

Money Laundering, Terrorist Financing, Proliferation Financing and Targeted Financial Sanctions: Inherent Risk Relating to Accounting Services in the Cayman Islands

Contents

Objective	2
Introduction	2
National Risk Assessment	3
Money Laundering and Terrorist Financing Risk Assessment	4
Terrorist Financing, Proliferation Financing and Targeted Financial Sanctions Risk Assessment	5
Relevance of Registration and Monitoring to Risk	6
Higher Risk Services	7
Handling Client Money, Transactions and Accounts	8
Payroll	8
Company formation and termination	8
Accounting and Bookkeeping-False Accounts	9
Medium Risk Services	10
Fiduciary	10
Lower Risk Services	11
Audit and Assurance	11
Controllerships	11
Tax Services	11
Transaction Advisory Services and Valuations	11
Inherent Service Risk and Controls	12

Objective

The purpose of this assessment is to identify the known or expected inherent risks of money laundering, terrorist financing, proliferation financing and targeted financial sanctions (“ML, TF, PF, TFS”) for the accounting profession in the Cayman Islands resulting from the threats it faces and its vulnerabilities.

This assessment is to then be used by:

- Firms to inform its own Risk Assessment and risk-based approach to managing and mitigating the risks, and
- CIIPA to inform its Supervisory Plan.

This assessment was initially based on the many years of experience of those in the profession, the staff of CIIPA drawing on experience in financial crime regimes and controls and the National Risk Assessment itself and has been updated following the implementation of supervision and market surveillance. As supervision of accountancy services providers matures, additional data will be available to inform the ongoing review and update of the assessment.

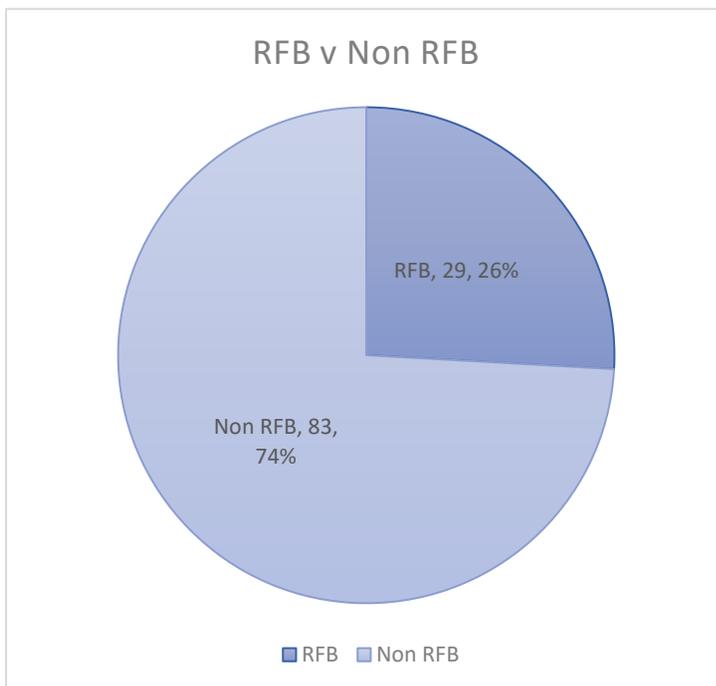
CIIPA herein issues its assessment focusing on accounting services to inform both its Supervisory Approach and the Guidance provided to Firms of Accountants.

Introduction

CIIPA is the professional body for accountants in the Cayman Islands. To be eligible for membership accountants must meet certain criteria including that they qualified with an Approved Overseas Professional Accountancy Institute (“OPAI”) who for the purpose of this Risk Assessment are referred to as “Professional Accountants”. It is not mandatory for all individual accountants to become a member of CIIPA to work as an accountant or bookkeeper in the Cayman Islands but since December 2017 with amendments to the Anti-Money Laundering Regulations, it is mandatory for a firm of Accountants to register with CIIPA and those that carry on relevant financial business (as defined in the Proceeds of Crime Law) are monitored by CIIPA in that regard.

