However, while we can only use the data from the survey to form hypothesis for future research, the auditors' answers are also important in that they suggest why the fight against money laundering in the SADC region is ineffective. From combining the answers to two of the questions in the survey—one concerning the challenges facing auditors in detecting money laundering and the other concerning the weakness of regulations—a general impression of some of the main challenges emerges. These challenges can be arranged into six basic themes.

1. For some, a key obstacle in regulating money laundering is the very nature of the southern African economy. Of crucial importance is the notion that in some southern African states the economy is largely cash driven and a significant proportion of economic activities fall outside the formal economy—numerous businesses are not registered, they do not pay tax or use a bank account and are therefore hidden from the prying eyes of the state. In this context, laundering dirty cash is no hard task, or at least, it is far easier than it would be in a well developed, highly regulated economy. What greatly facilitates money laundering in this context is that it may be almost impossible to distinguish between a cash payment involving the proceeds of crime and a cash payment involving entirely legitimate funds. Moreover, even if businesses do suspect cash payments as coming from a suspect source, economic hardship may mean that business people will find it difficult to choose the moral high ground and refuse the trade. Given this reality, legislation that punishes businesses severely for accepting dirty cash seems very harsh.

2. While the informal economy often receives the lion's share of concern, much dirty money in southern Africa originates from, and remain within, the so-called formal economy. In this context money laundering will stem from crimes such as tax evasion, corporate fraud, illicit kickbacks, bribes and embezzlement. Unlike the criminal activities of the informal economy, where the proceeds of crime are largely in cash, funds originating from crimes in the formal economy may be moved electronically, or alternatively may take the form of valued commodities and services (cars, property, share options etc.). There is therefore scope for money laundering to become exceedingly *complex* and beyond easy detection. The complexity of non-cash transactions will be exacerbated by the fact

that electronic banking permits funds to cross international boundaries with ease. Investigating such irregularities requires law enforcement to also operate *transitionally*—a task that is widely assumed to be far more problematic for law enforcement agencies than it is for capital.

3. A factor that was mentioned both in the survey and more forcibly in the telephone interviews, was *corruption*—underpaid officials may be particularly vulnerable to taking payments to help smooth money laundering activities. Clearly this poses a major stumbling block to the effectiveness of new legislation. However, it seems important to point out a potential contradiction here—if money laundering is so hard to detect then there will be little scope for officials to demand rent from this activity. Perhaps it may be the case that corruption will become of increasing concern when law enforcement becomes more efficient. This

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does not imply that an anti-money laundering regime should therefore not be enforced, rather that it can probably only reap benefits when undertaken in tandem with an effective anti-corruption strategy.

4. Closely related to official corruption, certain auditors lament the influence of a *poor business culture*—what we may interpret as a general disregard for any rules and regulations that impede the accumulation of personal wealth. Unfortunately, a poor business culture may extend to professionals such as lawyers and auditors who exploit their expertise and standing in society to assist money laundering operations. Again, in a very unregulated economy the services of those who can reduce the risk of money laundering operations may not be in high demand. Only in an environment where people feel they may get caught will expertise be sought.
5. Respondents to the survey also raised the point that measures to help combat money laundering may contradict a competitive business environment—what may be good for anti-money laundering might not be perceived to be good for business. For example, the respondent from Mauritius reported reluctance on behalf of the authorities to tighten up anti-money laundering legislation because it may diminish the very essence of an offshore financial centre, namely *confidentiality*. Elsewhere it was also noted that banking secrecy hindered money laundering investigations and that there was inadequate level of ‘knowing ones customer’. We may ponder the extent to which business would prefer not to work in conditions where its affairs are transparent and open to scrutiny. A country famed for stringent anti-money laundering measures may be a less popular destination for foreign businesses.
6. Finally, and representing a culmination of all the factors, a recurrent theme both in the interviews and the survey was the notion that criminal justice is woefully ineffective—expressed often by the fact that in most countries in SADC there has yet to be a major prosecution for money laundering. Law enforcement agencies are perceived to be underfunded, inefficient and under-trained. Moreover, it was noted that the traditional skills associated with law enforcement were of little use in money laundering cases. One may deduce that it is for this reason that in South Africa, law enforcement is taking the innovative step of outsourcing aspects of its investigations to skilled professionals, such as forensic auditors.

