ACCOUNTANCY EUROPE.

EGIAN
European Group of International Accounting Networks and Associations

european contact group

GOVERNANCE AND FIGHTING FRAUD AND FINANCIAL CRIME IN THE DIGITAL ERA

On 27 November 2018, the associations of audit firms ECG (European Contact Group) and EGIAN (European Group of International Accounting Networks and Associations), in collaboration with Accountancy Europe, held a conference in Brussels to explore **how to work smarter against fraud and financial crime.** The event brought members of the accountancy profession together with key stakeholders – including representatives of the corporate, regulatory, investor, policymaker, NGO and law enforcement communities.

> We in the profession are playing a key role to mitigate fraud and promote the public interest in that field.
>
> Olivier Boutellis-Taft, Accountancy Europe CEO

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FINANCIAL STATEMENT FRAUD

There are many challenges in preventing and detecting financial statement fraud – a category that includes misstatement, embezzlement or producing misleading financial statements to obtain an advantage. These challenges include lack of harmonisation across international corporate governance and regulatory frameworks. Even where sound frameworks exist, maintaining high standards of corporate governance over time can be difficult. Financial statement fraud often starts at the top of the organisation – with senior people – and involves collusion. Fraud can also occur in grey areas – there is a fine line between borderline accounting and fraud. Cultural factors also play a part, such as the skewed incentives in corporates that encourage management to become highly focused on reporting good results.

HOW TO COMBAT FINANCIAL STATEMENT FRAUD

1. COORDINATE EFFORT TO IMPLEMENT THE SPIRIT OF GOVERNANCE CODES

Good corporate governance doesn't just require codes of conduct, rules and regulations. It depends on the way organisations interpret and implement them. Creating a strong culture that encourages behaviour aligned to espoused values could be the best defence against fraud. While the "tone from the top" is important, all functions with accountability for the financial statements need to maintain a dialogue with each other and work together.

The role of audit committees should be reinforced. Audit committee oversight is vital, including the committee's willingness to challenge the executives. Audit committees need to be truly independent. It is not appropriate, for example, for an executive chairman to be on the audit committee. The presence of an executive director on the Audit committee may undermine the purpose of this committee in providing independent oversight and preventing conflicts of interests. Audit committee independence and effectiveness could be helped by making sure committees have access to internal audit without management.

Shareholder engagement and stewardship should be strengthened, for example, to encourage diversity in board composition and the avoidance of group think. Investors need to engage with audit committee chairs to gain reassurance about their oversight role and the existence of sound governance around the board.

2. HARNESS TECHNOLOGY

Big data analysis, machine learning and artificial intelligence could have an impact on information flows for management, external auditors and markets – helping to expose problems such as duplication of payments used as a money-laundering scheme. Numerous affordable technologies are now available to identify fraud risks and investigate fraud – preventative and forensic tools – and these should be used to full effect.

The application of new technology and algorithms could be helped through establishing a system whereby companies make anonymous datasets available for auditor experimentation. The anonymity would help to address data protection issues relating to the General Data Protection Regulation (GDPR). There is also scope for further development of neuroscience technologies to enable deep dives into IT systems and the analysis of, for example, system access history. In order to address professional liability concerns, a safe harbour provision in place for a few years could help auditors to experiment and see what works.

3. SHARE INFORMATION AND COLLABORATE

All interested parties need to collaborate to tackle financial statement fraud. The concept of collaboration extends beyond cooperation. For example, cooperation could involve sharing data, whereas collaboration involves auditors, regulators and other relevant parties working together to understand what the data means and then taking action. The audit profession could also collaborate to share fraud case studies in order to learn from each other.

In terms of sharing information, action could also be taken to improve public understanding. For example, a significant part of the auditors' work occurs behind closed doors and so is not visible to the public. The audit profession could collaborate to report annually on experiences to demonstrate to the public what happens behind the scenes.

“Financial statement crime will always be there. We won’t change people but the environment has. We have to react accordingly with our procedures.

Jens Poll, Chair of EGIAN

HOW TO WORK SMARTER TOGETHER IN FIGHTING FINANCIAL CRIME

Financial crime takes many forms, including money laundering, terrorist financing, tax evasion and even LIBOR fixing. According to a European Parliament study in 2017, between $1.5 trillion and $2.8 trillion of elicit funds go through the global financial network every year – but only 0.2% is ever seized by the authorities. There are numerous challenges to overcome to tackle financial crime effectively. These include a lack of international harmonisation of regulatory frameworks (e.g., some EU jurisdictions require obliged entities to report unusual transactions, while others require reporting of suspicious transactions) and failure to implement anti-money laundering (AML) directives fully. Regulations are also lagging behind developments in new technology, such as the emergence of distributed ledgers and cryptocurrencies. Current systems such as the requirements for Suspicious Activity Reports (SARs) have flaws: too many reports are generated and too few contain real information of value.