In principle, as it is mandatory for members of CIIPA to qualify through an OPAI’s examination, obtain a minimum number of years of experience, conduct continuing professional development, and abide by the requirements set out in the IFAC Code of Professional Ethics (which requires compliance with the fundamental principles of: integrity; objectivity; professional competence and due care; confidentiality and

professional behavior and skepticism), it is expected that there is less risk that they will be coerced or tricked by criminals provided there is full awareness of the risks, and vigilance is exercised. Consequently, firms comprised of staff that are not professional accountants will be subject to greater scrutiny in monitoring by CIIPA given the increased risk that they may be coerced or tricked. This assessment must be weighed with the possibility that professional accountants are attractive for those seeking to engage in high-end money laundering due to the credibility that their services can confer.



There are currently 112 firms providing accounting and audit services, registered with CIIPA and 29 of those are providing services that constitute relevant financial business, typically handling payments for clients. 22% only service local clients and 23% have a mixture of local and international including ‘stratas’ where property interests are in the Cayman Islands, but the owner’s primary residence is overseas, most commonly the US. 15% of all registered firms or 55% of the number of registered firms conducting relevant financial business are providing liquidation services some of which may be complex and involve international payments.

Figure 1

National Risk Assessment

The Government of the Cayman Islands conducted a [National Risk Assessment](#) and published summary results in 2017. With respect to accounting it concluded:

“The vulnerability of accountants was assessed at 0.28 or medium low when compared to the other categories within the sector. This assessment is due to the fact that accounting services in the Cayman Islands are primarily related to audit, accounting and related consultative work carried out by the top international accounting firms. The probability that these services could be exploited by those seeking to launder criminal proceeds is very small. Further, the accounting entities do not handle customer funds and the typical client profile of these firms is one of entities which are already regulated by CIMA.”

Furthermore, sector risk assessments published by the Government and other supervisors are also relevant to the accounting sector to varying degrees. In February 2020 the [International Components of Risk faced by the Cayman Islands as an International Financial Centre](#) was published. This included a summary of sector risk assessment for accountants as medium-low and drew on data from the assessment herein. As the accounting profession resides in the Cayman Islands the specific risks presented to it as an international financial centre, must be factored in. The following are likely relevant:

- The clients of accountants are Firms that may:
 - Have large, cross border, sophisticated operations
 - Lack of physical presence and overseas ownership particularly if in high risk countries
 - Provide complex products including the exercise of discretion
 - Provision of wide range of ancillary services and products
 - Are financial services not subject to supervision i.e. non-life/investment linked insurers
- Furthermore, the clients of accountants may have clients:
 - In, or connected to high risk countries, or
 - With complex ownership

Current data from CIIPA’s supervision indicates that firms’ client bases are split as in Figure 2:

Thus, the greatest exposure for the accounting profession relates to overseas clients and sophisticated services such as some liquidation work.

Further details on each sector risk assessment that accountants clients may be in are set out in the [International Components of Risk faced by the Cayman Islands as an International Financial Centre](#).

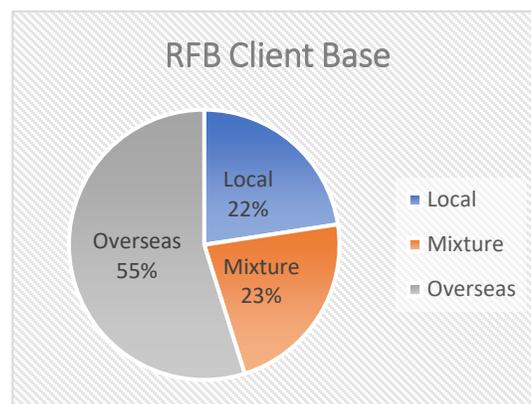


Figure 2

Money Laundering and Terrorist Financing Risk Assessment

Notably the key National Threats to the Cayman Islands are fraud, tax evasion and illegal drug trafficking.