When combined, these six challenges in the fight against money laundering seem ominous. There is ample cause for pessimism and it seems rather straightforward to doubt the ‘zero tolerance’ rhetoric that has become a growing trend in recent years. In South Africa, a zero tolerance perspective has led to aggressive legislation that places the onus on businesses to refuse dirty cash

and stipulates that business must report such incidents. However, the research for this paper suggests countries such as South Africa have a long way to go before a fight against money laundering will have any significant impact. It is unclear how detecting and reporting instances of money laundering will increase significantly. For this to happen there not only needs to be a vast improvement in the capacity and expertise of law enforcement, but also needs a fundamental shift in business culture—put simply, to reduce money laundering, principles guiding competitive business such as raw entrepreneurial flair and the importance of personal success will need to be coupled with a sense of social responsibility. Until this cultural shift is made, all other measures will struggle to make a substantial impact.

## CONCLUSION

The modest data obtained via a survey on money laundering, circulated to four major auditing firms throughout the SADC region, has suggested that those employees conducting general audits are unlikely to be a source of much detailed, reliable information on the nature and extent of money laundering. Unfortunately, this conclusion suggests that future surveys on organised crime activities by the ISS can not benefit from incorporating auditors involved in general audits. However, the information gleaned from both the survey and the telephone interviews suggest that a rich source of information may be obtained from in-depth qualitative interviews with forensic auditors who have been involved with organised crime investigations. Such research should be conducted, bearing in mind that the experience of forensic auditors may be limited to certain types of money laundering activities and significant gaps may exist in their knowledge of others.

The data obtained from the survey has also permitted a brief discussion on the regulation of money laundering and the potential role of auditing firms. This discussion can be summarised as follows:

- The survey suggests that many auditors are unclear about the measures in place to combat money laundering. This muddled understanding may influence the way in which auditors handle instances where they suspect money laundering to have occurred. This points towards a need for co-ordinated in-house training to close such gaps.
- It was argued that from their basic auditing work, auditing firms are unlikely to be able to function as money laundering police. The reasons for this involve the difficulty in detecting money laundering, as well as factors that may discourage auditors turning to the authorities when they do suspect an instance of money laundering.

## In most SADC countries there has yet to be a major prosecution for money laundering





- Two areas in which the auditing industry can help combat money laundering are in assisting law enforcement with the investigation of complex cases and in explaining to their clients what money laundering is and how to protect themselves from inadvertently accepting the proceeds of crime.
- The survey has highlighted that a high proportion of auditors feel pessimistic about the measures in place to combat money laundering. It was suggested that this pessimism may in turn lead to apathy in reporting and investigating instances of money laundering.
- There were six main reasons why auditors felt unconfident in their country's ability to combat money laundering. These were: the relative

importance of an informal cash economy that too easily accommodates dirty cash; the complexity of certain forms of money laundering, especially due to international transactions; the role of corruption; the prevalence of a poor business culture; the requirements of an environment conducive to business which may contradict anti-money laundering policies, especially surrounding issues of banking confidentiality; and finally, the weakness of the criminal justice system.

- It was argued that the evidence from the survey suggested that the popular zero tolerance stance against money laundering may be inappropriate and that the SADC region has a long way to go before money laundering can be significantly restricted.

### Box 1.

#### South Africa's new Financial Intelligence Centre: A model of good practice within the region?

(The following is based on information provided by the FIC in response to questions posed by the authors)

#### What is the FIC?

After five years of investigation and development, the Financial Intelligence Centre Act (Act 38 of 2001) became law in 2001. This Act set up a regulatory anti-money laundering regime which is intended to break the cycle used by organised criminal groups to benefit from illegitimate profits. To achieve this, the Act imposes 'know your client', record-keeping and reporting obligations on accountable institutions. It also requires them to develop and implement internal rules to facilitate compliance with these obligations.