HOW WE CAN WORK SMARTER AND ADDRESS CHALLENGES

1. ENCOURAGE COLLABORATION – PUBLIC-PRIVATE, INTERNATIONALLY AND ACROSS DISCIPLINES

One important means of collaboration is through public-private partnerships to encourage dialogue and share expertise and capabilities. For example, the UK’s public-private partnership, the Joint Money Laundering Intelligence Taskforce (JMLIT), brings together UK and international banks, law enforcement bodies, and national competent authorities. Europol is looking at launching a similar initiative.

JMLIT’s structure includes experts working groups addressing typologies or strategic themes in particular areas – such as trade-based money laundering, virtual currencies and money laundering through capital markets. JMLIT also has an operations working group that meets every week to discuss real cases. By sharing more information in such ways, the private sector may be encouraged to give more information back, to improve transactional monitoring. Banks, accountants and lawyers may also be able to direct their resources more effectively when tackling financial crime.

Internationally, further cooperation should be encouraged between Fraud Investigation Units (FIUs) and between prudential and AML supervision, so that red flags are raised earlier – when money laundering can be impeded. Reporting entities would appreciate feedback on SARs from FIUs in order to encourage reporting that is focussed on areas of money laundering risk. Banks, lawyers and accountants should also share information to create a better picture of how criminals are interacting with the financial system – and therefore how to prevent them.

> Forensic departments in accountancy firms do generally work closely with the auditors if there are red flags and to make sure the auditors know what the new financial crime typologies are. It's important to have that communication. Most firms are also looking at how much forensics – especially around data analysis – you can run to look for unusual patterns.
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> Rachel Sexton Head of Financial services – Forensics, EY

2. USE TECHNOLOGY FOR DATA ANALYTICS, AND SHARE INTERNATIONALLY

Technology is key to tackling financial crime e.g., for analysing huge numbers of SARs. The UK's National Crime Agency, with the help of Deloitte, has been exploring the potential of bulk, sophisticated analytics to identify links in data sets. The aim is to impede crime before it happens, rather than just identifying it afterwards. Although progress has been made, there needs to be better dialogue and information sharing internationally.

Effective use of technology and open data formats can support transparency. For example, the EU has endorsed the creation of public beneficial ownership registers, but not provided any technical specification that would allow for systems harmonisation. Beneficial ownership registers should ideally have free access and open data formats to enable cross-referencing of data.

3. STRIVE FOR ENHANCED CORPORATE GOVERNANCE – ENFORCE AND REPORT ON SANCTIONS

Organisations must follow best practice in corporate governance. For example, ethical risks must be reviewed at the start of each board meeting. Responsibility for ethical risks should be assigned to a specific committee e.g., the audit committee, strategy committee or governance committee, and the chair of that committee must report to the board. Every meeting should include a NED-only session. NEDs should also meet external and internal auditors, without management. There should be policies and manuals in place, digital information available online and training provided.

There must be consequences for bad behaviour. To support this, harmonised, appropriate and persuasive sanctions should be applied across jurisdictions for breaches of regulations designed to tackle financial crime. More transparency over sanctions, including the names of entities sanctioned and the value of fines, would be helpful.

Organisations should also be encouraged to communicate clearly not just what is working well, but also what has gone wrong. If there has been an incident, it should be reported widely (even if individual names cannot be used), saying what has happened, that it is unacceptable and the sanctions taken. This communication should not just be in English, but also in the local language to reach the maximum audience.

CONCLUSION

Whether tackling financial statement fraud or financial crime, common themes emerge. The time has come to move from theory to reality and from a culture of compliance to results. The answer lies perhaps not in the drafting of new regulations, but in making what we have work better. The spirit of regulations must be embraced – and more quickly. Technology could help to improve the efficiency and effectiveness of current frameworks and systems. It is also clear that financial crime does not recognise borders, so collaboration must also cross borders. Harmonisation is important to achieve stronger impact and efficiency of systems designed to tackle fraud and financial crime. The accounting profession can do much to enhance trust, integrity and transparency, but all stakeholders need to commit to work together and have the courage to speak up when required.

> It is important to move now from a culture of compliance to a culture of results.
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> Olivier Boutellis-Taft, Accountancy Europe CEO