Fraud

Accountants are by their nature shaped to identify fraud and thus an honest and diligent accountant may play a vital role in mitigating this threat.

Tax Evasion

Some accountants are involved in providing tax advice or compliance services or provide services that may result in awareness of tax arrangements and liabilities. These accountants may play a vital role in identifying and reporting tax practices that constitute criminal behavior.

Illegal Drug Trafficking

This threat in the Cayman Islands is likely the large, international and corporate type, relating to large scale drug operations. The origins of these monies need to be concealed and the audit trail disguised. This can be done through a variety of complex transactions between companies, use of nominees, false invoicing, transactions with shell companies, attempts at manipulating accounting standards, and complex (and short duration) investments, that accountants and auditors could potentially spot.

Those seeking to access accounting services in the Cayman Islands can do so relatively easily. Due to the number of individuals offering accounting services, costs are competitive, with those who are professionally regulated generally charging more.

The key specific threats to the accountancy sector are:

- complicit accountancy professionals facilitating ML TF PF or breaches of TFS;
- collusion with other parts of the regulated sector;
- coerced accounting professionals targeted by criminals;
- failure to identify suspicion and submit SARs;
- lack of supervision and universal awareness until 2019;
- relatively low barriers to entry for some parts of the sector.

Accountancy services remain attractive to criminals due to the ability to use them to gain legitimacy or transfer value. Accountants are in a position to legitimise transactions through accounting practices.

Terrorist Financing, Proliferation Financing and Targeted Financial Sanctions Risk Assessment

TF, PF and TFS-contravention risk primarily arises specifically for accountants where they handle client funds or transactions with the risk varying according the degree of control over the funds or transactions.

Further, the TF risk increases where payees or beneficiaries of transactions are outside of the Cayman Islands or otherwise new or temporarily in the Cayman Islands with no permanent address or employment.

The risk may also increase for payees or clients that are not for profit entities that are not supervised or otherwise well-known and accountable.

Of less but still notable risk, is the preparation of accounts or booking of transactions that may add a layer of credibility to a prohibited transaction.

Typology 1

FBME bank, a Tanzanian licensed bank for which the holding company was established in the Cayman Islands and serviced by a Cayman Trust and Corporate Services Provider ("TCSP"). The bank was alleged to be involved in and investigated by the US federal police for terrorism financing. The Cayman Islands holding company was struck off the company registry in 2016, after the Cayman Islands TCSP ended its relationship with the company.

Source: Cayman Islands National TF Risk Assessment

Relevance of Registration and Monitoring to Risk

Registration of firms reduces ML TF PF TFS-contravention risk in that it increases vigilance through raised awareness and resources for firms. Those firms that are carrying on relevant financial business (which is considered to be of greater risk for ML, TF, PF or TFS contravention) are subject to **monitoring** and are required to implement controls to mitigate the risk. Schedule 6 of the Proceeds of Crime Law sets out a list of activities, which constitute "relevant financial business" and paragraph 14 specifically applies to accountants. This reflects the services that the Financial Action Task Force considers to be relevant financial business, accountants globally may provide namely:

- (a) the sale, purchase or mortgage of land or interests in land on behalf of clients or customers;*
- (b) management of client money, securities or other assets;*
- (ba) organization of contributions for the creation, operation or management of companies;*
- (c) management of bank, savings or securities accounts; and*
- (d) the creation, operation or management of legal persons or arrangements, and buying and selling of business entities.*

In the Cayman Islands however, accounting firms engaged in activities (b), (ba) and (d) must be licensed by the Cayman Islands Monetary Authority according to e.g. the Companies Management Law or the Securities Investment Business Law. Although some firms provide bookkeeping and accounting services to estate agents and stratas, accountancy services in relation to (a) are uncommon and limited to date to Statements of account when strata interests are transferred.

