What Internal Auditors Should Know About Dirty Money Centers

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The Panama Papers, Paradise Papers, or the still unpublished Power-Center Papers are just a drop in the ocean of dirty money swilling around the world. No ultimate regulation, legislation or rhetoric is going to curtail this lucrative trade. The reason is simple: the financial elite have always been and will always be at least two steps ahead. Here are a couple of simple examples from our recent experience:

- Management with an ownership interest in a stock exchange company paid invoices for software licenses to a company in the Isle of Man. It transpired that these licenses had been purchased and sold on at an inflated price. Our investigations also uncovered that in fact, the founders of the Isle of Man company were at least two members of the management team.

- A significant and surprisingly autonomous subsidiary of an international company used tax haven companies and accounts to make large "facilitation payments" relating to deals in Africa. When the money was traced, it was discovered that it never reached the African ministers who it was earmarked for, but was siphoned off by certain employees and managers in the subsidiary itself.

But before we go any further, let's start with a short description of Dirty Money Centers (or DMCs).

What are Dirty Money Centers?

We define a DMC as a place or "vehicle" where assets, typically money, are hidden but at the same time connected to their rightful owners in a usually legal but also convoluted manner. Such complex ownership structures provide anonymity, which is the key element for fraud and corruption, as well as building up and using wealth in subtle ways.

The simplest example of DMC would be a combination of a safe deposit box and legal privilege. For example:

- Antony Kreefe, a renegade Londoner hiding out in the U.S., needs to hide cash and jewelry. A safe deposit company offers the service, and this company can be based anywhere in the world. Kreefe asks his lawyer (Marcos Ferdinand) to open a safe deposit box in M. Ferdinand's name but with the ultimate owner and beneficiary being Antony Kreefe. All instructions and conversations between lawyer and client are confidential and subject to attorney-client privilege, and so through this combination of confidentiality and privilege, M. Ferdinand cannot be subpoenaed to give evidence in court. The identity of Kreefe, the ultimate beneficiary, remains private.

More sophisticated variations include personal bank accounts in a country which permits numbered accounts, like Switzerland, or nominee directors and shareholders who lend their name to a firm but which, through a lawyer and attorney-client privilege, hold distance between owners and nominees.

By combining numbered accounts, holding companies and nominee directors, hidden ownerships are created.

There are also legitimate uses such as certain international funds and trusts, but the history of DMCs go back hundreds of years and as places to hide ownership of assets, companies, bank accounts, and proceeds of crime, as well as use these proceeds to do a variety of foul deeds. Also, the number of places involved is much wider than any "civilized" government would like to admit.

Far from being the likes of Panama and the British Virgin Islands, DMCs are almost everywhere. Hidden ownership is just as easy in Great Britain or the USA as it is in Gibraltar or Vanuatu.

A couple of years ago, we examined a multi-billion-dollar energy company our client was purchasing from, to discover that it was controlled by a Russian crime family whose virtually bulletproof ownership structure involved countries like Cyprus, Austria, the British Virgin Islands, Luxemburg, the UK, Ireland, Switzerland, Estonia and Canada. Thus, it seems that there is a need to revisit the definition of DMC, as the hidden assets are no longer located in one place but rather disbursed in multiple locations, both physical and digital. Therefore, we feel that a more accurate definition would be Dirty Money Constellations (moving forward in this article, keep in mind our updated definition).

What You Should Know About DMCs

In the past, DMCs tended to be relatively easy to discover. They could be as obvious as a company headquartered in the British Virgin Island with no business address other than a law firm or incorporation agent. Analysis of an invoice from a supplier would have revealed, relatively quickly, that the company in question was a "front." Following the collapse of major corporations due to fraud allegations and the press coverage of the Panama and Paradise papers, more laws and regulations are being put in place to tackle the issue. However, DMCs are far ahead of governments and regulators.

The DMC-industry thrives on exploiting legal loopholes, lax reporting requirements and inventing new ways to hide. Giving front companies a more legitimate look is back in vogue (again). This could take the form of a subsidiary, branch or address in a swanky city like Edinburgh, Dubai, New York, and Amsterdam, just as long as we would not normally suspect.

After the Panama Papers, the chairman of one of our clients asked his directors of Social Responsibility and Compliance if they had any shady dealings with Panama. Since we were helping them with a fraud detection review we could quickly give them the good news. They were "safe" from Panama. We had only discovered dealings with front companies and criminals based in the U.S., U.K., Gibraltar, the Middle East and Estonia.

DMCs are highly innovative, and perhaps cryptocurrencies are the next step in their evolution. However, as technology advances and data is more available, it also looks like the number of footprints DMCs leave is increasing.

Uncovering DMCs

Despite their complex ownership structure, DMCs can be cracked.

The investigative process behind is what we fraud investigators call "following the money". The idea is to target and track the transactions and analyze money flows in and out of the company. By analyzing payments and invoices in combination with the registered information about the suppliers and customers which are involved, it is possible to identify shell companies and those financial relationships which indicate that the firm is actually dealing with a DMC.

The key to detecting such harmful business relationships lies also in detecting typical patterns associated with how such entities operate today. For example, the sole fact that a supplier or customer is in one jurisdiction and the associated bank account is in another, is a red flag in itself. A dependent and exclusive relationship between the firm and its supplier, combined with large and regular payments where invoices have sequential numbers, is in many cases fraudulent. Investigators should look for disguised ownerships and hidden subsidiaries. Quite often, the clue to detecting major scams lies in small details.

So, if you live in London, New York, Singapore or any other financial nexus, please don't come down too hard on the likes of Panama, The Channel Islands, or St. Kitts. Look under your nose, where the dirty money flows and where it goes. Once we know where it is, we can choose to avoid it, and even decide to clean things up!

This *article is based on Chapter 10 of "The Continuing Imperialism of Free Trade," where Veronica Morino,* Dr *Matthew Higgins* and *Nigel Iyer, illustrate with real cases the constant evolution of Dirty Money Centres (DMCs) and their transformation to the financial elite's constellations of power.*

You can meet Veronica Morino and Nigel Iyer (and soon Asia Chernova) at many of MISTI's practical training courses in Europe and the Middle East and learn from their experiences of spotting and hunting down DMC's.