The creation of the FIC in February 2002 was a crucial dimension to the new regulatory regime to combat money laundering. The core function of the FIC is to collect and analyse information on instances of money laundering reported to it by accountable institutions. The Centre then uses this information to inform and advise various investigative authorities, including the SAPS, the National Prosecuting Authority through the Directorate of Special Operations (Scorpions) and the Asset Forfeiture Unit, the intelligence services and the South African Revenue Service (SARS).

The FIC also monitors compliance among accountable institutions and gives guidance to such them, to supervisory bodies and others. In addition it will also exchange information with similar bodies in other countries.

The FIC started receiving reports on suspicious and unusual transactions on the February 3, 2003.

#### Will the FIC be able to make a genuine impact on the extent of money laundering?

The FIC recognises that simply having an anti-laundering regime will not eradicate money laundering, although it is believed that it will have a deterrent effect.

The relationship between the FIC, accountable institutions and law enforcement agencies (LEAs) will certainly assist the LEAs to gather financial intelligence and could possibly lead to an increase in convictions for money laundering. The FIC will also liaise with the various supervisory bodies that have a responsibility under the Act and ensure that they fulfil their obligations to monitor compliance.

#### What are some of the main challenges facing the FIC in its attempt to combat money laundering?

The FIC cannot hope to cover the full range of accountable institutions at once. Therefore it will adopt a phased roll out of the legislation using a risk-based approach. As measures start to take effect, the net can be widened to embrace all of those who are obligated. The FIC is also mindful of the need to ensure that all stakeholders become participants in this process and that they 'buy into' the process. This requires extensive interaction with all stakeholders—on the side of government and its law enforcement authorities, as well as with industry, which provides the accountable institutions.

A very important element is ensuring that the level of public awareness is raised, so that any person who wishes to open a bank account or conduct a business transaction will understand that the institution concerned will ask questions regarding their identity. People need to understand that this is to enable them to do business in the context of a more secure financial system and environment in future.

As South Africa embarks on implementing an anti-laundering regime, it must also consider additional

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requirements under the new Countering of Financing of Terrorism (CFT) recommendations. These recommendations will add a new dimension to the anti-laundering regime. There are thus many challenges.

#### How will success be measured?

The FIC will be looking to quantify results as the reporting and data collection infrastructure is developed. However, it will only be able to start measuring its success in a few years time once there is sufficient information on which to reflect.

The FIC will also monitor the investigations and prosecutions that result from this flow of information. A very important part of this process will be to implement 'information feedback loops' from law enforcement to the various accountable institutions

and supervisory bodies. This will enable all the stakeholders to determine if they are on the right track.

The nature of this feedback could include the number and quality of reports received, successes achieved on reports received, trends identified and identification of any training possibilities.

The FIC has also identified the need to keep monitoring money laundering trends in South Africa. As these trends change, they will also offer information on the success or otherwise of the country's drive to combat money laundering. Indeed, launderers will have to adopt different approaches to their activities if the FIC is being successful.

For more information on the FIC, as well as details of how accountable institutions should report suspected instances of money laundering, visit the FIC's official web site at: <http://www.fic.gov.za>.

#### Notes

1 An audit partner/manager conducts statutory audits whereas a forensic auditor—who need not be a chartered accountant—conducts more detailed audits to establish whether any irregularities have occurred. A senior auditor explained the difference well by way of an analogy: "An auditor is the equivalent of a geologist whose job it is to search

for a seam of ore. The forensic investigator is the miner, whose job it is to go and dig out the seam and ensure that the ore is sent off for processing."

2 More details concerning the operation of these various bodies will appear in a forthcoming ISS paper by Charles Goredema, entitled *Money laundering in Southern Africa: Dealing with the complexities of the challenge*.

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## About this paper

In line with international developments, legislative measures to combat aspects of organised crime such as money laundering are being stepped up in the SADC region. However, gaps in knowledge still remain regarding the nature and extent of money laundering within the SADC states—making it difficult to formulate appropriate strategies. This paper is based upon both telephonic and written surveys of auditors employed by four major multinational auditing firms in seven southern African countries. The paper explores auditors' insight and experience of money laundering as well as the potential role that the auditing profession can play in combating it.

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