A much more common activity provided by accountants in the Cayman Islands is (c) whereby alongside bookkeeping activity accountants may act as initiator or approver of payment transactions. More detail on the risk arising from this activity is explored below in **Handling Client Money, Transactions and Accounts**.

The scope of registration with CIIPA according to the *Anti Money Laundering Regulations* is those firms providing accountancy services and specifically includes audit, assurance, payroll services, and tax advice and compliance which is broader than “relevant financial business”. However, only Firms engaged in relevant financial business are subject to monitoring.

The reason for the wider scope for registration is to:

- capture services that may entail relevant financial business incidentally,
- monitor the market in readiness for changes in international standards,
- inform the risk-based regime and supervisory approach; and
- ensure that the reporting of suspicious activity by all businesses is effective.

What follows then is a list of services **typically provided by accountancy firms** and the inherent ML, TF, PF, TFS-contravention risk those are considered to present, although they **may or may not constitute relevant financial business**. All firms, whether in scope of the *Anti-Money Laundering Regulations* and subject to monitoring or not, are urged to utilize this assessment with a view to reducing the likelihood of being used by criminals to facilitate money laundering and potentially committing an offence themselves under the Proceeds of Crime Law, Terrorism Law, Proliferation Financing (Prohibition) Law or the various targeted financial sanctions Orders.

Higher Risk Services

Any service engagements with high volume cash transaction businesses present a risk that these businesses front organised crime, or that they evade tax. Generally, any accountant can be misled by criminals, but the provision of certain services presents a greater inherent risk of being used for money laundering.

- Handling Client Money and Accounts including payroll
- Company Formation and termination
- Accounting and Bookkeeping

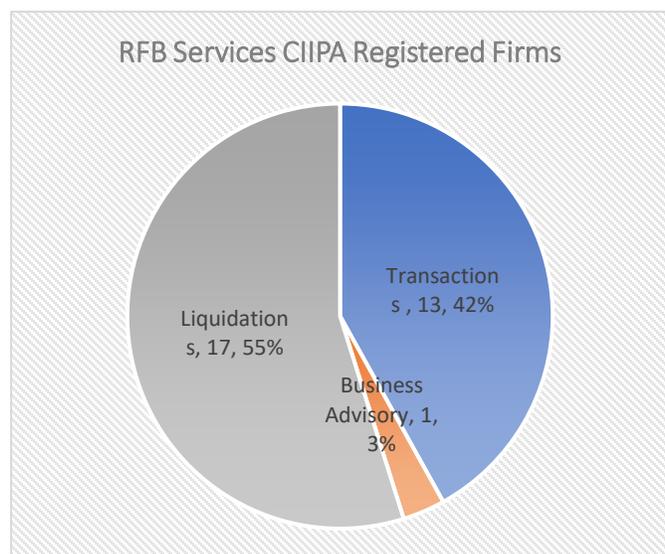


Figure 3

Handling Client Money, Transactions and Accounts

Where offered there is a high risk of misuse of accountants' client accounts for ML, TF, PF, and TFS-contravention purposes especially where high value transactions involving transfer of funds through bank accounts with little scrutiny or explanation. It is thought to be uncommon for accountancy firms to hold client money but there are currently no rules regarding the use of accountants' client money accounts in Cayman and there are many reports of criminals misusing clients' monies accounts to avoid detection.

A more commonly offered service by accountants is to initiate transactions for clients either by acting as signatory on cheques or as initiator or approver of online transactions.

Whilst most accountants are alert to the need to avoid complete control of client funds or accounts in order to manage its legal liability and own fraud risk, there remains a TF, PF and TFS-contravention risk for accountants even where it only has partial control.

This risk is high where the payee generally resides or works overseas, particularly higher risk countries; or where little information is available on the payee or transaction. Professional skepticism assists in mitigating the risk.

Typology 2:

McCoy is a junior member of a finance team who receives this email purporting to be from the CEO of a client.

From: Frost (<mailto:e.Frost@outlook.com>)

To: McCoy@outlook.com Subject: Project Blackbird

I have assigned you to manage Project Blackbird.

This is a strictly confidential financial operation which takes priority over other tasks.

Have you already been contacted by Marko from BOEM LLP?

This is very sensitive. We must make sure not to infringe regulations.

Regards, Frost

Soon after, McCoy receives a call from 'Marko' instructing him to make a funds transfer to a particular account. A follow-up email contains the destination account details and asks McCoy to send confirmation of the transfer by return email.

McCoy does as he is instructed. When he sends the confirmation, Marko responds with a lengthy sequence of emails providing McCoy with details of several more bank accounts and instructions to make a number of further payments.

All of the domain names associated with Marko's emails appear as if they belong to BOEM LLP. McCoy suspects nothing.

Source © ICPAC 2018

Payroll

This is a specific type of transaction entailing the transfers or handling of funds and accounts. Companies in the Cayman Islands may outsource this service to an accountant and attention must be paid to the increased risks especially where the wages are paid in cash by a higher risk or cash intensive business. Mitigating factors are where the employees are local and fully resident not sending salaries overseas or where all payments are made through Cayman bank accounts.

Company formation and termination

Company formation services pose a risk in that criminals may use companies to mask the audit trail of funds flowing through a company or hide the ownership of assets or mask the transfer of assets between persons. Further, company formation services offered by accountants rather than by pure corporate services

providers, present a vulnerability as criminals may seek access to and exploit the accountant’s wider services. That said the greater oversight that accountants have will in the case of a vigilant accountant increase the prospects for identification and reporting should the accountant be prepared to take on this responsibility.

However, accountancy firms that offer this service (ranging from company formation, company secretarial services and registered office services) must be licensed under the Companies Management Law (“CML”) and have been supervised by the Cayman Islands Monetary Authority (“CIMA”) since 2000 which mitigates the risk. Company formation or management services provided by accountants

that may be unaware of the requirement to be licensed or that are licensed but accounting services are not included in the business plan submitted to the supervisor (if not considered within the scope of the CML), would remain of higher risk.

Lastly, liquidation services providers are exposed to significant risk, may fall outside of supervision through failure to register and the fact that any person no matter their qualification, competencies or conflicts can be appointed as liquidator means there is a high risk of fraud, ML, TF, PF and TFS-contravention. There are various types of services provided or appointments that can be made in the sector, including official, provisional and voluntary liquidator appointments and **Controllerships** which are noted separately below. In the case of court appointments there may be mitigating factors namely the supervision of the court and the fact that only qualified insolvency practitioners may provide the service but these may be outweighed by the higher risks presented such as increased potential for fraud and difficulties in obtaining information in a timely manner.

Accounting and Bookkeeping-False Accounts

Providing false accounts and the preparation of business accounts can also be a means by which the source of ownership of funds and assets can be masked and legitimised through the use of accountants.

Typology 3

A New Zealand accountant has incorporated several companies which have subsequently been used by an overseas criminal group to facilitate importation of drugs into the jurisdiction. The accountant filed the company incorporation documents and registered himself as the director and/or shareholder of the companies. The companies’ bank accounts are used to fund drug imports and/or repatriate the proceeds of drug offending internationally. It is possible that the accountant is also falsifying the financial records of these companies (i.e. ‘cooking the books’) to obscure the illicit activity, though this has not yet been established.

Source: Asia Pacific Group 2019 Yearly Typologies Report

Typology 4

A private religious school in a southern border (Thailand) province commissioned an accounting firm for “window dressing” of the school’s accounts, in order to receive the per student financial support from the government that was then used to support terrorism activities in the area.

Source: Asia Pacific Group Yearly Typologies Report 2019

Accountancy services may be exploited to provide a veneer of legitimacy to falsified accounts or documents used to conceal the source of funds. For example, accountants preparing and signing off accounts for businesses engaged in criminality, thereby facilitating the laundering of the proceeds usually unwittingly signed off by accountants, but sometimes complicitly.

The risk of false accounting can arise in relation to both financial services and cash-based transactions, with accountants involved in the account preparation or review

processes for both small and large businesses.

Further, where accounting services are provided as a back-office function or combined with administration or company management functions, such as mutual fund administration or insurance management, the risk increases since the risks pertaining to both corporate formation and liquidation are introduced. In these cases, the firm or inhouse accountant has to manage the functions which may at times conflict with the accounting function.

Medium Risk Services

Fiduciary

The following services may be offered in many capacities including as part of a Corporate Services Provider licence, a mutual fund administrator licence, a Registered or Licensed Director or in a non-professional capacity:

Acting-

- As a director or secretary of a company
- As a partner of a partnership;
- In a similar position in relation to other legal persons;
- A trustee of an express trust or similar legal arrangement; or
- A nominee shareholder for a person other than a company whose securities are listed on a regulated market

In most cases the accountant is appointed because of their accounting expertise and thus adding credibility to the arrangement. Significant personal liability rests on those appointed as well as reputational risk but regardless where accountants act in these capacities they must be aware of the potential ML TF PF TFS-contravention risk.

Lower Risk Services

Audit and Assurance

Whilst providing assurances to third parties about the fair presentation of accounts, entails work in relation to historical transactions, the reports provided can be used to give credibility and thereby less scrutiny or monitoring by law enforcement of regulators, generally. Relatively, audit and other assurance services are assessed to be at lower risk of exploitation because of a strict set of statutory obligations and the small group of practitioners who offer the service who must be licensed. Further, auditors are required to conduct checks when on-boarding clients, such as professional clearance and the requirement to ensure that accepting a client does not compromise any obligations as set out in the Code of Professional Ethics (e.g. conflict of interest) which also mitigates the risk.

Controllerships

In the Cayman Islands, persons may be appointed as a controller of a regulated entity by the Cayman Islands Monetary Authority (“CIMA”). The terms of the controllership are determined by CIMA but typically entail taking over the operations of the firm which would constitute relevant financial business. However, the supervision by CIMA and specific reporting obligations of the controller mitigate the risks.

Tax Services

Tax services are unlikely to be used to launder the proceeds of other crimes, but services may be used to facilitate tax evasion and increased focus on tax compliance (e.g. Common Reporting Standards and US FATCA) may result in attempts to use new methods for evasion. All taxation services, where accountants are not skeptical and scrupulous in understanding the affairs of their client, are vulnerable.

Transaction Advisory Services and Valuations

Transaction advisory services, relating to the merger, purchase or sale of a business or asset, or raising debt or equity capital, present a risk in that such services may contribute to or facilitate money laundering, terrorist or proliferation financing or involve the provision of economic resources to sanctioned persons. The closer the nexus of the advice to a transaction, the higher the risk, although the fact that assets are not handled result in this service being low risk. Examples of services are:

- Advice relating to appropriate acquisition, divestment or capital raising strategy;
- Identify and liaison with interested counterparties;
- Advice relating to the pricing, form and structure of a transaction;
- Advice relating to the negotiation of a definitive agreement for the transaction;
- Advice relating to the key commercial parameters for closing of the transaction.

- Valuation of a business or asset, either in support of an acquisition, divestment or capital raising initiative, or as a separate and discrete engagement but only where provided for use by a third party.

Inherent Service Risk and Controls

The above assessment of the inherent risk for certain services must only be taken as one element to be considered alongside the client, geography and delivery channel risk and the controls adopted. Further information on using this risk assessment to conduct your Firm's ML TF PF TFS-contravention Risk Assessment can be found in the Supervisory Guidance for the Accounting Profession.